

[Securities Regulation Daily Wrap Up, TOP STORY—7th Cir.: Judges ponder if Coscia's commodities spoofing was criminal or just smart, \(Nov. 14, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Anne Sherry, J.D.](#)

The first commodities trader prosecuted under the Commodity Exchange Act's spoofing provision urged the Seventh Circuit to reverse his conviction on vagueness grounds. At oral argument, Michael Coscia's counsel [argued](#) that the statute does not adequately define the conduct that constitutes the crime of spoofing. Counsel for the government [stressed](#) that the statute's language either defines spoofing or gives an example; either way, Coscia was on notice ([U.S. v. Coscia](#), November 10, 2016).

Coscia was sentenced to three years in prison for using computer algorithms to trade in commodities products. He also settled a CFTC civil suit for \$2.8 million. His prosecution was the first under CEA Section 4c(a)(5)(C), which Dodd-Frank added to prohibit trading 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 the execution)."

Traders may legitimately hope orders aren't filled. Coscia's trading was different from that of other traders, his counsel, Michael S. Kim, conceded, but not in a way that put him on notice that his conduct was prohibited. The parenthetical description of spoofing in the statute, if taken literally, criminalizes many types of legitimate trading in the commodities markets. Stop-loss orders, in particular, are placed to minimize losses should the market go against the trader. The trader placing the stop-loss order hopes that the market goes its way and that the stop-loss is never executed.

Judge Rovner posited that stop-loss or "fill-or-kill" orders are different because there the trader intends for the order to be executed under certain circumstances. "I am trying to understand under what circumstances Mr. Coscia's algorithm would fill large orders," she said. Kim said that there is no principled distinction. Coscia kept his orders out for 250 to 400 milliseconds, long enough that there was a significant risk of execution. In fact, to a question about whether this kind of trading is simply pitting machine against machine, Kim said that human traders hit Coscia's orders thousands of times. (Counsel for the CFTC disputed this [account](#), saying that he actually fully filled only 260 large orders, or 0.08 percent.) He said that the CFTC is torturing the definition of spoofing by including orders where the trader simply hopes the order is canceled before execution

Barred conduct and algorithmic trading. Arguing for the government, Andrianna D. Kastanek made a distinction between the *conditions* under which a stop-loss or fill-or-kill order would be canceled, on the one hand, and the *parameters* under which Coscia's orders would be canceled. Conditions suggest events occurring after the order was placed; Coscia's parameters demonstrate that he did not want the orders to exist in the marketplace. Instead, the orders were designed to affect supply and demand.

The spoofing provision is either a definition, which is how it reads, or it's an example, Kastanek argued. Even if it is merely an illustration of prohibited conduct, Coscia had fair notice that his conduct constituted illegal spoofing.

Judge Rovner then brought up the suggestion that computer algorithms are simply trying to outsmart each other and make the appropriate calculations so they can buy low and sell high. Is it fundamentally different to have a computer program that figures out the market in a new way, and couldn't other traders adapt their algorithms to this new method? "In other words, are we punishing this defendant for being the first to build a better mousetrap?"

Kastanek responded that it is not illegal to build algorithms, respond to other traders, or buy low and sell high. The difference in this case is that Coscia's conduct was deceptive and fraudulent. He placed orders without

the intent to execute them. The fact that Coscia executed only a fraction of a percent of his large orders demonstrates that he intended to cancel.

Like Judge Rovner, Judge Manion expressed some hesitation about convicting a defendant for building a better algorithm. "We're dealing with such a high sophistication, why doesn't the other guy just come up with a better algorithm and ... intercept his scheme within a millisecond?" He indicated that he wanted to be diligent because this is the first prosecution under the spoofing statute, and there may be more.

Finally, Coscia's argument that his conduct was not commodities fraud because no one was misled misstated the law, Kastanek argued. The law requires a scheme and intent to defraud, and the defendant argued for that standard for the jury instructions. The court is taking the matter under advisement.

The case is [No. 16-3017](#).

Attorneys: Adrianna D. Kastanek, Assistant U.S. Attorney, for the United States. Michael S. Kim (Kobre & Kim LLP) for Michael Coscia.

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