U.S. Court Determines That Circumstantial Evidence Can Prove Manual "Spoofing" of Futures Market

A trader who places U.S. futures market orders manually can be found to have engaged in prohibited "spoofing," without direct proof of intent, if his trading pattern, market conditions and examples of trading show that he likely intended to withdraw the orders rather than to trade, according to a recent federal court ruling. This expands upon previous cases involving spoofing using automated trading systems to place orders.

In an order issued on August 23, an Illinois federal court denied a constitutional challenge brought against the anti-spoofing provision of the U.S. Commodity Exchange Act (the "CEA").[1] Defendants Igor Oystacher and 3Red Trading, LLC moved the court to dismiss on the pleadings a civil enforcement action brought by the CFTC, arguing that the anti-spoofing prohibition, as applied to their case, was unconstitutionally vague.[2] Of particular note, the court held that the CFTC's complaint need not allege direct evidence of intent to spoof in order for the complaint to pass constitutional muster. The court found instead that allegations that defendants routinely placed and very rapidly cancelled orders on one side of the market just before placing and filling orders on the opposite side, if true, would constitute circumstantial evidence of an intent to spoof.

The CEA's anti-spoofing provision prohibits conduct that is "commonly known" as "spoofing" on any CEA-registered trading facility (that is, any designated contract market or swap execution facility).[3] The statute defines "spoofing" as "bidding or offering with the intent to cancel the bid or offer before execution." When prosecuted as a civil action by the CFTC, the anti-spoofing prohibition carries a civil penalty of up to $140,000 per violation, or triple the gain.[4] The CFTC may also seek a range of other penalties, including a temporary or permanent trading ban.[5] If the spoofing was for the purpose of affecting market prices, a separate price manipulation charge is possible, carrying a civil penalty of up to $1,000,000 violation, or triple the gain.[6] Both

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1 7 U.S.C. § 1 *et seq.*

2 *CFTC v. Oystacher*, 15-cv-9196, Doc. 237 (August 23, 2016). The court also rejected defendants' arguments that the CFTC's Rule 180.1, a broad anti-fraud rule, is unconstitutionally vague and that the anti-spoofing provision represents an unconstitutional delegation of legislative authority from Congress to CFTC.

3 CEA § 4c(a)(5)(C). The CEA disruptive practices provision makes it "unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that—(A) violates bids or offers; (B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (C) 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). *Id.*

4 CEA § 6c.

5 *Id.*

6 *Id.*

spoofing and price manipulation are also criminal violations.[7] The first criminal conviction for spoofing futures markets occurred in Chicago in late 2015.[8]

Oystacher is the first case that has gone to trial involving allegations of “manual” spoofing. Last year, the U.S. Department of Justice (the “DOJ”) secured a criminal conviction of algorithmic trader Michael Coscia, relying in part on the testimony of an IT professional who helped create Coscia’s algorithm that the algorithm was designed to enter orders in a manner that would avoid execution.[9] Unlike in *Coscia*, the authorities will not be able to rely on “direct” evidence such as algorithmic design to prove that Oystacher engaged in spoofing.

The defendants in *Oystacher* argued that the anti-spoofing provision is unconstitutionally vague because the definition of spoofing contained in the provision does not clearly delineate spoofing from legitimate trading. Defendants further argued that, as applied to their case, the anti-spoofing provision is unconstitutionally vague because the CFTC has not, and cannot, allege direct evidence that defendants intended to withdraw orders rather than execute them. The court disagreed, holding that the statute was not unconstitutionally vague as applied to defendants’ case because it includes an intent element: in order to violate the statute, one must enter an order with the intent to withdraw it rather than to trade. The court found that the CFTC had met its burden on the intent element by alleging circumstantial evidence, including “a detailed description of Defendant Oystacher’s trading patterns, relevant market data, and examples of his trading . . . .”

The court’s ruling that circumstantial evidence can suffice to prove intent is noteworthy because direct evidence of intent may not always exist in spoofing cases, and especially in “manual” spoofing cases. Unlike many other CEA prohibitions, a trader need not enlist the help of anyone else in order to spoof the market. It is therefore less likely that the authorities will find direct evidence, such as statements demonstrating an intent to spoof in recorded communications. Had the court required direct evidence, the authorities’ ability to pursue spoofing cases would be greatly constrained. In the wake of this ruling, the authorities will likely continue aggressively pursuing spoofing cases, including cases of “manual” spoofing.

It remains to be seen whether a jury will be persuaded by the CFTC’s circumstantial evidence of intent. But the case makes clear that traders and their employers cannot safely assume that a lack of direct evidence of intent will put them beyond the reach of the spoofing prohibition.

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[7] CEA § 9(a).

[8] See "Spoofing: The First Criminal Conviction Comes in the U.S.", Futures and Derivatives law Report, Vol. 36, Issue 1 (January 2016)

[9] *Id.*

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