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DOJ's 1st Anti-Spoofing Prosecution Reflects 2 Trends

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A Chicago federal grand jury has indicted Michael Coscia, formerly a registered floor trader and sole owner of Panther Energy Trading LLC, for allegedly violating the anti-spoofing provision of the Commodity Exchange Act[1] and committing commodities fraud. The prosecution is the first by the U.S. Department of Justice under the anti-spoofing provision of the CEA, which was enacted as part of the Dodd-Frank Act in 2010.[2]

The Oct. 1, 2014, indictment follows administrative actions taken against the Coscia in 2013 by the U.S. Commodity Futures Trading Commission, the U.K. Financial Conduct Authority ("FCA") and the CME Group Inc. ("CME").[3] In the administrative actions, Coscia paid a total of $3.7 million in fines and penalties and neither admitted nor denied any wrongdoing.

The 12-count indictment focuses on six alleged instances of manipulating market prices to profit from commodity futures contract positions and charges Coscia with one count of commodities fraud under 18 U.S.C. § 1348 and one count of spoofing under 7 U.S.C. §§ 6c and 13 for each instance. Although the CEA has long prohibited commodities fraud, the government is prosecuting Coscia under relatively new statutory provisions. In 2009, Congress passed the Fraud Enforcement and Recovery Act, which expanded the fraud prohibition of 18 U.S.C. § 1348 to include commodities futures and options.[4] In addition, Congress criminalized "spoofing" of the commodities markets with the passage of the Dodd-Frank Act in 2010.[5]

Spoofing means to make a bid or offer "with the intent to cancel the bid or offer before execution."[6] According to the indictment, Coscia spoofed trades to generate profits ranging from $60 to $560 in each of the six futures contract positions described in the indictment and had overall profits of nearly $1.6 million from an undisclosed number of trades over two months. More specifically, the indictment alleges that Coscia used a high-frequency trading ("HFT") program in 2011 to manufacture and exploit risk-free profit opportunities in futures contracts by spoofing trades.

Coscia's algorithm allegedly worked by doing the following: (1) making a small futures contract order at a better-than-market price for Coscia (the "initial order"); (2) making multiple, large contract orders in the opposite direction of the initial order (and at prices progressively close to the price of the initial order); (3) waiting milliseconds for other market participants to react to the influx of the large orders and fill the initial order; and (4) canceling all of the large orders before other participants could fill them. The program subsequently re-executed the process to unwind the initial order and lock in profits from the spread between the below-market purchase price and above-market sale price. From start to finish, the process took less than one second.

As noted above, administrative actions against Coscia preceded his indictment. In July 2013, the CFTC, in conjunction with the FCA and the CME, settled the first action using this new anti-spoofing authority against him. The $3.7 million in financial penalties included a $1.4 million civil monetary penalty, $1.4 million in disgorgement and a $900,000 penalty to the FCA. In addition, the CFTC settlement banned Coscia from trading for one year and required him to waive any Double Jeopardy claims based upon the administrative penalties. In a concurring statement to the CFTC's order, Commissioner Bart Chilton expressed concerns about high-frequency trading and stated that he believed that Coscia's violation was "egregious" and that his penalty should have been more severe in order to serve as a deterrent to others.[7] Calling high-frequency traders "cheetahs," the commissioner expressed his desire to impose a penalty that would cause such "cheetahs" to expect "that regulators will always be harsh hard-hitters when the rules are broken."

Coscia's prosecution reflects two broad trends that merit watching. The first trend is the close scrutiny of HFT by government agencies. In April 2014 congressional testimony, Attorney General Eric Holder confirmed that the DOJ is investigating HFT "to determine whether it violates insider trading laws." Similarly, U.S. Securities and Exchange Commission Chairwoman Mary Jo White testified before Congress during the same month that the SEC has numerous ongoing HFT investigations.

The second trend is increasing cooperation between the CFTC and the DOJ in investigations. According to the CFTC, approximately 93 percent of the major fraud cases it filed during the 2013 fiscal year included a parallel criminal proceeding. The prosecution of Alex Ekdeshman, the former CEO of Paramount Management, for misappropriating investor funds is another recent example of a criminal action arising from parallel investigations. These kinds of parallel proceedings for commodities fraud are likely to increase given the April 2014 establishment of a Securities and Commodities Fraud Section in the U.S. Attorney's Office for the Northern District of Illinois; Illinois is home to more than two-thirds of all US futures market registrants.[8]

The CFTC has provided some guidance about how to avoid violating anti-spoofing laws and regulations. In the press release announcing its administrative action against Coscia, David Meister, the CFTC's enforcement director, drew a distinction between high-speed trading and spoofing. He cautioned that "while forms of algorithmic trading are of course lawful, using a computer program that is written to spoof the market is illegal and will not be tolerated."[9] Moreover, according to CFTC guidance, even reckless trading will not constitute spoofing so long as a person does not intend to cancel a bid or offer before execution.[10]

Because intent may be difficult to disprove or prove, businesses engaged in HFT should make sure that their trading patterns do not resemble spoofing or other prohibited practices. In a civil or criminal action, any defendant would be hard-pressed to overcome the devastating impact of thousands of trade orders that were uniformly (or almost uniformly) canceled without being filled — especially if nearly all of such orders were linked to profitable trades. If the government's evidence against Coscia is sufficient to support its allegations about his algorithm's trading, he will face such a daunting challenge.

Whether Coscia's prosecution is a harbinger of more prosecutions targeting spoofing or other violations related to HFT practices is not certain. But given the current trends and dedication of substantial DOJ and CFTC resources to commodities and securities fraud investigations, it would appear that more prosecutions are likely.

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[1] Indictment, United States v. Coscia, No. 14-CR-00551 (N.D. Ill. Oct. 1, 2014) available at, https://ia801405.us.archive.org/1/items/gov.uscourts.ilnd.301298/gov.uscourts.ilnd.301298.1.0.pdf.

[2] Pub. L. No. 111-203 § 747, 124 Stat. 1376, 1739 (2010) (the "Dodd-Frank Act") (codified at Commodity Exch. Act § 4c(a)(5)(C); 7 U.S.C. § 6c(a)(5)(C)).

[3] In the Matter of Panther Energy Trading LLC and Michael Cosica, CFTC Docket No. 13-26 (July 22, 2013); Final Notice: Michael Cosica, FCA (July 22, 2013); Panther Energy Trading Trade Notice, CME 11-8581-BC (July 22, 2013).

[4] Pub. L. 111-21 § 2(e), 123 Stat. 1617, 1618 (2009) (codified at 18 U.S.C. § 1348).

[5] Supra note 2. For comparative purposes, the maximum term of imprisonment for commodities fraud under 18 U.S.C. § 1348 is 25 years, while under the anti-spoofing provision, the maximum term of imprisonment is only 10 years.

[6] 7 U.S.C. § 6c(a)(5)(C).

[7] Press Release, CFTC, Concurring Statement of Commissioner Bart Chilton in the Matter of Panther Energy Trading LLC and Michael J. Coscia (July 22, 2013) available at, http://www.cftc.gov/PressRoom/PressReleases/chiltonstatement072213.

[8] Mayer Brown LLP Legal Update, "New Securities and Commodities Fraud Section Created by Chicago-

Based US Attorney" (April 22, 2014) available at, http://www.mayerbrown.com/New-Securities-and-Commodities-Fraud-Section-Created-by-Chicago-Based-US-Attorney-04-22-2014/; CFTC, Futures Industry Registrants by Location (Oct. 1, 2010) available at, http://www.cftc.gov/ucm/groups/public/@educationcenter/documents/file/registrantsbylocation.pdf.

[9] Press Release, "CFTC Orders Panther Energy Trading LLC and its Principal Michael J. Coscia to Pay $2.8 Million and Bans Them from Trading for One Year for Spoofing in Numerous Commodity Futures Contracts" (July 22, 2013) available at, http://www.cftc.gov/PressRoom/PressReleases/pr6649-13.

[10] Antidisruptive Practices Authority, 78 Fed. Reg. 31,890, 31,896 (May 28, 2013).
