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SEC and CFTC Market Abuse and Fraud Enforcement Regimes Compared: Becoming Similar but Still Materially Different

Unlike some other jurisdictions (for example, England), which designate a single prudential regulator to oversee conduct in (and operation of) the financial markets, the U.S. divides responsibility for policing specific portions of the financial markets amongst a variety of regulators with oversight of particular types of financial products. This means that, rather than monitoring all aspects of their business for compliance with a single, unified set of governing rules and regulations, participants in the U.S. markets must comply with a patchwork of several regulatory regimes, with particular agencies asserting primacy over the market for a given instrument.

As clarified by the 2010 Dodd-Frank Act, the U.S. Commodity Futures Trading Commission ("CFTC") possesses a broad remit under the Commodity Exchange Act ("CEA"), maintaining core jurisdiction over commodity futures and options contracts traded on regulated exchanges, as well as most swaps, and retaining police power over trading of nearly all "commodities"—traditional physical commodities (like gold), as well as financial instruments and currencies—that are or may be traded on a futures exchange.[1] The U.S. Securities Exchange Commission ("SEC") oversees trading of stocks and bonds and security-based swaps and options under the Securities Act of 1933 and the Securities Exchange Act of 1934 ("Exchange Act").

In some ways, it may be unsurprising that the products traded in these markets are regulated differently, as they are, with some exceptions, fundamentally dissimilar from one another. That said, there are some notable similarities in the operation of the marketplaces on which these products trade, whether on anonymous, centralized exchanges, or in bilateral over-the-counter transactions. These structural similarities may support an alignment in the anti-fraud and market abuse provisions and remedies employed in each market. However, while Congress has recently made some attempts at harmonization of the respective agencies' enforcement regimes—most notably as part of the Dodd-Frank Act—counsel for market participants should not assume those regimes operate identically.

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[1] 7 U.S.C. § 1a(9); *see also U.S. Commodity Futures Trading Comm'n v. Am. Bd. of Trade, Inc.*, 803 F.2d 1242, 1248 (2d Cir. 1986) (recognizing that nearly "anything" can be treated as a "commodity" subject to CEA oversight, "simply by its futures being traded on some exchange").

CFTC's New Anti-Fraud Authority

Market Manipulation

For nearly 40 years, CFTC targeted market manipulation under a standard that required them to show that a defendant specifically intended to—and did—cause an artificial price; that is, a price that does not reflect the legitimate forces of supply and demand.[2] CFTC had long chafed under this standard, maintaining that its enforcement efforts were hampered by the need to establish intent and artificiality, neither of which is required under SEC's principal anti-fraud statute, Exchange Act section 10(b).[3]

As part of the Dodd-Frank Act, Congress supplemented CFTC's existing enforcement authority with CEA section 6(c)(1), a new provision that is virtually identical to Exchange Act section 10(b), prohibiting the use of "any manipulative or deceptive device or contrivance" in connection with a product or instrument covered by the CEA.[4] A year later, CFTC finalized its implementing provision, Rule 180.1, which prohibits the use of "any manipulative device, scheme, or artifice to defraud," as well as "any act practice or course of business, which operates or would operate as a fraud or deceit upon any person."[5] CFTC has taken the view that, because CEA section 6(c)(1) prohibits manipulative devices in addition to deception, it is a market manipulation provision as opposed to simply an anti-fraud provision.[6]

Invoking the canon of statutory interpretation that Congress is presumed to have used like terms consistently, CFTC "modeled" new Rule 180.1 on SEC Rule 10b-5, which implements Exchange Act section 10(b).[7] In its release publishing the final rule, CFTC relied on judicial precedent interpreting Rule 10b-5 to state that—unlike under CFTC's pre-existing anti-manipulation authority—a violation of Rule 180.1 could exist where a defendant acted either "intentionally *or recklessly*," and a violation does not require CFTC to show any impact on price.[8] Some have suggested that with this Rule, CFTC effectively sought to do away with the elements of its traditional manipulation standard that the agency had found most troubling.

CFTC is using its new enforcement authority to target a broad array of market conduct. Last year marked the second in a row in which CFTC obtained enforcement awards of more than $3 billion, including the largest fine in agency history.[9] Most of these penalties were imposed under new Rule 180.1 (as well as CFTC's new anti-"spoofing" provision, discussed below). In the current environment, it is important for practitioners to consider some of the (sometimes subtle) ways in which CFTC's enforcement authority differs from SEC's.

New Interpretations of Familiar Language

CFTC has emphasized that "harmoniz[ing]" its new Rule 180.1 with existing Rule 10b-5, for which there is ample interpretive judicial precedent, would benefit market participants by fostering "increased certainty."[10] But CFTC has also said that, to

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2 *See, e.g.*, *In re Ind. Farm Bureau Coop. Ass'n, Inc.*, [1982-1984 Transfer Binder] Comm. Fut. L. Rep. (CCH) P 21,796, 1982 WL 30249, at *4 n.2 (Dec. 17, 1982).

3 *See, e.g.*, Bart Chilton, Comm'r, U.S. Commodity Futures Trading Comm'n, *Speech before the Institutional Investors Carbon Forum: Moment of Inertia* (Sept. 15, 2009), *available at* www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-26.

4 7 U.S.C § 9(1).

5 *Final Rule*: *Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation*, 76 Fed. Reg. 41,398, 41,401 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

6 *Id.* at 41,398 (clarifying that "[t]hese rules broadly prohibit fraud *and* manipulation") (emphasis added).

7 *Id.* at 41,407; *see also* 15 U.S.C. § 78j(b); 17 C.F.R. 240.10b-5.

8 76 Fed. Reg. at 41,399 (emphasis added).

9 Press Release, *U.S. Commodity Futures Trading Comm'n, Annual Enforcement Results for Fiscal Year 2015* (Nov. 6, 2015), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr7274-15.

10 76 Fed. Reg. at 41,399 & nn. 11-12.

account for "the differences between the securities markets and the derivatives markets," its interpretation of Rule 180.1 will only be "guided, *but not controlled by*" judicial decisions interpreting comparable passages of Rule 10b-5.[11]

For example, CFTC recently advanced a novel interpretation of the phrase "manipulative device, scheme, or artifice to defraud" under Rule 180.1, arguing in a market manipulation case in Illinois federal court that claims for violation of Rule 180.1 did not need to be pleaded with the particularity required of fraud claims under Federal Rule of Civil Procedure 9(b).[12] The district court disagreed, relying heavily on the Supreme Court precedent holding that the "nearly identical" language of Exchange Act section 10(b) and Rule 10b-5 "prohibit[] only fraudulent conduct."[13] Notably, CFTC relied on Rule 10b-5 precedent elsewhere in the same brief, without explaining why Exchange Act precedent should control interpretation of Rule 180.1 in some contexts but not others. This approach has led commentators to suggest CFTC will interpret Rule 180.1 consistently with Rule 10b-5 precedent only when doing so will advance the agency's pro-enforcement posture. It remains to be seen whether courts will accept CFTC's position that "differences" between the securities and derivatives markets justify interpreting identical statutory language differently under each regime.

Defense of Price

SEC has recognized certain limited circumstances in which it is appropriate for particular market participants to trade for the purpose of influencing the market price of a security – conduct which otherwise likely would be considered fraudulent or manipulative under the Exchange Act. For example, underwriters, brokers, and dealers participating in some types of securities offerings are permitted, under certain conditions, to execute transactions in order to "stabilize" (that is, to stop or slow the decline of) the market price of the security, to facilitate the offering.[14] SEC acknowledges that stabilizing "is price-influencing activity intended to induce others to purchase the offered security," but the agency permits such trading as a means of "fostering an orderly distribution," a goal that SEC deems sufficiently worthy to merit some exception to liability for trading that is intended to impact price.[15]

In contrast, CFTC has not identified analogous "defense of price" exceptions to the anti-fraud or anti-manipulation provisions of the CEA. In fact, seemingly just the opposite: in its 2013 settlement with JPMorgan regarding the well-publicized "London Whale" matter, CFTC concluded that trading large volumes of swaps in a short period of time for the purpose of defending a position against other market participants amounted to reckless employment of a manipulative device under Rule 180.1, because the size of JPMorgan's trades had the potential to affect market prices.[16]

The London Whale settlement was CFTC's first enforcement action utilizing new Rule 180.1 (which had not yet been interpreted or applied in any court). The settlement order represented an expansive reading of CFTC's power to control market conduct, seemingly placing traders at risk of liability whenever they have reason to believe an otherwise legitimate transaction may have some impact on price (as all transactions have the potential to do). It is worth noting that CFTC used its first application of Rule 180.1 to so readily target trading to defend price rather than to police trading conduct intended to deceive a market. Indeed, the JPMorgan swap transactions at issue were conducted not on a centralized exchange, but rather on a bilateral, over-the-counter basis, in a market where, as press reports later revealed, other traders (such as hedge funds) became aware of JPMorgan's large position and took aggressive, opposite positions to put pressure on price (arguably, itself a violation of Rule 180.1, on

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11 *Id.* at 41,399 (emphasis added).

12 *See U.S. Commodity Futures Trading Comm'n v. Kraft Foods Grp., Inc.*, No. 15 C 2881, 2015 WL 9259885 (N.D. Ill. Dec. 18, 2015).

13 *Id.* at *7 (considering applicability of Rule 180.1 to claims for so-called "open-market" transactions, which do not involve any outward manifestation of a defendant's fraud).

14 17 C.F.R. § 242.104.

15 *Final Rules: Anti-manipulation Rules Concerning Securities Offerings*, 62 Fed. Reg. 520, 535 (Jan. 3, 1997) (codified at 17 C.F.R. pts. 200, 228, 229, 230, 240, and 242).

16 Order at 14-15, *In re JPMorgan Chase Bank, N.A.*, CFTC No. 14-01 (Oct. 16, 2013) ("JPMorgan Order").

CFTC's broad reading).[17] CFTC's approach in penalizing JPMorgan for defending itself against such predatory trading seems to stand in stark contrast to SEC's recognition that, in some circumstances, defense of price is a legitimate goal.

CFTC's London Whale settlement was also noteworthy because it was the first in which the agency forced the settling defendant to admit the facts giving rise to the offense.[18] Previously, both CFTC and SEC had a long history of allowing defendants to resolve enforcement actions without admitting or denying the relevant conduct. This typically prevented plaintiffs from relying solely on factual allegations from a regulatory settlement agreement to establish follow-on private claims for relief, a concession regulators believed encouraged defendants to more readily resolve enforcement actions, thus preserving agency resources and avoiding the inherent uncertainties of trial. However, in response to public sentiment emphasizing the need for greater perceived "accountability" for market misconduct in the wake of the financial crisis (perhaps most prominently articulated in an opinion by Judge Jed Rakoff of the Southern District of New York criticizing regulators' "no-admit, no-deny" policy),[19] SEC announced in September 2013 that it would require an admission of wrongdoing in cases where the agency concluded there was a particular need for accountability, such as where the settling defendant's misconduct harmed a large number of investors or was otherwise particularly "egregious."[20] CFTC made no such public announcement, but the admissions in the London Whale settlement months later signaled to observers that CFTC may take a similar approach. Since then, both SEC and CFTC settlement orders have sometimes required settling defendants to admit certain allegations when resolving enforcement actions against them.[21]

"Purchase or Sale"

Some have suggested that CFTC's authority to target fraudulent or manipulative devices sweeps more broadly than SEC's, because while SEC can only target such conduct when it is "in connection with the purchase or sale of [a] security,"[22] new CEA §6(c)(1) contains no such "purchase or sale" limitation.[23] In other words, a transaction is not required for liability under CFTC Rule 180.1. Rather, CFTC has said that Rule 180.1 applies to fraudulent or manipulative conduct "in connection with" the "solicitation, execution, pendency, or termination" of instruments subject to the CEA's enforcement authority.[24] For example, CFTC has pursued enforcement actions under Rule 180.1 against defendants for fraudulently soliciting customer purchase orders for physical commodities contracts, even though the conduct never resulted in actual transactions.[25]

As many have observed, perhaps the greatest area of potential distinction in the scope of conduct covered by Rule 180.1 is with respect to swap contracts, which feature continuous obligations between parties (such as payment obligations) months or years after execution. Rule 180.1 seemingly contains no limiting language that would prevent CFTC from regulating conduct "in connection with" any activity undertaken during the "pendency" of a swap contract that is within CFTC's jurisdiction. In contrast, while Dodd-Frank amended the Exchange Act to prohibit fraud or manipulation in connection with "security-based swaps," this

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17 *See, e.g.*, Azam Ahmed, *The Hunch, the Pounce and the Kill*, N.Y. TIMES, May 26, 2012, at B1.

18 JPMorgan Order, *supra* note 16, at 1.

19 *U.S. Sec. & Exch. Comm'n v. Citigroup Global Markets Inc.*, 827 F. Supp. 2d 328, 333 (S.D.N.Y. 2011), *vacated and remanded*, 752 F.3d 285 (2d Cir. 2014).

20 Mary Jo White, Chairman, U.S. Sec. & Exch. Comm'n, *Speech at Council of Institutional Investors Fall Conference: Deploying the Full Enforcement Arsenal* (Sept. 26, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539841202#.UlxZdS7D_IU.

21 *See, e.g.*, *JPMorgan Chase & Co.*, Exchange Act Release No. 70458 (Sept. 19, 2013); Order, *U.S. Sec. & Exch. Comm'n v. v. Falcone.*, 12 Civ. 5027 (PAC) (S.D.N.Y. Sept. 16, 2013), ECF No. 44; *see also* Order ¶ 10, *U.S. Commodity Futures Trading Comm'n v. MF Global Inc.*, No. 11-cv-97866 (S.D.N.Y. Nov. 8, 2013), ECF No. 571 (stating that MF Global "[a]dmits the allegations pertaining to liability against MF Global . . . as set forth in this Consent Order and the Complaint").

22 *See* 15 U.S.C. § 78j.

23 *See* 7 U.S.C § 9(1).

24 *Final Rule*: *Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation*, 76 Fed. Reg. 41,398, 41,405 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

25 *See, e.g.,* Complaint ¶¶ *16-22, U.S. Commodity Futures Trading Comm'n v. Atlantic Bullion & Coin, Inc.,* No. 8:12-1503-JMC (D.S.C. June 6, 2012).

authority is subject to the same "purchase or sale" limiting language found in section 10(b).[26] SEC has proposed a rule that would authorize it to police conduct *after* a security-based swap transaction has been effected, but this rule has not been entered into force, and commentators have suggested it may exceed SEC's statutory authority (which remains subject to the "purchase or sale" limitation).[27] As a consequence, regular participants in the swaps markets may find themselves subject to continuing oversight for conduct well after purchase or sale for some transactions but not others.

Insider Trading

The securities laws contain well-known prohibitions on the trading of a company's securities on the basis of material non-public information ("MNPI") in breach of an insider's duty to the company's shareholders (the "classical theory") or, as the Supreme Court recognized more recently, in breach of a duty of loyalty owed to the source of the information (the "misappropriation theory").[28] Insider trading is regarded as a "manipulative or deceptive device" prohibited by Exchange Act section 10(b) and Rule 10b-5.

Historically, the CEA rejected the "classical" theory of insider trading, and contained only limited prohibitions on trading on the basis of MNPI.[29] This is both because (a) participants in the commodity derivatives markets—particularly hedgers—frequently trade on the basis of non-public information (concerning their own positions) that could potentially move the market, and (b) traders in these markets do not owe one another fiduciary duties (whereas a corporate insider owes such duties to shareholders). However, with its new authority under 6(c) and Rule 180.1 prohibiting "manipulative or deceptive device[s]," CFTC's authority to police market conduct is expanded to include trading on the basis of MNPI "in breach of a pre-existing duty" or when "obtained through fraud or deception."[30] With this language, CFTC has embraced the "misappropriation" theory of insider trading, though—likely for the reasons described above—not the "classical theory."

Last year, CFTC brought and settled its first insider trading case under Rule 180.1. Arya Motazedi, a gasoline trader, misappropriated non-public information from his employer concerning "times, accounts, and prices at which the company intended to trade energy commodity futures."[31] Motazedi used the information to trade in personal accounts at prices favorable to him, as well as to place trades ahead of orders for the company's account, in breach of a duty of confidentiality owed to his employer. These facts present a fairly straightforward application of the "misappropriation" theory of insider trading.

However, as some commentators have observed, the *Motazedi* settlement suggests CFTC may look to apply a different—and potentially broader—standard for "materiality" than is the case under the Exchange Act. Exchange Act Rule 10b-5 applies an objective materiality standard focusing on what a "reasonable investor" would view as "significantly alter[ing] the 'total mix'" of available information.[32] When proposing Rule 180.1, CFTC suggested it would apply the objective definition of "materiality"

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26 15 U.S.C. § 78i(j).

27 *Proposed Rule: Prohibition Against Fraud, Manipulation, and Deception in Connection With Security-Based Swaps*, 75 Fed. Reg. 68,560, 68,561 (Nov. 8, 2010) (proposing Rule 9j-1 to extend liability to "persons that engage in misconduct to trigger, avoid, or affect the value of . . . *ongoing payments or deliveries*" on security-based swaps) (emphasis added); *see also* Julia Lu & Eva Marie Carney, *Now You Have a Security, Now you Don't – Antifraud and Anti-manipulation Regimes for Loan Derivatives Products Under Dodd-Frank*, 31 No. 3 FUTURES & DERIVATIVES L. REP. 6 (March 2011).

28 *See Chiarella v. United States*, 445 U.S. 222 (1980) (articulating "classical theory" of insider trading); *United States v. O'Hagen*, 521 U.S. 642 (1997) (adopting "misappropriation theory" of insider trading).

29 7 U.S.C. §§ 6c(a)(4), 13(c)-(e) (prohibiting disclosure of, or trading on basis upon, non-public information, by CFTC employees or agents, other government employees, and employees of registered exchanges, boards of trade, and similar industry personnel, as well as by people who knowingly receive such information from government employees).

30 *Final Rule*: *Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation*, 76 Fed. Reg. 41,398, 41,403 (July 14, 2011) (codified at 17 C.F.R. pt. 180).

31 Order at 3, *In re Arya Motazedi*, CFTC No. 16-02 (Dec. 2, 2015) ("Motazedi Order").

32 *Carpenters Pension Trust Fund of St. Louis v. Barclays PLC*, 750 F.3d 227, 235 (2d Cir. 2014) (quoting *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988)).

utilized in the securities context.[33] However, CFTC did not apply such a standard in the *Motazedi* case. Instead of asserting that the information Motazedi traded on had the potential to move the market, or that a "reasonable person" would have considered it important, CFTC simply concluded (without explanation) that the information Motazedi misappropriated was material and non-public.[34] It remains to be seen whether CFTC will pursue insider trading cases on the basis of conduct not actionable under the Exchange Act.

Spoofing

The recent proliferation of high frequency and algorithmic trading strategies on both securities and derivatives exchanges has led to a surge in regulatory and law enforcement efforts to detect, deter, and punish a particular form of market abuse known as "spoofing," which typically involves the rapid making and cancelling of orders. On November 3, 2015, U.S. authorities secured their first criminal conviction for spoofing under the CEA.[35] Perhaps encouraged by this success, prosecutors have charged at least two other traders with criminal spoofing in the securities and commodity derivatives context.[36]

The Dodd-Frank Act amended the CEA to specifically prohibit trading practices on regulated trading exchanges for futures and derivatives that Congress deemed to be "disruptive," including conduct that "is, or is of the character of," spoofing.[37] The defining aspect of CFTC's new spoofing authority is the trader's contemporaneous "intent to cancel [a] bid or offer before execution."[38] The upshot of this new provision is that CFTC can punish spoofing without showing the trader intended to (or did) move the market. Civil penalties for spoofing include trading suspensions or bans, as well as fines.[39] CFTC can also refer willful violations of its anti-spoofing provision to the Department of Justice to prosecute as a criminal offence, punishable by up to 10 years in prison and $1 million fines for each spoofing count.[40]

By contrast, the Exchange Act does not specifically prohibit spoofing. In the breach, SEC has principally targeted spoofing in the securities markets under its existing anti-fraud and anti-manipulation authority, requiring them to show that the conduct intentionally or recklessly (a) artificially affected the price of a security, (b) sent a false pricing signal, or (c) deceived market participants about the natural interplay of supply and demand.[41] SEC also sometimes targets spoofing under Exchange Act 9(a)(2), prohibiting transactions that either "creat[e] actual or apparent trading" or raise or lower the price of a security "for the purpose of inducing" others to buy or sell.[42] U.S. authorities have criminally prosecuted spoofing in the securities markets under wire fraud and conspiracy to commit securities fraud statutes.[43]

As has been widely observed by commentators, any assessment of the differences between SEC and CFTC anti-spoofing enforcement is complicated by the lack of clarity surrounding the breadth of what constitutes spoofing under the CEA. CFTC says it will evaluate "relevant facts and circumstances of each particular case" when distinguishing legitimate trading activity from

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33 *Proposed Rulemaking: Prohibition of Market Manipulation*, 75 Fed. Reg. 67,657, 67,660 (Nov. 3, 2010) (to be codified at 17 C.F.R. pt. 180).

34 *See* Motazedi Order, *supra* note 31, at 2.

35 Jury Verdict, *United States v. Coscia*, No. 14-CR-551 (N.D. Ill. Nov. 3, 2015), ECF No. 84.

36 *See* Complaint, *United States v. Milrud*, No. 15-cr-00455 (D.N.J. Jan. 12, 2015) (alleging criminal spoofing of securities market) ("Milrud Complaint"); Complaint, *United States v. Sarao*, No. 15-cr-00075 (N.D. Ill. Feb. 11, 2015) (alleging criminal spoofing of commodities derivatives market).

37 7 U.S.C. § 6c(a)(5).

38 *Antidisruptive Practices Authority Interpretive Guidance and Policy Statement*, 78 Fed. Reg. 31,890, 31,896 (May 28, 2013).

39 7 U.S.C. §§ 9(4), 9(10), 13b.

40 7 U.S.C. § 13(a)(2).

41 *See, e.g.*, *Briargate Trading, LLC*, Securities Act Release No. 9959, 2015 WL 5868196 (Oct. 8, 2015) ("Briargate Order"); *Visionary Trading LLC*, Exchange Act Release No. 71871, 2014 WL 1338258 (Apr. 4, 2014).

42 *See, e.g.*, *Biremis Corp.*, Exchange Act Release No. 68456, 2012 WL 6587520 (Dec. 18, 2012); *Hold Bros. On-Line Inv. Serv., LLC*, Exchange Act Release No. 67924, 2012 WL 4359224 (Sept. 25, 2012).

43 *See* Milrud Complaint, *supra* note 36.

spoofing, including "market context" and "the person's trading activity (including fill characteristics)," though the agency has explained that a pattern of trading is not a necessary element of spoofing.[44] To date, CFTC has sought to establish contemporaneous intent to cancel through circumstantial evidence of (a) near-simultaneous orders and cancellations that generated, and produced profits based on, artificial market interest;[45] (b) high volumes of cancelled trades (both in absolute terms and relative to other market participants);[46] and (c) impact on price.[47]

In *United States v. Coscia,* the first successful criminal prosecution of spoofing under the CEA, prosecutors successfully established the defendant's contemporaneous intent to cancel orders by presenting evidence of the high volume and size of the defendant's orders (over 400,000 across a number of commodity futures markets), the speed at which the defendant entered and canceled orders, the outsized success rate on the trader's small orders (having benefited from cancelled large orders) relative to the rest of the market, and witness testimony, including that of a programmer who developed the defendant's trading program, who testified that the program was designed to cancel open orders after short amounts of time.[48] CFTC has also sometimes targeted spoofing conduct as a violation of its anti-manipulation provisions, including Rule 180.1, which (as noted above) was modeled on SEC Rule 10b-5.[49] (Whether spoofing can give rise to a private right of action under the CEA likely turns on whether the facts alleged satisfy the pleading elements of an anti-fraud or manipulation claim, some of the contours of which are discussed below.)

Thus, the types of circumstantial evidence CFTC has relied on to target spoofing to date may likewise give rise to a spoofing violation under the Exchange Act's existing anti-fraud and manipulation provisions. For example, late last year, SEC charged a New York trading firm and its co-founder with spoofing in the securities markets, and asserted that respondents acted with intent to defraud and created artificial prices, based on evidence of (a) the speed at which respondents entered and cancelled trades; (b) the sequence, price, and size of orders placed on both sides of a trade; (c) the frequency with which respondents cancelled orders; and (d) the price effect of respondents' conduct.[50]

However, it is by no means clear CFTC will exclusively pursue civil spoofing actions on the basis of such a developed body of circumstantial evidence of "intent." Observers raised a number of questions about CFTC's interpretive guidance on "spoofing," which included a "non-exhaustive" list of four examples that some have noted could encompass conduct that extends beyond the scope of the statute.[51] Nor is there clarity on what is encompassed by the conduct that is "of the character of" spoofing, a provision that has not been tested by the courts. Further clarity on the breadth of the CEA's spoofing prohibition may yet come from the *Coscia* criminal case, in the form of an appeal of Coscia's due process challenge to the CEA spoofing prohibition on vagueness grounds (which the district court rejected), or from CFTC's and DOJ's ongoing civil and criminal proceedings against Nav Sarao, an English national accused of using an algorithm to spoof the market for stock index futures, causing the 2010 "Flash Crash."

In the meantime, market participants should review trading strategies and algorithms in place on their securities and derivatives trading desks, and should strive to be able to defend the economics of all trades (especially orders that are eventually cancelled).

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[44] *Antidisruptive Practices Authority Interpretive Guidance and Policy Statement*, 78 Fed. Reg. 31,890, 31,896 (May 28, 2013).

[45] Order, *Panther Energy Trading LLC*, CFTC No. 13-26, 2013 WL 3817473, at *2-3 (July 22, 2013).

[46] Complaint ¶ 48, *U.S. Commodity Futures Trading Comm'n v. Nav Sarao Futures Limited PLC*, No. 15-cv-3398, 2015 WL 1843321 (N.D. Ill. Apr. 17, 2015) ("Sarao Civil Complaint").

[47] Complaint ¶¶ 17-19, 29, 32, *U.S. Commodity Futures Trading Comm'n v. Khara*, No. 15-cv-3497, 2015 WL 2066257 (S.D.N.Y. May 5, 2015).

[48] Indictment ¶¶ 4, 10-14, *United States v. Coscia*, No. 14-CR-551 (N.D. Ill. Oct. 19, 2015).

[49] *See, e.g.*, *U.S. Commodity Futures Trading Comm'n v. Igor B. Oystacher*, No. 15-cv-9196, 2015 WL 9259899 (N.D. Ill. filed Apr. 17, 2015) (pursuing alleged spoofing conduct as violation of both anti-spoofing provision and Rule 180.1); Sarao Civil Complaint, *supra* note 46, ¶ 10 (pursuing alleged spoofing conduct as violation of anti-spoofing provision as well as violation of Rule 180.1 and Rule 180.2).

[50] *See* Briargate Order, *supra* note 41, at 3-6.

[51] *Antidisruptive Practices Authority Interpretive Guidance and Policy Statement*, 78 Fed. Reg. 31,890, 31,896 (May 28, 2013).

Firms engaging in high-frequency trading, in particular, should ensure there is a legitimate rationale for programming instructions and that code cannot be reasonably interpreted to convey a wrongful intent.

Private Rights of Action

Both the Exchange Act and CEA provide private rights of action for conduct that violates the "manipulative device" prohibitions in the respective statutes. (The CEA does so expressly; courts have long recognized the Exchange Act does so impliedly).[52] In each case, appropriate plaintiffs are typically limited to parties who transacted with the defendant (or in the relevant market), at prices made artificial by a defendant's "manipulative or deceptive device."[53] In addition to the elements of a "manipulative device" claim, plaintiffs suing under the Exchange Act must also establish loss causation, reliance, and damages. CFTC has said these are also elements of private actions brought under Rule 180.1.[54] Typically, recovery under both statutes is limited to actual damages.[55]

One potentially significant difference between the two statutes is that the CEA expressly provides a private right of action for willful "aiding and abetting" of a primary violation, whereas courts have consistently rejected such private claims under the Exchange Act.[56] This means that parties not themselves liable for a primary violation of the CEA can nevertheless be liable for the full amount of the harm to investors if they knowingly and intentionally committed some act in furtherance of the principal's primary violation. Accordingly, plaintiffs have sought to assert aiding and abetting claims against financial institutions that act as clearing brokers for entities accused of manipulation.[57]

Conclusion

In the few years since Congress "lowered the bar" for CFTC to bring its enforcement authority more in line with SEC's authority under the Exchange Act, CFTC has pursued an aggressive enforcement agenda, prompting attention from commentators for advancing novel (and untested) interpretations of well-defined Exchange Act provisions. This, when coupled with some subtle textual differences between the relevant portions of the CEA and Exchange Act, mean that counsel for entities that participate in both the securities and commodity derivatives markets should not assume that market abuse and fraud will be regulated identically under each regime.

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52 *See* 7 U.S.C. § 25(a)(1) (enumerating bases for private rights of action under CEA); *see also Herman & MacLean v. Huddleston*, 459 U.S. 375, 380 (1983) (acknowledging that courts have "consistently recognized" a private right of action under Exchange Act section 10(b) and Rule 10b-5).

53 *See, e.g.*, *Loginovskaya v. Batratchenko*, 764 F.3d 266, 270 (2d Cir. 2014) (noting that private right of action under CEA is "limited to four circumstances, each of them explicitly transactional in nature"); *see also Caiola v. Citibank, N.A., N.Y.*, 295 F.3d 312, 322 (2d Cir. 2010) (standing to pursue private claim for securities fraud "is limited to actual purchasers or sellers of securities" (citing *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 731-32 (1975))).

54 *Proposed Rulemaking: Prohibition of Market Manipulation*, 75 Fed. Reg. 67,657, 67,660 (Nov. 3, 2010) (to be codified at 17 C.F.R. pt. 180).

55 *See* 7 U.S.C. § 25(a)(1) (CEA); 15 U.S.C § 78bb (Exchange Act).

56 *Compare* 7 U.S.C. § 25(a)(1) (providing private right of action under CEA for "anyone who willfully aids [or] abets . . . a violation of this Act"), *with Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 155-56 (2008) ("[T]here is no private right of action for aiding and abetting a § 10(b) violation.") (citations omitted). Of course, unlike private plaintiffs, SEC has authority to pursue enforcement actions under the Exchange Act for aiding and abetting liability. *See* 15 U.S.C. § 78t.

57 *See, e.g.*, *In re Amaranth Natural Gas Commodities Litig.*, 730 F.3d 170 (2d Cir. 2013) (affirming that provision of "normal clearing services," such as clearing of trades and extensions of credit, to an entity accused of market manipulation, did not give rise to CEA aiding and abetting claim against JPMorgan entities).

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