Guidance from the High Court on spoofing as a criminal offence

On 3 November 2016 the High Court handed down its judgment in the extradition proceedings between Navinder Sarao and the US Government. In doing so, the court has provided useful, if not unexpected, guidance as to the application of UK criminal law to the practice of spoofing.

Background

"Spoofing" is a term commonly used to describe the practice of placing and cancelling orders on an exchange for the purpose of manipulating the market.

In the US a specific anti-spoofing provision was added to the US Commodity Exchange Act by the Dodd Frank Act of 2010. The first criminal conviction under that provision came on 3 November 2015 when Michael Coscia was convicted in Chicago federal court of six counts of spoofing. See our briefing "Spoofing: the first criminal conviction comes in the US – perspectives from the US and UK".[1]

In the UK there is no specific civil or criminal spoofing offence. Although the FCA has successfully taken action against spoofing as a form of civil market abuse, there have been no criminal prosecutions to-date and there has been some uncertainty as to which offences might be available to prosecutors.

Navinder Sarao is a 36-year-old British national. The US Department of Justice alleges that between January 2009 and April 2014 Mr Sarao engaged in spoofing of the market for "E-minis" – a stock market index futures contract based on the Standard & Poors 500 Index - on the Chicago Mercantile Exchange ("**CME**"), operating from his residence in the UK.

The US requested Mr Sarao's extradition from the UK so that he can be prosecuted in the US. Mr Sarao challenged the extradition request on a number of grounds including that the conduct alleged would not constitute an offence in the UK.

[1] https://www.cliffordchance.com/briefings/2016/03/spoofing_the_firstcriminalconvictioncomesi.html

Dual criminality

The Extradition Act 2003 provides that the US extradition request had to be refused unless Mr Sarao's alleged conduct would constitute an offence in the UK punishable by at least 12 months in prison. This requirement is often referred to as the 'dual criminality test'.

The US relied on three UK offences to satisfy the test: sections 1 and 2 of the Fraud Act 2006, section 397(3) of the Financial Services and Markets Act 2000 ("**FSMA**") and section 90 Financial Services Act 2012 ("**FSA**") (in force since 1 April 2013 and applying to some of Mr Sarao's later conduct).

Mr Sarao argued that the alleged conduct could not constitute an offence under any of these provisions.

As to the Fraud Act, he argued that spoofing orders could not give rise to any false representation within the meaning of the legislation, in particular because placing an order did not give rise to a representation that it would not be cancelled, given that, in his submission, the vast majority of orders placed on exchanges are cancelled.

As to the FSMA and FSA offences Mr Sarao argued that, since his orders were genuinely at risk of execution, they could not give rise to any "false or misleading impression" within the meaning of the legislation.

The High Court rejected these arguments. The court drew a "*clear distinction*" between (1) "*placing an offer which at the time it is placed is intended by the offeror to be open for acceptance, though it might subsequently be cancelled prior to acceptance*"; and (2) "*placing an offer which, at the time it is placed, the offeror does not genuinely intend should be accepted*". In this context the court is using the

term "offer" to refer to an order, so the term should be taken to include bids.

The court held that conduct falling into the second category would constitute an offence under section 2 of the Fraud Act 2006, section 397 FSMA and section 90 FSA. By placing an order a trader is impliedly representing that at the time the order is placed it is intended to be open for acceptance – even though that intention might subsequently change. It is irrelevant that an order is at risk of acceptance whilst it remains in the market and it is immaterial that many, perhaps even most, traders frequently cancel offers prior to acceptance.

Comment

It is perhaps not surprising that the courts have confirmed that spoofing may constitute a criminal offence in this jurisdiction. But the judgment helpfully emphasises that the crucial issue is the trader's intent at the time the relevant orders are placed.

In the Sarao case there is evidence as to intent in the form of contemporaneous emails. The court cited some of these in its judgment noting that they should make "*uncomfortable*" reading for Mr Sarao. In one he wrote "*If I am short I want to spoof it* [i.e., the market] *down, so I will place joint offer orders….at the 1st offer and 2nd offer and an order….into the 1st bid. These will not be seen.*" In another he wrote "*If I keep entering the same clip sizes, people will become aware of what I am doing, rendering my spoofing pointless.*"

But in other cases evidence of intent may not be so readily available. It remains to be seen how prosecutors will seek to establish intent in those cases, in particular whether and how prosecutors may invite a jury to infer intent from a pattern of trading data.

Authors

Carlos Conceicao
Partner

T: +44 20 7006 8281
E: carlos.conceicao @cliffordchance.com

Oliver Pegden
Senior Associate

T: +44 20 7006 8160
E: oliver.pegden @cliffordchance.com

This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance, 10 Upper Bank Street, London, E14 5JJ

© Clifford Chance 2016

Clifford Chance LLP is a limited liability partnership registered in England and Wales under number OC323571

Registered office: 10 Upper Bank Street, London, E14 5JJ

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta* ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

*Linda Widyati & Partners in association with Clifford Chance.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.