Securities Regulation Daily Wrap Up, TOP STORY—U.S.: Supreme Court declines to review spoofing conviction in U.S. v. Coscia, (May 14, 2018)

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By Lene Powell, J.D.

The Supreme Court denied certiorari in Michael Coscia's challenge to his conviction for criminal commodities spoofing, leaving an affirmance by the Seventh Circuit intact. Coscia had argued that the statute was overly vague and improperly swept up legitimate trading activity (*U.S. v. Coscia*, May 14, 2018).

In the first criminal prosecution of the statute, Coscia was convicted by a jury in 2015 of six counts each of spoofing and commodities fraud, and was sentenced to three years in prison. The Seventh Circuit upheld the conviction. In his petition for certiorari, Coscia argued that leaving the Seventh Circuit decision standing would cause confusion in the lower courts about what trading qualified under the statute and would subject market participants to "crippling uncertainty." But the U.S. Solicitor General argued that the statute was clear, and that it would be premature to grant certiorari where it appeared that Coscia's prosecution was the first to mention the statute in any circuit court of appeals case.

Spoofing. As added by the Dodd-Frank Act, Section 4c(a)(5)(C) of the Commodity Exchange Act (7 U.S.C. 6c(a)(5)(C)), prohibits the disruptive trading practice of spoofing, defined as "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)." In a common spoofing scheme, the trader places large and small orders on opposite sides of the market. He then places a small order at a price below the current market price and places large orders to sell around the market price, but with the price incrementally decreasing. This creates the artificial impression that the market is flooded with supply and the market price is falling. The trader then cancels the sell orders within milliseconds and fills the small orders at the deflated price.

Vagueness. Coscia argued that the statute is "hopelessly vague" and that there is no practice "commonly known to the trade" as "spoofing" in the commodity futures markets. He contended the term is sometimes used in the securities markets, but not the commodity futures markets.

But the Seventh Circuit and the Solicitor General focused on the second part of the definition "(bidding or offering with the intent to cancel the bid or offer before execution)." Because "Congress provided the necessary definition" in the statute, the court explained, Congress "put the trading community on notice" that conduct like petitioner's was unlawful. Even if the parenthetical were illustrative rather than definitional, the statute put Coscia on notice that when he submitted offers with the purpose of cancelling them, his actions constituted spoofing, the court ruled.

Arbitrary enforcement. Coscia contended that the practice of spoofing is very common in the commodity futures markets, that the "overwhelming majority" of orders are cancelled, often within fractions of a second, and that many legitimate trading techniques involve placing orders with the expectation and intent that they will be cancelled. Further, there is no minimum "time in force" requirement for orders on the Chicago Mercantile Exchange. The statute thus subjects legitimate trading activity to arbitrary enforcement, said Coscia.

But the court and Solicitor General drew a distinction between spoofing and legitimate order types like partial-fill, good-til-date, and stop-loss. These legitimate order types are designed to be executed upon the arrival of certain *subsequent* events, whereas spoofing orders are placed with an intent to cancel the order *at the time it was placed.* According to the court, "The fundamental difference is that legal trades are cancelled only following a condition subsequent to placing the order, whereas orders placed in a spoofing scheme are never intended to be filled at all."

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Coscia argued in his reply brief that this is an incoherent distinction. But as evidence of intent, the Seventh Circuit had noted that Coscia commissioned a software program specifically designed to cancel orders if they ever risked being filled. Further, the Solicitor General observed that Coscia succeeded in cancelling the overwhelming majority of his large orders, including 99.92 percent of his orders on the Chicago Mercantile Exchange. The fact that a tiny fraction were ultimately filled did not show that he intended them to be filled at the time he placed them, said the Solicitor General. Rather, it showed that his plan always to cancel those orders was occasionally unsuccessful.

Other spoofing cases. Along with numerous civil enforcement actions settled by the CFTC, a number of other criminal spoofing caseshave been brought. In a joint sweep with the CFTC in January 2018, the DOJ charged seven individuals with spoofing and/or related commodities fraud in the precious metals futures markets. An eighth individual, Andre Flotron, was charged with conspiracy to commit spoofing, wire fraud, and commodities fraud, but he was acquitted in April 2018.

The case is No. 17-1099.

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