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Article

The (Questionable) Legality of High-Speed "Pinging" and "Front Running" in the Futures Markets

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Institutional investors complain that high-frequency trading (HFT) firms engage in high-speed "pinging" and "front running" of their orders for trades. By sending out lightning fast "ping" orders for trades that operate much like sonar does in the ocean, HFT firms can detect when institutional investors will make large trades in futures contracts. Once a large trade has been detected, an HFT firm rapidly jumps in front of the institutional investor, buying up the liquidity in the contract and selling it back at higher or lower prices (depending on if it was a buy or a sell order).

None other than Warren Buffett's right-hand man has called the HFT practice "evil" and "legalized front running." While many criticize these HFT tactics, they accept their legality at face value. But what if that understanding is incorrect?

This Article posits that some high-speed pinging tactics violate at least four provisions of the Commodity Exchange Act—the statute governing the futures and derivatives markets—and one of the regulations promulgated thereunder. The better approach is not to view high-speed pinging as a form of front running or insider trading, but as analogous to disruptive, manipulative, or deceptive trading practices, such as banging the close (submitting a high number of trades in the closing period to influence the price of a contract), spoofing (submitting an order for a trade with the intent to immediately cancel it), or wash trading (self-dealing, or taking both sides of a trade), all of which are illegal.

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GREGORY SCOPINO*

I. INTRODUCTION

The world's fastest sharks do not swim in water or eat fish, although they do hunt for whales, just not the aquatic mammal variety. The quickest predators on the planet swim in oceans of data, move through interconnected computer networks associated with electronic trading platforms, and can place bids and offers for futures contracts[1] faster than a human can blink,[2] all the while looking for large trades to pick off.

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[1] A futures contract is defined as follows:

> [A] futures contract provides for the buyer (the "long") to purchase and the seller (the "short") to sell a specified quantity of a specified commodity at a specified future date. Futures contracts are standardized, permiting [sic] them to be offset on the exchanges. For example, a trader holding a short contract could enter into an offsetting long contract and thereby cancel out the initial obligation. To do so, however, requires that the offsetting contract provide for delivery in the same delivery month as the initial contract. Most futures contracts are settled by offset. Cash settlement may also be used in some futures contracts, particularly financial futures contracts on stock indexes. Because futures contracts are standardized, the only negotiable term is the price.

Jerry W. Markham, *Manipulation of Commodity Futures Prices—The Unprosecutable Crime*, 8 YALE J. ON REG. 281, 282 n.1 (1991).

[2] Sarah Anderson, *Wall Street's Speed Demons: A 10-Point Primer*, HUFFINGTON POST (May 4, 2012), http://www.huffingtonpost.com/sarah-anderson/wall-streets-speed-demons_b_1474355.html ("[To high-frequency trading (HFT) firms] 'the blink of an eye' is an eternity. It takes you 300–400 milliseconds to blink. Computers can now receive and send trading information in the span of 10 milliseconds. Since that's way faster than even a chess grandmaster's brain can react, mere humans will have a tougher time foreseeing and managing future financial catastrophes."); *see* Keri Geiger & Sam Mamudi, *High-Speed Trading Faces New York Probe into Fairness*, BLOOMBERG (Mar. 18, 2014), http://www.bloomberg.com/news/2014-03-18/high-speed-trading-said-to-face-n-y-probe-into-fairness.html ("Computer-driven trades can be executed in about 300 microseconds, according to one study. At that speed more than 1,000 trades can be made in the blink of a human eye, which lasts 400 milliseconds.").

Proprietary trading firms[3] that use automated trading systems (ATSs)[4] to employ high-frequency trading (HFT)[5] strategies are said to engage in a category of tactics in the financial markets that have been variously called (among other things) high-speed "pinging,"[6] "HFT front running,"[7] "abusive liquidity[8] detection,"[9] and even "exploratory trading."[10] Pursuant

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[3] *Proprietary Trading*, INVESTOPEDIA, http://www.investopedia.com/terms/p/proprietarytrading.asp (last visited Sept. 21, 2014) ("When a firm trades for direct gain instead of commission dollars. Essentially, the firm has decided to profit from the market rather than from commissions from processing trades.").

[4] Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, 78 Fed. Reg. 56,542, 56,544 n.7 (Sept. 12, 2013) ("[T]he term [ATS] is generally understood to mean a computer-driven system that automates the generation and routing of orders to one or more markets.").

[5] The U.S. Commodity Futures Trading Commission's (CFTC's) Technology Advisory Committee has stated that HFT is a type of automated trading that uses "[a]lgorithms for decision making, order initiation, generation, routing, or execution, for each individual transaction without human direction," and that, inter alia, involves using low-latency technology, high-speed connections to markets for order entry, and high message rates for orders and cancellations. *Id.* at 56,545. The Securities and Exchange Commission (SEC) defines HFT firms as "professional traders acting in a proprietary capacity that engage in strategies that generate a large number of trades on a daily basis." Concept Release on Equity Market Structure, 75 Fed. Reg. 3594, 3606 (Jan. 21, 2010). The SEC also mentions several common characteristics of HFT firms, such as the following:

> (1) The use of extraordinarily high-speed and sophisticated computer programs for generating, routing, and executing orders; (2) use of co-location services and individual data feeds offered by exchanges and others to minimize network and other types of latencies; (3) very short time-frames for establishing and liquidating positions; (4) the submission of numerous orders that are cancelled shortly after submission; and (5) ending the trading day in as close to a flat position as possible (that is, not carrying significant, unhedged positions over-night).

Id.

[6] *See* Gail MarksJarvis, *Technology Favors Hare in Race vs. Tortoise; High-Frequency Trading Costs Individuals in Subtle Ways*, CHI. TRIB., May 23, 2010, at C1 (discussing the detrimental effects of techniques like pinging on individual investors).

[7] *See* Paloma Migone, *HFT Helps Stabilise the Market During Shocks—Eurex*, THE TRADE (May 9, 2013), http://www.thetradenews.com/news/Regions/Europe/HFT_helps_stabilise_the_market_during_shocks_-_Eurex.aspx (describing the strategy of front-running). Some sources hyphenate the term, "front-running," whereas others do not. For purposes of this Article, I will not hyphenate the term unless it is hyphenated in quoted material.

[8]

> Liquidity [is the] ability to buy or sell an asset quickly and in large volume without substantially affecting the asset's price. Shares in large blue-chip stocks like General Motors or General Electric are liquid, because they are actively traded and therefore the stock price will not be dramatically moved by a few buy or sell orders. However, shares in small companies with few shares outstanding, or commodity markets with limited activity, generally are not considered liquid, because one or two big orders can move the price up or down sharply.

DICTIONARY OF FINANCE AND INVESTMENT TERMS 391 (John Downes & Jordan Elliot Goodman eds., 9th ed. 2014).

[9] In 2013, the Investment Industry Regulatory Organization of Canada (IIROC), a national self-regulatory organization (SRO) that oversees all investment dealers and trading activity on debt and

to such tactics, HFT firms[11] use various methods to detect large trading orders by mutual funds[12] or other institutional investors[13] to buy or sell

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equity marketplaces in Canada, issued final guidance on trading activities that are frequently employed by HFT firms and that are considered manipulative and deceptive trading practices under IIROC's Universal Market Integrity Rules (UMIR). *See* IIROC/OCRCVM, NOTICE 13-0053, GUIDANCE ON CERTAIN MANIPULATIVE AND DECEPTIVE TRADING PRACTICES 1–5 (2013), [hereinafter IIROC Notice 13-0053] *available at* http://www.iiroc.ca/Documents/2013/6a825012-1c65-4fd3-9d93-20b3f0ccf4e8_en.pdf ("IIROC is of the view that strategies which enter orders . . . to detect the existence of a large buyer or seller with the intention to trade ahead of, rather than with, the large buyer or seller, is a manipulative and deceptive practice[.]"); *IIROC Releases Guidance on Deceptive Trading Practices*, CANADIAN SECURITIES LAW (Feb. 22, 2013), http://www.canadiansecuritieslaw.com/2013/02/articles/securities-distribution-tradin/iiroc-releases-guidance-on-deceptive-trading-practices/. Included in the list of trading practices considered manipulative and deceptive was "abusive liquidity detection," which is defined as follows:

> Entering large orders during the pre-open or employing 'pinging' orders to detect a large buyer or seller and get trades in ahead of them. After a profitable price movement, the trades are reversed, or in the event the price moves contrary to the position taken, the trading interest of the large buyer or seller may be viewed as a free option to trade against.

Barbara Shecter, *Canadian Regulator Set to Get Tough on High-Frequency Trading*, FINANCIALPOST.COM (July 18, 2012), http://business.financialpost.com/2012/07/18/canadian-regulator-se t-to-get-tough-on-high-frequency-trading/; IIROC Notice 13-0053, at 5 ("IIROC is of the view that strategies which enter orders . . . to detect the existence of a large buyer or seller with the intention to trade ahead of, rather than with, the large buyer or seller, is a manipulative and deceptive practice . . . ."); *see also* IIROC/OCRCVM, NOTICE 12-0221, PROPOSED GUIDANCE ON CERTAIN MANIPULATIVE AND DECEPTIVE TRADING PRACTICES 1–2 (2012), [hereinafter IIROC/OCRCVM NOTICE 12-0221], *available at* http://www.iiroc.ca/Do cuments/2012/f62c746a-b5c9-448a-b57f-f1c04c 88de14_en.pdf (proposing the promulgation of substantially similar guidelines a year earlier).

[10] *See* Adam D. Clark-Joseph, *Exploratory Trading* 4–10 (Jan. 13, 2013) (unpublished paper on file with Nanex), *available at* http://www.nanex.net/aqck2/4136/exploratorytrading.pdf) (outlining the tactic known as exploratory trading).

[11] Philip Stafford, *Computer Errors: Mishaps Prompt Greater Scrutiny of High Speed Traders*, FIN. TIMES (Oct. 16, 2012), http://www.ft.com/intl/cms/s/0/f8c3eb58-0e21-11e2-8b92-00144feabdc0.html ("[HFT is t]ypically conducted by investors trading their own capital, these transactions rely on superfast computers, and algorithms and automation to hold positions in assets for fractions of seconds.").

[12]

> An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. . . . One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities, which would be quite difficult (if not impossible) to create with a small amount of capital.

Mutual Fund, INVESTOPEDIA, http://www.investopedia.com/terms/m/mutualfund.asp (last visited Sept. 21, 2014).

[13] "A non-bank person or organization that trades securities in large enough share quantities or dollar amounts that they qualify for preferential treatment and lower commissions. Institutional investors face fewer protective regulations because it is assumed that they are more knowledgeable and

financial products—such as futures contracts or other derivatives[14]—and, with lightning speed, trade ahead of the large orders that are detected, thereby raising (or lowering) the prices paid by the institutional investors.[15] The scenario typically plays out as follows:

> The big game in this hunt became known as a *whale*—an order from a leviathan fund company such as Fidelity, Vanguard, or Legg Mason.[16] If the algos[17] could detect the whales, they could then have a very good sense for whether a stock was going to rise or fall in the next few minutes or even seconds. They could either trade ahead of it or get out of its way. The bottom line: Mom and Pop's retirement accounts were full of mutual funds handing over billions of dollars a year to the Bots.[18]

Although the example above references the stock market, HFT pinging and

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better able to protect themselves." *Institutional Investor*, INVESTOPEDIA, http://www.investopedia.com/terms/i/institutionalinvestor.asp (last visited Sept. 21, 2014).

[14] "'Derivative' is a generic term for any security or contract whose value is *derived* from that of some *underlying* natural security, such as a stock or a bond. Instead of owning the asset, and either profiting or losing as its price rises or falls, a derivative is a bet on some aspect of its behavior." ALAN S. BLINDER, AFTER THE MUSIC STOPPED 61 (2013); *see* Kelly S. Kibbie, *Dancing with the Derivatives Devil: Mutual Funds' Dangerous Liaison with Complex Investment Contracts and the Forgotten Lessons of 1940*, 9 HASTINGS BUS. L.J. 195, 196 n.1 (2013) ("Derivatives are broadly defined as financial instruments whose value is derived from other variables (referred to as 'reference assets' or 'underliers').").

[15] *See* Katherine Heires, *Could a Delay Tame the World of High Frequency Trading?* INSTITUTIONAL INVESTOR, June 28, 2012 ("[T]he pinging or sonar-like exploration of other traders' intentions that HFT critics abhor . . . ."); *Better Oversight of HFT*, PENSION & INVESTMENTS, Apr. 14, 2014, at 10 ("Institutional investors should lend their support to efforts to halt, or at least slow, high-frequency trading because they are potentially the biggest losers from the practice. . . . Because institutional investors often trade in hundreds of thousands of shares at a time, the high-frequency traders collect substantial amounts of 'toll' from each trade."); *see also* MICHAEL LEWIS, FLASH BOYS 30–32 (2014) (providing an example of how high frequency trading has negatively impacted traditional investors by anticipating their trades before they are made); William Alden, *Michael Lewis Views Market as "Rigged" in Favor of High-Speed Traders*, N.Y. TIMES (Mar. 30, 2014), http://dealbook.nytimes.com/2014/03/30/michael-lewis-views-market-as-rigged-in-favor-of-high-speed-traders (stating that Lewis argues "that high-frequency traders are able to 'front-run' other investors, by quickly spotting orders and positioning themselves to take advantage of them").

[16] Fidelity, Vanguard, and Legg Mason are mutual funds. *See* Colin Barr, *Vanguard Dethrones Fidelity*, FORTUNE (Sept. 30, 2010), http://finance.fortune.cnn.com/2010/09/30/vanguard-dethrones-fidelity/ (discussing such funds and their interactions).

[17] "Algo" is short for "algorithm." *See* Scott Patterson, *How Robots Run the Markets*, SUNDAY BUS. POST, Sept. 23, 2012 (defining "algos" as algorithmic trading programs). An algorithm is "a step-by-step procedure for solving a problem or accomplishing some end especially by a computer." *Algorithm*, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/algorithm (last visited Oct. 5, 2014).

[18] SCOTT PATTERSON, DARK POOLS: HIGH-SPEED TRADERS, A.I. BANDITS, AND THE THREAT TO THE GLOBAL FINANCIAL SYSTEM 7 (2012). "Bots" is short for "robots." *See* Patterson, *supra* note 17 (using "bots" and "robots" interchangeably to refer to computers).

front running are also issues in the futures and derivative markets.[19] For example, the pro-financial reform nonprofit organization Better Markets[20] wrote in December of 2013 to the U.S. Commodity Futures Trading Commission (CFTC)—the financial regulator for the futures and derivatives markets—about how HFT firms engage in such tactics:[21]

> Suppose a high frequency trader has detected an institutional investor seeking to transact a large position in small increments. The HFT can discover this by pinging the market with small test orders at various price levels, immediately cancelling those orders that are not instantly filled. This technique is akin to using sonar to locate a whale underwater in order to harpoon it. Having established the presence of such a large trader, the HFT can position itself ahead of the trade, taking a small loss at first (to wipe out existing liquidity) before then making a big profit by flipping its position to the institutional investor. . . . For example, suppose an institutional investor uses an algorithm that is set to progressively increase in size if it gets filled, or move to a higher (or lower) price if it does not. . . . Once the HFT detects this, it can jump in before the algorithm returns and bid the price up (or down) by placing orders and clearing the available liquidity before turning around and offering "liquidity" at a new, less attractive price.[22]

Some refer to the tactic as high-speed pinging, a reference to the

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[19] Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, 78 Fed. Reg. 56,542, 56,545 (Sept. 12, 2013) ("An established body of data indicates the importance of electronic and algorithmic trading in U.S. futures markets."). Much of the reporting and commentary about HFT has referred to the use of HFT in the stock markets. *See, e.g.*, LEWIS, *supra* note 15, at 268–69 (describing the desire of HFT firms to have fast connections between the futures markets in Chicago and the stock market facilities located in New Jersey to take advantage of arbitrage opportunities from price differences between those markets); Vince Heaney, *The War Against "Insider Trading 2.0"*, FIN. TIMES (Oct. 20, 2013), http://www.ft.com/intl/cms/s/0/bdb99a02-359a-11e3-b539-00144feab7de.html ("In 2009, Samantha Bee, one of the cast members on The Daily Show, the satirical US television programme, said that 'if I know about a stock's activity the day before, it's called insider trading. But if I know about a stock's activity one second before, it's called high-frequency trading.'").

[20] Annie Lowrey, *Facing Down the Bankers*, N.Y. TIMES, May 31, 2012, at B1 ("[Better Markets is] a nonprofit organization that pushes for a stringent interpretation of the Dodd-Frank financial regulatory law, which passed in 2010 but whose specific rules and regulations are currently the focus of an intense, complex and expensive behind-the-scenes battle."). "Better Markets does not march against banks, or bring loudspeakers to their lobbies. It instead writes detailed comment letters to regulators, meets with them, files friend-of-the-court briefs, puts out studies and testifies before Congress." *Id.*

[21] Letter from Dennis M. Keller, President & CEO, Better Markets, Inc., to Melissa Jurgens, Sec'y, CFTC (Dec. 11, 2013) [hereinafter Better Markets Comment Letter], *available at* http://comments.cftc.gov/PublicComments/ViewComment. aspx?id=59446&SearchText=.

[22] *Id.* at 3.

technique's similarities to sonar,[23] which involves the use of sound waves—"pings"—to detect objects underwater.[24] Others liken this high-speed tactic to front running[25] because HFT firms are able to trade ahead of large orders to their benefit, which is viewed as analogous to traditional front running,[26] in which a person (typically a broker) would take a futures contract or option position based upon nonpublic information regarding an impending transaction (that is, a large order to buy or sell) by another person (generally, one of the broker's customers) in the same or related futures contract or option.[27] Charles Munger,[28] the vice chairman of

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[23] The National Ocean and Atmospheric Administration explains sonar as follows:

> Sonar, short for *Sound Navigation and Ranging*, is helpful for exploring and mapping the ocean because sound waves travel farther in the water than do radar and light waves. . . . Active sonar transducers emit an acoustic signal or pulse of sound into the water. If an object is in the path of the sound pulse, the sound bounces off the object and returns an "echo" to the sonar transducer. If the transducer is equipped with the ability to receive signals, it measures the strength of the signal. By determining the time between the emission of the sound pulse and its reception, the transducer can determine the range and orientation of the object.

What Is Sonar?, NAT'L OCEAN & ATMOSPHERIC ADMIN., http://oceanservice.noaa.gov/facts/sonar.html (last visited Sept. 21, 2014); *see also Elements of Submarine Operation*, U.S. NAVY MUSEUM, http://www.history.navy.mil/branches/teach/dive/elem.htm (last visited Sept. 21, 2014) ("Active sonar produces and emits a burst of sound or a 'ping.'").

[24] LEWIS, *supra* note 15, at 268 ("[T]he purpose of these buy and sell orders was not to buy and sell stock but to tease out market information from others . . . .").

[25] *See, e.g.*, Diane Brady, *Lewis Calls* Flash Boys *Blowback 'Thoughtless'*, BLOOMBERG BUS. WEEK (Apr. 2, 2014), http://www.businessweek.com/articles/2014-04-02/michael-lewis-interview-on-the-blowback-from-flash-boys ("These firms make their money by front-running trades. They're using their speed advantage to buy shares first and then selling them back at a higher price. The result is higher prices for investors in those shares. That's rigged." (quoting author Michael Lewis)); Nancy Folbre, *The Front-Runners of Wall Street*, N.Y. TIMES (Apr. 7, 2014), http://economix.blogs.nytimes.com/2014/04/07/the-front-runners-of-wall-street/?_php=true&_type=blogs&ref=business&_r=0 ("In the world of financial trading, a front-runner is someone who gains an unfair advantage with inside information, including access to a high-speed transaction network revealing specific trades other people are trying to make.").

[26] U.S. CFTC TRANSCRIPT OF THE TECHNOLOGY ADVISORY COMMITTEE MEETING 157–58, (Feb. 10, 2014), *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/tac_021014_transcript.pdf (statement of Caitlin Kline, derivatives specialist at Better Markets) ("When HFTs receive and digest market information many times faster than investors, they effectively are able to see the future. . . . [I]t's unclear how many of these high-speed strategies are not functionally front running."); Tom Polansek, *High-Speed Traders Mount Defense as CFTC Studies Sector*, REUTERS (Feb. 10, 2014), http://www.reuters.com/article/2014/02/10/cftc-hft-committee-idUSL2N0LF1LG20140210 ("It is important for the CFTC to assess a number of potential regulatory changes in light of the high-speed trading environment, including its definitions of banned practices, like front running, said Caitlin Kline, derivatives specialist for Better Markets, a group that says it fights for the public interest in financial markets.").

[27] *CFTC Glossary*, CFTC, http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm (last visited Sept. 21, 2014). "Trading ahead" is defined in the website glossary with a simple, "See Front Running." *Id.*; *see* Jerry W. Markham, *Prohibited Floor Trading Activities Under the Commodity Exchange Act*, 58 FORDHAM L. REV. 1, 20 n.110 (1989) ("[F]rontrunning or

Berkshire Hathaway,[29] likewise indicated that he viewed these kinds of HFT tactics as "legalized front running," saying,

> I think it is very stupid to allow a system to evolve where half the trading is a bunch of short-term people trying to get information one-millionth of a nano-second ahead of somebody else. It's legalized front-running; I think it's basically evil and it should never have been able to reach the size that it did . . . why should all of us pay a little group of people to engage in legalized front-running of our orders?[30]

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trading ahead of customer orders, where a dual trading floor broker, with a customer's order in hand, executes an order for his personal account ahead of the customer's order.").

[28] Charlie Munger is described as:

> The Vice-Chairman of Berkshire Hathaway Corporation, the diversified company chaired by renowned investor Warren Buffett. Upon graduating from Harvard Law School in 1948, Charles Thomas Munger, known as Charlie, founded Munger, Tolles & Olson LLP, a real estate law firm. In 1965, he began concentrating on managing investments and formed an investment firm, Wheeler, Munger and Company, with a seat on the Pacific Coast Stock Exchange. While practicing law in Omaha, Munger met Warren Buffet and eventually joined Berkshire Hathaway has Buffet's "right hand man".

Charlie Munger, INVESTOPEDIA, http://www.investopedia.com/terms/c/charlie-munger.asp (last visited Sept. 21, 2014).

[29] Berkshire Hathaway is

> [a] holding company for a multitude of businesses run by Chairman and CEO Warren Buffett. Berkshire Hathaway is headquartered in Omaha, Nebraska and began as just a group of textile milling plants, but when Buffett became the controlling shareholder in the mid 1960s he began a progressive strategy of diverting cash flows from the core business into other investments.

Berkshire Hathaway, INVESTOPEDIA, http://www.investopedia.com/terms/b/berkshire-hathaway.asp (last visited Sept. 21, 2014).

[30] Sam Mamudi, *Charlie Munger: HFT Is Legalized Front-Running*, BARRONS (May 3, 2013), http://blogs.barrons.com/stockstowatchtoday/2013/05/03/charlie-munger-hft-is-legalized-front-running/. Warren Buffett has stated that he agrees with Munger's characterization of HFT, saying that HFT "is not contributing anything to capitalism." *CNBC Excerpts: Billionaire Investor Warren Buffett Sits Down with CNBC's Becky Quick on "Squawk Box" Today*, CNBC (May 6, 2013), http://www.cnbc.com/id/100711480; *see also* Barry Ritholtz, *Speed Trading in a Rigged Market*, BLOOMBERG (Mar. 31, 2014), http://www.bloombergview.com/articles/2014-03-31/speed-trading-in-a-rigged-market ("I call it legalized theft. High-frequency trading is a tax on investors . . . ."). Kelleher of Better Markets stated the following:

> Note that this is a clear analog to traditional concepts of front-running. The HFT is able to determine a large order coming—information that is not available to the rest of the market because it can only be determined by high-speed pinging. The HFT can therefore move the market in anticipation of that position, before trading against it at the new, advantageous price. In the past, front-running was often enabled by insider tip-offs about order flow. The difference here is that the HFT gathers the information by poking and pinging the market to determine the trading intent of the large investor rather than getting a tip from a broker or other market participant. The

The purpose of this Article is not to argue that high-speed trading is good, bad, or indifferent, but to argue that Munger's statement about the legality of high-speed pinging and front running tactics, which is in keeping with the conventional wisdom in this area, is wrong, or at least not unquestionably correct. Intentional high-speed pinging and related tactics are quite possibly illegal in the markets for futures and derivatives, based on existing provisions of the Commodity Exchange Act (CEA)[31] and CFTC Regulations[32] promulgated thereunder.[33] As such, mutual funds and other market participants could bring claims against firms that engage in such tactics. Rather than comparing high-speed pinging and similar order anticipation strategies[34] to front running, these tactics are best viewed as variations of trading practices such as banging the close,[35] wash trading,[36]

> results are the same however: predatory actions resulting in worse prices for institutional and retail investors, and, ultimately, a consequent loss of faith in the markets.

Better Markets Comment Letter, *supra* note 21. "Mad Money" TV show host Jim Cramer has said, "We used to call [it] illegal front-running . . . but [it] has since been accepted by the geniuses at the SEC as totally legal and even positive behavior that gives the markets more depth [and] greater liquidity." Michelle Fox, *Cramer: It's Time to Embrace High-Frequency Trading*, CNBC (May 6, 2013, 7:07 PM), http://www.cnbc.com/id/100712294 (including Cramer's later statement that, regardless of whether HFT is beneficial for the markets, "[t]he fact is it's here to stay. Learn to stop hating it, embrace the madness, and profit from it"); *see also* Nick Baker & Sam Mamudi, *High-Speed Traders Rip Investors Off, Michael Lewis Says*, BLOOMBERG (Mar. 31, 2014), http://www.bloomberg.com/news/2014-03-30/high-frequency-traders-ripping-off-investors-michael-lewis-says.html ("'The problem with high-frequency trading right now is that there's a perception that for the little guy, the markets aren't fair,' [said SEC Commissioner Daniel Gallagher.] 'That perception to me is a reality. It's something we need to address.'"); Joe Nocera, *Michael Lewis's Crusade*, N.Y. TIMES (Apr. 4, 2014), http://www.nytimes.com/2014/04/05/opinion/nocera-michael-lewiss-crusade.html (stating that HFT firms engage in "a highly sophisticated version of front-running—that is, knowing how someone is going to trade and profiting by getting in front of that trade" which "is illegal—except, apparently, when high-frequency traders do it").

[31] 7 U.S.C. § 1 et seq. (2012).

[32] 17 C.F.R. § 1.1 et seq. (2009).

[33] This Article focuses on *intentional* conduct, i.e., on situations in which humans programmed ATSs to use HFT tactics to engage in high-speed pinging or front running. The difficulty of proving the existence of a culpable mental state in the context of computerized, automated trading is beyond the scope of this Article. For a discussion of that issue, see Gregory Scopino, *Do Automated Trading Systems Dream of Manipulating the Price of Futures Contracts? Policing Markets for Improper Trading Practices by Algorithmic Robots*, 66 FLA. L. REV. (forthcoming 2015).

[34] The SEC defined order anticipation strategies as generally including "the employment of sophisticated pattern recognition software to ascertain from publicly available information the existence of a large buyer (seller), or the sophisticated use of orders to 'ping' different market centers in an attempt to locate and trade in front of large buyers and sellers." Concept Release on Equity Market Structure, 75 Fed. Reg. 3594, 3609 (Jan. 21, 2010).

[35] Banging the close is the practice of buying or selling large volumes of commodity contracts in the closing moments of a trading day with the intent of moving the price of the contract (or contracts). *See* David Cho, *CFTC Charges Firm With Manipulating Oil Prices; Agency Under Pressure to Rein in Trading*, WASH. POST, July 25, 2008, at D3 (describing the practice of "banging the close"); David Sheppard & Jonathan Stempel, *Optiver Pays $14 Million in Oil Manipulation Case*, REUTERS (Apr. 20,

and spoofing,[37] which courts and regulators have found to be illegal, manipulative, deceptive, and disruptive activities in both the futures and securities markets.

This Article maintains that at least some forms of high-speed pinging appear to violate four CEA provisions and one CFTC Regulation. Specifically, high-speed pinging—that is, the sending out of small batches of "ping" orders, the majority of which are cancelled without being executed—arguably violates the following provisions of the CEA: (1) Section 4c(a)(2)(B)'s prohibition on causing non-bona fide prices to be reported;[38] (2) Section 4c(a)(5)(C)'s prohibition on spoofing;[39] (3) the prohibition in Section 9(a)(2) and CFTC Rule 180.1(a)(4) on delivering false, misleading, or knowingly inaccurate crop or market information or reports;[40] and (4) Section 6(c)(1)[41] and CFTC Rule 180.1,[42] which prohibit

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2012), http://www.reuters.com/article/2012/04/20/us-optiver-settlement-idUSBRE83J01220120420 (describing the practice of "banging the close").

[36] Wash trading is the name given to illegally taking both sides of prearranged, noncompetitive trades. It is also referred to as "wash sales." *See* Ann Saphir, *Regulators Examining 'Wash Trades,' CFTC's Chilton Says*, REUTERS (Mar. 19, 2013), http://www.reuters.com/article/2013/ 03/18/cftc-washtrades-chilton-idUSL1N0CADUD20130318 (defining a wash trade as when "a trading firm improperly sells a contract to itself without taking any risk in the market" and noting that U.S. futures regulators are examining the practice and are considering new rules to prevent the practice).

[37] *See* Marty Steinberg, *CFTC Charges Trading Firm Under New 'Antispoofing' Authority*, CNBC (July 22, 2013), http://www.cnbc.com/id/100902782 ("Spoofing, a form of disruptive trading [practice] that is becoming more common with the entrance of high speed trading, is a scheme in which false price bids are entered and then pulled back before anyone can execute them.").

[38] Commodities Exchange Act, Pub. L. No. 74-675, § 4c(a)(2)(B), 49 Stat. 1491 (codified at 7 U.S.C. §§ 6c(a)(1), 6c(a)(2), 6c(a)(2)(B) (2012)) ("It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction . . . involving the purchase or sale of any commodity for future delivery (or any option on such a transaction or option on a commodity) or swap if the transaction . . . is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price."). The CFTC has used CEA Section 4c(a)(2)(B) to combat improper trading practices, equating (in certain circumstances) bids and offers for trades with causing the reporting of prices that are not true and bona fide. *See In re* Gelber Grp., LLC, CFTC Docket No. 13-15, 2013 WL 525839, at *3 (C.F.T.C. Feb. 8, 2013) (holding that Gelber violated Section 4c(a)(2)(B)); *In re* Bunge Global Mkts., Inc., CFTC Docket No. 11-10, 2011 WL 1099346, at *4 (C.F.T.C. Mar. 22, 2011) (holding that there was a violation of Section 4c(a)(2)(B)).

[39] Commodities Exchange Act, Pub. L. No. 74-675, § 4c(a)(2)(B), 49 Stat. 1491 (codified at 7 U.S.C. § 6c(a)(5)(C) (2012)) ("It shall be unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that is, 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).").

[40] Commodities Exchange Act, Pub. L. No. 74-675, § 4c(a)(2)(B), 49 Stat. 1491 (codified at 7 U.S.C. § 13(a)(2) (2012)) (stating that it is unlawful to, inter alia, "knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce"). As with CEA Section 4c(a)(2)(B), the CFTC has used CEA Section 9(a)(2) to combat improper trading practices, arguing that bids and offers for trades can cause the delivery of false, misleading, or knowingly inaccurate reports that tend to affect the price of a commodity. *See In re*

reckless, fraud-based manipulation and which were modeled after, and intended to draw from the federal common law under, Section 10(b) of the Securities Exchange Act (Exchange Act) of 1934[43] and Securities and Exchange Commission (SEC) Rule 10b-5.[44]

Part II of this Article provides a background which (1) describes high-speed pinging and related tactics in the derivative markets, (2) outlines the historically permissive regulatory approach toward trading on material nonpublic information under the CEA, and (3) describes the legal framework surrounding trading on material nonpublic information—i.e., insider trading—in the securities markets. Part III describes CEA provisions and CFTC Regulations that high-speed pinging might violate, with an emphasis on CEA Section 6(c)(1) and CFTC Rule 180.1. Part IV explains how high-speed pinging and similar tactics arguably violate specific existing statutory and regulatory provisions that prohibit, inter alia, the use of manipulative and deceptive devices, such as wash trading and banging the close, in the financial markets. Part V poses some questions concerning the potential scope of the statutory and regulatory provisions in question.

II. BACKGROUND

A. *The Financial Markets Today*

Today, less and less trading in futures and derivatives is initiated by humans, whether in the "pits" or trading floors, of futures exchanges or from retail investors calling in instructions to their brokers.[45] Nowadays, many participants in the futures markets, from mutual funds to banks to proprietary trading firms, use ATSs[46] to initiate and place bids and offers

Gelber Grp., 2013 WL 525839, at *4 (holding Gelber violated Section 9(a)(2)); *In re Bunge Global Mkts.*, 2011 WL 1099346, at *4 (holding there was a violation of Section 9(a)(2)).

[41] 7 U.S.C. § 9(1) (2012) (It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the [CFTC] shall promulgate . . . .").

[42] 17 C.F.R. § 180.1 (2014).

[43] 15 U.S.C. § 78j(b) (2012).

[44] 17 C.F.R. § 240.10b-5 (2014).

[45] *See* Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, 78 Fed. Reg. 56,542, 56,542 (Sept. 12, 2013) (noting transition from human oriented trading centers to automated and interconnected environments).

[46] *Id.* at 56,544 n.7 ("[T]he term [ATS] is generally understood to mean a computer-driven system that automates the generation and routing of orders to one or more markets.").

for trades in futures, commodity options, and other derivatives.[47] One form of automated trading is HFT:[48] "[C]ertain features are indicative of [HFT] strategies: very high order amounts; rapid order cancellation; a flat position at the end of the trading day; extracting very low margins per trade; and trading at ultra-fast speeds."[49] Some HFT strategies involve order cancellation rates of ninety percent or more.[50] A report by the Federal Reserve Bank of Chicago[51] summed up the situation as follows:

> Over the past decade, a confluence of market, regulatory and technological events has radically changed the microstructure of many exchange traded markets. . . . These changes, combined with technological advances in communications and digital computing, have expedited the migration from

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[47] *Id.* at 56,545 ("By the end of the first quarter of 2010, ATSs accounted for over 50% of trading volume in a number of significant product categories at CME Group, Inc.'s ('CME Group') [futures exchanges, officially referred to as designated contract markets].").

[48] *Id.* ("Effectively, HFT is a form of automated trading, but not all automated trading is HFT.").

[49] Andrew J. Keller, Note, *Robocops: Regulating High Frequency Trading After the Flash Crash of 2010*, 73 OHIO ST. L.J. 1457, 1459 (2010).

[50] *See* Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 299 (2012) (describing the common characteristics of proprietary trading firms that engage in HFT strategies as including, "the submission of numerous orders that are cancelled shortly after submission"); Keller, *supra* note 49, at 1466–67 **(**noting an HFT strategy which "can generate an enormous volume of orders and high cancellation rates of 90% or more"); Peter J. Henning, *Markets Evolve, as Does Fraud*, N.Y. TIMES, Nov. 12, 2013, at F12 ("High-frequency trading, for example, involves the use of algorithms to identify profitable trades in which computers prepare and enter a high volume of market orders in nanoseconds, but many are then canceled just as quickly."); Matt Levine, *Regulators Not Happy With Guy Whose Algorithm Tricked Some Other Algorithms*, DEALBREAKER (July 22, 2013, 3:41 PM), http://dealbreaker.com/2013/07/regulators-not-happy-with-guy-whose-algorithm-tricked-other-algorithms ("An estimated 95% to 98% of orders submitted by high-speed traders are canceled as the firms rapidly react to shifts in prices across the stock market . . . ."); Christine Stebbins & Peter Bohan, *High Speed Traders Jolt U.S. Grain Trade*, REUTERS (Nov. 19, 2012), http://uk.reuters.com/article/2012/11/19/usa-grains-hft-idUKL1E8MJ5XJ20121119 ("'The high frequency trader is constantly putting orders in and canceling it without the intent to trade,' said grain analyst Roy Huckabay at Linn Group in Chicago. 'It's not unusual for him to put in an order to buy 5,000 December corn and cancel as soon as one is filled.'").

[51] DICTIONARY OF FINANCE AND INVESTMENT TERMS, *supra* note 8, at 260 (defining federal reserve bank as "one of the 12 banks that, with their branches, make up the federal reserve system" and that "[t]he role of each Federal Reserve Bank is to monitor the commercial and savings banks in its region to ensure that they follow Federal Reserve Board regulations and to provide those banks with access to emergency funds from the Discount Window"); *id.* (defining the "Federal Reserve System" as the "system established by the Federal Reserve Act of 1913 to regulate the U.S. monetary and banking system. . . . The Federal Reserve System's main functions are to regulate the national money supply, set reserve requirements for member banks, supervise the printing of currency at the mint, act as clearinghouse for the transfer of funds throughout the banking system, and examine member banks to make sure they meet various Federal Reserve regulations"); *see* Jacob Bunge, *Fed Paper Urges Trading Reforms to Help Humans Compete*, WALL ST. J. (May 20, 2013, 6:51 PM), http://online.wsj.com/article/BT-CO-20130520-712329.html ("In the U.S., the Chicago Fed has taken a leading role in analyzing high-frequency trading, with many of the world's top automated firms based in the city.").

> floor-based to electronic (point-and-click) to high speed trading (HST) where computers programmed by humans make trading decisions. So called black boxes are capable of reacting to market data, transmitting thousands of order messages per second, cancelling and replacing orders based on changing market conditions, and capturing price discrepancies with little or no human intervention.[52]

One key reason for implementing some high-speed trading strategies is faster than normal receipt of information that is likely to move markets, be it trade data from exchanges,[53] or machine-readable data feeds of news reports.[54] Many HFT firms also pay exchanges to "co-locate" their computers next to the exchange's trading data centers so that the HFT firms can receive trade data more quickly.[55] But even without advantages

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[52] Carol Clark & Rajeev Ranjan, *How Do Broker-Dealers/Futures Commission Merchants Control the Risks of High Speed Trading?*, FED. RES. BANK OF CHI., June 2012, at 3 & n.2 ("Black box trading strategies are 100 percent automated, pre-programmed, and traders cannot interact or modify the algorithms.").

[53] Leah McGrath Goodman, *Is Wall Street Pulling a Fast One?*, NEWSWEEK, May 30, 2014, at 1 (stating that many investors "are largely unaware that high-frequency traders and institutional investors are paying up to $180,000 a year to receive direct data feeds from exchanges that give them prices and crucial market information faster than the ordinary investor by roughly 15 to 20 minutes").

[54] *FOi TechNews: Dow Jones Enriches Corporate Events News Feed*, FO WEEK (Dec. 17, 2010), http://www.fow.com/2744553/FOi-TechNews-Dow-Jones-enriches-corporate-events-news-feed.html ("Dow Jones has added a range of 'news catalysts' to its machine-readable Corporate Elementized News Feed, a low latency corporate data feed it sells to high frequency traders. . . . 'With more data, traders can build smarter algorithms and gain a competitive advantage for trades executed during normal market hours and after-hours trading that revolves around earnings events . . . .'" (citation omitted)); Ryan Terpstra, *Hedge Funds Seeking Differentiation Look to Event Data*, INSTITUTIONAL INVESTOR (Oct. 28, 2010), http://www.institutionalinvestor.com/Article/2701147/Money-Managers-Archive/Hedge-Funds-Seeking-Differentiation-Look-to-Event-Data.html (stating that "hedge funds are turning to events and event data as a new way to generate alpha," i.e., to beat the market).

[55] Tom C.W. Lin, *The New Financial Industry*, 65 ALA. L. REV. 567, 575 (2014) ("This emphasis on speed in finance has given considerable advantages to market participants who can afford better technology and better real estate so as to reduce the latency of their trade executions through the process of colocation. Latency refers to the period between an order submission and the receipt of an order acknowledgement. If an institution's server is located closer to the server of an exchange or other relevant intermediary, then that institution can lower their latency period and increase their execution speed."); William Alden, *Inquiry Into High-Speed Trading Widens*, N.Y. TIMES, Mar. 19, 2014, at B3 ([New York Attorney General Eric T. Schneiderman] "has zeroed in on the exchanges . . . that permit high-frequency traders to pay to put their computer servers within the exchanges' data centers. The practice, known as co-location, shaves milliseconds off the time it takes them to receive market information"); *see also* Satyajit Das, *When the Machines Are Insider Traders, Will They Be Prosecuted?*, THE INDEP., June 27, 2014, at 56 ("[Exchanges] offer 'co-location' opportunities allowing traders to position their computers adjacent to the exchange's price-matching engines to gain information and speed advantages over competitors, in exchange for fees."); Goodman, *Is Wall Street Pulling a Fast One?*, *supra* note 53 ("For a fee, the high-frequency trading firms also install their trading computers in the same data centers that house exchange trade-matching engines, benefitting from specially designed cable links and router configurations that allow them to receive, analyze and trade on exchanges' raw data feeds first."); David S. Hilzenrath, *SEC Still Concerned About High-*

like co-location[56] and quicker data and news feeds, many high-speed automated trading systems can still "read" news releases far more quickly than humans.[57] New York State Attorney General Eric T. Schneiderman has recently been investigating what he has called "insider trading 2.0," which involves, inter alia, circumstances where news and market data providers release information (such as consumer survey data from the University of Michigan) "two seconds earlier to high-frequency trading clients who paid an additional fee."[58]

Frequency Trading, WASH. POST, Feb. 23, 2012, at A14 ("Many exchanges sell a service called 'co-location,' which allows traders to place their computer servers closer to the heart of the exchange and thereby reduce the transmission time for market data and order messages . . . . When trading advantages are measured in mere thousandths or millionths of a second, co-location could be the difference between success and failure."). *But see* Alden, *supra* note 55 (quoting the chief executive of an HFT firm as stating that "[p]eople who take advantage of commercial offerings that are available on a widespread basis aren't breaking any laws" and that banning exchange-sponsored co-location would "set off a far more expensive arms race for physical proximity" as HFT firms would simply purchase land adjacent to exchange data centers).

[56] Some sources do not hyphenate the word "co-location," while other sources do. This Article will hyphenate the word except in quoted text where it is not hyphenated.

[57] *See* Charles R. Korsmo, *High-Frequency Trading: A Regulatory Strategy*, 48 U. RICH. L. REV. 523, 558–60 (2014) (describing co-location and direct data feeds provided by some exchanges—for a price—and the "fairness concerns" related to exchange decisions to offer such services); Rachel Abrams, *Goldman Under Investigation for High-Speed Trading*, N.Y. TIMES (May 9, 2014), http://dealbook.nytimes.com/2014/05/09/goldman-under-investigation-for-high-speed-trading ("In April, Attorney General Eric H. Holder Jr. confirmed that the Justice Department was investigating high-speed trading 'to determine whether it violates insider trading laws.'"); Goodman, *Is Wall Street Pulling a Fast One?*, *supra* note 53 (noting that HFT firms' "systems are fundamentally faster anyway" and quoting an executive of an HFT firm as saying, "We wouldn't care if we got the data alongside everyone else"); Scott Patterson & Michel Rothfeld, *FBI Investigates High-Speed Trading; Probe Centers on Whether It's Insider Trading When High-Frequency Traders Act on Information Others Can't See*, WALL ST. J. (Mar. 31, 2014), http://online.wsj.com/news/articles/SB10001424052702304886904579473874181722310 ("Among the activities being probed is whether high-speed firms are trading ahead of other investors based on information that other market participants can't see. Among the types of trading under scrutiny is the practice of placing a group of trades and then canceling them to create the false appearance of market activity. Such activity could be considered potential market manipulation by encouraging others to trade based on false orders."); Kara Scannell, *FBI and SEC Team Up for Trading Probe*, FIN. TIMES (Mar. 5, 2013), http://www.ft.com/intl/cms/s/0/11b81d74-85a4-11e2-9ee3-00144feabdc0.html#axzz 2OVflTvB8 ("Authorities are exploring potential holes in the system, including new algorithms referred to as 'news aggregation' which search the internet, news sites and social media for selected keywords, and fire off orders in milliseconds. The trades are so quick, often before the information is widely disseminated, that authorities are debating whether they violate insider trading rules, the people familiar with the matter said. Authorities are also monitoring alpha capture systems, platforms where sell-side firms share information with buyside professionals, for potential front running or insider trading.").

[58] Vince Heaney, *The War Against "Insider Trading 2.0"*, FIN. TIMES (Oct. 20, 2013), http://www.ft.com/intl/cms/s/0/bdb99a02-359a-11e3-b539-00144feab7de.html ("In today's electronic markets, two seconds is an eternity."); *see* Scott Patterson, *Speed Traders Get an Edge; Paying for Direct Access to News Releases Can Give a Lucrative Time Advantage*, WALL ST. J. (Feb. 6, 2014), http://online.wsj.com/articles/SB10001424052702304509045793675094660656 2 (stating that HFT "traders are getting news releases from Business Wire, which distributes corporate-earnings releases and economic reports such as the Philadelphia Federal Reserve's monthly manufacturing survey, and

The issue of high-speed pinging and front running is not entirely new, as it has been discussed both by legal commentators and by journalists.[59] For example, one article in the *Duke Law and Technology Review* stated that, "[i]n 'pinging,' an automated market maker issues an order ultra fast; and if nothing happens, it cancels the order. If something does happen, then the market maker learns hidden information that it can use to its advantage."[60] A *Journal of High Technology Law* article describes the issue of high-speed front running in the following manner:

> A major issue with HFT is that trades in the open market are subject to being front-run by the HFT computer programs. The front running occurs when these computer programs notice a pattern indicating an investor trade and, using their high speed trading ability, high-frequency traders will execute their own trade before the investor can complete his trade, thus making the investor's trade more expensive or less

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from Marketwired, a Toronto company that distributes earnings releases and the ADP monthly employment report" and that "[s]uch direct access isn't illegal" even though it gives traders buying the direct access data feeds an "edge over other investors" because of the "tiny lags between the time the distributors release the news and when media outlets send them out to the public, including other investors"); *see also* Jake Zamansky, *High Frequency Insider Trading—And It's Completely Legal!*, FORBES (July 9, 2013), http://www.forbes.com/sites/jakezamansky/2013/07/09/high-frequency-insider-trading-and-its-completely-legal/. As a result of negative publicity and pressure from the New York State Attorney General, Business Wire and Marketwired subsequently ceased offering direct access feeds to HFT firms. *See* Christie Smythe, *Marketwired Shuts Off Traders Amid New York Probe*, BLOOMBERG (Mar. 19, 2014), http://www.bloomberg.com/news/2014-03-19/marketwired-shuts-off-traders-from-press-release-service.html.

[59] *See* PATTERSON, *supra* note 18, at 258 (referring to a comment letter from Southeastern Asset Management to the SEC that was critical of HFT firms, stating, "[a] classic short-term strategy is to sniff out an elephant and trade ahead of it . . . . That is front-running if you are a fiduciary to the elephant but just good trading if you are not, or so we suppose"); Tom Keene & Sara Eisen, Transcript, *Former OMB Director Alice Rivlin Talks Debt on Bloomberg TV*, BLOOMBERG, Aug. 28, 2012 (asking Dr. Alice Rivlin, former director of the Office of Management and Budget "[D]o you think the SEC should intervene and do something to basically take all these high-frequency traders, guys with co-located servers and algo bots that are front-running pension funds and mutual funds and sort of bring them to heel?"); *The Fast and the Furious; High-Frequency Trading*, ECONOMIST (Feb. 25, 2012), http://www.economist.com/ node/21547988 ("[S]ome big institutional investors who accuse HFTs of front-running their orders . . . ."). Charles Schwab, founder and chairman of the discount brokerage firm operating under his name, along with the president and CEO of the company, issued a statement saying that "[h]igh-frequency trading is a growing cancer that needs to be addressed." Sital S. Patel, *Charles Schwab, Jack Bogle Join the Debate on High-Frequency Trading*, MARKET WATCH (Apr. 3, 2014, 7:12 PM), http://blogs.marketwatch.com/ thetell/2014/04/03/charles-schwab-jack-bogle-join-the-debate-on-high-frequency-trading/ ("Schwab and [the company's CEO Walt] Bettinger go on to call high-frequency trading 'manipulative' by taking advantage of the technological advances and enabling users to 'gain millisecond time advantages' and cut ahead in line in front of traditional orders and with access to market data not available to other market participants.").

[60] Michael J. McGowan, *The Rise of Computerized High Frequency Trading: Use and Controversy*, 16 DUKE L. & TECH. REV. ONLINE, ¶ 23 n.62 (2010), http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=1211&context=dltr.

lucrative.[61]

To help others understand the practical effects of high-speed pinging and front running, one can consider the following analogy of shopping in a supermarket:

> "Say you're [in the] supermarket and [you] want to buy a gallon of milk for $5[] . . . . But as soon as you go to the register it's $5.05, and instead of selling you the gallon it's ¾ of a gallon." . . . . Once HFT programs know [what other traders will do next], they can figure out how to manipulate investors by, say, putting in orders they never intend to fill. "While you're walking (around the grocery store) there are surveillance cameras checking you out. The HFTs are filling up the lines. There's a time stamp placed on a person when they're walking up to cash out. When you stuff a bunch of people ahead of them, the supermarket will have problems keeping order in the line. That's what's happening—they see us walking up."[62]

One of the primary complaints that some have about high-speed pinging

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[61] Edwin Batista, *A Shot in the Dark: An Analysis of the SEC's Response to the Rise of Dark Pools*, 14 J. HIGH TECH. L. 83, 84 (2014); *see High-Frequency Traders Push Markets Towards the Precipice; Regulators Need to Get a Grip on New Trading Technologies or Risk Increased Volatility that Will Hurt Investors*, THE IRISH TIMES, July 2, 2013, at 4 ("One particular activity of the high frequency traders is the use of computerised trading programmes that send out thousands of orders in milliseconds only to withdraw the same orders a millisecond later. The aim is to sniff out big institutional orders—buy or sell—and to then front-run those orders, scalping profits as they go."). Likewise, *Wall Street Journal* reporter and author Scott Patterson describes the situation as follows:

> The heart of the problem . . . was that fast-moving robot trading machines were front-running long-term investors on exchanges such as the New York Stock Exchange and the Nasdaq Stock Market. For instance, if Fidelity wanted to buy a million shares of IBM, the Bots could detect the order and start buying IBM themselves, in the process driving up the price and making IBM more expensive. If Fidelity wanted to sell a million shares of IBM, the Bots would also sell, pushing the price down and causing Fidelity to sell on the cheap.

PATTERSON, *supra* note 18, at 4–5.

[62] Linette Lopez, *What Is High-Frequency Trading? Here's What the Whole Debate Is All About in Plain English*, BUS. INSIDER (Sep. 26, 2012, 2:16 PM), http://www.businessinsider.com/high-frequency-trading-debate-in-english-2012-9; *see* Baker & Mamudi, *supra* note 30 ("'The best analogy I can think is that your family wants to go to a concert . . . You go onto StubHub, there's four tickets all next to each other for 20 bucks each. You put in an order to buy four tickets, 20 bucks each, and it says, 'You've bought two tickets for 20 bucks each.' And you go back and those same two seats that are sitting there have now gone up to $25.'" (quoting Brad Katsuyama)); Michael J. de la Merced & William Alden, *Scrutiny for Wall Street's Warp Speed*, N.Y. TIMES (Mar. 31, 2014), http://dealbook.nytimes.com/2014/03/31/ scrutiny-for-wall-streets-warp-speed ("[Hedge fund manager] William A. Ackman denounced the speedy trading that he said often prevented him from getting stock orders filled at the advertised price. 'I thought someone was tapping our phone lines,' Mr. Ackman said . . . .").

(and HFT strategies in general) is that the tactic generally involves cancelling a high number of orders for trades that are submitted.[63] Put another way, "[c]omputer programs try to bait institutional investors by simultaneously placing millions of offers to see where they get a bite, then quickly canceling them."[64] One research paper states that, based on

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[63] *See* Sarah Anderson, *Wall Street's Speed Demons: A 10-Point Primer*, HUFFINGTON POST (May 4, 2012), http://www.huffingtonpost.com/sarah-anderson/wall-streets-speed-demons_b_1474355.html ("[HFT] strategies smell like manipulation: High frequency traders are constantly sending and cancelling orders almost simultaneously. The head of U.S. stock trading for 'slow' mutual fund seller T. Rowe Price told the *Baltimore Sun*, 'We know that some high-frequency trading strategies have cancellation rates in the 95 percent range. So that means that 95 percent of the time that you say you want to buy 100 shares of IBM, you don't really buy it. And that begs the question: Why have you said you want to buy? Are you trying to influence someone to do something else? And is that manipulative?'"); Nick Baumann, *Too Fast to Fail: Is High-Speed Trading the Next Wall Street Disaster?*, MOTHER JONES (Jan. 2013), http://www.motherjones.com/politics/2013/02/high-frequency-trading-danger-risk-wall-street (describing an incident in which an unknown algorithmic trader "consumed 10 percent of the bandwidth of the U.S. stock market" and "generated 4% of U.S. stock market quote activity" without actually executing a single trade, "cancelling every order"; some suspect that the incident was the result of "a new algorithm being tested, but . . . no one knows for sure, least of all the SEC"). *But see The Fast and the Furious; High-Frequency Trading*, *supra* note 59 ("It is certainly true that HFTs are constantly sending and cancelling orders. . . . But the legitimate explanation for it is that marketmakers cannot afford to be static in case the market moves against them, and that in an ever-faster market HFTs have to be quicker to adjust prices."); Matthew Philips, *What Michael Lewis Gets Wrong About High-Frequency Trading*, BLOOMBERG BUS. WEEK (Apr. 01, 2014), http://www.businessweek.com/articles/2014-04-01/what-michael-lewis-gets-wrong-about-high-frequen cy-trading ("Many retail investors enter the market through buy-side institutional investment firms such as pension and mutual funds. [One argument is] that these big, slow traders are also getting screwed by HFT. While that certainly might have been the case a decade ago, they caught up years ago. Talk to most chief investment officers at these big firms today and you're more likely to hear how efficient trading is today, compared to 20 years ago—back in the era when orders got routed through human market-makers standing on the floors of exchanges.").

[64] Dina ElBoghdady, *High-Speed Stock Trading: Threat or Boon?*, WASH. POST, Oct. 26, 2012, at A14 ("'They generate an action simply to watch our reaction,' [said Andrew M. Brooks, head of U.S. equity trading at T. Rowe Price.] 'Then they position themselves to profit from that reaction.'"); MarksJarvis, *supra* note 6 (stating that mutual fund consultant "faults high-frequency traders for practices such as confusing investors with fake orders, or 'pinging'").

> [M]any high-frequency trading strategies are designed to initiate an order to simply gauge the market's reaction then quickly react and transact faster than other investors can. This seems inherently wrong. Our understanding is that the continued push for speed is not producing any marginal benefit to investors and in fact may be detrimental.

Computerized Trading: What Should the Rules of the Road Be?: Hearing Before the Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Housing, & Urban Affairs, 112th Cong. (2012) (statement of Andrew M. Brooks, Vice President and Head of U.S. Equity Trading, T. Rowe Price Associates, Inc.). Brooks also stated that institutional investors such as T. Rowe Price "need protection because our orders are larger and a lot of the marketplace today is trying to identify our order flow and trade against it. So we're—we're paranoid about that and we should be." *Hearing on Computerized Trading*, *Hearing Before the Subcomm. On Securities, Insurance, and Investment of the S. Comm. on Banking, Housing and Urban Affairs*, 113th Cong. (2012) (statement of Andrew M. Brooks, Head of U.S. Equity Trading, T. Rowe Price); *see also* LEWIS, *supra* note 15, at 111 ("The easiest way for [an HFT firm] to extract the information it needed to front-run other investors was to trade with them."); *id.* at 112 ("A

analysis of trading data, HFT firms operating in the futures markets typically appear to lose money on the small "ping" orders but more than make up for those losses by using the information obtained from the small orders to profitably trade ahead of large orders.[65]

Alternatively, one could conceptualize high-speed pinging and front running as two parts of one overarching deceptive and manipulative contrivance. First, the HFT firm attempts to detect large trades by sending out "ping" orders for trades, immediately cancelling the orders if the pings do not result in executed trades. If, however, the ping orders become executed trades, the HFT firm uses the material, nonpublic information about the other person's trading intentions, strategies, and price sensitivities that was obtained from the pinging to front run the rest of the other person's trades. The HFT firm likely could engage in this overarching contrivance more effectively if it had quicker access than most other market participants to trade data from the futures exchange, with the relevant data including, but not limited to, its own trade order confirmations.

It appears, however, that not all order anticipation or liquidity detection strategies involve submitting "ping" orders for trades to locate large trades. CFTC Commissioner Scott O'Malia provided a hypothetical "trading scenario" involving HFT "front-running" that he used in questioning then CFTC Enforcement Director David Meister during the May 16, 2013 open meeting to discuss and vote on the CFTC's Antidisruptive Practices Authority.[66] In Commissioner O'Malia's hypothetical trading scenario, "front-running" was defined as an "HFT strategy that relies on ultra high speeds to observe a trade take place in the marketplace (that [the HFT firm] took no part in), so as to rush and buy or sell the underlying stock or future in front of the anticipated forthcoming hedge orders."[67] In the hypothetical, the HFT firm does *not* "ping" the

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front-runner sells you a hundred shares of some stock to discover that you are a buyer and then turns around and buys everything else in sight, causing the stock to pop higher (or the opposite, if you happen to be a seller)."); Gail MarksJarvis, *Trade Frequency Spurs High Anxiety*, CHI. TRIB., Sept. 26, 2012, at C1 ("Often trading systems send out phony trades aimed at manipulating others into buying and selling. The activity can mislead legitimate traders working for mutual funds, pension funds or individuals to buy a stock at too high a price or sell it at too low a price.").

[65] Clark-Joseph, *supra* note 10, at 36; *see* LEWIS, *supra* note 15, at 207–08 (discussing Clark-Joseph's paper).

[66] *See* Antidisruptive Practices Authority, 78 Fed. Reg. 31,890, 31,895 (May 28, 2013) ("[A] CEA section 4c(a)(5)(B) violation may occur when a market participant accumulates a large position in a product or contract in the period immediately preceding the closing period with the intent (or reckless disregard) to disrupt the orderly execution of transactions . . . .").

[67] *Trading Scenarios Posed by Commissioner O'Malia at the May 16, 2013 Open Meeting During the Presentation on Anti-disruptive Practices Authority – Interpretive Guidance and Policy Statement*, CFTC, http://www.cftc.gov/PressRoom/SpeechesTestimony/omaliaantidisruptive051613 (last updated May 21, 2013).

market, but instead, "having nothing to do with this trade, uses its high speed data to observe the trade taking place and races" in to beat the institutional investor—which is not as fast as the HFT firm—to the trades.[68] Under Commissioner O'Malia's hypothetical, the HFT firm does not ping and poke the market with orders for trades but simply observes the order flow via a high-speed data feed. When asked if Commissioner O'Malia's "front-running" hypothetical trading scenario would violate the CFTC anti-disruptive practices authority, Meister said he needed to study the issue.[69]

The SEC says the following about traders that use "order anticipation" strategies: "Order anticipators are *parasitic traders*. They profit only when they can prey on other traders. They do not make prices more informative, and they do not make markets more liquid. . . . Large traders are especially vulnerable to order anticipators."[70] Notwithstanding the fact that the SEC does not have positive things to say about the use of order anticipation strategies, the regulator appears to accept the conventional wisdom in this area and does not, however, consider such trading practices illegal, absent misappropriation of information or other misconduct.[71]

The quintessential example of front running—taken from the times when floor brokers and floor traders entered trades in the pits of futures exchanges—involves a situation in which a broker receives a large order for a trade from a customer and, knowing that the customer's order likely will move the price of the futures contract or other derivative, places a trade for himself in the same contract before filling the customer's order.[72]

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[68] *Id.*

[69] CFTC, OPEN MEETING ON THE 29TH SERIES OF RULEMAKINGS UNDER THE DODD-FRANK ACT 223–24 (May 16, 2013), *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission_051613-trans.pdf ("I read this to say there's some strategy to watch trading take place, to sort of make observations about what trading is taking place[,] and then once you get that observation[,] you take advantage of the information that you've gathered. . . . [F]or this one[,] I'd want to study this further.").

[70] Concept Release on Equity Market Structure, 75 Fed. Reg. 3,594, 3,609 (Jan. 21, 2010) (to be codified at 17 C.F.R. pt. 242).

[71] *See id.* One could even argue that markets need at least some parasites. *See* Korsmo, *supra* note 57, at 558–60 ("[T]he primary victims of parasitic trading are far from defenseless—they themselves are large, sophisticated traders making large transactions."); MarksJarvis, *supra* note 6 ("[M]utual funds are not without their defenses. But while they also try to hide what they are doing with technology, the computers used by high-frequency traders are much more sophisticated. They can sniff out trading in an instand, causing a stock to rise or drop."); Scott Patterson & Jacob Bunge, *Newedge Fined for Lax Oversight of Manipulative Trades*, WALL ST. J. (July 10, 2013), http://online.wsj.com/article/SB10001424127887324425204578597962040067332.html?mod=dist_smartbrief
("'Professional traders and [brokers] have developed systems and functionality to avoid being taken advantage of through bad behaviors, whether it's spoofing or other forms' . . . ." (quoting Chris Concannon, Partner at Virtu Financial LLC)).

[72] *See* Will Acworth, *Making Markets: A Conversation with Five High-Frequency Trading Firms*, FUTURES INDUS. (Apr. 27, 2012), http://www.futuresindustry.org/fi-magazine-home.asp?a=1443&iss=191 ("My understanding is that [front running] is acting on nonpublic information and,

Thus, front running is often thought of as involving material nonpublic information about customer orders.[73]

Leaders of HFT firms and their supporters argue that they are not front running large trades because they are simply reacting to public information available to all traders.[74] To the extent that HFT firms can detect large orders for trades and then "jump in front of large orders," the HFT firms contend that they are helping to ensure that "all available information in the marketplace is taken into account," in that "a firm like ours perceives an imbalance in order flow and bids up the price of that asset to reflect the fact that there seems to be, at that moment in time, more buyers than

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more specifically, on customer orders that have not yet been made public to the marketplace. Since a majority of high frequency trading firms do not have customer orders, there's no possible way that they could be engaged in front running."). Front running is also referred to as "trading ahead." "Trading ahead" is when a dual trader buys or sells for his own account and holds an executable customer order for the same side, so that a trade results for the dual trader that is at a better price than the trade filled for the customer. 13A JERRY W. MARKHAM, COMMODITIES REG. § 18:8 (2014); *see also* 5 THOMAS LEE HAZEN, LAW SEC. REG. § 14.13 ("Front running is but one example of improperly trading ahead of a customer. . . . A broker's trading ahead of customers violates the broker's best execution obligation irrespective of whether front running or insider trading is involved."); *id.* § 14.10 n.92 ("Front running is a type of illegal trading on nonpublic inside information. Front running consists of trading ahead of customers' orders in order to take advantage of inside information pertaining to other [orders] that will have an effect on the price."); Jerry W. Markham, *Prohibited Floor Trading Activities Under the Commodity Exchange Act*, 58 FORDHAM L. REV. 1, 9 n.46 (1989) ("Trading ahead of customers means that a broker, aware that a large order coming to the exchange will likely influence prices, trades prior to that order and benefits from the effect of the large order on prices.").

[73] One could conceive of front running more broadly to include trading by third-parties who are tipped as to an impending large trade, transactions in which the trader herself engages in hedging transactions before the large block trade (called "self-front running"), and even "inter-market front running," which involves receiving material nonpublic information about a large trade in one financial product (e.g., a security) and then placing "front running" trades in a different financial product (e.g., options or futures). *See* Jerry W. Markham, *"Front-Running"—Insider Trading Under the Commodity Exchange Act*, 38 CATH. U. L. REV. 69, 70–71, 74–75 (1988). Although hedging is often a form of "self-front running," it is thought to be beneficial to the futures markets. *Id.* at 88–89. "Hedgers, almost by nature, engage in a front-running operation. That is, they know that their transactions will often have a price effect. If that effect is known to the rest of the marketplace, however, they will not be able to hedge effectively." *Id.* at 94. "[T]he hedging function of futures exchanges that allows a user or producer of a commodity to, in effect, insure against adverse changes in prices, has long been considered legitimate, and even desirable." *Id.* at 93–94.

[74] *See, e.g.*, Acworth, *supra* note 72 ("To the concern that they are 'front running' customer orders, they argue that in fact they are reacting to the same information that is available to everyone else. Granted, they have the capacity to do this at vastly faster speeds than most other market participants."); Renee Caruthers, *High-Frequency Trading Fights Back*, TRADERS MAG., May 2014 (quoting an HFT firm executive as stating: "There is no front-running that high-frequency traders engage in. . . . [F]ront running has a specific legal definition. It means giving your order more preference than a client's order that you are entrusted to execute on their behalf. . . . All high-frequency traders do is, they use publicly available information as intelligently as possible"). Better Markets, however, noted that while the common defense raised by HFT firms is that their behavior is not actually front running, "this objection overlooks the crucial fact that traditional front-running was a concept developed during a period when HFT did not exist and could not even be imagined." Better Markets Comment Letter, *supra* note 21, at 4.

sellers."[75] Richard Gorelick, chief executive officer of HFT firm RGM Advisors "has argued, this 'is what the market is supposed to do.'"[76]

B. *The Commodity Exchange Act, Commodity Futures Trading Commission Regulations, and Front Running*

Generally speaking, the CEA requires futures contracts to be traded on CFTC-regulated boards of trade, called "designated contract markets,"[77] and to be cleared with clearinghouses, called "derivatives clearing organizations."[78] Unlike in the securities markets, where a person can buy a specific stock on one of many exchanges and sell that same stock on a different exchange, in the futures markets, a specific futures contract that is bought on one futures exchange cannot then be sold on any other futures exchange, as futures exchanges do not allow (and are not required to

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[75] Acworth, *supra* note 72. For a cogent defense of HFT "front running" and other tactics see Cliff Asness et al., *High Frequency Hyperbole, Part Deux*, REAL CLEAR MARKETS (May 22, 2014), http://www.realclearmarkets.com/articles/2014/05/22/high_frequency_trading_hyperbole_part_deux_101072.html ("Let's be clear, HFTs indeed try to do something like this, but all, or almost all (remember we make no claim to have checked every HFT's trading!) of it is legal, ethical, and only uses public information. It's also what traders of all types have always done since before computers, electronics, and the steam engine: guess at the direction of the market or a particular security and position themselves accordingly. . . . Much of what is being talked about as 'front running' is really just the legal, ethical, and economically beneficial practice of order anticipation, which is a fancy word for educated guessing.").

[76] Korsmo, *supra* note 57, at 560; *see* Caruthers, *supra* note 74 (quoting an HFT firm executive as stating: "It's not possible to avoid moving the market with a large order. The reason the market goes up is more buyers than sellers, and the reason the market goes down is more sellers than buyers, and the reason for that is that buying or selling large blocks of shares impacts the market . . . It's supposed to. That's why we have prices").

[77] *See* 7 U.S.C. § 6(a) (2012); *CFTC Glossary: Designated Contract Market*, CFTC, http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm#D (last visited Sept. 21, 2014).

[78] CFTC Regulation 1.3(d) defines the term "DCO" as:

> [A] clearinghouse, clearing association, clearing corporation, or similar entity, facility, system, or organization that, with respect to an agreement, contract, or transaction (1) Enables each party to the agreement, contract, or transaction to substitute, through novation or otherwise, the credit of the derivatives clearing organization for the credit of the parties; (2) Arranges or provides, on a multilateral basis, for the settlement or netting of obligations resulting from such agreements, contracts, or transactions executed by participants in the derivatives clearing organization; or (3) Otherwise provides clearing services or arrangements that mutualize or transfer among participants in the derivatives clearing organization the credit risk arising from such agreements, contracts, or transactions executed by the participants.

17 C.F.R. § 1.3(d) (2012); *see* PHILIP MCBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION § 1.05 ("Every contract market maintains a mechanism either within its own organization or through a separate entity for the daily clearance of all futures transactions.").

allow) "interoperability" of contracts.[79] This is because futures exchanges typically have their own affiliated clearinghouses and use a "'vertical silo' model, where contracts that are traded at a venue are processed through the exchange's clearinghouse," which requires contract holders to sell futures contracts on the exchange where they were bought.[80] As a result, in the futures markets (unlike in the securities markets), one HFT "front-running" tactic is not a concern because an HFT firm cannot detect a large order for a specific futures contract on one exchange and then front run the order on other exchanges.[81] CME Group Inc., which owns, inter alia, the Chicago Mercantile Exchange, the Chicago Board of Trade, the Kansas City Board of Trade, and the New York Mercantile Exchange, is the world's largest

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[79] *See* REVIEW OF THE REGULATORY STRUCTURE ASSOCIATED WITH FINANCIAL INSTITUTIONS, COMMENTS OF THE U.S. DEP'T OF JUSTICE, TREAS-DO-2007-0018 (Jan. 31, 2008), *available at* http://www.justice.gov/atr/public/comments/229911.htm; John Damgard, *Restructure Clearing*, FUTURES INDUSTRY (Sept. 1, 2002), http://www.futuresindustry.org/fi-magazine-home.asp?a=791 ("We do not have a competitive environment right now. Instead we have exchanges that are each monopolies in their own products."); Matthew Leising, *Killing Dark Pools Is CME Chairman's Fix for Stock Market*, BLOOMBERG (Apr. 22, 2014), http://www.bloomberg .com/news/2014-04-22/killing-dark-pools-is-cme-chairman-s-fix-for-broken-stock-market.html ("Futures trading is more concentrated. CME Group, where 14 million contracts a day changed hands in February, has its own clearinghouse, setting it apart from stock markets such as the NYSE. The clearinghouse requires investors who buy a contract on CME Group to return to the exchange to sell it."); Tom Osborn, *Forget Interoperability in Derivatives Clearing, Says Liddell*, FUTURES & OPTIONS WORLD (July 23, 2010), http://www.fow.com/2637026/forget-interoperability-in-derivatives-clearing-says-liddell.html (discussing how Liddell is no longer as concerned about the "'race to the bottom' among clearing houses").

[80] Philip Stafford, *Crunch Time for Exchanges' 'Vertical Silo' as EU Rules Finalized*, FIN. TIMES (Dec. 17, 2013), http://www.ft.com/cms/s/0/885bfca4-6724-11e3-8d3e-00144feabdc0.html; *see* Jeremy Grant, *DOJ Challenges Ownership of Clearing Houses*, FIN. TIMES (Feb. 5, 2008), http://www.ft.com/intl/cms/s/0/6f56ad82-d425-11dc-a8c6-0000779fd2ac.html ("The US Department of Justice has called for clearing houses to be broken off from the futures exchanges that own them, throwing down a challenge to the business model that has propelled CME Group to become the world's largest futures exchange."); Lynne Marek, *CME Plays Down 'Flash Boys' Links*, CRAIN'S CHI. BUS. (May 1, 2014), http://www.chicagobusiness.com/article/20140501/NEWS01/140509985/cme-plays-down-flash-boys-links# ("CME executives . . . sought to draw distinctions between the structure of the futures market, which is dominated by CME, and the structure of the stock market, where traders race between multiple exchanges and dark pools to place orders. 'We will . . . continually draw the differences between our market structure and the equity market structure so we don't get swept into some kind of reform that doesn't apply to our business,' [stated CME Chairman and President Terrence Duffy].").

[81] *See High Frequency and Automated Trading in Futures Markets: Hearing of the S. Comm. of Agric., Nutrition, & Forestry*, 113th Cong. (2014) [hereinafter Duffy Testimony] (written testimony of Terrence Duffy, executive chairman and president of CME Group) ("Many of the complaints about high-frequency trading in equity markets simply do not apply to the U.S. futures markets."); *id.* ("[I]n a vertical silo, which is what we operate in the futures market, people don't have the ability to go outside of our walls and race customers to different venues to beat them to that trade"); LEWIS, *supra* note 15, at 73–75 (discussing the issue in the securities markets); Kevin Dugan, *Exchange Head Downplays High-Frequency Trading Danger*, N.Y. POST (May 13, 2014), http://nypost.com/2014/05/13/exchange-head-downplays-high-frequency-trading-danger/ (discussing Duffy's testimony).

U.S. futures exchange.[82] CME Group's electronic trading system for its designated contracts markets is CME Globex.[83] In testifying before Congress CME Group Executive Chairman and President Terrence Duffy indicated that CME Group does not offer faster trade data feeds to firms willing to pay for quicker access to market information.[84] CME Group has a co-location facility in Aurora, Illinois, in which traders can rent space to have closer connections to the CME Globex electronic trading platform.[85] Duffy further stated that CME "provides equal access" to traders that rent space to co-locate by ensuring that "[e]veryone in our facility connects with the same length fiber, so there are no unequal advantages."[86] That is, there are no unequal advantages among firms that pay to co-locate.

According to articles in the *Wall Street Journal* in 2013, HFT firms trading on CME Globex reportedly could "detect when their own orders for certain commodities are executed a fraction of a second before the rest of the market sees that data" and sought to implement trading strategies to

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[82] *See CME Group Overview*, CME GROUP, http://www.cmegroup.com/company/files/cme-group-overview.pdf (last visited Sept. 21, 2014); *Timeline of CME Achievements*, CME GROUP, http://www.cmegroup.com/company/history/timeline-of-achievements.html (last visited Sept. 21, 2014) (detailing when CME Group acquired different exchanges). CME is a "for-profit company that operates the world's largest futures exchange." Lynne Marek, *Futures Regulators Challenged by Changing Industry*, CRAIN'S CHI. BUS. (Apr. 22, 2013), http://chicagobusiness.com/article/20130420/ISSUE01/304209982/futures-regulators-challenged-by-changing-industry; *see* Andrew Harris & Matthew Leising, *CME Sued on Claims High-Frequency Traders Bought Access*, BLOOMBERG (Apr. 14, 2014), http://www.bloomberg.com/news/print/2014-04-13/cme-gave-high-frequency-traders-peek-at-market-lawsuit-claims.html (describing CME Group as the "owner of the world's largest futures market").

[83] *CME Group Overview*, *supra* note 82 ("Today, more than 80 percent of the trades at CME Group are electronic.").

[84] Duffy Testimony, *supra* note 81 ("While customers have several options in terms of how they want to receive that data from us, we do not restrict access.").

[85] *CME Co-Location and Data Center Services*, CME GROUP, http://www.cmegroup.com/trading/colocation/co-location-services.html (last visited Sept. 21, 2014). Co-location costs $12,000 per month with a $2,000 one-time installation fee. *See Connectivity Options 2014*, CME GROUP, http://www.cmegroup.com/globex/files/connectivityoptions.pdf (last visited Sept. 21, 2014) (providing information about connectivity services). *See generally CME Co-Location Services Overview Video*, CME GROUP (last visited Mar. 16, 2013), http://www.cmegroup.com/globex/trading-cme-group-products/cme-co-location-services-overview-video.html (describing CME's co-location services); *CME Co-Location Services Brochure*, CME GROUP, http://www.cmegroup.com/ globex/files/CME-Co-Location-Services-Overview.pdf (last visited Sept. 21, 2014) (describing CME's co-location services). "Low-latency connectivity to Globex is via the internal GLink network, with all connections equidistant to provide equality of access. GLink is available at 1 and 10 gigabit per second connections, though inbound rate for both is limited to 1 gigabit." Pete Harris, *CME's Aurora Co-Lo: Quick Facts*, LOW-LATENCY (Oct. 14, 2011), http://www.low-latency.com/blog/cmes-aurora-co-lo-quick-facts.

[86] Duffy Testimony, *supra* note 81 ("[I]t used to be that the benefit of speed from proximity was available only through traders who could buy real estate near an exchange, or where he or she thought the server would be. Because of co-location facilities . . . every trader has access to colocation. This includes everyone from small retail participants to the largest of Wall Street banks.").

take advantage of the advance receipt of that information.[87] Some sophisticated market participants reportedly had been aware of the lag time (anywhere from one to ten milliseconds) between when a trader received a confirmation that a trade had been executed and when the rest of the market learned that information.[88] In May of 2014, however, Duffy stated "that the futures exchange operator had taken steps to reduce delays in the time between when clients, including high-speed traders, receive market data and when other firms get the same information."[89]

One important distinction between the securities laws and the CEA is that, "[u]nlike the federal securities laws, the [CEA] does not contain a broad proscription against the use of 'inside information.'"[90] And while it has been argued that trading on nonpublic information in the futures markets is "a potentially serious problem that can result in unfairness to traders who are not privy to such information,"[91] historically that has been a minority view. Instead, the predominant view is that such a prohibition on insider trading would be improper and even harmful to futures markets:

> In contrast to the broad prohibition against insider trading found in the securities laws, insider trading is considered an accepted and integral practice in the commodity futures and derivatives markets. Not only does the [CEA] lack a prohibition against insider trading in commodities (except with respect to certain individuals connected with the

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[87] Scott Patterson et al., *High-Speed Traders Exploit Loophole*, WALL ST. J. (May 1, 2013), http://online.wsj.com/article/SB10001424127887323798104578455032466082920.html?mod=dist_smartbrief (describing several ways that HFT firms could use their advance knowledge of their own trade order confirmations to their advantage in trading futures and quoting a finance professor as stating that "[t]raders able to see market swings milliseconds before others gives them 'an informational advantage'").

[88] *Id.*

[89] Scott Patterson, *CME Softens High-Speed Traders' Edge*, WALL ST. J. (May 13, 2014), http://online.wsj.com/news/articles/SB10001424052702303851804579559880884993894 (quoting CME Group Inc. Chairman Terrence Duffy as stating, in congressional testimony, that CME had significantly reduced the time difference between when traders receive confirmations that their trades have been executed and when the rest of the market receives that information, but that "there are still delays of as much as a millisecond in certain contracts"). A group of traders are suing CME for allegedly providing HFT firms with market data ahead of other traders. *See* Harris & Leising, *supra* note 82 ("[CME] was sued by three of its users who alleged the company sold access to order information to high-frequency traders ahead of other market participants."). CME issued a statement saying that "the complaint is 'devoid of any facts supporting the allegations and, even worse, demonstrates a fundamental misunderstanding of how our markets operate.'" *Id.* (citation omitted). CME also stated that it has only one data feed that provides data to all market participants at the same time. *Id.*

[90] 13A JERRY W. MARKHAM, COMMODITIES REG. § 18:8 (2014).

[91] Nina Swift Goodman, Note, *Trading in Commodity Futures Using Nonpublic Information*, 73 GEO. L.J. 127, 127–28 (1984) ("[Recommending] that trading in futures on nonpublic information be controlled by a prohibition on all trading that involves misappropriated information, regardless of whether the trading can be characterized as fraudulent.").

> regulation, self-regulation, or exchange governance of those markets), but the CEA actually accepts insider trading as a means to facilitate efficient pricing of commodities.[92]

Put simply, the CEA and CFTC Regulations reject the proposition that a wheat farmer would be prohibited from trading in wheat futures because the farmer possessed "inside information" about the state of the farmer's own wheat crop.[93] The reason for the different regulatory approach is that securities and futures markets serve different functions.

> In contrast to the securities markets, whose purpose centers on capital formation, which in turn gives rise to a number of obligations, including those of a fiduciary nature, the purpose of the commodity futures and derivatives markets is to provide a forum for price discovery and risk management. These markets, as a joint report by the SEC and CFTC acknowledges, "permit hedgers to use their non-public material information to protect themselves against risks to their commodity positions."[94]

Indeed, "[i]t is doubtful whether a broad inside information concept could be applied to commodities since most 'inside' information will be 'market' information that may be freely acted upon even under the federal securities laws."[95] Importantly, "[t]rading in futures using nonpublic

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[92] Bradley J. Bondi & Steven D. Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance*, 8 N.Y.U. J.L. & BUS. 151, 167 (2011) (citing Sharon Brown-Hruska & Robert S. Zwirb, *Legal Clarity and Regulatory Discretion—Exploring the Law and Economics of Insider Trading in Derivatives Markets*, 2 CAP. MARKETS L.J. 245, 254 (2007)).

[93] *See* 13A JERRY W. MARKHAM, COMMODITIES REG. § 18:8 (2014) ("Numerous futures market participants may have legitimate access to what some may perceive as superior information. For example, hedgers, who comprise a substantial portion of the markets, also participate in the production, processing, distribution and/or consumption of the cash commodity underlying the futures market. By nature of their businesses, many hedgers are privy to nonpublic information that may prove to be material in futures markets." (quoting CFTC, A STUDY OF THE NATURE EXTENT AND EFFECTS OF FUTURES TRADING BY PERSONS POSSESSING MATERIAL, NONPUBLIC INFORMATION (1984)).

[94] Bondi & Lofchie, *supra* note 92, at 168 (quoting U.S. COMMODITY FUTURES TRADING COMM'N ET AL., A JOINT REPORT OF THE SEC AND THE CFTC ON HARMONIZATION OF REGULATION 7 (Oct. 16, 2009), *available at* http://www.sec.gov/news/press/2009/cftcjointreport101609.pdf).

[95] 13A JERRY W. MARKHAM, COMMODITIES REG. § 18:8 ("The difficulty with applying inside information concepts to the commodity futures industry is that many market traders have information that could be considered inside, i.e., information that is unavailable to others. For example, knowledge of a large trade about to be conducted is information that gives a market advantage to a trader with that knowledge. A large hedger will also have very broad knowledge concerning the supply status of a commodity that it is hedging. In fact, it may be hedging against price changes it anticipates from the nonpublic information. It would be difficult, if not impossible, for these hedgers to use the commodity futures markets if they are to be penalized for acting up that information."); *see also* Goodman, *Trading in Commodity Futures Using Nonpublic Information*, *supra* note 91, at 133 n.34 ("Trading on nonpublic information in futures cannot accurately be called 'insider trading' since there is no real analogy in futures to the corporate insider in securities.").

information is unlikely to involve a breach of a fiduciary duty," which (as will be discussed in greater detail below) generally is considered a requirement for finding an insider trading violation under the securities laws.[96]

Congressional leaders at various times considered enacting legislation that would prohibit trading on material nonpublic information in the futures markets, but—beyond specific, limited instances, such as prohibiting CFTC employees from trading—none of the proposals became law.[97] The most that Congress did was mandate that the CFTC study the issue of insider trading in futures. Thus, "the CFTC conducted a study and filed a report with Congress that essentially rejected the application of insider trading concepts to futures trading, except with respect to government and self-regulating organization officials."[98]

The CEA and CFTC Regulations do, however, prohibit front running in specific circumstances. For example, the quintessential example of front running—that of a broker with a customer order for a large trade in a futures contract, who first buys or sells some of the same futures contract for the broker's own account before filling the customer order—is prohibited by CFTC Regulations governing the different types of brokers. CFTC Regulation 155.2[99] prohibits floor brokers[100] from buying futures contracts for their own accounts when they have customer orders to buy

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[96] Goodman, *Trading in Commodity Futures Using Nonpublic Information*, *supra* note 91, at 144. As Goodman explains, "[a] share of stock is an interest in the corporation, and the insiders of the corporation are fiduciaries of the shareholders. In contrast, a futures contract is traded on a futures exchange but is not an interest in the exchange itself." *Id.*

[97] *See* Markham, *supra* note 73, at 102–05 (noting that "several legislative efforts to impose prohibitions [against front-running in the CEA] have been attempted" and discussing those proposals).

[98] Markham, *supra* note 73, at 105.

> The CFTC noted that a securities insider owes a fiduciary duty to the issuer of the security and to purchasers or sellers of the security. It is this duty that gives rise to an obligation to disclose material insider information or to refrain from trading. The CFTC asserted, however, that futures transactions do not create a corresponding fiduciary relationship. The futures markets are derivative, risk-shifting markets and it would defeat their economic function of hedging risks to question whether trading based on knowledge of one's own position was permissible.

Id. at 106.

[99] 17 C.F.R. § 155.2 (2014).

[100] 7 U.S.C. § 1a(22)(A) (2012) defines the term, "floor broker," as "any person who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, shall purchase or sell for any other person [any futures contract, security futures product, swap, or commodity option] or who is registered with the [CFTC] as a floor broker." A "floor trader," by comparison, is "any person who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, purchases, or sells solely for such person's own account any [futures contract, security futures product, swap or commodity option] or who is registered with the [CFTC] as a floor trader." *Id.* § 1a(23)(A).

futures contracts or options in the same commodity.[101] Similarly, CFTC Regulation 155.3 imposes this same prohibition on commodities brokers,[102] who are called futures commission merchants in the CEA and CFTC Regulations.[103] Regulation 155.4[104] imposes the same prohibition on introducing brokers.[105] Additionally, there are prohibitions on derivatives trading by CFTC employees[106] and by certain employees of self-regulatory organizations, including exchanges.[107] Further, the CFTC requires exchanges—called "contract markets" in the CEA—to have rules that prohibit front running and other improper trading practices.[108]

As previously mentioned, the CEA and CFTC Regulations generally require futures and options transactions to occur on exchanges, where, among other things, prices are reported in real time.[109] But, subject to certain requirements, persons are permitted to privately negotiate large "block trades" in futures (and other derivatives) that meet specific minimum quantity thresholds.[110] Such block trades occur off the floor or

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[101] 17 C.F.R. § 155.2; *see also* Markham, *supra* note 73, at 99–100 ("CFTC regulation 155.2 requires exchanges to adopt rules that prohibit floor brokers from purchasing futures contracts for their own accounts where they are holding customer orders for the purchase of futures contracts, or options subject to CFTC regulation. . . . It applies only to trading ahead of futures transactions.").

[102] 17 C.F.R. § 155.3 (2014).

[103] 7 U.S.C. § 1a(28) (2012) (defining FCM). "The [FCM], if in the securities business, would probably be called a brokerage house. . . . A person wishing to trade on the CFTC-regulated markets may open an account at a [FCM] . . . . Trading orders are given by the customer, directly or indirectly, to the FCM . . . ." JOHNSON & HAZEN, *supra* note 78, at § 1.06[1].

[104] 17 C.F.R. § 155.4 (2014).

[105] *Id.* An IB is defined as any person (except anyone registered as an AP of a FCM) who solicits or accepts orders for, inter alia, the purchase or sale of any futures contract, swap or commodity option; and who does not accept any money to secure any trades that may result from those orders. 7 U.S.C. § 1a(31) (2012).

[106] Goodman, *Trading in Commodity Futures Using Nonpublic Information*, *supra* note 91, at 148 n.141.

[107] 17 C.F.R. § 1.59 (2014). For a critique of CFTC Regulation 1.59, see generally Gary Rubin, Note, *CFTC Regulation 1.59 Fails to Adequately Regulate Insider Trading*, 53 N.Y.L. SCH. L. REV. 599, 601 (2009).

[108] *See, e.g.*, 17 C.F.R. § 38.152 (2014) ("A designated contract market must prohibit abusive trading practices on its markets by members and market participants. Designated contract markets . . . must prohibit customer-related abuses including, but not limited to, trading ahead of customer orders, trading against customer orders, accommodation trading, and improper cross trading. Specific trading practices that must be prohibited by all designated contract markets include front-running, wash trading, pre-arranged trading (except for certain transactions specifically permitted under part 38 of this chapter), fraudulent trading, money passes, and any other [abusive] trading practices.").

[109] *See* JOHNSON & HAZEN, supra note 78, at § 1.04[1] ("The [CEA] defines a *board of trade* in section 1a[6] as 'any organized exchange or other trading facility.'" (quoting 7 U.S.C. § 1a)).

[110] *See* Lisa A. Dunsky, *United States: EFRPs and Block Trades: Where Did They Come From and Where Are They Going?*, MONDAQ BUS. BRIEFING (Feb. 24, 2014), http://www.mondaq.com/unitedstates/x/295246/EFRPs+And+Block+Trades+Where+Did+They+Come+From+And+Where+Are+They+Going (stating that block trades are among the "exceptions to the general prohibition against noncompetitive and prearranged transactions in U.S. futures markets" and, therefore, are allowed to be negotiated bilaterally off exchange subject to specified conditions); Hal Weitzman, *CME Floor Traders*

through an exchange's electronic trading platform and are reported publicly to other market participants after a delay.[111] Only high net worth or sophisticated market participants can engage in privately negotiated, off-exchange block trades.[112] Block trades are relevant here because, in the right circumstances, persons with the time and ability to do so can avoid high-speed "front running" by privately negotiating off-exchange block trades.

C. *Insider Trading Under the Securities Laws*

A brief overview of the securities law prohibition on insider trading is insightful for comparative purposes.

"[I]t is a violation of federal securities laws to buy or sell a security when in possession of material nonpublic information about that security, in violation of a duty of trust or confidence owed to the issuer, its shareholders or any other source of the information."[113]

"This prohibition arises primarily from the prohibitions against 'deceptive devices' found in Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder,"[114] despite the fact that neither Section

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Protest Block Trades, FIN. TIMES (Apr. 13, 2012), http://www.ft.com/intl/cms/s/0/36aaf692-859b-11e1-90cd-00144feab49a.html (describing "block trades" as "large, privately negotiated deals"); *Market Regulation Advisory Notice: Block Trades*, CME GROUP 2 (Oct. 24, 2012), http://www.cmegroup.com/rulebook/files/nymex-comex-ra1205-4.pdf ("Orders may not be bunched to meet the minimum block quantity thresholds.").

[111] *See Block Trades*, CME GROUP, www.cmegroup.com/clearing/trading-practices/block-trades.html (last visited Sept. 21, 2014) ("Rule 526 ('Block Trades') governs block trading in the Chicago Mercantile Exchange, the Chicago Board of Trade, the New York Mercantile Exchange and COMEX products. Block trades are permitted in specified products and are subject to minimum transaction size requirements which vary according to the product, the type of transaction and the time of execution."). For more information about Rule 526, see generally *Market Regulation Advisory Notice: Block Trades*, CME GROUP (Nov. 8, 2013), http://www.cmegroup.com/rulebook/files/cme-cbot-ra1313-3-block-trades.pdf.

[112] *Market Regulation Advisory Notice: Block Trades*, *supra* note 110, at 2 ("Each party to a block trade must be an Eligible Contract Participant as that term is defined in Section 1a of the Commodity Exchange Act."). Generally speaking, the CEA defines the term "Eligible Contract Participant" to include, inter alia, financial institutions, insurance companies, investment companies, and high net-worth entities and individuals. 7 U.S.C. § 1a(18) (2012).

[113] NORA M. JORDAN ET AL., ADVISING PRIVATE FUNDS: A COMPREHENSIVE GUIDE TO REPRESENTING HEDGE FUNDS, EQUITY FUNDS AND THEIR ADVISERS § 21:3 (2010); *see also id.* § 21:14 ("The elements of a private 10b-5 insider trading claim are (i) a duty of trust or confidence to the issuer, its shareholders, or the source of the information (i.e., 'insider' status), (ii) a duty to the other party of the transaction, (iii) material and nonpublic information, (iv) awareness of such information when purchasing or selling securities, (v) causation of a loss to the other party, and (vi) scienter (e.g., knowing, or recklessly not knowing, that such information was material and nonpublic)."); 11 SIMON M. LORNE & MARLENE BRYAN, ACQUISITION & MERGERS §1:22 (2014) ("The primary source of regulation of such insider trading generally . . . is Section 10(b) of the 1934 Act and Rule 10b-5 thereunder.").

[114] JORDAN ET AL., *supra* note 113, at § 21:3; *see also* Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 887 (2010)

10(b) nor Rule 10b-5 explicitly mention such a prohibition.[115]

Generally speaking, insider trading cases have followed "two reasonably clear and predictable molds" in that corporate insiders violate the law by engaging in insider trading if they trade on material nonpublic information in breach of a duty owed to their corporations and shareholders, whereas corporate outsiders will violate the prohibition against "insider trading" if they trade on information in breach of a duty owed to the source of the information. "Corporate insiders will incur liability for trading on material nonpublic information in breach of the duty they owe their corporations and shareholders, and corporate outsiders will be liable if they misappropriate and trade on such information in breach of a duty they owe to the source of their information."[116] For example, "[u]nder the Court's so-called 'classical' theory, corporate insiders have a duty to their shareholders not to trade on confidential information obtained 'by reason of their position,' unless they first disclose the information."[117] Additionally, "[u]nder the 'misappropriation' theory, 'outsiders' of a corporation have the same duty to a source who has entrusted them with access to confidential information about the corporation."[118] As a general

("The federal securities laws' primary weapon against insider trading is the general antifraud Rule 10b-5.").

[115] *See* 4 THOMAS LEE HAZEN, LAW OF SECURITIES REGULATION § 12:17 ("The securities laws do not expressly prohibit trading on the basis of nonpublic information. . . . [T]he federal law of insider trading has developed in the courts as a common law of federal securities fraud. Congress' failure to explicitly address when trading on nonpublic information is permissible has led to a very uneven and in some instances incoherent set of rules. This is because the improper trading has to fit within a fraud prohibition."). The characterization of insider trading as a form of fraud has been criticized. *See, e.g.*, Hazen, *Identifying the Duty*, *supra* note 114, at 889 ("[D]ealing with insider trading through an antifraud rule is like trying to fit a square peg into a round hole."); Donald C. Langevoort, *"Fine Distinctions" in the Contemporary Law of Insider Trading*, 2013 COLUM. BUS. L. REV. 429, 459 ("[T]he use of 10b-5 tools . . . fail to recognize that the deception in insider trading is largely fictional."); *id.* at 440 ("[Insider trading] is not really fraud, even though we have chosen to call it fraud in order to preserve and embellish the useful message of investor protection."); Donald C. Langevoort, *Setting the Agenda for Legislative Reform: Some Fallacies, Anomalies, and Other Curiosities in the Prevailing Law of Insider Trading*, 39 ALA. L. REV. 399, 402 (1988) ("[I]nsider trading may be many bad things, but it is unlikely that deception is one of them.").

[116] Stephen J. Crimmins, *Insider Trading: Where Is the Line?*, 2013 COLUM. BUS. L. REV. 330, 330.

[117] *Id.* at 335 (quoting United States v. O'Hagan, 521 U.S. 642, 651–52 (1997)); *see also* Bondi & Lofchie, *supra* note 92, at 157 ("The 'classical' theory of insider trading generally applies when an insider, in violation of a fiduciary duty to his or her company . . . trades in the securities of the company on the basis of material nonpublic information obtained by reason of the insider's position.").

[118] Crimmins, *supra* note 116, at 335 (quoting *O'Hagan*, 521 U.S. at 652–53); *see also* HAZEN, *supra* note 72, at §12:17 ("The essence of the misappropriation theory is the existence of a fiduciary or other relationship imposing a duty of disclosure."); Bondi & Lofchie, *supra* note 92, at 158, 176, 188–89 ("The 'misappropriation' theory applies to situations in which a person, who is not an insider, lawfully comes into possession of material nonpublic information, but nevertheless breaches a duty of trust or confidence . . . owed to the source of the information by trading on the basis of such information or conveying the information to another person to trade."); Crimmins, *supra* note 116, at

matter, the existence of a duty of trust or confidence or a fiduciary duty has been considered essential to finding a violation of the securities laws for trading without disclosing material nonpublic information[119] because insider trading is considered a form of fraud, and silence generally is not considered fraudulent absent a duty to disclose.[120] The SEC has maintained that a duty of trust or confidence can arise by contract or agreement, and can exist among close family members and in friendships where there is a pattern of shared confidences.[121]

One of the most significant recent developments in insider trading decisional law, however, has been the possible easing of the requirement that a trader breach a fiduciary duty or similar duty of trust. The Second Circuit Court of Appeals held, in *SEC v. Dorozhko*,[122] that an individual who obtained confidential information about the earnings of a particular company by hacking into a secure server but who owed no fiduciary duty to the source of the misappropriated information could be liable for insider trading if he accomplished the theft by means of a "fraudulent misrepresentation that was 'deceptive' within the ordinary meaning of Section 10(b)."[123] The *Dorozhko* court's holding that deception absent a breach of fiduciary duty could constitute a violation of Rule 10b-5[124] has been viewed as an expansion of existing insider trading liability.[125] Accordingly, the *Dorozhko* decision has been controversial and generated a fair amount of legal scholarship.[126]

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335 ("Typically, such misappropriation cases involve corporate outsiders who breach a duty to their own employers, rather than a duty to the issuer.").

[119] 4 ALAN R. BROMBERG ET AL., BROMBERG & LOWENFELS ON SECURITIES FRAUD § 6:493 (2d ed. 2003).

[120] *See* SEC v. Dorozhko, 574 F.3d 42, 50 (2d Cir. 2009) ("[M]isrepresentations are fraudulent, but . . . silence is fraudulent only if there is a duty to disclose." (quotation and citation omitted)); *see also* Bondi & Lofchie, *supra* note 92, at 158–60 (discussing and analyzing the *Dorozhko* decision).

[121] 17 C.F.R. § 240.10b5-2 (2014); *see also* 4 ALAN R. BROMBERG ET AL., *supra* note 119, at § 6:493; Bondi & Lofchie, *supra* note 92, at 189–90 (discussing Rule 10b5-2's non-exhaustive list of relationships that generally establish a duty of trust and confidence under a misappropriation theory of insider trading).

[122] 574 F.3d 42, 50 (2d Cir. 2009).

[123] *Id.* at 44, 45, 51. The Second Circuit remanded the case to the district court to determine if the defendant's hacking was "deceptive" under the statute. *Id.* at 51.

[124] *Id.* at 51.

[125] *See* John C. Coffee, Jr., *Introduction: Mapping the Future of Insider Trading Law: Of Boundaries, Gaps, and Strategies*, 2013 COLUM. BUS. L. REV. 285–86 ("[I]n [Dorozhko], the Second Circuit opened the door to the prosecution of persons who trade on material nonpublic information, even when they do not breach a fiduciary (or similar confidential) relationship, at least so long as they obtain the material nonpublic information through 'deception.'" (footnote omitted)); Edward Greene & Olivia Schmid, *Duty-Free Insider Trading?*, 2013 COLUM. BUS. L. REV. 369, 418 ("[*Dorozhko*] is a recent example illustrating the U.S. courts' frustration with the confines of the fiduciary duty framework, and their subsequent attempt to reach beyond it.").

[126] *See, e.g.*, Mark F. DiGiovanni, *Weeding Out a New Theory of Insider Trading Liability and Cultivating an Heirloom Variety: A Proposed Response to* SEC v. Dorozhko, 19 GEO. MASON L. REV.

In reaching its conclusion, the Second Circuit in *Dorozhko* first noted that Section 10(b) of the Securities Exchange Act of 1934 proscribes the "use or employ, in connection with the purchase or sale of any security . . . , [of] any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe."[127] The issue before the court was "whether the 'device' in this case—computer hacking—could be 'deceptive.'"[128] The court held that computer hacking could be "deceptive" if it involved an affirmative misrepresentation.[129]

If the theory underlying the *Dorozhko* decision is generally accepted by other courts, an alternative basis for supporting insider trading claims would exist that could address circumstances where a person traded on material nonpublic information obtained through "deceptive" conduct that involves an affirmative misrepresentation.[130] Indeed, "the reasoning underlying the [misappropriation] theory can easily be applied to deceptive acts or practices generally in connection with a defendant's own trading, fiduciary breach or not."[131] The idea that, absent a fiduciary relationship, "a thief [who] breaks into your office, opens your files, learns material

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593, 596–97 (2012) (arguing that constructive breach theory, whereby "one wrongfully obtains property from another, . . . [thereby] creat[ing] a constructive trust between the wrongdoer and the victim as to that property," should replace the Second Circuit's theory of insider trading in *Dorozhko*); Sean F. Doyle, *Simplifying the Analysis: The Second Circuit Lays Out a Straightforward Theory of Fraud in* SEC v. Dorozhko, 89 N.C. L. REV. 357, 385 (2010) (arguing that *Dorozhko* both complies with the "original spirit" of 10(b) and is consistent with precedent); Elizabeth A. Odian, SEC v. Dorozhko*'s Affirmative Misrepresentation Theory of Insider Trading: An Improper Means to a Proper End*, 94 MARQ. L. REV. 1313, 1317–18 (2011) (arguing that while the *Dorozhko* court "impermissibly combined two distinct theories of securities fraud," public policy demands that Rule 10b-5 extend to computer hacking); Michael D. Wheatley, *Apologia for the Second Circuit's Opinion in* SEC v. Dorozhko, 7 J.L. ECON. & POL'Y 25, 49–52 (2010) (arguing that *Dorozhko* highlights shortcomings of the fiduciary duty framework to insider trading and that a "property-rights approach would be an improvement").

[127] *Dorozhko*, 574 F.3d at 45 (quoting 15 U.S.C. § 78j(b) (2006)).

[128] *Id.* at 45–46 (footnote omitted).

[129] *See id.* at 51 ("In our view, misrepresenting one's identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly 'deceptive' within the ordinary meaning of the word. It is unclear, however, that exploiting a weakness in an electronic code to gain unauthorized access is 'deceptive,' rather than being merely theft. Accordingly, depending on how the hacker gained access, it seems to us entirely possible that computer hacking could be, by definition, a 'deceptive device or contrivance' that is prohibited by Section 10(b) and Rule 10b-5.").

[130] *See, e.g.*, Coffee, *supra* note 126, at 285–86 ("[I]n [*Dorozhko*], the Second Circuit opened the door to the prosecution of persons who trade on material nonpublic information, even when they do not breach a fiduciary (or similar confidential) relationship, at least so long as they obtain the material nonpublic information through 'deception.'" (footnote omitted)).

[131] 18 DONALD C. LANGEVOORT, INSIDER TRADING: REGULATION, ENFORCEMENT & PREVENTION § 6:14 (12th release 2014). Langevoort looks favorably upon the reasoning underlying the *Dorozhko* decision. *See id.* ("[T]here is little reason to believe that gaining a trading advantage by deceptive theft is any less deserving of proscription under Rule 10b-5 than gaining a trading advantage by a secretive breach of fiduciary duty." (footnote omitted)).

nonpublic information, and trades on that information [is] . . . exempt from insider trading liability" was questionable from the start because "drawing a line that can convict only the fiduciary and not the thief seems morally incoherent" and not "doctrinally necessary."[132]

While the *Dorozhko* decision appeared to open the door to some new types of insider trading claims, it also seemed to adopt an overly narrow view of what constitutes a "deceptive device" by requiring an affirmative misrepresentation,[133] despite the fact that the logic of the decision and the language of Rule 10b-5 would appear to prohibit any use of trickery or deception—even without an affirmative misrepresentation—to acquire material nonpublic information for use in trading securities.[134] In any event, the *Dorozhko* decision shows that SEC Rule 10b-5 is a flexible antifraud remedy that likely will continue to evolve through federal common law as cases involve new fact patterns:

> Because the law has developed in the courts, insider trading law is fluid and continues to evolve as markets grow, technology changes, and the [Department of Justice] and SEC press new theories of insider trading. Inevitably accompanying those new and expansive prosecutorial theories are new legal and factual defenses that should be considered.[135]

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[132] Coffee, *supra* note 126, at 281.

[133] *See Dorozhko*, 574 F.3d at 51 (comparing "misrepresent[ation of] one's identity in order to gain access to information that is otherwise off limits," which would be deceptive, with "exploiting a weakness in an electronic code to gain unauthorized access," which may not be).

[134] Coffee, *supra* note 126, at 294–95 ("[The *Dorozhko* court] found that a computer hacker who misrepresents his identity to gain access to the information does violate Rule 10b-5, but it also suggested that a hacker who penetrates computer security without a misrepresentation and then fails to disclose that he is trading based on the 'possession of nonpublic market information' does not. Understandable as this distinction may have been in light of the existing case law, it is neither morally self-evident nor compelled by the language of Rule 10b-5 . . . ."). Coffee recommends that the SEC codify *Dorozhko*'s holding—"or some variant of it"—in a rule, along with a definition of "what 'deception' might mean in this special context of trading markets." *Id.* at 306. Coffee proposes a "Rule 10b5-4" that would broadly define deceptive conduct to cover affirmative misrepresentations and other "covert act[s] or subterfuge," which would include misappropriating material nonpublic information by, inter alia, "open[ing] another's briefcase or desk drawer to discover confidential information . . . ." *Id.* at 306–07.

> [T]he simplest course would be for the SEC to define by rule that deception by trick, ruse, or subterfuge violates Section 10(b) and Rule 10b-5, even if no affirmative misrepresentation is made. This is justifiable both in terms of Section 10(b)'s original purpose of serving as the flexible catch-all remedy to bar all other "cunning devices," and Webster's 1934 definition of "deceive" to include "cheating" and dealing "treacherously" with another.

Id. at 317 (footnotes omitted).

[135] Bondi & Lofchie, *supra* note 92, at 169 (footnote omitted).

Put another way, it is inevitable that "new 'cunning devices' will surface from time to time, as fraud evolves and mutates" but, in recognition of that fact, "Rule 10b-5 was intended to evolve to keep pace with the ingenuity of fraudsters."[136]

The *Dorozhko* decision, then, is best understood as one step in the continuing evolution of Rule 10b-5. Notwithstanding the flexible and adaptive nature of Rule 10b-5's antifraud prohibition, as developed in decisional law, there appear to be limits to Rule 10b-5's reach. For example, SEC Chair Mary Jo White stated in April of 2014 that an exchange's provision of "high-speed market data . . . to top-paying traders ahead of ordinary investors" did not constitute insider trading.[137] Overall, the SEC "views high-speed trading as a regulatory rather than an enforcement issue and will not generally be pursuing front-running cases against these traders."[138] Based on the insider trading decisional law discussed above, HFT firms that pay for high-speed data feeds and co-location services arguably are not committing insider trading because (1) the HFT firms are not violating a duty of trust or confidence by paying to receive data feeds and co-locate their computers next to exchange matching engines, and (2) alternatively, per the *Dorozhko* decision, the HFT firms did not obtain the high-speed data feeds and space in co-location facilities through deceptive fraudulent misrepresentations.[139] The exchanges publicly advertise these services,[140] so they are not concealed from other investors, which weighs against their being deemed fraudulent.[141]

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[136] Coffee, *supra* note 126, at 317.

[137] Leah McGrath Goodman, *Is Wall Street Pulling a Fast One?*, NEWSWEEK (May 22, 2014), http://www.newsweek.com/2014/05/30/wall-street-pulling-fast-one-251784.html; *see also* William Alden, *Turf Wars Seen in Response to High-Frequency Trading*, N.Y. TIMES (May 22, 2014), http://dealbook.nytimes.com/2014/05/22/turf-wars-seen-in-response-to-high-frequency-trading/?module=BlogPost-Title&version=Blog.

[138] Neil Roland, *SEC Not Pursuing Front-Running Cases Against High-Speed Traders, Official Says*, MLEX, July 15, 2014 (quoting the SEC official as stating that "'the vast majority of what one would term predatory high-frequency trading'" is "'not in the legal sense of the word front-running'").

[139] *See* Matt Levine, *New York Attorney General Will Supervise When and How News Organization Can Report News*, DEAL BREAKER (July 8, 2013), http://dealbreaker.com/2013/07/new-york-attorney-general-will-supervise-when-and-how-news-organization-can-report-news/ ("Legal experts have said the tiered pricing arrangement Thomson Reuters has with its customers [in which HFT firms paid for quicker access to data] does not violate federal insider trading laws . . . . [T]he company can disseminate the information as it pleases, as long as it fully discloses the practice, they say. And trading on the early data release is also legal because no one is breaching any duty in leaking the information . . . .").

[140] *See, e.g.*, *Co-Location (CoLo)*, NASDAQ OMX, http://www.nasdaqtrader.com/Trader.aspx?id=colo (last visited Sept. 26, 2014).

[141] Some have criticized the practice of selling direct–and therefore faster–access to market data as unfair to the investors, who choose not to purchase direct access data feeds. For example, the Securities Industry and Financial Markets Association (Sifma) has stated that "[a]ll users of market data should have access at the same time" and "it is important that the [data feeds used by the public]

But others believe that such services constitute insider trading and other violations of securities laws.[142] For example, in May of 2014, lawyers brought a class action lawsuit on behalf of public investors against stock exchanges, brokerage firms, and high-frequency trading firms alleging that the defendants "participated in [a] scheme . . . whereby certain market participants were provided with material, non-public information so that those market participants could use the informational advantage obtained to manipulate the U.S. securities market."[143] The plaintiffs' Complaint in the case, *City of Providence v. BATS Global Markets, Inc.*, further alleges that the defendant stock exchanges, in allowing the defendant high-frequency trading firms to "co-locate" computers adjacent to the exchanges, gave the defendants advance access to proprietary, material nonpublic information about the plaintiffs' "intentions to trade," thereby enabling the defendants to engage in improper high-speed pinging and front running tactics in violation of, inter alia, Exchange Act Section 10(b) and Rule 10b-5.[144] Since the April 2014 filing of the Complaint in the *City of Providence* case, several other similar lawsuits have been filed.[145]

Further, as mentioned, New York State Attorney General Eric T. Schneiderman has criticized certain practices, such as selling advance notice of news reports and other information to high-speed traders, as "insider trading 2.0."[146] For example, news and financial information

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and the direct feeds provided by the exchanges [be] distributed to all users at the same time." Curt Bradbury & Kenneth E. Bensten Jr., *How to Improve Market Structure*, N.Y. TIMES (July 14, 2014), http://dealbook.nytimes.com/2014/07/14/how-to-improve-market-structure/; *see also* Eric T. Schneiderman, *The Need for Speed Is Costing Billions*, N.Y. DAILY NEWS (Apr. 3, 2014), http://www.nydailynews.com/opinion/speed-costing-billions-article-1.1743553 ("Because high-frequency trading firms receive market prices before traders relying on the consolidated feed, they are able to see the prices early, jump in and take the best one in the blink of an eye. Regular investors are left in the dark.").

[142] *See, e.g.*, Complaint ¶¶ 133–34, Am. European Ins. Co. v. BATS Global Mkts., Inc., No. 14 CV 3133, 2014 WL 1722728 (S.D.N.Y. May 2, 2014) (alleging violations of Exchange Act Section 10(b) and Rule 10b-5 for, inter alia, receiving "insider trading proceeds," "misappropriat[ing] material nonpublic information about Plaintiff's and the Plaintiff Class's future intentions to trade," and having "actual knowledge of the illegal practices and insider trading set forth herein").

[143] *Id.* at ¶¶ 1–2, 5.

[144] *Id*. at ¶¶ 113, 116, 133.

[145] *See* Complaint ¶¶ 118, 139, Harel Ins. Co. v. BATS Global Mkts. Inc., No. 14 CV 3608, 2014 WL 2106291 (S.D.N.Y. May 20, 2014) (alleging violation of 10(b) and 10b-5 by virtue of HFT Defendants' receiving advance notice of plaintiffs' "intentions to trade"); Complaint, ¶¶ 125, 145, Flynn v. Bank of Amer. Corp., No. 14 CV 4321, 2014 WL 2709439 (S.D.N.Y. June 13, 2014) (alleging violation of 10(b) and 10b-5 by virtue of HFT Defendants' receiving advance notice of plaintiffs' "intentions to trade"); *see also* Complaint ¶¶ 1–2, 7, Lanier v. BATS Exch. Inc., No. 14 CV 3745, 2014 WL 2197609 (S.D.N.Y. May 23, 2014) (alleging breach of contract by defendant securities exchanges by virtue of defendants' providing customers with market data in advance of plaintiffs, thereby rendering plaintiffs' data "obsolete").

[146] Bryan Cohen, *N.Y. AG Notes Growing Threat of Early Access Trading Abuses*, LEGAL NEWSLINE (Sept. 25, 2013), http://legalnewsline.com/issues/financial-crisis/244471-n-y-ag-notes-growing-threat-of-early-access-trading-abuses.

provider Thomson Reuters agreed to stop selling HFT firms an early glimpse of consumer confidence surveys. "Thomson Reuters, the financial information provider, agreed . . . to end its practice of selling speedy traders an early look at a closely watched survey of consumer confidence" at the urging of the attorney general.[147] Similarly, pressure from Schneiderman in 2014 caused press-release distributors Business Wire and Marketwired to cease letting trading firms purchase direct access to their services.[148] PR Newswire always refused to give HFT firms direct access to its data feed of news releases, despite repeated requests for such a service.[149] The Federal Reserve Bank of Chicago (the Bank or the Chicago Fed) issued a report stating that it does not "take issue with the ability of market participants and trade intermediaries to have a latency advantage when entering their orders, because of their colocation in the trading venue's data center."[150] The Chicago Fed takes issue, however, with the ability of co-locating firms to receive trade data "before such information is generally made available to the public at large."[151] "Public policy issues

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[147] Alden, *Inquiry Into High-Speed Trading Widens*, *supra* note 55; *see also* Louis M. Thompson, *Time to End the Jump Some Investors Get on Information?*, COMPLIANCE WEEK (Aug. 20, 2013), http://www.complianceweek.com/blogs/louis-m-thompson/time-to-end-the-jump-some-investors-get-on-information ("A two-second head start on market-moving news can be an eternity for a high-speed trader using an algorithmic super computer program, and many companies pay handsomely for the advantage.").

[148] *See* Stephen Foley et al., *Buffett's Business Wire Ends Feeds to High-Speed Traders*, FIN. TIMES (Feb. 20, 2014), http://www.ft.com/intl/cms/s/0/6cdf6a90-9a7f-11e3-8232-00144feab7de.html ?siteedition=intl#axzz2twCu9eDS ("Business Wire, which has published corporate news releases in the US for the last half century, will stop selling direct feeds to high-speed traders . . . . Business Wire had also been in talks with the New York attorney-general Eric Schneiderman, whose office is investigating the distribution of financial data . . . ."); Christie Smythe, *Marketwired Shuts Off Traders Amid New York Probe*, BLOOMBERG (Mar. 19, 2014), http://www.bloomberg.com/news/2014-03-19/marketwired-shuts-off-traders-from-press-release-service.html ("[Marketwired's] decision was disclosed . . . by New York Attorney General Eric Schneiderman . . . . Schneiderman yesterday announced a probe into whether stock exchanges provide banks and trading firms with faster access to data and richer information than what's typically available to the public.").

[149] Scott Patterson, *Speed Traders Get an Edge: Paying for Direct Access to News Releases Can Give a Lucrative Time Advantage*, WALL ST. J., Feb. 6, 2014, at C1. In April of 2014, PR Newswire took additional steps to ensure that its news feed was not used by HFT firms, such as requiring its direct data feed recipients to certify that they will not engage in high-frequency trading. Press Release, Eric Schneiderman, N.Y. Attorney Gen., A.G. Schneiderman Announces Unprecedented Steps by News Distribution Firm to Curb Preferential Access for High-frequency Traders (April 30, 2014), *available at* http://www.ag.ny.gov/press-release/ag-schneiderman-announces-unprecedented-steps-news-distribution-firm-curb-preferential.

[150] John McPartland, *Recommendations for Equitable Allocation of Trades in High Frequency Trading Environments*, FED. RESERVE BANK OF CHI. 28 (July 10, 2014), https://www.chicagofed.org /digital_assets/publications/policy_discussion_papers/2013/PDP2013-01.pdf.

[151] *Id.* at 29.

> Organizations that collocate in the data centers of trading venues should not be receiving trade information from the trade match engines but should be receiving such information from the same ticker plants from which the general public receives

of fairness would seem to be mollified if firms that collocate were to receive trade information at the same time that such information were made available to the public at large," the Bank's report states.[152]

While it is somewhat unusual to see two prominent government officials—in this case, New York's Schneiderman and the SEC's White—holding different views as to the propriety of services such as co-location and high-speed trading and news data feeds,[153] some have speculated that Schneiderman may be better able to attack these practices (i.e., "insider trading 2.0") than White.[154] Schneiderman can invoke New York State's Martin Act,[155] which, unlike liability under Exchange Act Section 10(b) and SEC Rule 10b-5, does not require proof of intent to defraud on the part of defendants or reliance on fraudulent misrepresentations by other traders and market participants.[156]

> trade information. The issue is whether some firms have access to–and can trade on–information that has not yet reached the public domain.

Id. at 3.

[152] *Id.* at 29; *see also* Doni Bloomfield & Sam Mamudi, *Chicago Fed Calls for Curbs on High-Frequency Trading*, BLOOMBERG (July 10, 2014), http://www.bloomberg.com/news/2014-07-10/chicago-fed-calls-for-curbs-on-high-frequency-trading.html ("The issue[,] . . . especially in U.S. equities, is: Are people who have servers co-located in the data facilities trading on information that's not yet in the public domain . . . . And if the answer is 'yes,' that needs to be fixed." (quoting Telephone Interview with John McPartland (July 10, 2014) (internal quotation marks omitted))).

[153] *See* Alden, *Turf Wars Seen in Response to High-Frequency Trading*, *supra* note 139 ("Mary Jo White, the head of the Securities and Exchange Commission, said recently that using computer algorithms to buy and sell stocks ahead of other investors is 'not unlawful insider trading.'"); Goodman, *Is Wall Street Pulling a Fast One?*, *supra* note 53 ("A source familiar with the SEC's thinking who asked not to be named said the SEC 'is looking in the rear view mirror, and they see the [New York] attorney general's office, and they also fear the courts.'"); Thompson, *supra* note 149 (quoting Columbia Law School Professor John C. Coffee Jr. as stating that "Schneiderman is 'a mile ahead of the SEC, which has dragged slowly and grudgingly toward raising the standard of behavior'").

[154] *See* Evan Weinberger, *The Martin Act May Be Key to Federal MBS Crackdown*, LAW 360 (Oct. 2, 2012), http://www.law360.com/articles/383602/ny-s-martin-act-may-be-key-to-federal-mbs-crackdown (explaining how the Martin Act grants Schneiderman greater flexibility than the tools available to federal regulators).

[155] N.Y. GEN. BUS. LAW §§ 352, 353 (McKinney 2014); *see* Eric R. Dinallo et al., *Defending Clients in Attorney General and Department of Financial Services Investigations and Enforcement Actions*, *in* DEFENDING CORPORATIONS & INDIVIDUALS IN GOVERNMENT INVESTIGATIONS 435, 451 (Daniel J. Fetterman & Mark P. Goodman eds., 2012–2013 ed. 2012) ("[Sections] 352 to 353 of the New York General Business Law [are] well-known [as the] 'Martin Act.'").

[156] *See* Eric R. Dinallo et al., *supra* note 155, at 456 ("In fact, the only elements in a Martin Act violation, assuming that there is jurisdiction in the State of New York and that the conduct was engaged in to induce or promote the purchase or sale of a security, are: (1) a misrepresentation or omission; (2) that is material."); Roberta S. Karmel, *Reconciling Federal and State Interests in Securities Regulation in the United States and Europe*, 28 BROOK. J. INT'L L. 495, 521 (2003) ("In the New York Attorney General's view, in contrast to the requirements of the federal securities laws, no purchase or sale of stock is required, nor are intent, reliance or damages required elements of a [Martin Act] violation."); Frank C. Razzano, *The Martin Act: an Overview*, 1 J. BUS. & TECH. L. 125, 129 (2006) ("A showing of neither intent nor scienter is required to prove a violation of the Act and sustain civil liability or criminal culpability, unless a felony is charged."); William Alden, *At Heart of Christie Inquiry, a Law*

III. RELEVANT PROVISIONS OF THE COMMODITY EXCHANGE ACT AND COMMODITY FUTURES TRADING COMMISSION REGULATIONS

A. *Harmful Trading Practices Prohibited by the Commodity Exchange Act*

1. *Wash Trades*

The CEA prohibits several specific trading practices that are considered fraudulent, manipulative, or disruptive. For example, CEA Section 4c(a)(2)[157] makes it unlawful for anyone to enter into certain kinds of transactions that are considered noncompetitive or are believed to facilitate noncompetitive trading.[158] In particular, since 1936,[159] the CEA has prohibited wash trades (also called wash sales)—"which are fictitious, prearranged sales in which the same parties agree to a pair of offsetting trades for the same commodity, at no economic risk or net change in beneficial ownership."[160] Wash sales are "a powerful multipurpose tool that can be used . . . for significant frauds and market manipulations,"[161] and, as such, they "are considered harmful because they create illusory price movements in the markets."[162] That is, wash trades can be used to create "a burst in volume [that] can lure more traders, creating the

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Feared on Wall Street, N.Y. TIMES (June 24, 2014), http://dealbook.nytimes.com/2014/06/24/at-heart-of-christie-inquiry-a-law-feared-on-wall-street/?smid=tw-dealbook&seid=auto ("To prove a violation of the Martin Act, prosecutors do not have to establish an intent to defraud. Nor do they have to show that victims relied on a misrepresentation of fact. They do not even have to show that a purchase of securities occurred or that any damages were suffered. Those requirements are the bedrock of cases brought under federal securities laws. Not so with the Martin Act. To prove that a securities offering violates the Martin Act, the only thing that prosecutors need to establish is a misrepresentation or omission of material fact."); Levine, *supra* note 139 (referring to the advantage of using the Martin Act over federal securities laws).

[157] 7 U.S.C. § 6c(a)(2) (2012).

[158] Charles R.P. Pouncy, *The Scienter Requirement and Wash Trading in Commodity Futures: The Knowledge Lost in Knowing*, 16 CARDOZO L. REV. 1625, 1635–36 (1995).

[159] 7 U.S.C. §§ 6c(a)(1)–(2); *see* Pouncy, *supra* note 158, at 1645 ("The Senate debate of the bill that became the Commodity Exchange Act demonstrates that wash trades in commodity futures were viewed exclusively as instruments of fraud and deceit. However, the fraud and deceit contemplated by section 4c was not fraud against individuals, but rather, fraud against the market itself.").

[160] 6 Steven Wolowitz, *Commodities and Futures*, *in* BUSINESS & COMMERCIAL LITIGATION IN FEDERAL COURTS 855, 876 (Robert L. Haig ed., 3d ed. 2012); *see* Pouncy, *supra* note 158, at 1625 ("Wash trading . . . consists of the simultaneous purchase and sale of the same number of futures contracts at the same or very similar price."). Wash sales "are considered harmful because they create illusory price movements in the markets." Wilson v. CFTC, 322 F.3d 555, 559 (8th Cir. 2003).

[161] Pouncy, *supra* note 158, at 1626.

[162] *Wilson*, 322 F.3d at 559; *see* Craig Pirrong, *Energy Market Manipulation: Definition, Diagnosis, and Deterrence*, 31 ENERGY L.J. 1, 5 (2010) (noting that a "type of manipulation [that] involves some sort of fraud" is when "a trader [engages] in a wash trade that gives a misleading impression of actual buying or selling interest in a market"); *see also* Patterson & Bunge, *supra* note 71 (stating, in reference to the securities markets, that, with "wash trades," "a firm acts as a buyer and seller in the same trade to distort market activity" and that "[t]he practice can create the illusion of heavy trading volume that lures firms that are tracking for such activity").

impression of more action than is actually taking place" in a particular market.[163] To establish a violation of the CEA's prohibition against wash sales (or accommodation sales), the CFTC must show (1) the simultaneous purchase and sale (2) of the same delivery month of the same futures contract (or option or swap)[164] (3) at the same or similar price,[165] and (4) the requisite mental state.[166] To prove the required mental state of a violation of CEA Section 4c(a)(2) (for an alleged wash sale or in connection with any other kind of noncompetitive transaction), one must show that the individuals traded with the intent to negate risk or price competition at the time the transaction was initiated, and knew at the time that the transaction was designed to achieve a wash result that negated risk.[167] Wash trading is also illegal in the securities markets.[168]

2. *Causing Non-Bona Fide Prices To Be Reported*

In addition to prohibiting wash trades, Section 4c(a)(2)(B) also makes it unlawful to offer to enter into, enter into, or confirm the execution of a commodity futures transaction that "is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price."[169]

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[163] Scott Patterson et al., *Futures Trades Scrutinized: At Issue Are High-Speed "Wash" Transactions Banned Under U.S. Statutes*, WALL ST. J., Mar. 18, 2013, at C1; *see* Scott Patterson & Michael Rothfeld, *FBI Investigates High-Speed Trading*, WALL ST. J. (Mar. 31, 2014), http://online.wsj.com/news/articles/SB10001424052702304886904579473874181722310# ("CFTC investigators are probing whether high-frequency firms are routinely distorting futures markets by acting as buyer and seller in the same transactions, illegal activity known as wash trades. Such trades are banned by U.S. law because they can feed false information into the market and manipulate prices."). Spoofing also is viewed as a trading practice that HFT firms use to "lure other traders into the market." Bradley Hope, *Regulators, Traders Are Out of Sync*, WALL ST. J., July 14, 2014, at C1.

[164] Generally speaking, "[a] swap contract is an agreement to exchange future cash flows." MICHAEL DURBIN, ALL ABOUT DERIVATIVES 29 (2011). Alternatively, a swap can be described as "an agreement between two parties to exchange payments on regular future dates, where each payment leg is calculated on a different basis." ANDREW M. CHISHOLM, DERIVATIVES DEMYSTIFIED 2 (2d ed. 2010).

[165] *See In re* Piasio, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶28,276, at 50,691 (CFTC Sep. 29, 2000) ("The factors that show a wash result are . . . delivery . . . at the same (or a similar price." (citing *In re* Gilchrist, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶24,993, at 37,653 (CFTC Jan. 25, 1991))); *accord* Wilson v. CFTC, 322 F.3d 555, 559 (8th Cir. 2003).

[166] Reddy v. CFTC, 191 F.3d 109, 115 (2d Cir. 1999); *see In re* Citadel Trading Co. of Chi., Ltd. [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,082, at 32,190 (CFTC May 12, 1986) ("The central characteristic of a wash sale is the intent not to make a genuine bona fide trading transaction.").

[167] *Wilson*, 322 F.3d at 560; *see Reddy*, 191 F.3d at 119 ("[T]he [CFTC] must prove intent to establish a violation of . . . [Section] 4c of the CEA.").

[168] *See* Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476 (1977) (stating that manipulation includes "practices, such as wash sales, [and] matched orders or rigged prices, that are intended to mislead investors by artificially affecting market activity"); *accord* ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 99–100 (2d Cir. 2007); JOHNSON & HAZEN, *supra* note 78, at § 5.08.

[169] 7 U.S.C. § 6c(a)(2)(B) (2012); *see In re* Gelber Grp., [2012–2013 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶32,534, at 72,115 (CFTC Feb. 8, 2013) ("The common denominator of the specific abuses prohibition in Section 4c(a) . . . is the use of trading techniques that give the appearance

Under this prohibition, it is "unlawful to confirm the execution of any commodity futures transaction if such transaction" causes a non-bona fide price to be reported, registered, or recorded, which occurs, inter alia, "[b]y entering into trades that [are] not permitted by the [CEA] or [exchange] rules."[170] "[T]he prices reported on unlawfully executed noncompetitive trades are non-bona fide even if they accurately reflect the prices agreed upon by the parties and the current price for similar contracts traded on exchange."[171]

3. *Banging (or Marking) the Close*

Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act)[172] added new provisions to CEA Section 4c(a) that prohibit several kinds of disruptive trading practices.[173] Specifically, Section 4c(a)(5)(B) prohibits "banging the close" (also referred to as "marking the close"),[174] which, generally speaking, is the practice of "buying or selling large volumes of commodity contracts in the closing moments of a trading day" with the intent to move the price of the

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of submitting trades to the open market while negating the risk or price competition incident to such a market." (citation omitted)).

[170] *In re* Casas Sendas Comercio E Industria S.A., [2003–2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶29,566, at 55,446 (CFTC Aug. 18, 2003).

[171] *In re* Morgan Stanley & Co., [2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶32,218, at 69,781 (CFTC June 5, 2012).

[172] Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[173] Antidisruptive Practices Authority, 76 Fed. Reg. 14,943, 14,944 (Mar. 18, 2011) (describing the disruptive practices prohibited by the Dodd-Frank Act). Additionally, on August 28, 2014, CME Group submitted a notice with the CFTC that it was promulgating a rule (with an effective date of September 15, 2014) that would explicitly prohibit spoofing and other trading practices banned by CEA § 6(c)(5). *Adoption of Rule 575 ("Disruptive Practices Prohibited") and Issuance of CME Group Market Regulation Advisory Notice RA1405-5*, CME GROUP, (Aug. 28, 2014), http://www.cftc.gov/filings/orgrules/rule082814cmedcm001.pdf. CME also issued an advisory notice explaining the new rule. *Id.* CME had previously prohibited spoofing and other improper trading practices pursuant to other (broadly-worded) exchange rules that did not explicitly mention such practices. *Id.* In June of 2014, SEC Chair Mary Jo White announced that she had "directed staff to develop a recommendation . . . for an anti-disruptive trading rule" to cover certain HFT tactics. Mary Jo White, Chairman, SEC, Speech: Enhancing Our Equity Market Structure (June 5, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370542004312#.U5j2xfldWSq ("Such a rule will need to be carefully tailored to apply to active proprietary traders in short time periods when liquidity is most vulnerable and the risk of price disruption caused by aggressive short-term trading strategies is highest."); Sarah N. Lynch et al., *U.S. SEC Chair Plots Major Rules for High-Speed Traders, Dark Pools*, REUTERS (June 5, 2014), http://www.reuters.com/article/2014/06/05/sec-markets-idUSL1N0OM1OB20140605 (describing Mary Jo White's proposed "anti-disruptive trading" rule).

[174] CFTC v. Amaranth Advisors, L.L.C., 554 F. Supp. 2d 523, 534 (S.D.N.Y. 2008) ("[M]arking the close or any other trading practices, without an allegation of fraudulent conduct, can also constitute manipulation in contravention of the CEA, so long as they are pursued with a manipulative intent."); *see* Antidisruptive Practices Authority, 78 Fed. Reg. 31,895 (May 28, 2013) ("A person with manipulative intent, such as one attempting to 'bang' or 'mark the close' may also intend to disrupt the orderly execution of transactions during the closing period . . . .").

contract (or contracts).[175] Scienter is a required element of a CEA Section 4c(a)(5)(B) "banging the close" claim. The CFTC's Antidisruptive Practices Authority Interpretive Guidance stated

> The [CFTC] interprets Congress's inclusion of a *scienter* requirement in CEA section 4c(a)(5)(B) as meaning that accidental, or even negligent, trading, practices or conduct will not be sufficient basis for the [CFTC] to claim a violation under CEA section 4c(a)(5)(B). The [CFTC] interprets CEA section 4c(a)(5)(B) as requiring a market participant to at least act recklessly to violate CEA section 4c(a)(5)(B).[176]

The Interpretive Guidance further stated that "[r]ecklessness is a well-established *scienter* standard, which has consistently been defined as conduct that 'departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing.'"[177] The CFTC's Interpretive Guidance stated that, overall, "the [CFTC] will be guided, but not controlled, by the substantial body of judicial precedent applying the concepts of orderly markets established by the courts with respect to the securities markets."[178] In particular, the Interpretive Guidance stated:

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[175] 7 U.S.C. § 6c(a)(5)(B) (2012); Cho, *supra* note 35. The CFTC also has civilly prosecuted banging the close with the statutory provisions prohibiting price manipulation in CEA Sections 6(c), 6(d) and 9(a)(2), codified at 7 U.S.C. §§ 9, 13b & 13(a)(2). *See* CFTC v. Wilson, No. 13-CV-7884-AT, 2014 WL 2884680, at *15 (S.D.N.Y. June 26, 2014) (denying a motion to dismiss where a high-speed trading firm was accused of banging the close in violation of CEA Section 6(c) and Section 9(a)(2)); Press Release 6766-13, CFTC, CFTC Charges Donald R. Wilson and His Company, DRW Investments, LLC, with Price Manipulation (Nov. 6. 2013), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6766-13 (stating that the CFTC has filed a civil enforcement action, for violations of 7 U.S.C. Sections 6(c), 9(a), and 13(b), against Wilson and DRW investments for allegedly "banging the close" in order to manipulate settlement prices); Press Release 6239-12, CFTC, Federal Court Orders $14 Million in Fines and Disgorgement Stemming from CFTC Charges Against Optiver and Others for Manipulation of New York Mercantile Exchange Crude Oil, Heating Oil, and Gasoline Futures Contracts and Making False Statements (Apr. 19, 2012), *available at* http://www.cftc.gov/ PressRoom/PressReleases/pr6239-12 ("'The CFTC will not tolerate traders who try to gain an unlawful advantage by using sophisticated means to drive oil and gas futures prices in their favor,' said David Meister, the Director of the CFTC's Division of Enforcement. 'Manipulative schemes like 'banging the close' harm market integrity . . . .'"); *see also Statement of Acting Director of Enforcement Stephen Obie*, CFTC (July 24, 2008), http://www. cftc.gov/ucm/groups/public/@newsroom/documents/speechandtestimony/obieoptiverstatement072408.pdf ("[T]he [Optiver case] defendants employed a manipulative scheme commonly known as 'banging' or 'marking' the close."); Patterson & Bunge, *supra* note 71 (describing, in the context of the securities markets, "marking the close" as situations in which "firms push around stock prices at the close of trading in order to benefit from the final price").

[176] Antidisruptive Practices Authority, 78 Fed. Reg. 31,890, 31,895 (May 28, 2013).

[177] *Id.* (quoting Drexel Burnham Lambert, Inc. v. CFTC, 850 F.2d 742, 748 (D.C. Cir. 1988)).

[178] Antidisruptive Practices Authority, 78 Fed. Reg. at 31,895.

> that an orderly market may be characterized by, among other things, parameters such as a rational relationship between consecutive prices, a strong correlation between price changes and the volume of trades, levels of volatility that do not dramatically reduce liquidity, accurate relationships between the price of a derivative and the underlying such as a physical commodity or financial instrument, and reasonable spreads between contracts for near months and for remote months.[179]

Banging (or marking) the close also violates the securities laws.[180]

4. *Spoofing*

Likewise, Section 4c(a)(5)(C) prohibits "any trading, practice, or conduct . . . that is, 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)."[181] Spoofing has also been referred to as "quote

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[179] *Id.* at 31,895–96. Banging the close is to be distinguished from "banging the beehive," which is defined as sending "fusillades of phony trades that hit exchanges just milliseconds before major economic reports are published by the Labor and Commerce Departments." Denny Gulino, *Analysis: Algo Traders Wonder How CFTC Caught Up with Spoofer*, THE MAIN WIRE, July 23, 2013. Traders have contended that HFT firms engage in "banging the beehive" in the futures markets. Jerry A. DiColo, *CFTC Examines Gas Trades*, WALL ST. J., Feb. 16, 2013, at B1 (describing "banging the beehive" as follows: "Just before the data land, a high-speed trader will flood the market with orders to fill existing orders just above or below the current prevailing futures price. If these orders can trigger enough transactions, the flurry of trades can create wide swings once the data hit, presenting a chance for the high-speed firm to conduct rapid buying and selling to profit from being faster than other players in the market"); Jerry A. DiColo & Geoffrey Rogow, *Gas Market Stung by Rapid Traders*, WALL ST. J., Oct. 16, 2012, at C1 (describing "banging the beehive" as a tactic in which "high-speed traders send a flood of orders in an effort to trigger huge price swings just before the data [that is about to be revealed by an agency] hit" and contending that HFT firms "bang the beehive" before "the weekly report of [natural] gas-inventory figures by the U.S. Energy Information Administration" are released at 10:30 a.m. on Thursdays).

[180] *See* 3 ALAN R. BROMBERG ET AL., *supra* note 119, at § 6:68 ("'Marking the close' is a type of manipulative activity which consists of entering a quote or effecting a purchase or sale at or near the close of a trading session in order to artificially affect the closing quote or the closing sale price of a security. . . . Marking the close may violate [the Exchange Act] §10(b) and Rule 10b-5 . . . ."); JOHNSON & HAZEN, *supra* note 78, at §5.02[2] (stating that "[m]arking the close can also be used to manipulate the securities markets" and citing decisions). The SEC views marking the close as a form of fraud and thus a violation of Exchange Act Section 10(b) and SEC Rule 10b-5. *See* SEC v. LNB Bancorp, Inc., et al., Civil Action No. 04 CV 0933, SEC Litigation Release No. 18718, 2004 WL 1124934, at *1 (N.D. Ohio May 19, 2004) ("By marking the close, the Defendants artificially supported the price of LNB Bancorp common stock on Nasdaq. As a result, the Defendants fraudulently manipulated the closing price of LNB Bancorp common stock."). The complaint in *SEC v. LNB Bancorp* can be found at http://www.sec.gov/litigation/complaints/comp18718.pdf. *See also* SEC v. Moises Saba Masri, et al., 04 CV 1584, SEC Litigation Release No. 18593, 2004 WL 349834, at *1 (S.D.N.Y. Feb. 25, 2004) ("[T]he defendants violated the anti-fraud provisions of the federal securities laws by unlawfully 'marking the close' and thereby manipulating the price of [a company's] American Depository Receipts, which are listed on the New York Stock Exchange.").

[181] 7 U.S.C. § 6c(a)(5)(C) (2012).

stuffing," "order stuffing," and "layering."[182] Spoofing has been described as an "illegal activity [that] briefly distorts the shape of the limit order book,[183] with the explicit goal of misleading other traders of all frequencies."[184] With spoofing, other traders "are misled about the supply and demand of financial instruments available in the markets and, as a result, about the impending movement of the markets."[185] The Interpretive Guidance indicated that intent is integral to a Section 4c(a)(5)(C) claim, stating that "a CEA section 4c(a)(5)(C) violation requires a market participant to act with some degree of intent, or *scienter*, beyond recklessness to engage in the 'spoofing' trading practices prohibited by CEA section 4c(a)(5)(C)."[186] "Because CEA section 4c(a)(5)(C) requires that a person intend to cancel a bid or offer before execution, the [CFTC]

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[182] Peter J. Henning, *Markets Evolve, as Does Fraud*, N.Y. TIMES, Nov. 12, 2013, at F12 ("When orders are entered and canceled in the blink of an eye, is that 'order stuffing' intended to affect prices or just a common – if quite rapid – way of doing business?"); *SEC to Study Rapid-Fire Stock Orders*, N.Y. TIMES, Sept. 8, 2010, at B9 ("Federal regulators are examining certain practices involving 'quote stuffing,' where large numbers of rapid-fire stock orders are placed and canceled almost immediately, the chairwoman of the Securities and Exchange Commission, Mary L. Schapiro, said on Tuesday."); Felix Salmon, *The Problems of HFT, Joe Stiglitz Edition*, REUTERS (Apr. 16, 2014), http://blogs.reuters.com/felix-salmon/2014/04/15/the-problems-of-hft-joe-stiglitz-edition/ ("Today, the markets are overwhelmed with quote-stuffing. Orders are mostly fake, designed to trick rival robots, rather than being real attempts to buy or sell investments."). Some sources appear to differentiate spoofing from quote/order stuffing, although both strategies involve placing orders for trades and then canceling them before execution. *See, e.g.*, Eliot Lauer et al., *Stay Afloat in the New Wave of High-Frequency Trading Actions*, N.Y. L.J., Feb. 25, 2013, at nn.29–30 ("The CFTC's interpretation seems to also prohibit layering [another disruptive HFT tactic] and quote stuffing . . . ."); McPartland, *supra* note 150, at 7–9 (defining spoofing, layering, and quote stuffing in a manner that is similar, but not identical to the statutory language in the CEA defining "spoofing"). The Federal Reserve Bank of Chicago report by McPartland states that trading practices that involve placing and then canceling orders for trades, i.e., spoofing, layering, and quote stuffing, are "deceptive." McPartland, *supra* note 150, at 8, 27.

[183] A "limit order book" refers to exchanges and trading platforms that show market participants a "continually updated list, or 'book,' of outstanding offers to buy (bids) or sell (offers) at various prices." Korsmo, *supra* note 57, at 534 & n.55.

[184] Irene Aldridge, *The Risks of High-Frequency Trading*, HUFFINGTON POST (Mar. 29, 2013), http://www.huffingtonpost.com/irene-aldridge/the-risks-of-highfrequenc_b_2966242.html. Aldridge is referring to the fact that spoofing floods the order limit book with additional bids and (or) offers (that the trader who is engaging in the spoofing intends to cancel before they become executed trades). Huw Jones & John McCrank, *U.S. and U.K. Fine High-Speed Trader for Manipulation*, REUTERS (July 22, 2013), http://www.reuters.com/article/2013/07/22/britain-fca-hft-idUSL6N0FS1VL20130722 ("'Spoofing sends false signals to markets in order to lure prey and game the system,' CFTC Commissioner Bart Chilton [said].").

[185] Aldridge, *supra* note 184 (referring to spoofing as "HFT market manipulation"); *see also* Lynne Marek, *Futures on the Line in D.C.; Reformers Aim to Fence in Chicago Traders*, CRAIN'S CHI. BUS. (Jan. 24, 2011), http://www.chicagobusiness.com/article/20110122/ISSUE01/301229976/futures-on-the-line-in-d-c (stating that spoofing "allows traders to smoke out buyers or sellers without committing to a transaction"); Patterson & Bunge, *supra* note 71 (stating that, in regards to securities markets, "spoofing" involves "plac[ing] orders designed to trick other firms into buying or selling stock").

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

does not interpret reckless trading, practices, or conduct as constituting a 'spoofing' violation."[187] The Interpretive Guidance further stated:

> When distinguishing between legitimate trading (such as trading involving partial executions) and 'spoofing,' the [CFTC] intends to evaluate the market context, the person's pattern of trading activity (including fill characteristics), and other relevant facts and circumstances. For example, if a person's intent when placing a bid or offer was to cancel the entire bid or offer prior to execution and not attempt to consummate a legitimate trade, regardless of whether such bid or offer was subsequently partially filled, that conduct may violate CEA section 4c(a)(5)(C).[188]

The CFTC provided

> four non-exclusive examples of possible situations for when market participants are engaged in 'spoofing' behavior, including: (i) Submitting or cancelling bids or offers to overload the quotation system of a registered entity, (ii) submitting or cancelling bids or offers to delay another person's execution of trades, (iii) submitting or cancelling multiple bids or offers to create an appearance of false market depth, and (iv) submitting or canceling bids or offers with intent to create artificial price movements upwards or downwards.[189]

The Interpretive Guidance stated that "the [CFTC] intends to distinguish between legitimate trading and 'spoofing' by evaluating all of the facts and circumstances of each particular case, including a person's trading practices and patterns."[190] But a CEA Section 4c(a)(5)(C) violation does not require a pattern of activity; indeed, "even a single instance of trading activity can violate CEA section 4c(a)(5)(C), provided that the activity is conducted with the prohibited intent."[191]

Spoofing can be viewed as a cousin of wash trading. With wash trading, a trader (or traders) creates the false appearance of liquidity or activity in the market by trading with herself.[192] With spoofing, a trader creates the false appearance of liquidity or activity in the market by

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[187] *Id*. "Similar to violations under CEA section 4c(a)(5)(B),the [CFTC] does not interpret CEA section 4c(a)(5)(C) as reaching accidental or negligent trading, practices, or conduct." *Id.*

[188] *Id.*

[189] *Id.*

[190] *Id.*

[191] *Id.*

[192] *See* Pouncy, *supra* note 158, at 1625–26 ("[A]t the trade's conclusion, no position has been taken in the market.").

submitting bids and offers—i.e., orders for trades—that are briefly visible to other traders until the orders are canceled before trades can be executed.[193]

On July 22, 2013, the CFTC issued an Order that simultaneously filed and settled the first case involving charges of violating CEA Section 4c(a)(5)(C)'s prohibition on spoofing.[194] Panther Energy Trading LLC, of

[193] *See* Complaint at ¶ 32, CFTC v. Moncada, No. 12 Civ. 8791, 2014 WL 2945793 (S.D.N.Y. Dec. 4, 2012) [hereinafter Moncada Compl.] (alleging, in a complaint with claims of attempted manipulation in violation of CEA Sections 6(c), 6(d), and 9(a)(2), that spoofing, i.e., entering and immediately canceling orders in futures contracts, created the "misleading impression of increasing liquidity"); Press Release 6441-12, CFTC, CFTC Files Complaint in Federal Court Against Eric Moncada, BES Capital LLC, and Serdika LLC Alleging Attempted Manipulation of Wheat Futures Contract Prices, Fictitious Sales, and Non-Competitive Transactions (Dec. 4, 2012) [hereinafter Moncada Press Release], *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6441-12; Mem. in Supp. of Pl.'s Mot. for Summ. J. Against Def. Eric Moncada at 2, CFTC v. Moncada, No. 12 Civ. 8791, 2014 WL 2945793 (S.D.N.Y. Jan. 29, 2014) ("Moncada wanted to profit by illegally causing price movements in the market by a practice commonly referred to as 'spoofing'—placing and immediately canceling orders without the intent to have them filled."). On July 15, 2014, the district court largely endorsed the CFTC's theory of manipulation, granting in part and denying in part the CFTC's motion for summary judgment while holding that "virtually no material facts are in dispute" and scheduling the case for a bench trial on the attempted manipulation claims to resolve what the court viewed as the only contested fact, namely, the issue of the defendant's intent. *Moncada*, 2014 WL 3533990, at *1 ("I also agree with the CFTC that the most compelling inference one might draw from the trading records is that Moncada was indeed trying to manipulate the market [but that] the Second Circuit prefers that issues of intent go to trial, so the better part of valor is to hold a trial to resolve" the only factual issue—"Moncada's intent."). The District Court also granted the CFTC's motion for summary judgment in connection with the wash sales and Regulation 1.38 violation claims. *Id.* at *3. The CFTC has observed that "[s]ome traders have used the 'spoofing' technique to place orders in the market to give the impression of interest on one side of the market, but cancel the order before it can be filed, in order to fill their small-lot orders on the opposite side of the market."). Moncada. Compl., *supra* note 193 (citing, inter alia, *In re* Ecoval Dairy Trade, Inc., [2011-2012 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶32,013, at 66,926–28 (CFTC July 19, 2011)). The Moncada and Ecoval Dairy Trade cases illustrate that the CFTC used CEA Sections 6(c), 6(d), and 9(a)(2) to combat spoofing that occurred before the passage of the Dodd-Frank Act, which, as mentioned, added a specific anti-spoofing provision to the CEA (i.e., Section 4c(a)(5)(C)).

[194] *In re* Panther Energy Trading & Michael J. Coscia, CFTC Docket No. 13-26, 2013 WL 3817473, at *1 (C.F.T.C. July 22, 2013); Press Release 6649-13, CFTC, 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 (June 22, 2013) [hereinafter CFTC Orders Panther], *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6649-13; *see* Nathaniel Popper, *New Powers Invoked to Curb a High-Speed Trading Feint*, N.Y. TIMES, July 23, 2013, at B3 ("Regulators are using new powers to crack down on a high-speed trading firm that they contend was trying to manipulate the prices of futures contracts."). In 2013, Coscia also settled charges related to this conduct with designated contract market CME Group and the U.K. Financial Conduct Authority. *See* Steve Goldstein, *In Pursuing Spoofing, Justice Department Finds a Familiar Target*, MARKETWATCH (Oct. 2, 2014), http://blogs.marketwatch.com/capitolreport/2014/10/02/in-pursuing-spoofing-justice-department-finds-a-familiar-target/. Additionally, in March of 2011, the CFTC simultaneously filed and settled charges for $550,000 against Bunge Global Markets, Inc. in connection with allegations of spoofing in soybean futures by Bunge employees. Press Release 6007-11, CFTC, CFTC Sanctions Bunge Global Markets, Inc. $550,000 for Entering Pre-Market Soybean Futures Orders on Globex that Caused Non-Bona Fide Prices to Be Reported, (Mar. 22, 2011) [hereinafter CFTC Sanctions Bunge], *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6007-11;

Red Bank, New Jersey, and Michael J. Coscia, of Rumson, New Jersey, were ordered to pay $2.8 million and banned from trading for one year for spoofing numerous commodity futures contracts in the fall of 2011.[195] According to the CFTC's news release, Coscia and Panther made money by employing a computer algorithm that was designed to unlawfully place and quickly cancel orders in exchange-traded futures contracts, pursuant to which "Coscia and Panther sought to give the market the impression that there was significant buying interest, which suggested that prices would soon rise, raising the likelihood that other market participants would buy from the small order Coscia and Panther were offering to sell."[196] Coscia's activities appear to have constituted "layering," which is a sub-category of spoofing in which a small order that the trader intends to execute is placed on one side of the market (e.g., a sell order) and then numerous large orders at various price levels that the trader intends to cancel once the small order is filled are placed on the opposite side of the market (e.g., buy

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Robert Fallon, *CFTC Takes Early Enforcement Action Against "Spoofing" in Derivatives Markets*, DODD-FRANK.COM (April 13, 2011), *available at* http://dodd-frank.com/cftc-takes-early-enforcement-action-against-spoofing-in-derivatives-markets/ [hereinafter Early Enforcement Action]. Because the Dodd-Frank Act had not yet taken effect, the CFTC used existing CEA provisions, such as the prohibition of price manipulation, to address spoofing. *Id.* Specifically, the CFTC alleged that Bunge violated (1) CEA Section 4c(a)(2)(B), codified at 7 U.S.C. § 6c(a)(2)(B), by causing prices that were not true and bona fide to be reported, and (2) CEA Section 9(a)(2), codified at 7 U.S.C. § 13(a)(2), by knowingly delivering market reports or market information that were false and misleading that affected the price of a commodity in interstate commerce. CFTC Sanctions Bunge, *supra* note 194. The Bunge Order can be found at http://www.cftc.gov/ucm/groups/public/@lrenforcementactions/documents/legalpleading/enfbungeorder032211.pdf. Similarly, on December 4, 2012, the CFTC also filed a complaint in the Southern District of New York alleging that a trader engaged in a manipulative scheme involving "spoofing," using the existing CEA provisions against attempt manipulation (because the Dodd-Frank Act's antidisruptive practices authority had not yet taken effect). Moncada Press Release, *supra* note 193.

[195] CFTC Orders Panther, *supra* note 194; *see* Dina ElBoghdady, *U.S. Fines Firm, Its Owner Over Lightning-Fast 'Spoofing' Trades*, WASH. POST, July 23, 2013, at A12 ("A high-speed trading firm in New Jersey and its owner agreed on Monday to pay $2.8 million to settle federal charges that they used a disruptive market trading practice that was banned by Congress three years ago. The [CFTC] accused Panther Energy Trading and its owner, Michael J. Coscia, of using sophisticated computer algorithms to illegally place and quickly cancel bids on commodity contracts, a practice known as 'spoofing.'").

[196] CFTC Orders Panther, s*upra* note 195; Silla Brush & Lindsay Fortado, *Panther, Coscia Fined Over High-Frequency Trading Algorithms*, BLOOMBERG (July 22, 2013), http://www.bloomberg.com/news/2013-07-22/panther-coscia-fined-over-high-frequency-trading-algorithms-1-.html ("Panther, based in Red Bank, New Jersey, and Coscia used a computer algorithm that placed and quickly canceled bids and offers in futures contracts for commodities including oil, metals, interest rates and foreign currencies, the U.S. Commodity Futures Trading Commission said in a statement today. The enforcement action was the CFTC's first under Dodd-Frank Act authority to target disruptive trading practices."); *see* Paul Murphy, *Should Michael Coscia Have Been Fined, or Medicated?*, FIN. TIMES ALPHAVILLE (Jul. 22, 2013), http://ftalphaville.ft.com/2013/07/22/1576892/should-michael-coscia-have-been-fined-or-medicated/ (stating that the British's regulator, the FCA, also dished out a $903,176 fine to Coscia).

orders).[197] The numerous large orders give the appearance of market interest and liquidity, which increases the likelihood of the small order getting filled at a favorable price, at which point the numerous large orders are cancelled.[198] Coscia's computerized-trading program would enter large orders on the opposite side of the market that he intended to cancel milliseconds after he had entered the small orders that he intended to fill.[199] The (then) CFTC Enforcement Director David Meister stated that "using a computer program that is written to spoof the market is illegal and will not be tolerated."[200] Coscia's legal problems in connection with his 2011 spoofing activities did not end there, however. On October 2, 2014, the U.S. Department of Justice announced the first criminal prosecution of a person—namely, Coscia—for violating the Dodd-Frank Act's anti-spoofing provision in the CEA (Section 4c(a)(5)(C)),[201] which also appears to be the first U.S. prosecution of someone for engaging in improper HFT market practices.[202] Specifically, Zachary T. Fardon, U.S. Attorney for the Northern District of Illinois, announced on October 2, 2014 that a grand jury had returned a twelve-count indictment against Coscia[203] for spoofing

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[197] *See* John Collingridge, *UK and US Regulators Fine Trader Michael Coscia $3m for 'Manipulation of Oil Market'*, INDEPENDENT (UK) (July 22, 2013), http://www.independent.co .uk/news/business/news/uk-and-us-regulators-fine-trader-michaelcoscia3m-for-manipulation-of-oil-market-8726834.html.

[198] *Id.*; *see FCA Fines US Based Oil Trader US $903K for Market Manipulation*, FIN. CONDUCT AUTHORITY (July 22, 2013), http://www.fca.org.uk/news/fca-fines-us-based-oil-trader#.

[199] *See* William Alden, *High-Frequency Trader Charged with Manipulating Commodity Prices*, N.Y. TIMES (Oct. 2, 2014), http://dealbook.nytimes.com/2014/10/02/high-frequency-trader-charged-with-manipulating-commodity-prices/?_php=true&_type=blogs&_r=0.

[200] CFTC Orders Panther, *supra* note 194.

[201] *See* Lynne Marek, *Chicago Feds Crack Down on High-Speed Trading*, CRAIN'S CHI. BUS. (Oct. 2, 2014), http://www.chicagobusiness.com/article/20141002/NEWS01/141009949/chi cago-feds-crack-down-on-high-speed-trading ("Federal regulators in Chicago raised the stakes today for high-speed traders, with the first criminal indictment for 'spoofing.'"); Gregory Meyer & Kara Scannell, *Chicago Lawmakers Get Tough on Spoofing*, FIN. TIMES (Oct. 8, 2014), http://www.ft.com /intl/cms/s/0/922cddec-4e92-11e4-adfe-00144feab7de.html#axzz3FRuwV4Mo ("The first criminal case against spoofing has unsettled traders around Chicago, a hub for proprietary firms that use sophisticated algorithms to outwit one another. . . . 'What's interesting is that we're finally seeing the potential of jail time for someone who wrote an algo that broke the rules.'"); Kara Scannell & Gregory Meyer, *Trader Faces Criminal 'Spoofing' Charges*, FIN. TIMES (Oct. 2, 2014), http://www.ft.com/intl/cms/s/0/9bf94196-4a53-11e4-b8bc-00144feab7de.html# axzz3EzVaO6gg ("A high-frequency trader has been indicted on charges he manipulated commodities markets by 'spoofing' —marking the first time US authorities have criminalised the practice.").

[202] It appears that the only criminal cases involving HFT practices involve improper theft of computer algorithms for HFT strategies. *See, e.g.*, United States v. Agrawal, 726 F.3d 235, 237 (2d Cir. 2013); United States v. Aleynikov, 676 F.3d 71, 72 (2d Cir. 2012). While the CFTC can only bring civil enforcement actions against those who violate the CEA and the regulations promulgated thereunder, federal prosecutors can pursue felony criminal charges for such violations. *See Enforcement*, CFTC, http://www.cftc.gov/LawRegulation/Enforcement/OfficeofDirectorEnforcement.

[203] Indictment, United States v. Coscia, 14-CR-551 (N.D. Ill. Oct. 1, 2014) [hereinafter Coscia Indictment]; *see* Press Release, U.S. Attorney's Office, Northern District of Illinois, High-Frequency Trader Indicted For Manipulating Commodities Futures Markets in First Federal Prosecution For

in violation of a federal prohibition against commodities fraud,[204] and in violation of the applicable provisions of the CEA, Sections 4c(a)(5)(C) and 9(a)(2), that make spoofing a felony.[205] The indictment broadly characterizes Coscia's computer-automated, high-speed spoofing in the futures markets as fraudulent behavior that deceived other market participants, stating, inter alia, that Coscia "intended to trick other traders into reacting to the false price and volume information he created with his fraudulent and misleading" orders for trades.[206] The indictment further states that "Coscia devised [his high-speed spoofing] strategy to create a false impression regarding the number of contracts available in the market, and to fraudulently induce other market participants to react to the deceptive market information he created."[207] Each count of commodities fraud carries a maximum sentence of twenty-five years in prison and a $250,000 fine, while each count of spoofing carries a maximum penalty of ten years in prison and a $1 million fine.[208]

Lastly, because Section 4c(a)(5)(C) also prohibits conduct that is "of the character of" spoofing, the CFTC might be able to invoke this statutory provision to combat more trading practices than those that fall firmly within the ambit of the definition of spoofing. In this manner, CEA Section 4c(a)(5)(C) could serve as a catch-all provision to prohibit all manner of disruptive trading practices that are accomplished, in whole or in part, by the successive placement and immediate cancelation of orders for trades, or analogous behavior. Spoofing also is prohibited in the securities markets.[209]

"Spoofing", (Oct. 2, 2014) [hereinafter Press Release, *High-Frequency Trader Indicted*], *available at* http://www.justice.gov/usao/iln/pr/chicago/2014/pr1002_01.html.

[204] The first six counts of the indictment were violations of the federal prohibition against commodity fraud. Coscia Indictment, *supra* note 203, at Counts One to Six (violations of 18 U.S.C. § 1348).

[205] The last six counts of the indictment referenced violations of CEA Sections 4c(a)(5)(C) and 9(a)(2). *Id.*, at Counts Seven to Twelve. Prosecutors charged Coscia with violating both CEA Sections 4c(a)(5)(C) and 9(a)(2) because the two provisions work together. Section 4c(a)(5)(C) contains the prohibition on spoofing and Section 9(a)(2) provides that it is a felony to violate, inter alia, CEA Section 4c.

[206] *Id.* at ¶ 10.

[207] *Id.* at ¶ 3. The indictment also states that "[i]t was further part of the scheme that Coscia did misrepresent, conceal, and hide, and cause to be misrepresented, concealed and hidden, the true acts and the purposes of the acts done in furtherance of the scheme." *Id.* at ¶ 14.

[208] *See* Marek, *Chicago Feds Crack Down on High-Speed Trading*, *supra* note 201 ("'Another front has been opened in the ongoing battle,' said James Angel, an associate professor at Georgetown University who specializes in the structure and regulation [of] financial markets.").

[209] *See* SEC v. Shpilsky, Litigation Release No. 17221, 2001 WL 1408740, at *1 (D.D.C. 2001) ("In separate administrative proceedings, without admitting or denying the Commission's findings, Shenker and the Blackwells consented to cease and desist from violating the antifraud provisions of the federal securities laws and pay disgorgement plus interest of $7,206 and $3,213, respectively."); *In re* Visionary Trading, LLC, Admin. Proceeding File No. 3-15823, 2014 WL 1338258, at ¶ 35 (SEC Apr. 4, 2014) (stating that, by engaging in spoofing, one of the defendants "willfully violated Section 10(b)

B. *Price Manipulation and False Reporting*

In analyzing the new CFTC Rule 180.1, it helps to understand the pre-Dodd-Frank Act causes of action for price manipulation and false reporting as a basis for comparison. A leading derivatives law treatise describes "price manipulation" in the following manner:

> The phrase *price manipulation* . . . means the elimination of effective price competition in a market for cash commodities or futures contracts (or both) through the domination of either supply or demand and the exercise of that domination intentionally to produce artificially high or low prices. Price manipulation is kindred to the exercise of monopoly power to dictate prices that would be unachievable in a truly competitive environment. The existence of price manipulation is largely a factual question involving determinations whether the requisite domination or

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of the Exchange Act and Rule 10b-5 thereunder"); *In re* Hold Bros. On-Line Inv. Servs., Admin. Proceeding File No. 3-15046, 2012 WL 4359224, at ¶ 2 (S.E.C. Sept. 25, 2012) (stating that the brokerage firm failed to adequately monitor traders that "engaged in a manipulative trading strategy typically referred to as 'layering' or 'spoofing'"); John Connor, *No Joke: NASD Plans Crackdown on 'Spoofing,' Placing and Canceling a Quote to Spark a Move*, WALL ST. J., Feb. 28, 2000, at C9 (discussing the NASD's plans for spotting and stopping those who are spoofing); Press Release 2014-67, SEC, SEC Charges Owner of N.J.-Based Brokerage Firm With Manipulative Trading (Apr. 4, 2014), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370541406190 (stating that the SEC had "charged the owner of a Holmdel, N.J.-based brokerage firm with manipulative trading of publicly traded stocks through an illegal practice known as 'layering' or 'spoofing'"); David Barboza, *S.E.C. Moves Against Day-Trading Broker*, N.Y. TIMES (Dec. 19, 2012), http://dealbook.nytimes.com/2012/12/19/s-e-c-moves-against-day-trading-broker/?_php=true&_type=blogs&_r=0 (stating that the SEC, inter alia, "revoked the license of a Canadian brokerage firm" whose "day traders . . . engaged in manipulative practices known as 'layering, 'gaming' or 'spoofing'"); Greg Farrell, *Traders Bilked Investors with Deceptive Tactics, SEC Says*, BLOOMBERG (Apr. 4, 2014), http://www.bloomberg.com/news/2014-04-04/traders-bilked-investors-with-high-speed-tactic-sec-says.html (quoting an SEC official as saying that "[t]he fair and efficient functioning of the markets requires that prices of securities reflect genuine supply and demand" and that "[t]raders who pervert these natural forces by engaging in layering or some other form of manipulative trading invite close scrutiny by the SEC"); Sarah N. Lynch, *U.S. SEC Charges Trading Firm Owner, Others in 'Spoofing' Case*, REUTERS (Apr. 4, 2014), http://www.reuters.com/article/2014/04/04/sec-enforcement-spoofing-idUSL1N0MW11G20140404 ("U.S. securities regulators filed charges against two trading firms and five individuals on Friday in a case involving an illegal manipulative trading practice known as 'spoofing.'"). Further, spoofing violates the rules of the Financial Regulatory Authority (FINRA), the securities industry SRO. *See* News Release, FINRA, FINRA Joins Exchanges and SEC in Fining Hold Brothers More Than $5.9 Million for Manipulative Trading, Anti-Money Laundering, and Other Violations (Sept. 25, 2012), *available at* https://www.finra.org/Newsroom/NewsReleases/2012/P17 8687; News Release, FINRA, FINRA Sanctions Trillium Brokerage Services, LLC, Director of Trading, Chief Compliance Officer, and Nine Traders $2.26 Million for Illicit Equities Trading Strategy (Sept. 13, 2010), *available at* http://www.finra.org/Newsroom/NewsReleases/2010/P121951. For a general discussion of how spoofing violates the CEA and federal securities laws, see D. Deniz Aktas, *Spoofing*, 33 REV. BANKING & FIN. L. 89 (2013).

> monopoly exists, whether an artificial price is caused by the exercise of that power and whether the dominant party specifically intended to bring about that artificial price.[210]

CEA Section 9(a)(2) prohibits any person from manipulating (or attempting to manipulate) the price of a commodity in interstate commerce, futures contract, or swap.[211] To state a claim for price manipulation, one must allege that the defendant (1) had the ability to influence market prices; (2) an artificial price existed; (3) the defendant caused the artificial price; and (4) the defendant specifically intended to cause the artificial price.[212] "An artificial price is a price that does not reflect basic forces of supply and demand."[213] The specific intent element is satisfied if the defendant "acted (or failed to act) with the purpose or conscious object of causing or effecting a price or price trend in the market that did not reflect the legitimate forces of supply and demand."[214] That is, "the necessary intent must attach to the creation of artificial prices, rather than simply to intentional trading that thereafter brought about unintended artificial prices," which means that "the manipulator must have a specific intent to create artificial prices."[215] Interestingly, the CFTC has brought price manipulation (or attempted price manipulation) claims for conduct that involved (1) banging the close,[216] (2) wash trading,[217] and (3)

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[210] JOHNSON & HAZEN, *supra* note 78, at § 5.02[3].

[211] 7 U.S.C. § 13(a)(2) (2012). Sections 6(c) and 6(d) authorize the CFTC to file a complaint and impose, inter alia, civil monetary penalties and cease and desist orders if the CFTC believes that a person has manipulated or attempted to manipulate the market price of any commodity, futures contract, or swap (or has violated any of the provisions of the CEA). 7 U.S.C. § 9 (2012) (codifying CEA § 6(c)); 7 U.S.C. § 13(b) (2012) (codifying CEA § 6(d)). For that reason, some refer to CEA Sections 6(c), 6(d), and 9(a)(2) as collectively prohibiting price manipulation. Technically, Section 9(a)(2) makes it a felony to, among other things, manipulate the price of a futures contract, swap, or other derivative, but Section 6(c) enables the CFTC, which cannot prosecute criminal cases, to bring civil injunctive actions for violations of the CEA.

[212] CFTC v. Parnon Energy Inc., 875 F. Supp. 2d 233, 244 (S.D.N.Y. 2012). To prove attempted manipulation under CEA Section 9(a)(2), the CFTC must prove: (1) a specific intent to affect the market price, and (2) overt acts in furtherance of that specific intent. Intent may be inferred from the totality of circumstances. *In re* Hohenberg Bros., [1975-1977 Trans. Binder] Comm. Fut. L. Rep. (CCH) ¶20,271, at 21,477 (CFTC Feb. 18, 1997).

[213] *Parnon*, 875 F. Supp. 2d at 246 (internal quotation and citations omitted). In 2011, the CFTC promulgated Rule 180.2, 17 C.F.R. § 180.2, which mirrors traditional price manipulation (and attempted price manipulation) claims. *See* Manipulative and Deceptive Device Prohibitions, 76 Fed. Reg. 41,398, 41,407 (July, 14, 2011) ("[I]n applying final Rule 180.2, [the CFTC] will be guided by the traditional four-part test for manipulation that has developed in case law arising under [CEA Sections] 6(c) and 9(a)(2).").

[214] *Parnon*, 875 F. Supp. 2d at 249 (internal quotation and citations omitted).

[215] JOHNSON & HAZEN, *supra* note 78, at § 5.05[1]; s*ee also* Hershey v. Energy Transfer Partners, L.P., 610 F.3d 239, 248 (5th Cir. 2010) (discussing the plaintiff's attempt to prove intent to manipulate the price of natural gas).

[216] As mentioned earlier, "banging the close" violates CEA § 4c(a)(5)(B), codified at 7 U.S.C. § 6c(a)(5)(B), which was added to the CEA by the Dodd-Frank Act. But the CFTC has civilly prosecuted

spoofing.[218]

1. *Manipulation by False Reports—Made Famous by the LIBOR Scandal*

Another method of market manipulation involves spreading false

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such activity with the statutory provisions prohibiting price manipulation in CEA §§ 6(c), 6(d), and 9(a)(2), codified at 7 U.S.C. §§ 9, 13(b), and 13(a)(2). *See* CFTC v. Wilson, No. 13 Civ. 7884(AT), 2014 WL 2884680, at *20 (S.D.N.Y. 2014) (denying a motion to dismiss where a high-speed trading firm was accused of banging the close in violation of CEA § 6(c) and § 9(a)(2)); CFTC v. Amaranth Advisors, L.L.C., 554 F. Supp. 2d 523, 535 (S.D.N.Y. 2008) (denying a motion to dismiss the CFTC's complaint and finding sufficient allegations of manipulation); *In re* Shak, CFTC Docket No. 14-03, 2013 WL 7085760, at *1 (C.F.T.C. Nov. 25, 2013) (stating that the defendant violated the prohibitions on attempted price manipulation contained in CEA Sections 6(c), 6(d) and 9(a)(2) by banging the close in palladium and platinum futures contracts in Light Sweet Crude Oil futures contracts); *In re* Pia, CFTC Docket No. 11-17, 2011 WL 3228315, at *1 (C.F.T.C. July 25, 2011) (stating that the defendant violated the prohibitions on attempted price manipulation contained in CEA Sections 6(c), 6(d) and 9(a)(2) by banging the close in palladium and platinum futures contracts); *In re* Moore Capital Mgmt., LP, CFTC Docket No. 10-09, 2010 WL 1767196, at *1 (C.F.T.C. Apr. 29, 2010) (denying a motion to dismiss the CFTC's complaint and finding sufficient allegations of manipulation); David Sheppard, *Firm Pays $14m To Settle Oil Price Manipulation Case*, THE DAILY GLEANER (NEW BRUNSWICK), Apr. 21, 2012, at D1 ("In its first major case against an algorithmic trader" and the biggest financial penalty involving manipulation in the oil futures market, "the [CFTC] said" late Thursday that "a court settlement required the Amsterdam-based firm to pay $1 million in profits and an additional $13 million over allegations it used a rapid-fire tool nicknamed 'The Hammer' to influence U.S. oil prices in 2007."); Landon Thomas, Jr., *Inquiry Stokes Unease Over Trading Firms that Shape Markets*, N.Y. TIMES, Sept. 4, 2009, at B1 (noting that the recent allegations against Optiver are raising concerns for trading firms); Press Release 6766-13, CFTC, CFTC Charges Donald R. Wilson and His Company, DRW Investments, LLC, with Price Manipulation (Nov. 6. 2013), *available at* http://www.cftc.gov/PressRoom /PressReleases/pr6766-13 ("Wilson and DRW allegedly executed a manipulative strategy to move the Three-Month Contract market price in their favor by 'banging the close' . . . ."); David Sheppard & Jonathan Stempel, *High-frequency Trader Optiver Pays $14 Million in Oil Manipulation Case*, REUTERS (Apr. 20, 2012), http://www.reuters.com/article/2012/04/20/us-optiver-settlement-idUSBRE8 3J01220120420 ("The [CFTC] alleged that traders in Optiver's Chicago office reaped a $1 million profit by engaging in a practice called 'banging the close,' in which the firm attempted to move U.S. oil prices by executing a large volume of deals during the final moments of trading.").

[217] Under the anti-manipulation provisions of the CEA, wash sales can be viewed as part of a price manipulation scheme. *See, e.g.*, *In re* W. States Wholesale Nat. Gas Antitrust Litig., 661 F. Supp. 2d 1172, 1181 (D. Nev. 2009) (denying a motion for judgment on the pleadings, stating that "accepting as true the allegations in the pleadings that Defendants conspired to manipulate natural gas prices through devices such as intentionally engaging in prearranged wash trades involving roughly the same price and volume, and intentionally engaging in churning designed to create a false impression of supply and demand, such conduct is prohibited under the CEA"); *In re* Nat. Gas Commodity Litig., 337 F. Supp. 2d 498, 504 (S.D.N.Y. 2004) (alleging that the defendants participated in wash trading that manipulated gas futures prices).

[218] *See* CFTC v. Moncada, No. 12 Civ. 8791(CM), 2014 WL 3533990, at *1 (S.D.N.Y. Dec. 4, 2012) (discussing the District Court's decision largely endorsing the CFTC's view of the case and scheduling a bench trial to resolve the sole open factual issue of Moncada's intent); Moncada Compl., *supra* note 193, at ¶¶ 29, 41, 43, 46, 48–51, 54 (alleging that the defendant had attempted to manipulate the prices of futures contracts by entering and immediately canceling orders to create the "misleading impression of increasing liquidity"); Moncada Press Release, *supra* note 193 ("CFTC seeks civil monetary penalties, trading and registration bans, and permanent injunctions . . . .").

rumors or reports about crop or market information.[219] Specifically, CEA Section 9(a)(2) also makes it unlawful for

> [a]ny person to manipulate or attempt to manipulate the price of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, or of any swap, . . . or knowingly to deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.[220]

To state a claim for false reporting, the CFTC must allege (1) that a defendant knowingly transmitted or delivered market reports or market information through interstate commerce, (2) that the reports or information were knowingly false, misleading, or inaccurate, and (3) that the reports or information affected or tended to affect the price of a commodity in interstate commerce.[221] False reports claims have most of the hallmarks of standard fraud claims except that the misrepresentations are not typically targeted at select people, but instead are generally sent to an exchange or market information provider, and then communicated to the market as a whole. Using Section 9(a)(2)'s authority to prohibit false reports, the CFTC has, for example, investigated and filed suit against persons for manipulating or attempting to manipulate prices by reporting false information to energy industry publications.[222] But undoubtedly the

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[219] *See* Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971) ("The aim must be . . . to discover whether conduct has been intentionally engaged in which has resulted in a price which does not reflect basic forces of supply and demand."); CFTC v. Atha, 420 F. Supp. 2d 1373, 1379, 1383 (N.D. Ga. 2006) ("[T]he means of manipulation are 'limited only by the ingenuity of man'" (quoting *Cargill, Inc.*, 452 F.2d at 1163)); United Egg Prod. v. Bauer Int'l Corp., 311 F. Supp. 1375, 1383 (S.D.N.Y. 1970) (holding that a false report of an increase in supply is information that affects the market price of a commodity and therefore is actionable under CEA Section 9(a)(2)); 23A JERRY W. MARKHAM & THOMAS LEE HAZEN, BROKER-DEALER OPERATIONS SEC. & COMM. LAW § 9:17:50 (2013) (discussing the history of commodity manipulations); Note, *The Delivery Requirement: An Illusory Bar to Regulation of Manipulation in Commodity Exchanges*, 73 YALE L.J. 171, 175 (1963) ("[O]ther price movements may be the result of such deliberate trader activity as the spreading of rumors, undertaken to influence the market price for the trader's benefit.").

[220] Commodity Exchange Act, Pub. L. No. 74-675, § 9(a)(2), 49 Stat. 1491 (codified at 7 U.S.C. § 13(a)(2) (2012)).

[221] *Atha*, 420 F. Supp. 2d at 1380 (citing United States v. Valencia, 394 F.3d 352, 354 (5th Cir. 2004)); *see* Pirrong, *supra* note 162, at 5 (stating that an example of fraud-based manipulation would be when "a trader . . . misreport[s] the prices of transactions when price reports are used to determine the settlement price of a derivatives contract").

[222] CFTC v. Bradley, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,289 (N.D. Okla. 2006) (denying the defendant's motion for summary judgment as to claims involving alleged false reports to industry publications of natural gas prices); CFTC v. Foley, [2005-2007 Transfer

most famous CFTC case involving manipulation by false reports is the global investigation into the setting of the London Inter Bank Offered Rate (LIBOR)[223] in which traders at various banks worldwide, for the purpose of benefitting their swaps and derivatives trading positions, submitted false LIBOR rates to the organization that set the LIBOR, thereby manipulating the ubiquitous benchmark interest rate.[224] The CFTC has contended that this conduct constituted the making of false, misleading, and knowingly inaccurate reports concerning the cost of borrowing unsecured funds (which is what LIBOR purports to represent) in violation of CEA Section 9(a)(2).[225] At the time of this writing, seven financial institutions had reached settlements with the CFTC and other authorities, with fines and penalties totaling in the billions of dollars, and with more settlements likely to follow.[226]

Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,333, at 58,556 (S.D. Ohio 2006) (same); Dominion Resources, [2005-2007 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 30,331, at 58,546 (CFTC 2006) (finding, by consent, that the defendants had knowingly reported false and misleading information about natural gas transactions to industry publications such as Gas Daily and Inside FERC); Dynegy Mktg. & Trade, [2002-2003 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,262, at 54,500–01 (CFTC 2002) (finding, by consent, that the defendants engaged in manipulation and attempt manipulation by providing false reports about, among other things, nonexistent trades, to reporting services for natural gas price indexes); *see also* MARKHAM & HAZEN, *supra* note 219, at § 9:17:50 (discussing cases where persons were manipulating or attempting to manipulate market prices by reporting false information).

[223] Christine E. Edwards et al., *Implications for Commercial Organizations of the Global Investigation into LIBOR*, 129 BANKING L.J. 831, 831 (2012) ("LIBOR is the predominant benchmark interest rate used in commercial agreements globally.").

[224] Kristin N. Johnson, *Governing Financial Markets: Regulating Conflicts*, 88 WASH. L. REV. 185, 188–89 (2013) (discussing the LIBOR manipulation scandal). For further discussion on the LIBOR manipulation scandal, see generally Peter Eavis & Nathaniel Popper, *Libor Scandal Shows Many Flaws in Rate-Setting*, N.Y. TIMES (July 19, 2012), http://dealbook.nytimes.com/2012/07/19/libor-scandal-shows-many-flaws-in-rate-setting/?_r=0; *see also* Peter Eavis, *A Rate Setting Mechanism of Far-Reaching Effects*, N.Y. TIMES (June 28, 2012), http://dealbook.nytimes.com/2012/06/27/how-a-rate-mechanism-set-in-london-affects-americans/ (discussing specifically the rate setting system's global effects). During the relevant time, LIBOR was calculated daily by the British Bankers' Association, with the calculation rate made based on the submissions of banks selected by the Bankers' Association. Edwards, *supra* note 223, at 831–32. The allegations against certain banks focus on the submission of rates to the BBA, with the banks accused of submitting figures that were artificially high or low. *Id.* at 382.

[225] *E.g.*, Press Release, CFTC, CFTC Orders UBS to Pay $700 Million Penalty to Settle Charges of Manipulation, Attempted Manipulation and False Reporting of LIBOR and Other Benchmark Interest Rates (Dec. 19, 2012), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6472-12; *see also In re* UBS AG & UBS Secs. Japan Co. Ltd., CFTC Docket No. 13-09, 2012 WL 6642376, at *53–57 (C.F.T.C. Dec. 19, 2012) (treating the making of false, misleading, or knowingly inaccurate reports as a violation of CEA Section 9(a)(2)).

[226] The seven financial entities are: (1) Barclays, (2) UBS, (3) Royal Bank of Scotland, (4) Rabobank, (5) Icap, (6) RP Martin, and (7) Lloyds. *In re* Cooperatieve Centrale RaiffeisenBoerenleenbank, B.A. ("Rabobank"), CFTC No. 14-02, 2013 WL 5872872, at *1 (C.F.T.C. Oct. 29, 2013); Chad Bray, *Dutch Bank Settles Case Over Libor Deceptions*, N.Y. TIMES (Oct. 29, 2013, 8:37 P.M.), http://dealbook.nytimes.com/2013/10/29/rabobank-to-pay-more-than-1-billion-in-libor-settlement-chairman-resigns/ ("[Rabobank] is the fifth financial firm to settle accusations that its

Additionally, CEA Section 9(a)(2) also might be able to serve as the basis of a separate civil offense for delivering false, misleading, or knowingly inaccurate reports or information that tends to affect the price of a commodity, aside from serving as the basis for price manipulation claims under a manipulation-by-false-reports legal theory. The CFTC appears to have raised such claims in settlements and in litigation.[227] It is uncertain if the CFTC must prove specific intent in a non-manipulation Section 9(a)(2) false reports claim.[228] In any event, the "false reporting" clause in CEA Section 9(a)(2) uses the word "knowingly" so—at a minimum—intentional conduct appears to be required.[229]

C. *Spoofing as Violating Commodity Exchange Act Sections 4c(a)(2)(B) and 9(a)(2)*

Although not as well-reported as the LIBOR scandal, but perhaps more significant concerning innovative approaches to anti-manipulation law, the CFTC has argued that the act of spoofing violates CEA Section

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employees manipulated the London interbank offered rate, or Libor. The settlement with Rabobank is the second-largest agreement after the $1.5 billion penalty imposed on UBS related to the manipulation of benchmark rates, which help determine the borrowing costs for trillions of dollars of mortgages, business loans, credit cards and other financial products."); Chad Bray, *Lloyds Bank to Pay Over $380 Million to Resolve Rate Manipulation Inquiries*, N.Y. TIMES (July 28, 2014, 9:01 AM), http://dealbook.nytimes.com/2014/07/28/lloyds-to-pay-nearly-370-million-to-resolve-libor-investigations/; Chad Bray, *RP Martin Fined $2.2 Million in Libor Rigging*, N.Y. TIMES (May 15, 2014, 8:26 P.M.), http://dealbook.nytimes.com/2014/05/15/rp-martin-fined-more-than-2-million-in-libor-inquiry/?_php=true&_type=blogs&_r=0; Sara Webb et al., *Rabobank Faces Second-Biggest Fine in Libor Scandal*, REUTERS (Oct. 23, 2013), http://uk.reuters.com/article/2013/10/23/uk-rabobank-libor-idUKBRE99 M0Q920131023 (noting that U.S. and British authorities had fined Barclays, UBS, Royal Bank of Scotland, and ICAP (a broker) approximately $2.7 billion over the manipulation of LIBOR and other benchmark interest rates).

[227] "In a series of settlements with energy and power marketing companies in 2003 and 2004, the [CFTC's] orders often treated the quoted prohibited conduct and market manipulation as *separate* offenses . . . ." JOHNSON & HAZEN, *supra* note 78, at § 5.05[3] (citing *In re* Duke Energy Trading & Mktg. LLC, [2003-2004 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 29,582 (C.F.T.C. Sep. 17, 2003)). The CFTC also appears to have litigated a manipulation case in which the stated causes of action included (1) a manipulation by false reports claim and (2) a separate claim alleging false reports under Section 9(a)(2). *See* CFTC's Trial Brief at 1, CFTC v. Delay, No. 7:05CV5026, 2006 WL 1354512, at *2–4 (D. Neb. Apr. 26, 2006) (referring to separate claims, one of which alleged that the defendant manipulated the price of a futures contract by false reports in violation of CEA Sections 6(c), 6(d) and 9(a)(2), and another that accused the defendant of knowingly delivering false, misleading, or inaccurate reports in violation of Section 9(a)(2)). The CFTC's settlement orders with the business entities accused of manipulating LIBOR and other benchmark interest rates also appear to consider false reporting as a separate offense from price manipulation. *E.g.*, *In re* ICAP Europe Ltd., CFTC Docket No. 13-38, 2013 WL 5409329, at *30–35 (C.F.T.C. Sep. 25, 2013); *In re* UBS AG, 2012 WL 6642376, at *1–4 (C.F.T.C. Dec. 19, 2012).

[228] One derivatives law treatise has stated that "[t]he need to establish specific intent is less settled when the [CFTC] asserts a claim under [the false reporting clause of CEA section 9(a) . . . ." JOHNSON & HAZEN, *supra* note 78, at § 5.05[3].

[229] 7 U.S.C. § 13(a)(2) (2012).

4c(a)(2)(B)'s prohibition on causing non-bona fide prices to be reported and Section 9(a)(2)'s prohibition on causing the delivery of false, misleading, or knowingly inaccurate market information or reports that affect or tend to affect the price of any commodity.[230] In pursuing such claims, the CFTC has called orders for trades that one does not intend to execute "false orders."[231] For example, according to the CFTC, liability under Section 9(a)(2) for false reports follows if a trader makes "false orders" in the pre-opening trading session that are included in the indicative opening price (IOP)—i.e., the price at which the contract is expected to trade at the opening of trading[232]—that is published to market participants by an exchange.[233]

In recent years, two companies—Gelber Group and Bunge Global

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[230] CFTC v. Atha, 420 F. Supp. 2d 1372, 1380–81 (N.D. Ga. 2006) (holding that the scope of what constitute "reports" under CEA Section 9(a)(2) is not limited to "formal records or documents" but that, in light of, inter alia, "[t]he varied means of providing such reports" in the statute, "reports" is to be construed broadly); *In re* Bunge Global Mkts., Inc., CFTC Docket No. 11-10, 2011 WL 1099346, at *2, *5 (C.F.T.C. Mar. 22, 2011) ("The entry of the orders [for soybean futures] significantly affected Globex's Indicative Opening Price ('IOP') . . . . [B]ecause the traders had no intention of allowing the orders to be executed, the orders constituted false, misleading or knowingly inaccurate reports concerning crop or market information that affected or tended to affect the price of soybeans in violation of Section 9(a)(2) of the [CEA]. The IOP . . . was published to persons and entities that use such data to make pricing decisions relating to the purchase or sale of soybeans, a commodity in interstate commerce."); Press Release, CFTC, CFTC Sanctions Bunge Global Markets, Inc. $550,000 for Entering Pre-Market Soybean Futures Orders on Globex that Caused Non-Bona Fide Prices to be Reported (Mar. 22, 2011) [hereinafter CFTC Sanctions Bunge], *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6007-11 (stating that the traders' orders "caused significant distortion in Globex's [IOP]" and that "CME sends IOP information to Globex users and the CME market data feed, after which it is available to publishers of financial data, who disseminate the IOP information to the general public"); *see also* CFTC v. Moncada, No. 12 Civ. 8791(CM), 2014 WL 3533990, at *1 (S.D.N.Y. July 15, 2014) (noting that the defendant's trading practices constituted attempted manipulation if, as appeared likely, the defendant had acted with the requisite intent); Moncada Compl., *supra* note 193, at ¶¶ 31–32, 39, 43, 46, 50, 52 (filing a complaint alleging that spoofing created a "misleading impression of increasing liquidity" and thus constituted attempted manipulation in violation of CEA Sections 6(c), 6(d) and 9(a)(2)); Moncada Press Release, *supra* note 193 (filing a complaint alleging that spoofing created a "misleading impression of increasing liquidity" and thus constituted attempted manipulation in violation of CEA Sections 6(c), 6(d) and 9(a)(2)). The CFTC's approach to false reports in Bunge Global Markets has been criticized on the grounds that, inter alia, "section 9(a)(2) requires that the inaccurate reports 'affect or tend to affect the price of any commodity in interstate commerce,' and though the IOP does relate to the price of the underlying commodity to be traded, once the offending orders are cancelled, the IOP no longer reflects those orders." Matthew F. Kluchenek & Jacob L. Kahn, *Deterring Disruptions in the Derivatives Markets: A Review of the CFTC's New Authority over Disruptive Trading Practices*, HARV. BUS. L. REV. ONLINE 131 (Mar. 18, 2013), http://www.hblr.org/2013/03/deterring-disruption-in-the-derivatives-markets-a-review-of-the-cftcs-new-authority-over-disruptive-trading-practices/ [hereinafter Deterring Disruptions] (citation omitted).

[231] *E.g.*, *In re* Gelber Grp., LLC, CFTC Docket No. 13-15, 2013 WL 525839, at *3–4 (C.F.T.C. Feb. 8, 2013).

[232] Press Release, CFTC, CFTC Sanctions Gelber Group, LLC $750,000 for Trading Abuses on Two Exchanges (Feb. 8, 2013), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6512-13.

[233] *E.g.*, *In re Gelber Grp.*, 2013 WL 525839, at *2.

Markets—settled with the CFTC in connection with spoofing activities related to the IOP of futures contracts.[234]

> The alleged spoofing violations . . . occurred during the pre-opening session on CME's electronic trading platform, Globex. Orders cannot be executed during the pre-opening session. However, except for the last 30 seconds before the market opens, orders can be cancelled at any time. At pre-determined intervals, CME calculates what is known as an [IOP] using data from the unexecuted orders in Globex. Once the market opens, trading will begin at a price somewhere in-between the unexecuted bids and offers, and the IOP provides a running estimate of this figure. The IOP is sent to Globex users and recipients of CME's data feed, and becomes available to the public shortly thereafter.[235]

In the *Gelber Group* and *Bunge Global Markets* cases,[236] the traders in question "sent (and later cancelled) large orders into Globex during the pre-opening session at varying prices," with the large orders "mov[ing] the IOP up or down, depending on the prices in the orders."[237] In this manner, "[t]he sanctioned traders . . . were able to discern the depth of support at different price levels because they knew the IOP had moved in response to their orders."[238] The CFTC stated that the traders had violated CEA Sections 4c(a)(2)(B)—causing non-bona fide prices to be reported—and 9(a)(2)—causing false, misleading, or knowingly inaccurate reports to be delivered that affect the price of a commodity.[239]

In the *Bunge Global Markets* case, the CFTC stated that the traders "sought to gain an advantage over other traders" by entering orders in the pre-opening session to test the market depth in a futures contract, thereby "obtain[ing] information that was unavailable to other traders."[240] The CFTC also noted in the *Bunge Global Markets* case that "[t]he trader acknowledged that on occasion he had entered orders in the pre-opening

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[234] *Id.* at *1; *In re Bunge Global Mkts.*, at *1. The CFTC also fined former Gelber Group trading manager Martin A. Lorenzen for engaging in wash sales. *In re* Lorenzen, CFTC Docket No. 13-16, 2013 WL 525841, at *4–5 (C.F.T.C. Feb. 8, 2013); Press Release 6512-13, CFTC, CFTC Sanctions Gelber Group, LLC $750,000 for Trading Abuses on Two Exchanges (Feb. 8, 2013), *available at* http://www.cftc.gov/PressRoom/Press Releases/pr6512-13.

[235] Kluchenek & Kahn, *supra* note 230, at 130 (citing *In re Gelber Grp.*, 2013 WL 525839; *In re Bunge Global Mkts.*, 2011 WL 1099346).

[236] *In re Gelber Grp.*, 2013 WL 525839; *In re Bunge Global Mkts.*, CFTC Docket No. 11-10, 2011 WL 1099346 (C.F.T.C. March 22, 2011)/

[237] Kluchenek & Kahn, *supra* note 230, at 130.

[238] *Id.* at 131.

[239] *In re Gelber Grp.*, 2013 WL 525839, at *3–4; *In re Bunge Global Mkts.*, 2011 WL 1099346, at *3–4.

[240] *In re Bunge Global Mkts.*, 2011 WL 1099346, at *1.

that he did not intend to fill for the purpose of probing the market."[241] In the *Gelber Group* case, the CFTC stated that the trader in question "entered the orders in the pre-open session for the NASDAQ E-mini [futures] contract for the purpose of seeing where the offers were so he could use that information in making trading decisions."[242] In both cases, the CFTC stated that "[t]he orders were false and misleading because [the traders in question] did not intend to execute the orders."[243] As such, the CFTC seems to view sending orders for trades solely for the purpose of probing the market for a futures contract (and without the intention of executing those orders for trades) as (1) giving the perpetrators an unfair advantage in the form of information "that [is] unavailable to other traders"[244] and (2) spreading "false and misleading"[245] prices in the market. Put simply, the CFTC appears to believe that a trader who submits orders for trades without the intention of executing those orders is misleading others, and a trader who uses such a strategy to probe the market is unfairly gaining information at the expense (and exclusion) of other market participants.

One could argue that CEA Sections 4c(a)(2)(B) and 9(a)(2) are poor vehicles to combat spoofing,[246] and, indeed, the CFTC might rely on the Dodd-Frank Act's anti-spoofing provision—i.e., CEA Section 4c(a)(5)(C)[247]—to combat such violations in the future. But given that it has been said that manipulative schemes are limited only by the human ingenuity,[248] one could argue that the CFTC's use of its statutory and regulatory tools must also, at times, be equally creative to meet the challenges posed by new manipulative schemes.

D. *The Commodity Futures Trading Commision's Clone of Securities and Exchange Commission Rule 10b-5: Rule 180.1*

Section 753 of the Dodd-Frank Act's amended subsection 6(c)(1) of the CEA[249] to enhance the CFTC's ability to police market manipulation

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[241] *Id.* at *3.

[242] *In re Gelber Grp.*, 2013 WL 525839, at *2.

[243] *Id.* at *4; *In re Bunge Global Mkts.*, 2011 WL 1099346, at *4.

[244] *In re Bunge Global Mkts.*, 2011 WL 1099346, at *1.

[245] *Id.* at *4; *In re Gelber Grp.*, 2013 WL 525839, at *4.

[246] Kluchenek & Kahn, *supra* note 230, at 131 ("Neither of these sections, however, clearly fits the charge of spoofing. In particular, section 4c(a)(2)(B) requires a 'transaction,' and an unexecuted order does not clearly constitute a 'transaction.' Similarly, section 9(a)(2) requires that the inaccurate reports 'affect or tend to affect the price of any commodity in interstate commerce,' and though the IOP does relate to the price of the underlying commodity to be traded, once the offending orders are cancelled, the IOP no longer reflects those orders.").

[247] *Supra* text accompanying note 173.

[248] Cargill, Inc. v. Hardin, 452 F.2d 1154, 1163 (8th Cir. 1971) ("The methods and techniques of manipulation are limited only by the ingenuity of man.").

[249] 7 U.S.C. § 9 (2012).

and fraud by inserting language into the CEA that mirrors the SEC's catch-all prohibition against deceptive and manipulative devices—Section 10(b) of the Exchange Act.[250] Section 10(b) provided the SEC with its basis for promulgating SEC Rule 10b-5[251]—its multi-purpose tool for fighting fraud and manipulation.[252] On July 7, 2011, the CFTC unanimously voted to adopt final Rule 180.1,[253] which implements "the statutory prohibition under CEA section 6(c)(1) against using or employing 'any manipulative or deceptive device or contrivance' in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity."[254] The CFTC modeled Rule 180.1 on SEC Rule 10b-5.[255] In its final rule release, the CFTC stated:

> Final Rule 180.1 prohibits fraud and fraud-based

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[250] Manipulative and Deceptive Device Prohibitions, 76 Fed. Reg. 41,398, 41,399 (July 14, 2011) ("T]he language of CEA section 6(c)(1), particularly the operative phrase 'manipulative or deceptive device or contrivance,' is virtually identical to the terms used in section 10(b) of the Securities Exchange Act of 1934 ('Exchange Act')."). "Given the similarities between CEA section 6(c)(1) and Exchange Act section 10(b), the [CFTC] deems it appropriate and in the public interest to model final Rule 180.1 on SEC Rule 10b-5." *Id*. The CFTC further stated that "by modeling final Rule 180.1 on SEC Rule 10b-5, the [CFTC] takes an important step toward harmonization of regulation of the commodities, commodities futures, swaps and securities markets." *Id.* at 41,399 n.11.

[251] 17 C.F.R. § 240.10b-5 (2014).

[252] Manipulative and Deceptive Device Prohibitions, 76 Fed. Reg. at 41,399.

[253] 17 C.F.R. § 180.1 (2014); *see also* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,398 (July 14, 2011) (reporting the adoption of CFTC Rule 180.1); Press Release, CFTC, Open Meeting on Five Final Rule Proposals under the Dodd-Frank Act (July 7, 2011), *available at* http://www.cftc.gov/Press Room/Events/opaevent_cftcdoddfrank070711 (showing a unanimous vote). The new anti-fraud and anti-manipulation provisions became effective on August 15, 2011. Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,398. The CFTC had issued its notice of proposed rulemaking on October 26, 2010, which was published in the Federal Register on November 3, 2010. *Id.* (citing Prohibition of Market Manipulation, 75 Fed. Reg. 67,657).

[254] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,399. For an in-depth analysis of Rule 180.1 see generally Rosa M. Abrantes-Metz et al., *Revolution in Manipulation Law: The New CFTC Rules and the Urgent Need for Economic and Empirical Analyses*, 15 U. PA. J. BUS. L. 357 (2013).

[255] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,399 ("Given the similarities between CEA section 6(c)(1) and Exchange Act section 10(b), the [CFTC] deems it appropriate and in the public interest to model final Rule 180.1 on SEC Rule 10b-5."). The CFTC further stated that "by modeling final Rule 180.1 on SEC Rule 10b-5, the [CFTC] takes an important step toward harmonization of regulation of the commodities, commodities futures, swaps and securities markets." *Id.* at 41,399 n.11; *see also Fact Sheet: Anti-Manipulation and Anti-Fraud Final Rules*, CFTC (July 7, 2011), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/ amaf_factsheet_final.pdf ("Final Rule 180.1, which is modeled on Securities and Exchange Commission Rule 10b-5, broadly prohibits manipulative and deceptive devices and contrivances, employed intentionally or recklessly, regardless of whether the conduct in question was intended to create or did create an artificial price.").

> manipulations, and attempts: (1) By any person (2) acting intentionally or recklessly (3) in connection with (4) any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity (as defined in the CEA).[256]

Rule 180.1 prohibits fraud-based manipulation claims under a lower scienter standard of recklessness, as opposed to CEA Sections 6(c), 6(d), and 9(a)(2), which require proof of specific intent.[257] In the final rule release, the CFTC stated that it was not taking a position on the application of the fraud-on-the-market theory in connection with Rule 180.1.[258] In the securities law context, the CFTC noted that the American Bar Association Derivatives Committee stated that the fraud-on-the-market theory:

> establishes a rebuttable presumption in private rights of action under Exchange Act Section 10(b) and SEC Rule 10b-

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[256] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,400. A violation of Rule 180.1 does not necessarily "require[] proof of a market or price effect." *Id.* at 41,401. In relevant part, Rule 180.1(a) states the following:

> It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or recklessly: (1) Use or employ, or attempt to use or employ, any manipulative device, scheme, or artifice to defraud; (2) Make, or attempt to make, any untrue or misleading statement of a material fact or to omit to state a material fact necessary in order to make the statements made not untrue or misleading; (3) Engage, or attempt to engage, in any act, practice, or course of business, which operates or would operate as a fraud or deceit upon any person; or, (4) Deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate. Notwithstanding the foregoing, no violation of this subsection shall exist where the person mistakenly transmits, in good faith, false or misleading or inaccurate information to a price reporting service.

17 C.F.R. § 180.1(a).

[257] *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,404 ("Upon consideration of all the comments in this rulemaking record, the [CFTC] clarifies that a showing of recklessness is, at a minimum, necessary to prove the scienter element of final Rule 180.1."). The CFTC stated "that final Rule 180.1 does not reach inadvertent mistakes or negligence." *Id.* at 41,405 & n.90 ("Consistent with the Supreme Court's interpretation of Exchange Act section 10(b) in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 206 (1976), the [CFTC] finds no indication in CEA section 6(c)(1) that Congress intended anyone to be made liable for a violation of final Rule 180.1 unless he or she acted other than in good faith."). "Under final Rule 180.1, the plaintiff bears the burden of proving the violation by a preponderance of the evidence." *Id.* at 41,405.

[258] *Id.* at 41,403.

> 5 that in an efficient market for a security a plaintiff can be held to have relied on a defendant's fraudulent misrepresentation or omission in connection with the purchase or sale of a security—even if the plaintiff was not aware of the misrepresentation or omission—by virtue of the plaintiff's reliance on the fact that a security's price reflects the fraudulent misrepresentation and omission . . . .[259]

The CFTC stated that a feature of the fraud-on-the-market theory is to enable private plaintiffs in securities fraud lawsuits to establish the reliance element of their claims.[260] The CFTC stated that its view on the fraud-on-the-market theory under Rule 180.1 was accordingly beyond the scope of the rulemaking because the CFTC, like the SEC, does not need to prove reliance in litigating cases involving fraudulent conduct in the financial markets.[261]

1. *Legislative History of Commodity Exchange Act Section 6(c)(1)*

United States Senator Maria Cantwell, the sponsor of Section 753 of the Dodd-Frank Act, stated that Section 753's purpose was to "strengthen[] the Commodity Futures Trading Commission's authority to go after manipulation and attempted manipulation in the swaps and commodities markets."[262] Senator Cantwell was critical of the specific intent scienter requirement for price manipulation under then-existing federal law, stating:

> Current law makes it very difficult for the [CFTC] to prove market manipulation. The CFTC has to prove that someone had specific intent to manipulate, and that is a very difficult standard to prove. Most individuals don't write an e-mail, for example, saying they intend to manipulate prices, but that is currently what the law requires the [CFTC] to prove: "specific intent" to manipulate. As a result of this, the Federal courts have recognized that with the CFTC's weaker anti-manipulation standard, market "manipulation cases

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[259] *Id.* at 41,402 n.50 (citations and emphasis omitted); *see* Basic, Inc. v. Levinson, 485 U.S. 224, 247 (1988) ("An investor who buys or sells stock at the price set by the market does so in reliance on the integrity of that price."). *But see* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2417 (2014) (holding that, prior to class certification, defendants could attempt to overcome the presumption that stock price reflected material misrepresentations).

[260] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,403.

[261] *Id.*

[262] 156 CONG. REC. S3348 (daily ed. May 6, 2010) (statement of Sen. Cantwell). Senator Cantwell further stated that "current law does not have enough protections for our consumers" and that "[w]e want the CFTC to have strong tools to go after this kind of behavior." *Id.*

generally have not fared so well."[263]

Although the CFTC rule release stated that, "[t]o account for the differences between the securities markets and the derivatives markets, the [CFTC] will be guided, but not controlled, by the substantial body of judicial precedent applying the comparable language of SEC Rule 10b-5,"[264] the legislative history shows that Senator Cantwell intended for securities-law precedent to guide interpretation of CEA Section 6(c)(1) and Rule 180.1. In explaining the objectives of Section 753, Senator Cantwell explicitly referenced decisional law under SEC Rule 10b-5, indicating that "[t]his language in this amendment is patterned after the law that the SEC uses to go after fraud and manipulation; that there can be no manipulative devices or contrivances. It is a strong and clear legal standard that allows regulators to successfully go after reckless and manipulative behavior."[265] Senator Blanche Lincoln stated that Section 753 of the Dodd-Frank Act was needed because "[m]arket manipulation is an ever-present danger in derivatives trading" and that the "integrity [of the markets] must be

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[263] *Id*. (citation omitted); *see In re* Soybean Futures Litig., 892 F. Supp. 1025, 1043 (N.D. Ill. 1995) ("The court recognizes that manipulation cases generally have not fared well with either the CFTC or the courts.").

[264] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,399. "Such extensive judicial review serves as an important benefit to the [CFTC] and provides the public with increased certainty because the terms of Exchange Act Section 10(b) and SEC Rule 10b–5 have withstood challenges to their constitutionality in both civil and criminal matters." *Id.* Senator Cantwell stated that courts should look to Exchange Act Section 10(b) and Rule 10b-5 decisional law in interpreting CEA Section 6(c)(1):

> In the 75 years since the enactment of the Securities and Exchange Act of 1934, a substantial body of case law has developed around the words "manipulative or deceptive devices or contrivances." The Supreme Court has compared this body of law to "a judicial oak which has grown from little more than a legislative acorn." It is worth noting that the courts have held the SEC's authority is not intended to catch sellers who take advantage of natural market forces or supply and demand, only those who attempt to affect the market or price by artificial means unrelated to the natural forces of supply and demand.

156 CONG. REC. S3348 (daily ed. May 6, 2010) (statement of Sen. Cantwell). Senator Cantwell's "judicial oak" statement was a quotation from a U.S. Supreme Court decision penned by former Chief Justice Rehnquist. *See* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) ("When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.").

[265] 156 CONG. REC. S3348 (daily ed. May 6, 2010) (statement of Sen. Cantwell). Senator Cantwell further stated that "[t]his legislation tracks the Securities Act in part because Federal case law is clear that when the Congress uses language identical to that used in another statute, Congress intended for the courts and the Commission to interpret the new authority in a similar manner, and Congress has made sure that its intention is clear." *Id.* The federal precedent surrounding Rule 10b-5 has been called "the world's most powerful body of antifraud law." *See* Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 581 (2011) ("[T]he real questions are what fraud is as a concept and which conception of fraud the world's most powerful body of antifraud law is pursuing.").

preserved."[266] Senator Cantwell stated that Dodd-Frank Act Section 753's language contained a "strong antimanipulation [sic] standard" that "will truly put a policeman on the beat and stop the kind of manipulation that has occurred in these commodities markets."[267]

2. *Comments of Commissioners and Commodity Futures Trading Commission Officials About Rule 180.1's Scope*

In unanimously adopting Rule 180.1, the CFTC's Commissioners and David Meister, the CFTC's Enforcement Director at the time, echoed the sentiments of Senator Cantwell that Section 6(c)(1) would enable the CFTC to better police the derivatives markets. For example, Meister told the Commissioners:

> Under Section 6(c)(1) and Rule 180.1, the [CFTC] will also have the authority to bring enforcement actions against and sanction defendants who recklessly engage in acts of fraud and deception in connection with swaps, commodity and futures transactions. In this regard, we will have [the] advantage of looking through the lens of a substantial body of well-settled precedent, applying comparable laws and rules in the securities context.[268]

Similarly, the CFTC's then-chairman, Gary Gensler, in speaking before voting to approve the rule release that included Rule 180.1, stated that Rule 180.1 would "broaden the types of cases we can pursue and improve the chances of prevailing over wrongdoers" because, unlike the CEA's traditional antimanipulation prohibition, Rule 180.1 can reach "the reckless use of fraud-based manipulation schemes."

> In the past the CFTC has had the ability to prosecute manipulation, but to prevail it had to prove the specific intent of the accused to create an artificial price. Under the new law

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[266] 156 CONG. REC. S3349 (daily ed. May 6, 2010) (statement of Sen. Lincoln). Additionally, Senator Lincoln stated:

> I wholeheartedly support Senator CANTWELL's amendment, which takes the significant step of adding a new and versatile standard for deceptive and manipulative practices under the Commodity Exchange Act. . . . Senator CANTWELL's amendment will give the CFTC a very important new weapon in its arsenal to combat ever-evolving forms of manipulative trading schemes that undermine public confidence in the proper functioning of these markets.

Id.

[267] 156 CONG. REC. S3348 (daily ed. May 6, 2010) (statement of Sen. Cantwell).

[268] CFTC, OPEN MEETING ON FIVE FINAL RULE PROPOSALS UNDER THE DODD-FRANK ACT 1, 37 (July 7, 2011) [hereinafter Transcript of Open Meeting] (statement of Director Meister), *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmissionmult_070711-trans.pdf.

> in one of the rules before us today, the [CFTC's] anti-manipulation reach is extended to prohibit the reckless use of fraud-based manipulation schemes. This closes a significant gap as it will broaden the types of cases we can pursue and improve the chances of prevailing over wrongdoers.[269]

Likewise, then-Commissioner Bart Chilton referred to Rule 180.1 as "serious and significant new ammo in our enforcement arsenal."[270] Further emphasizing the importance of the CFTC's new fraud-based manipulation prohibition, Meister stated, "[i]n my opinion, Section 6(c)(1) is one of the most important provisions of Dodd-Frank. It enhances [the CFTC's] ability to promote market integrity and protect market participants from all manner of fraud and manipulation."[271]

The broad scope of the kind of improper behavior covered by Exchange Act Section 10(b) and SEC Rule 10b-5, and the flexibility with which courts have interpreted those provisions, is a large part of what makes securities-law precedent a useful model for CEA Section 6(c)(1) and Rule 180.1. As mentioned previously, courts have stressed that SEC Rule 10b-5 is a flexible remedy that can be invoked to prohibit new and innovative manipulative and deceptive devices on the grounds that "[m]anipulative schemes may not be allowed to succeed solely because they are novel."[272] This fluid approach is appropriate because "[t]he purpose of Section 10(b) is 'to keep the channels of interstate commerce, the mail, and national securities exchanges pure from fraudulent schemes, tricks, devices, and all forms of manipulation', and 'to outlaw the employment of manipulative or deceptive devices or contrivances, however novel or atypical.'"[273]

Rule 180.1's reach is especially broad given that the rule (as with CEA

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[269] *Id.* at 40–41 (statement of Chairman Gensler).

[270] *Id.* at 51 (statement of Commissioner Chilton).

[271] *Id.* at 34 (statement of Director Meister).

[272] Crane Co. v. Westinghouse Air Brake Co., 419 F.2d 787, 793 (2d Cir. 1969); *see* Donald C. Langevoort, *Rule 10b-5 as an Adaptive Organism*, 61 FORDHAM L. REV. S7, S8 (1993) (stating that SEC Rule 10b-5 has, throughout its history, been able to adapt not only to cover new forms of fraud but also to "embrace[] new ideas and images about investing that achieve some level of elite social consensus"); *see also id.* at S7 ("The attribution of a fluid character to Rule 10b-5 is not a novel insight. The rule has long been praised as being sufficiently open ended so as to avoid presenting a blueprint for fraud, tempting the 'versatile inventions of fraud-doers.'" (internal quotation marks omitted)).

[273] Smallwood v. Pearl Brewing Co., 489 F.2d 579, 590 (5th Cir. 1974) (citation omitted) (quoting Hooper v. Maintain States Secs. Corp., 282 F.2d 195, 202 (5th Cir. 1960); Herpich v. Wallace, 430 F.2d 792, 806 (5th Cir. 1970)); *see also* Advanced Multilevel Concepts, Inc. v. Bukstel, 919 F. Supp. 2d 564, 576 (E.D. Pa. 2013) (stating that the Court had "found case law suggesting that [two elements of a cause of action for securities fraud] should not be read so narrowly as to preclude novel securities fraud actions that are consistent with the purpose of Section 10(b)"); Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 10 n.7, 12 (1971) (stating that the language of Section 10(b) and Rule 10b-5 "must be read flexibly, not technically and restrictively" to ensure that "unique form[s] of deception" involving "[n]ovel or atypical methods" do not evade their reach).

Section 6(c)(1)) explicitly covers fraud and manipulation involving not just futures and swaps—which are traditionally within the CFTC's enforcement jurisdiction—but activities "in connection with" a "contract of sale of any *commodity* in interstate commerce."[274] The CEA defines the term "commodity" in an extremely broad fashion to include just about everything, except onions and box office movie receipts.[275]

3. *Manipulation-as-Fraud*

The CFTC's rule release stated that "CEA section 6(c)(1) and final Rule 180.1, like Exchange Act section 10(b) and SEC Rule 10b-5 upon which they are modeled, focus on conduct involving manipulation or deception,"[276] but the vast majority of decisional law interpreting Rule 10b-5 emphasizes the rule's role in combatting fraud and deception, with manipulation targeted to the extent that it also constitutes fraud.[277] As I will explain shortly, however, this is not the limitation that one might expect. For example, the CFTC's rule release favorably cited judicial decisions that emphasized the fact that SEC Rule 10b-5 was limited to conduct that involved fraud, such as the oft-cited quotation that "Exchange Act 'section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.'"[278] At the open meeting in which the CFTC voted to adopt Rule 180.1, Meister agreed that Rule 180.1 was limited to fraudulent conduct,

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[274] 17 C.F.R. § 180.1(a) (2014) (emphasis added); *see* Commodity Exchange Act § 6(c)(1), 7 U.S.C. § 9 (2012) (using identical language).

[275] *See* 7 U.S.C. § 1a(9) (2012) ("The term 'commodity' means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions (as provided by Section 13-1 of this title) and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in."); *see also* Timothy E. Lynch, *Derivatives: A Twenty-First Century Understanding*, 43 LOY. U. CHI. L.J. 1, 13 n.48 (2011) [hereinafter *A Twenty-First Century Understanding*] ("[T]he CEA definition of 'commodity' seems to include literally everything except, expressly, onions and movie box office receipts.").

[276] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,400 (July 14, 2011).

[277] SEC Rule 10b-5 is not the only provision in the securities law that prohibits manipulation, but it is the focus of the analysis here because the CFTC modeled Rule 180.1 after Rule 10b-5. For an overview of the law relating to securities manipulation, see JOHNSON & HAZEN, *supra* note 78, at § 5.08.

[278] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,400 n.13 (quoting Chiarella v. United States, 445 U.S. 222, 234–35 (1980)). The CFTC also cited *Santa Fe Industries v. Green*, 430 U.S. 462, 473–76 (1977) and *Dirks v. S.E.C.*, 463 U.S. 646, 666 n.27 (1983) for the proposition that, "to constitute a violation of Rule 10b-5, there must be fraud." Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,400 n.13 (internal quotation marks omitted).

saying, among other things, "under Section 6(c)(1), we would look to apply that to all manner of fraud" and that "[i]t has to be fraud and we have to prove recklessness, but the idea is to not apply this statute restrictively but to apply it flexibly, and that's what we would recommend doing."[279]

Fraud-based claims generally require proof of a misrepresentation or an omission that makes a statement misleading (for example, a deceptive or fraudulent omission).[280] The fact that decisional law limits Rule 10b-5's scope to fraud (despite the lack of reference to fraud and the explicit reference to deceptive and manipulative devices in the statute and rule)[281] raises the question of how manipulation can be construed as fraud. The answer lies in the fact that courts have construed schemes involving securities manipulation to be fraudulent by describing the word "manipulative," as "virtually a term of art when used in connection with securities markets,"[282] and noting that "[i]t connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities."[283] The U.S. Supreme Court has stated that "[t]he term refers generally to practices, such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity."[284] That is, "[t]he gravamen of

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[279] Transcript of Open Meeting, *supra* note 268, at 57 (statement of Director Meister). Meister also stated that "the idea is to capture fraudulent conduct" and "fraud-based manipulation." *Id.* at 53 (statement of Director Meister).

[280] *See* CFTC v. R.J. Fitzgerald & Co., Inc., 310 F.3d 1321, 1328 (11th Cir. 2002) ("[T]o establish liability for fraud, CFTC . . . [must prove] three elements: (1) the making of a misrepresentation, misleading statement, or a deceptive omission; (2) scienter; and (3) materiality."). Deceptive omissions also are actionable under the CEA's antifraud prohibitions. *See* R&W Tech. Servs. Ltd. v. CFTC, 205 F.3d 165, 169–70 (5th Cir. 2000) (holding that failing to disclose material facts concerning trading record, such as the fact that results cited were only hypothetical and not real, can constitute fraud); Clayton Brokerage Co. v. CFTC, 794 F.2d 573, 580 (11th Cir. 1986) (holding that it is deceptive for a brokerage firm not to disclose all material information about the risk of loss); CFTC v. Commonwealth Fin. Grp., Inc. 874 F. Supp. 1345, 1353–54 (S.D. Fla. 1994) (holding that a commodity firm's failure to disclose its track record of eighty percent losses, with a majority of customers losing substantial amounts of money, while projecting large profits, was fraudulent).

[281] *See R.J. Fitzgerald & Co.*, 310 F.3d at 1328 (explaining the vague requirements of proving fraud, which do not include manipulation).

[282] Ernst & Ernst v. Hochfelder, 425 U.S. 185, 199 (1976).

[283] *Id.* Director Meister made similar comments to CFTC Commissioners during the open meeting when the CFTC adopted Rule 180.1, stating:

> The terms manipulative and deceptive device or contrivance are terms of art that the Supreme Court has considered and interpreted for many years and they generally capture fraud. In Section 10(b) law, there is case law that says that Section 10(b) is a broad catchall statute but what it must capture is fraud.

Transcript of Open Meeting, *supra* note 268, at 51–52 (statement of Director Meister). With regard to CEA Section 6(c)(1) and Rule 180.1, Meister also stated that "the design of the rule and . . . the design of the statute is to broadly capture fraudulent conduct." *Id.* at 52.

[284] Santa Fe. Indus., Inc. v. Green, 430 U.S. 462, 476 (1977). Incidentally, a federal prosecutor who indicted a high-frequency trader for spoofing in October of 2014 used similar reasoning, stating

manipulation is deception of investors into believing that the prices at which they purchase and sell securities are determined by the natural interplay of supply and demand, not rigged by manipulators."[285] Accordingly, "[t]he basic aim of the antifraud provisions is to 'prevent rigging of the market and to permit operation of the natural law of supply and demand.'"[286] "In identifying activity that is outside the 'natural interplay of supply and demand,' courts generally ask whether a transaction sends a false pricing signal to the market."[287] Under securities manipulation decisional law, trading activity can "constitute[] an implied misrepresentation in violation of Rule 10b5 and Section 10(b)" because "'[c]onduct itself can be deceptive[]' and liability under Section 10(b) and Rule 10b-5 does not require 'a specific oral or written statement.'"[288]

Pursuant to what this Article refers to as a manipulation-as-fraud legal theory, market participants are entitled to rely on the assumption that the securities market is free of manipulation and they are therefore deceived when, unbeknownst to them, a wrongdoer manipulates the market and distorts the way that the market prices securities.[289] Implicit within the manipulation-as-fraud approach is the idea that had the bad actor disclosed his manipulative device to the market beforehand, his actions would not have constituted fraud, notwithstanding the fact that, unlike insider trading,

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that the trader had engaged in a "fraudulent trading strategy" "to create a false impression regarding the number of contracts available in the market, and to fraudulently induce other market participants to react to the deceptive market information." Coscia Indictment, *supra* note 203 at ¶¶ 3, 6 & 7.

[285] Gurary v. Winehouse, 190 F.3d 37, 45 (2d Cir. 1999); *see* Schultz Inv. Advisors, Inc. & Scott Schultz, Exchange Act Release Nos. 33-8650, 34-53029; IA-2470, 87 SEC Docket (CCH) 4, 9 (Dec. 28, 2005) (showing a consent order imposing a $100,000 fine and disgorgement of profits for marking the close scheme); 3 ALAN R. BROMBERG ET AL., *supra* note 119, at CH. 6 SUMMARY ("Wash sales, matched orders, painting the tape, marking the close, and other methods of artificially influencing prices are manipulations and violate 10b-5 . . . and other fraud provisions.").

[286] S.E.C. v. First Jersey Secs., Inc., 101 F.3d 1450, 1466 (2d Cir. 1996) (quoting United States v. Stein, 456 F.2d 844, 850 (2d Cir. 1972)).

[287] ATSI Commc'ns, Inc. v. Shaar Fund, Ltd., 493 F.3d 87, 100 (2d Cir. 2007) (citation omitted). Market manipulation requires "market activity" that "create[s] a false impression of how market participants value a security." *Id*. at 101 ("[A] claim for market manipulation is a claim for fraud . . . .").

[288] VanCook v. S.E.C., 653 F.3d 130, 141 (2d Cir. 2011) (citing and quoting Stoneridge Inv. Partners, LLC v. Scientific–Atlanta, Inc., 552 U.S. 148, 158 (2008)).

[289] *See* Wilson v. Merrill Lynch & Co., 671 F.3d 120, 129 (2d Cir. 2011) (stating that the elements of a securities manipulation claim under Exchange Act Section 10(b) are "(1) manipulative acts; (2) damage[;] (3) caused by reliance on an assumption of an efficient market free of manipulation; (4) scienter; (5) in connection with the purchase or sale of securities; (6) furthered by the defendant's use of the mails or any facility of a national securities exchange" (quoting *ATSI Commc'ns, Inc.*, 493 F.3d at 101) (citations omitted)); *see also* Fezzani v. Bear, Stearns & Co. Inc., 716 F.3d 18, 22–23, 23 n.3 (2d Cir. 2013) (noting that "[t]hese elements—save for the requirement of manipulative acts and a misplaced belief in the price of the security as being set by arms-length, *bona fide* trading—are, of course, identical to Section 10(b) claims generally" and interpreting the *ATSI Communications* decision's reference to an "efficient" market as "mean[ing] only a *bona fide* market free of manipulation" (internal quotation marks omitted)).

manipulative schemes, such as wash trading and banging the close, have not been described as "disclose or abstain" violations.[290] Characterizing manipulation as fraud is analogous to the fraud-on-the-market theory, except that the "fraud" that is perpetrated on the market—and, therefore, on all market participants—is the undisclosed manipulative device that deceives the other market participants because they are entitled to rely on their collective belief that the market is free of manipulative devices.

The manipulation-as-fraud approach is much different from the normal conception of fraud, which typically involves facts similar to a Ponzi scheme (for example, the scheme perpetrated by Bernard L. Madoff) where a fraudster solicits money from customers purportedly to invest the money in the stock market but instead uses the customers' money to support a lavish lifestyle and to pay other customers their so-called "profits."[291] Under a manipulation-as-fraud legal theory, the deceptive actor typically directs his improper behavior at the entire market (as opposed to specific individuals) and manipulates (or attempts to manipulate) the price of a derivative through market behavior,[292] such as engaging in a high volume of trades right before the day's trading closes (i.e., marking the close), without disclosing the improper scheme. Here, the fraud arises from an omission or nondisclosure to others about the manipulation (or attempted manipulation).[293] Put simply, when a person engages in manipulative trading practices in the markets and does not let others know of his manipulative acts, the fraud derives from the failure to inform the other market participants, who are entitled to rely on their belief that the market is free of such improper behavior.[294]

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[290] *See* Chiarella v. United States, 445 U.S. 222, 227 (1979) (quoting *In re* Cady, Roberts & Co., 40 S.E.C. 907, 911 (1961)) (explaining the origin of the obligation to disclose or abstain).

[291] *See Ponzi Schemes*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/answers/ponzi.htm (last visited on Oct. 3, 2014) ("A Ponzi scheme is an investment fraud that involves the payment of purported returns to existing investors from funds contributed by new investors. Ponzi scheme organizers often solicit new investors by promising to invest funds in opportunities claimed to generate high returns with little or no risk. In many Ponzi schemes, the fraudsters focus on attracting new money to make promised payments to earlier-stage investors to create the false appearance that investors are profiting from a legitimate business."); *see also* Diana B. Henriques, *Madoff Victims, Five Years the Wiser*, N.Y. TIMES, Dec. 8, 2013, at BU1 (reporting on the aftermath of the global Ponzi Scheme conducted by Manhattan stockbroker Bernard Madoff).

[292] *See* Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1066–67 (1990) (footnotes omitted) (exploring the Supreme Court's decision in *Basic* to allow plaintiffs to use a fraud-on-the-market theory to satisfy Rule 10b-5's reliance requirement).

[293] *See, e.g.*, Stephanie Yang, *5 Years Ago Bernie Madoff Was Sentenced to 150 Years in Prison—Here's How His Scheme Worked*, BUS. INSIDER (July 1, 2014), http://www.businessinsider.com/how-bernie-madoffs-ponzi-scheme-worked-2014-7 (noting that the "investing strategies" driving Ponzi schemes like Madoff's are "vague and/or secretive, which schemers claim is to protect their business") (internal quotation marks omitted).

[294] *See, e.g.*, Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 563 (2011) (explaining a similar approach to insider trading under Rule 10b-5, in which "nondisclosure [of insider

Decisional law under SEC Rule 10b-5 categorizes manipulation as a form of fraud because manipulative schemes control or artificially affect the price of securities without informing other market participants, who justifiably rely on the assumption that the market for those securities is functioning normally and not being manipulated. Viewed from this perspective, a securities manipulation scheme is a kind of fraudulent omission that is committed when a wrongdoer fails to disclose his manipulative activities to other market participants.[295] Oddly, this means that a manipulative device would not be illegal under a fraud-based manipulation legal theory under SEC Rule 10b-5's "manipulative device" decisional law if the manipulator publicly announced to the market beforehand that he was going to use a "manipulative device."[296]

As a practical matter, however, under a manipulation-as-fraud legal theory, one could easily construe virtually any form of market manipulation or any trading practice that disrupts the markets as fraud, unless the perpetrator previously had informed other market participants of the plan to manipulate or disrupt the markets.[297] Accordingly, if courts analyzing CEA Section 6(c)(1) and Rule 180.1 adopt the reasoning of the manipulation-as-fraud decisional law under SEC Rule 10b-5, then the CFTC should be able to characterize any scheme involving market manipulation, banging the close, wash trading, spoofing, or such trading practices as a violation of Rule 180.1, provided that the scheme was not disclosed to market participants. This may not result in significant differences in how the CFTC approaches cases involving such trading

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trading] is deceptive because the counterparty assumes that the trader does not have a particular kind of informational advantage . . . . [o]r, in the common scenario of highly liquid, faceless markets, the counterparty assumes that the market is relatively free of such traders").

[295] *See id.* ("In order for market activity to be manipulative, that conduct must involve misrepresentation or nondisclosure."). Therefore, the "manipulative acts" element of a securities manipulation claim must include conduct that involves misrepresentation or nondisclosure (i.e., deceptive or fraudulent omissions). As mentioned previously, the legal theory equating concealment (nondisclosure) of a manipulative scheme with fraud has been criticized as trying to fit a "market power peg" into a "fraud hole." *See* Craig Pirrong, *supra* note 162, at 11–13 (identifying difficulties in regulating market power manipulations). Professor Craig Pirrong of the University of Houston's C.T. Bauer College of Business also stated that "the CEA at least has the virtue of explicitly recognizing market power manipulation as an important phenomenon, and one distinct from fraud." *Id.* at 13. Pirrong further states that "10b(5)-type language is reasonably applicable to fraud-based manipulations, but completely inappropriate for market power-based manipulations." *Id.* at 14.

[296] *See* Wilson v. Merrill Lynch & Co., 671 F.3d 120, 130 (2d Cir. 2011) ("As the district court here put it, '[t]he market is not misled when a transaction's terms are fully disclosed.'" (quoting Merrill Lynch Auction Rate Sec. Litig, 704 F. Supp. 2d 378, 390 (S.D.N.Y. 2010))).

[297] *See* Santa Fe Industries v. Green, 430 U.S. 462, 476 (1977) (noting the various ways that manipulation can be construed in the securities market). "Likewise if [a] broker told his client he was stealing the client's assets, that breach of fiduciary duty might be in connection with a sale of securities, but it would not involve a deceptive device or fraud." Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398 41,406 (July 14, 2011) (quoting S.E.C. v. Zandford, 535 U.S. 813, 825 n.4 (2002)).

practices, given that the regulator, in its efforts to combat improper market activity, has previously taken a flexible and creative approach to using the statutory and regulatory provisions that it has at its disposal. For example, the CFTC has argued that spoofing gives other market participants a "misleading impression of increasing liquidity" and thereby constitutes attempted manipulation in violation of CEA Sections 6(c), 6(d), and 9(a)(2).[298] John McPartland, a senior policy advisor in the Financial Markets Group of the Federal Reserve Bank of Chicago, has also indicated that he considers trading practices such as spoofing to be "deceptive."[299] It is not any more of a stretch to argue, pursuant to a manipulation-as-fraud legal theory, that undisclosed spoofing—in creating a misleading impression of increasing liquidity—violates Rule 180.1 because other market participants are deceived when they justifiably assume that the markets are free from the illusory liquidity that results from spoofing. The main benefit of Rule 180.1 to the CFTC, however, will be that Rule 180.1 only requires proof of recklessness, whereas CEA Sections 6(c), 6(d), and 9(a)(2) require proof of specific intent.[300] Indeed, the *Financial Times* reported in 2013 that CFTC Commissioner Scott O'Malia "told the [New York University Polytechnic School of Engineering] Big Data Finance conference that 'reckless behaviour' [sic] was replacing 'market manipulation' as the standard for prosecuting misbehaviour [sic]."[301] In any event, the CFTC's first use of its "manipulative device" authority under CEA Section 6(c)(1) and Rule 180.1 is illustrative of how the CFTC likely will employ this theoretical approach to manipulation cases.[302]

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[298] Complaint at 8, 10–14, 20–21, U.S. Commodity Futures Trading Comm'n v. Moncada, No. 12 Civ. 8791(CM), 2014 WL 353390 (S.D.N.Y. July 15, 2014). The District Court generally agreed with the CFTC's view of the facts. *See* U.S. Commodity Futures Trading Comm'n v. Moncada, No. 12 Civ. 8791(CM), 2014 WL 3533990, at *1 (S.D.N.Y. July 15, 2014) ("I also agree with the CFTC that the most compelling inference one might draw from the trading records is that Moncada was indeed trying to manipulate the market.").

[299] *See* McPartland, *supra* note 150, at 8 (discussing, inter alia, HFT spoofing in electronic and physical forms).

[300] *Compare* 17 C.F.R. § 180.1(a) (2014) ("It shall be unlawful for any person, directly or indirectly, in connection with any swap, or contract of sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity, to intentionally or *recklessly* . . . .") (emphasis added), *with* Commodity Exchange Act § 6(c), 7 U.S.C. § 9 (2012) (prohibiting persons from "directly or indirectly" employing "manipulative or deceptive device[s]"), *and* Commodity Exchange Act § 6(d), 7 U.S.C. § 13b (2012) (requiring the perpetrator's knowledge to incur liability), *and* CEA § 9(a)(2), 7 U.S.C. § 13(a)(2) (2012) (requiring the perpetrator's knowledge to incur liability).

[301] Maureen O'Hara & David Easley, *Financial Markets Are at Risk of a 'Big Data' Crash*, FIN. TIMES (May 20, 2013, 6:37 PM), http://www.ft.com/intl/cms/s/0/48a278b2-c13a-11e2-9767-00144feab7de.html?siteedition=intl#axzz388jFDV5V.

[302] *See In re* JPMorgan Chase Bank, N.A., CFTC No. 14–01, 2013 WL 6057042, at *12 (C.F.T.C. Oct. 16, 2013) ("JP Morgan . . . recklessly used or employed manipulative devices and contrivances with swaps in violation of Section 6(c)(1) . . . and Regulation 180.1 . . . .").

4. *The London Whale Gets Harpooned by Rule 180.1*

JPMorgan Chase agreed to pay $100 million in fines and admitted that some of its traders in London acted recklessly, trading credit default swaps[303] that resulted in $6.2 billion in "London Whale" trading losses for the bank.[304] In the Order, the CFTC found that JPMorgan failed to supervise the traders in question, who were accused of recklessly manipulating the prices of credit default swaps in an effort to reduce the bank's losses at the expense of other investors:[305] JPMorgan, "acting

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[303] Credit default swaps are swaps "whose payoffs are derived from the occurrence or non-occurrence of a 'credit event' of some reference entity or entities, such as the bankruptcy of an identified corporation, a debt default by some foreign government, or the third default within a basket of bonds." Lynch, *supra* note 275, at 22; *see* Kristin N. Johnson, *Things Fall Apart: Regulating the Credit Default Swap Commons*, 82 U. COLO. L. REV. 167, 169–70 (2011) ("Credit default swaps are agreements that, in simplest terms, offer insurance-like protection against the risk of a debtor's default on debt obligations."). A credit default swap can be based on a single company or bond, or on more than one company or bond, such as an index of bonds. *See, e.g.*, Jesse Eisinger, *The Trade: In JPMorgan Scrutiny, Crucial Questions Left Unasked*, N.Y. TIMES, May 17, 2012, at B4 (referring to the credit default swap index at the center of the "London Whale" controversy); Steven Pearlstein, *Why Do They Trade This Stuff Anyway?*, WASH. POST, May 20, 2012, at G01 (referring to the credit default swap index at the center of the "London Whale" controversy). Under the Dodd-Frank Act, the CFTC was given regulatory authority over swaps, which include, generally speaking, credit default swaps on a broad-based index of securities or bonds; the SEC was given regulatory authority to regulate security-based swaps, which include swaps based on single loans, on single issuers of securities or on a narrow-based index of securities or issuers of securities. *See* 15 U.S.C. §§ 8302(a)(1)–(2) (2012) (outlining the CFTC's and SEC's authority to promulgate rules and regulations regarding credit default swaps); 15 U.S.C. § 78c(a)(68) (2012) (defining security-based swap); *see also* Arthur W.S. Duff & David Zaring, *New Paradigms and Familiar Tools in the New Derivatives Regulation*, 81 GEO. WASH. L. REV. 677, 689 (2013) (discussing the authority of the SEC and CFTC to regulate the derivatives market).

[304] In re *JP Morgan Chase Bank*, 2013 WL 6057042, at *2, *8; Danielle Douglas, *CFTC Will Fine JPMorgan $100 Million in 'Whale' Case*, WASH. POST, Oct. 17, 2013, at A17; *see* Ben Protess, *A Regulator Cuts Its New Teeth on JPMorgan in 'Whale' Case*, N.Y. TIMES, Oct. 17, 2013, at B1 ("The [CFTC] announced . . . that JPMorgan Chase, the nation's biggest bank, agreed to pay $100 million and admit wrongdoing to settle an investigation into market manipulation involving the bank's multibillion-dollar trading loss in London."). In September 2013, JPMorgan paid $920 million to four other regulatory agencies "to resolve accusations that the bank allowed a group of traders to go unchecked as they racked up losses." Protess, *supra* note 304. At the end of 2011, the London-based JPMorgan traders in question held a portfolio in credit default swaps based on various indices worth $51 billion net notional, "the outsized amount spurring press reports referring to one [JPMorgan's Chief Investment Office] trader as the 'London Whale.'" Press Release PR6737-13, CFTC, CFTC Files and Settles Charges Against JPMorgan Chase Bank, N.A., for Violating Prohibition on Manipulative Conduct in Connection with "London Whale" Swaps Trades (Oct. 16, 2013), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6737-13; *see* David Henry & Emily Flitter, *JPMorgan Faces Fallout from 'Whale' Inquiries*, CHI. TRIB., Sept. 4, 2012, at C1 (noting that one of the traders involved in the JPMorgan debacle "became known in the market as the 'London Whale' for the size of his positions").

[305] *See* In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *3–4, *7 ("JPMorgan's supervision of the [traders in question] was inadequate as demonstrated by the fact that the trading limits imposed were routinely breached with little repercussion and without adequate analysis of the causes of the breaches."); Douglas, *supra* note 304, at A17 (discussing the allegations against JPMorgan and its agreement to pay fines pursuant to the CFTC Order); *see also* Peter J. Henning, *Markets Evolve, as Does Fraud*, N.Y. TIMES, Nov. 12, 2013, at F12, (stating that the agency used Rule 180.1, which "let

through its traders, recklessly disregarded the fundamental precept on which market participants rely, that prices are established based on legitimate forces of supply and demand."[306]

The CFTC's Order focuses on trading that occurred on February 29, 2012, when JPMorgan's traders—in a desperate effort to "defend [the bank's] position" and stem mounting losses[307]—sold more than $7.17 billion of credit default swaps in "one particular credit default index," an amount that accounted for more than ninety percent of the day's net volume traded by the entire market.[308] Of that $7 billion, $4.6 billion "was sold during a three-hour period as the day drew to a close."[309] The CFTC stated that "[m]arket participants are entitled to rely on the notion that [credit default swap] prices are established based on legitimate forces of supply and demand," but "JPMorgan traders acted recklessly with respect to this fundamental precept by employing an aggressive trading strategy concerning a particular type of" credit default swap.[310] The CFTC's Order describes the "manipulative device" that JPMorgan employed with the following two sentences:

> In a properly functioning market, prices reflect the competing judgments of buyers and sellers as to the fair price of a commodity or, in this instance, swaps. Here, acting on behalf of JPMorgan, the . . . traders' activities on February 29, 2012 constituted a manipulative device in connection with swaps because they sold enormous volumes of [a particular credit default index] in a very short period of time at month-end.[311]

The CFTC further stated in the Order that the activities of the JPMorgan

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the agency unveil a new approach that allowed [the CFTC] to punish reckless trading practices even without proving there was any intentional misconduct" and noting that "[t]hese provisions reach more than actual trading that drives prices up or down because any 'manipulative device' can be the basis for a violation, even if it did not actually succeed in causing harm to investors").

[306] Press Release PR6737-13, *supra* note 304; *see* In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *11 n.17 ("Regardless of whether the conduct in question was intended to create or did create an artificial price, it interfered with the free and open markets to which every participant is entitled.").

[307] *See* In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *2, *5 ("In February 2012, daily losses were large and growing, and by February 29 the traders believed the portfolio's situation was grave.").

[308] In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *2, *5–6; Press Release PR6737-13, *supra* note 304.

[309] In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *2; Press Release PR6737-13, *supra* note 304.

[310] In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *1.

[311] *Id.* at *11 (citations omitted). The CFTC stated that "selling $7.17 billion of the [specified credit default index] on February 29 in a concentrated period . . . constituted a manipulative device employed by the traders in reckless disregard of the possible consequences of their conduct, including obvious dangers to legitimate market forces." Press Release PR6737-13, *supra* note 304.

traders fell "squarely within the prohibitions of Section 6(c)(1) of the [CEA] and [Rule] 180.1(a)" because "[t]he traders recklessly disregarded the possible consequences of selling an unprecedented $7.17 billion in protection in the [credit default index in question] on February 29, including $4.6 billion in the last three hours of the trading day," which "demonstrated a reckless disregard to obvious dangers to legitimate market forces from their trading."[312]

In determining that JPMorgan had employed a "manipulative device," the Order relied on judicial precedent construing Exchange Act 10(b) and SEC Rule 10b-5.[313] Much of that judicial precedent invoked the manipulation-as-fraud theory, in which manipulation is viewed as a form of deceit because undisclosed manipulative devices trick other market participants into believing that securities are priced in accordance with the rules of supply and demand, "not rigged by manipulators."[314] Notably, the CFTC's Order did not state that JPMorgan's actions on February 29, 2012 were fraudulent or undisclosed to other market participants. Instead, the focus of the Order was that the traders must have known that their conduct had the potential to interfere with "legitimate market forces,"[315] and not that other market participants were deceived when the traders failed to disclose to the market that they were employing a manipulative device that had the potential to distort prices of the credit default index in question. The Order contains no mention of any deceptive omission that resulted from the failure to disclose the manipulative device to others. Likewise, the Order does not contain quotations from judicial decisions about the fact that SEC Rule 10b-5 is limited to fraud-based manipulation, such as "Exchange Act 'section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.'"[316] The Order does, however, state that "the gravamen of manipulation is deception."[317] As such, the CFTC might have

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[312] In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *12.

[313] *Id.* at *10.

[314] *Id.* (quoting Gurary v. Winehouse, 190 F.3d 37, 45 (2d Cir. 1999)).

[315] *Id.* at *12.

[316] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,400 n.13 (July 14, 2011) (citing Chiarella v. United States, 445 U.S. 222, 234–35 (1980)). The CFTC also cited *Dirks v. S.E.C.*, 463 U.S. 646, 666 n.27 (1983) for the proposition that, "to constitute a violation of Rule 10b-5, there must be fraud." *Id.*

[317] In re *JPMorgan Chase Bank*, 2013 WL 6057042, at *10 (quoting *Gurary*, 190 F.3d at 45). Professor Pirrong, however, is critical of legal theories that equate market-power manipulations with fraud because of the "concealment and secrecy about positions and intentions." Craig Pirrong, *supra* note 162, at 6. Pirrong argues that given the differences between market-power and fraud-based manipulation, "it can be, and will be seen as quite dangerous to use a single catch-all phrase to refer to both." *Id.* Pirrong also stated that "since market power manipulation does not distort prices through fraud and deceit, any such enforcement actions are likely to require extreme logical contortions to fit the square market power peg in the round fraud and deceit hole." *Id.* at 12.

viewed the deceptive omission as implicit in the Order.[318] In any event, even though news reports made some market participants aware that there was a "London Whale" who was trading heavily in credit default indices at some point during the relevant timeframe, the exact trading that occurred on February 29, 2012—which the CFTC pinpoints as the "manipulative device"—likely was undisclosed to others, and therefore would appear to meet the requirements of the manipulation-as-fraud approach common in securities law cases.

Given that courts have been using the manipulation-as-fraud legal theory in securities law decisions for some time, its use in commodities law cases should not be particularly controversial. Even more, the theory is so accepted that a district judge in the Southern District of New York approved of such an approach to a price manipulation claim under CEA Sections 6(c), 6(d) and 9(a)(2), stating that "[j]ust as with securities, commodities manipulation deceives traders as to the market's true judgment of the worth of the commodities."[319]

One derivatives law treatise noted that, although the CFTC adopted a "distinction between fraud-based and non-fraud based manipulation, there is no bright-line test for this distinction," a fact that could enable the CFTC to use Rule 180.1 and its recklessness standard to "eviscerate the specific intent requirement under former law."[320] The treatise speculated that "CFTC enforcement staff [might] look for anything that might be considered deceptive in order to charge the easier violation and thus not hav[e] to prove the specific intent."[321] But, as is evident from the discussion above, CFTC enforcement employees do not need evidence of

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[318] Two reasons make it unlikely that the CFTC would try to use the *JPMorgan* case to support the proposition that a "manipulative device" under CEA Section 6(c)(1) and Rule 180.1 is not a species of fraud and deception. First, the Order explicitly acknowledges that, under the relevant securities law precedent, manipulation is construed as a form of deception. Second, the Order is a settlement, so it is not clear that a federal court would necessarily agree with such a view.

[319] *See In re* Amaranth Natural Gas Commodities Litig., 587 F. Supp. 2d 513, 534 (S.D.N.Y. 2008) (Schleindlin, J.) (applying securities law manipulation-as-fraud theory to manipulation claim under the pre-Dodd-Frank Act CEA). The District Court further stated:

> This logic applies equally to the commodities markets. Just as with securities, commodities manipulation deceives traders as to the market's true judgment of the worth of the commodities. . . . Because every transaction signals that the buyer and seller have legitimate economic motives for the transaction, if either party lacks that motivation, the signal is inaccurate. Thus, a legitimate transaction combined with an improper motive is commodities manipulation.

Id. Of course, unlike a claim under Rule 180.1, a price manipulation cause of action would require proof of specific intent and the creation of an artificial price. *Id.* at 530.

[320] JOHNSON & HAZEN, *supra* note 78, at 278.

[321] *See id.* at 278–79 ("Given the language of [Rule] 180.1, it is likely that the CFTC enforcement division may expand its raw-power investigations to try to find other conduct (lying to the broker about motive, not answering phone calls, citing hedging need, etc.) in order to invoke the fraud-based manipulation recklessness standard.").

deception to be able to employ a manipulation-as-fraud legal theory, so long as the manipulative trading activities are not disclosed to other market participants.[322] Indeed, the treatise admitted as much, acknowledging the existence of "authority under SEC Rule 10b-5 to pursue manipulative conduct, claiming that the manipulation deceived investors regarding the market value of securities."[323]

In short, as one commentator said:

> [t]he new authority [i.e., CEA Section 6(c)(1) and Rule 180.1, which only require proof of recklessness] was essential to the *JPMorgan* case, where it was unclear whether the traders had intended to distort the market. The broader authority also enabled the agency to accuse the bank of 'employing a manipulative device,' without proving that the bank actually manipulated the price of swaps.[324]

The CFTC's use of manipulation-as-fraud legal theory for Rule 180.1 in the *JPMorgan* case is not particularly surprising, given that this theory is commonly employed in securities law and the CFTC's rule release stated that it would interpret its authority under CEA Section 6(c)(1) "flexibly."[325] Additionally, Enforcement Director Meister had promised that the CFTC would "aggressively use" its CEA Section 6(c)(1) authority to combat fraud and manipulation.[326] He also made public comments

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[322] *See supra* notes 276–78 and accompanying text (discussing how, under a manipulation-as-fraud legal theory, one could easily construe virtually any form of market manipulation or any trading practice that disrupts the markets as fraud, as long as there has been no disclosure of the activities).

[323] JOHNSON & HAZEN, *supra* note 78, at 279 ("The CFTC may take a similar view of [Rule] 180.1.").

[324] Protess, *supra* note 304. The CFTC's press release about the London Whale case settlement quoted Enforcement Director Meister as stating:

> In Dodd-Frank, Congress provided a powerful new tool enabling the CFTC for the first time to prohibit reckless manipulative conduct. As this case demonstrates, the [CFTC] is now better armed than ever to protect the market from traders, like those here, who try to 'defend' their position by dumping a gargantuan, record-setting volume of swaps virtually all at once, recklessly ignoring the obvious dangers to legitimate pricing forces.

Press Release PR6737-13, *supra* note 304.

[325] *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,401 (July 14, 2011) ("The [CFTC] intends to interpret and apply CEA section 6(c)(1) and final Rule 180.1 'not technically and restrictively, but flexibly to effectuate its remedial purpose.'" (quoting S.E.C. v. Zandford, 535 U.S. 813, 819 (2002))).

[326] *See* Bill Despo, *Dodd-Frank Considered Game Changer for CFTC per Enforcement Director*, LECLAIRRYAN (Dec. 28, 2011), http://www.leclairryan.com/pubs/xprPubDetail.aspx?xpST=PubDetail&pub=676 [hereinafter *SIFMA'S Monthly Meeting*] (summarizing Meister's comments at SIMFA's monthly meeting); *see also* Zach Brez & Jon Daniels, *The New Financial Sheriff: CFTC Anti-Fraud Authority After Dodd-Frank*, 127 BNA DAILY REP. FOR EXECUTIVES, July 3, 2012, at B-1, B-2 [hereinafter *The New Financial Sheriff*] (explaining that one effect of the creation of Section 6(c)

stating that, in his view, CEA Section 6(c)(1) "allows us to, I would say, be creative in our use of anti-fraud authority."[327] For example, Meister stated that CEA Section 6(c)(1) is flexible enough to cover situations involving failures to adequately supervise activities that are unlawful.[328] Meister also stated that Section 6(c)(1)'s prohibitions could reach situations involving "gatekeepers," such as auditors of CFTC registrants that "fail to perform proper audits of firms that have engaged in fraud."[329] In bringing such lawsuits, the CFTC likely will invoke securities law precedents associated with SEC Rule 10b-5, holding accountants and auditors liable for failing to act properly (by, inter alia, recklessly causing material misrepresentations in a firm's financial statements) in connection with their duties or internal supervisory failures.[330] As mentioned previously, CEA Section 6(c)(1) "specifically direct[ed] the [CFTC] to prohibit the 'attempt[ed]' use or employment of any manipulative or deceptive devices or contrivances,"[331] so even the unsuccessful employment of a manipulative device or contrivance constitutes a violation of Rule 180.1.[332]

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makes it easier to charge individuals and entities with violations because it creates a lower threshold including reckless actions).

[327] *The New Financial Sheriff*, *supra* note 326, at B-3 (citing MEISTER, TRANSCRIPT OF PANEL DISCUSSION AT THE SEC HISTORICAL SOCIETY ON ENFORCEMENT AFTER DODD-FRANK (Sep. 13, 2011), *available at* http://c0403731.cdn.cloudfiles.rackspacecloud.com/collection/programs/sechistorical-09132011-transcript.pdf).

[328] *The New Financial Sheriff*, *supra* note 326, at B-3 (citing *SIFMA's Monthly Meeting*, *supra* note 326). According to an article by attorneys from the private law firm of Fulbright & Jaworski, "by shifting from the 'affirmative intent' requirement of the past, the CFTC is moving to an enforcement environment where inadequate controls, lax supervision, or flawed compliance programs could be sufficient to establish 'recklessness' under the new anti-fraud rule." Peggy A. Heeg et al., *CFTC Adopts Final Anti-Manipulation and Anti-Fraud Rules & Begins Final Rulemaking Phase Implementing Dodd-Frank*, FULBRIGHT & JAWORSKI FIN. REFORM TASK FORCE 1, 2, http://www.norton rosefulbright.com /files/us/images/publications/07112011FRTF_CFTCAdoptsFinalAntiManipulationandAntiFraudRules_secure.pdf (last visited on Oct. 4, 2014).

[329] *The New Financial Sheriff*, *supra* note 326, at B-3 (citing *SIFMA's Monthly Meeting*, *supra* note 326).

[330] *See, e.g.*, Overton v. Todman & Co., CPAs, P.C., 478 F.3d 479, 483–88 (2d Cir. 2007) (discussing accountant liability for SEC Rule 10b-5 violation); Hollinger v. Titan Capital Corp., 914 F.2d 1564, 1576 (9th Cir. 1990) (discussing failure to supervise as SEC violation); Henricksen v. Henricksen, 640 F.2d 880, 884–87 (7th Cir. 1981) (discussing failure to supervise as SEC violation); *In re* Acterna Corp. Sec. Litig., 378 F. Supp. 2d 561, 572–84 (D. Md. 2005) (discussing auditor liability for SEC Rule 10b-5 violation); *In re* Qwest Commc'ns Int'l., Inc., 396 F. Supp. 2d 1178, 1189–92 (D. Colo. 2004) (discussing auditor liability for SEC Rule 10b-5 violation); *In re* Raytheon Sec. Litig., 157 F. Supp. 2d 131, 154–56 (D. Mass. 2001) (discussing auditor liability for SEC Rule 10b-5 violation); *see also* 5D ARNOLD S. JACOBS, DISCLOSURE & REMEDIES UNDER THE SEC. LAWS § 18:49 (2010) (collecting sources for the proposition that, "[i]n the [SEC's] view, failure to supervise is an independent basis for charging a firm or supervisor with a 10b-5 infringement").

[331] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,401 (July 14, 2011).

[332] SEC Rule 10b-5 does not explicitly cover attempts, but "courts interpreting the statutory phrase, 'any manipulative or deceptive device' as it is used in Section 10(b) of the Exchange Act have deemed it broad enough to encompass an attempt." *Id*. at 41,401 n.34 (citing S.E.C. v. Martino, 255 F.

5. *No Duty to Disclose Lawfully Obtained Information, With Exceptions*

The manipulation-as-fraud legal theory, which is premised on a defendant's nondisclosure of a manipulative device or contrivance,[333] would seem to be somewhat at odds with the fact that the futures and derivatives markets generally have not required significant disclosures of information from market participants. As mentioned above, the securities markets historically have had "extensive disclosure obligations," whereas the commodities and derivatives markets have not.[334] Congress addressed the disclosure issue by including in CEA Section 6(c)(1) a provision that states:

> no rule or regulation promulgated by the [CFTC] shall require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect . . . .[335]
>
> Further, it is not a violation of final Rule 180.1 to withhold information that a market participant lawfully possesses about market conditions. The failure to disclose such market information prior to entering into a transaction, either in an anonymous market setting or in bilateral negotiations, will not, by itself, constitute a violation of final Rule 180.1. Therefore, the [CFTC] clarifies that silence, absent a pre-existing duty to disclose, is not deceptive within the meaning of final Rule 180.1.[336]

The above statement mirrors the longstanding belief that there is no "insider trading" in the futures and derivatives markets. But, the CFTC stated that

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Supp. 2d 268, 287 (S.D.N.Y. 2003)) ("[A]n attempted manipulation is as actionable as a successful one.").

[333] *See* JERRY W. MARKHAM, LAW ENFORCEMENT AND THE HISTORY OF FINANCIAL MARKET MANIPULATION § 5:4, at 218–20 (2014).

[334] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,402.

[335] *Id.* at 41,402 (quoting CEA § 6(c)(1), 7 U.S.C. § 9(1) (2012)). The CFTC further stated, "[t]o be clear, the [CFTC] is not, by this rulemaking, imposing any new affirmative duties of inquiry, diligence, or disclosure." *Id.*

[336] *Id.* at 41,402 (citing Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988)). "Similarly, the [CFTC] interprets 'no comment' statements as 'generally the functional equivalent of silence.'" *Id.* at 41,402–03 (citing *Basic Inc.*, 485 U.S. at 239 n.17).

> [i]n response to comments requesting that "front-running" and similar misuse of customer information be considered a form of fraud-based manipulation under final Rule 180.1, the [CFTC] declines to adopt any per se rule in this regard, but clarifies that final Rule 180.1 reaches all manner of fraud and manipulation within the scope of the statute it implements, CEA section 6(c)(1).[337]

More interestingly, the CFTC further stated that:

> [d]epending on the facts and circumstances, a person who engages in deceptive or manipulative conduct . . . for example by trading on the basis of material nonpublic information in breach of a pre-existing duty (established by another law or rule, or agreement, understanding, or some other source), or by trading on the basis of material nonpublic information that was obtained through fraud or deception, may be in violation of final Rule 180.1."[338]

Similarly, the explicit text of the rule indicates that a person does, in fact, have a duty to disclose information if doing so is necessary to make a prior statement not misleading.[339]

As such, there is now an affirmative duty to disclose information to others in the futures and derivatives markets in the post-Dodd Frank Act

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[337] *Id.* at 41,401. Additionally, in the CFTC's final rule release concerning external business conduct standards for swap dealers and major swap participants, the CFTC stated that

> [t]he final [external business conduct] rules also do not include a free standing prohibition against front running or trading ahead of counterparty transactions . . . because the [CFTC] has determined that such trading, depending on the facts and circumstances, would violate the [CFTC's] prohibitions against fraudulent, deceptive or manipulative practices, including . . . [Rule] 180.1.

Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734, 9736 n.21 (CFTC Final Rule Feb. 17, 2012). That is, the CFTC indicated that it was not adopting a specific prohibition on front running for swap dealers and major swap participants because "[the CFTC's] other deceptive and manipulative practices provisions, including . . . [CEA Section] 6(c)(1) and [Rule] 180.1 . . . also prohibit trading ahead and front running." *Id.* at 9756 n.303.

[338] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,403; *see also* 13A JERRY W. MARKHAM, COMMODITIES REG. §18:8 (2014) (stating that "[t]he CFTC also adopted a misappropriation theory for non-public information and limited disclosure duty" in connection with Rule 180.1); Energy Bar Ass'n Compliance & Enforcement Comm., *Report of the Compliance & Enforcement Committee*, 33 ENERGY L.J. 185, 202 (2012) ("Concern has been raised about the meaning of 'understanding', but no further guidance has been offered.").

[339] *See* 17 C.F.R. § 180.1(b) (2014) ("Nothing in this section shall be construed to require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.").

regulatory environment under certain circumstances.[340] The idea that "Rule 180.1 prohibits trading on the basis of material nonpublic information in breach of a pre-existing duty, or trading on the basis of material nonpublic information that was obtained through fraud or deception"[341] appears to track, if not exceed, the scope of the misappropriation theory of insider trading and the *Dorozhko* decision's prohibition on obtaining information deceptively.[342] Indeed, then "CFTC Commissioner Bart Chilton has confirmed that the CFTC intends to utilize the insider-trading authority, [stating that] '[p]ocketing profits from the misuse of privileged information will now be prosecuted. We'll be able to get at, for example, bad actors akin to insider traders.'"[343]

Therefore, Rule 180.1 appears to ban "insider trading" in futures and derivatives if the person trades on the basis of material nonpublic information that was obtained either (1) "in breach of a pre-existing duty," or (2) "through fraud or deception."[344] Interestingly, potential sources of the pre-existing duty can include "another law or rule, or agreement, understanding, or some other source"[345] that is remarkably broad. This represents a significant change in the existing law of futures and derivatives. Notably, because the final rule release stated that the acquisition of material nonpublic information through fraud or deception could violate Rule 180.1,[346] this prohibition appears to reach thieves and hackers who do not owe any duty to the source of the information but who use deception in obtaining the information.

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[340] *Id*.

[341] *Q & A—Anti-Manipulation and Anti-Fraud Final Rules*, CFTC 1 (2011), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/amaf_qa_final.pdf; *see* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,403 ("[A] person who engages in deceptive or manipulative conduct . . . for example by trading on the basis of material nonpublic information in breach of a pre-existing duty . . . or by trading on the basis of material nonpublic information that was obtained through fraud or deception, may be in violation of final Rule 180.1."); *see also* JORDAN ET AL., *supra* note 113, at § 21.13 (stating the elements that the SEC must show to bring a claim to enforce insider trading laws and regulations).

[342] JORDAN ET AL., *supra* note 113, at § 21.5 (citing S.E.C. v. Dorozhko, 574 F.3d 42, 51 (2d Cir. 2009)) (illustrating how the Supreme Court has extended "insider trading prohibitions beyond the bounds of the corporate boardroom to persons receiving confidential information from a company").

[343] *Id*. (quoting Bart Chilton, *"The Waiting": Statement Regarding Anti-Fraud and Anti-Manipulation Final Rules*, CFTC (July 7, 2011), http://www.cftc.gov/PressRoom/SpeechesTestimony/chiltonstatement070711).

[344] Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,403.

[345] *Id*.

[346] *See* 7 U.S.C. § 9(1) (2012) ("It shall be unlawful for any person, directly or indirectly, to use or employ . . . any manipulative device or contrivance, in contravention of such rules and regulations as the Commission shall promulgate . . . .").

6. *Reckless Manipulation by False Reports*

The new CEA Section 6(c)(1)(A),[347] which the CFTC implemented with Rule 180.1(a)(4),[348] contains a prohibition against manipulation (and attempted manipulation) by transmission of false information or reports that is similar to the false reporting prohibition in Section 9(1)(A), but with a lower intent requirement of recklessness.[349] As mentioned previously, the CFTC has construed "false reports" broadly in pre-Dodd-Frank Act decisional law to include, in certain circumstances, the submission of orders for trades that are almost immediately thereafter cancelled (i.e., spoofing).[350] The CFTC likely will continue to interpret "false reports" broadly, which means that a person need not actually communicate with other market participants in the conventional sense (that is, in words, either verbally or in writing) to be liable for spreading false information or reports, as simply submitting orders for trades pursuant to an improper scheme could be viewed as transmitting false, misleading, or inaccurate information to the market, thereby violating Rule 180.1(a)(4).

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[347] Commodity Exchange Act § 6(c)(1)(A), 7 U.S.C. § 9(1)(A) (2012).

[348] 17 C.F.R. § 180.1(a)(4) (2014). The rule states that it is unlawful to:

> Deliver or cause to be delivered, or attempt to deliver or cause to be delivered, for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.

Id.

[349] *Compare* 17 C.F.R. § 180.1(a)(2) (2014) ("It shall be unlawful for any person . . . to manipulate or attempt to manipulate the price of any swap . . . ."), *with* 7 U.S.C. § 9(2) (2012). Section 6(c)(1)(A), a "Special Provision for Manipulation by False Reporting," extends the CFTC's prohibition against unlawful manipulation to include

> delivering, or causing to be delivered for transmission through the mails or interstate commerce, by any means of communication whatsoever, a false or misleading or inaccurate report concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce, knowing, or acting in reckless disregard of the fact that such report is false, misleading or inaccurate.

Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. at 41,398. As discussed above, the pre-Dodd-Frank Act anti-manipulation provisions of the CEA require proof of specific intent to cause an artificial price, which is a more difficult intent standard to satisfy. *See In re* Amaranth Natural Gas Commodities Litig., 587 F. Supp. 2d 513, 534 (S.D.N.Y. 2008) (discussing the intent requirements of the anti-manipulation provision of the CEA before the Dodd-Frank Act). CEA Section 6(c)(1)(C) and Rule 180.1(a)(4) contain exceptions for the good faith mistaken transmissions of false, misleading, or inaccurate information or reports. 7 U.S.C. § 9(1)(C) (2012); 17 C.F.R. § 180.1(a)(4) (2014).

[350] *See In re* Gelber Grp., LLC, CFTC No. 13-15, Comm. Fut. L. Rep. P 32534, 2013 WL 525839, at *3–5 (C.F.T.C. Feb. 8, 2013) (finding, inter alia, that the actions of the respondent amounted to delivery of a false report within the meaning of the CEA).

IV. EXISTING THEORIES OF LIABILITY AS APPLIED TO HIGH-SPEED PINGING AND FRONT RUNNING

High-speed pinging likely violates several provisions of the CEA and one regulation promulgated thereunder, to the extent that high-speed pinging involves submitting and then immediately canceling orders for trades—that is, spoofing—in the process of searching for a "whale" trade.[351] High-speed pinging does not, however, seem to violate the statutory and regulatory prohibitions related to actual front running or insider trading; instead, such tactics arguably run afoul of prohibitions against deceptive, disruptive, and manipulative trading practices.[352] Order anticipation strategies that predict future market moves merely by observing orders—without "poking and pinging"[353] the market—do not appear to violate any laws or regulations. But, notwithstanding that cautionary statement, some forms of high-speed pinging arguably violate the following provisions of the CEA: (1) Section 4c(a)(2)(B)'s prohibition on causing non-bona fide prices to be reported;[354] (2) Section 4c(a)(5)(C)'s prohibition on spoofing and trading practices that are of the character of spoofing;[355] (3) the prohibition in CEA Section 9(a)(2) and CFTC Rule 180.1(a)(4) on delivering false, misleading, or knowingly inaccurate crop

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[351] Better Markets Comment Letter, *supra* note 21, at 3.

[352] High-speed pinging does not appear to fit within Rule 180.1's prohibition against trading on the basis of material, nonpublic information that was obtained through fraud, deceit, or in violation of a pre-existing duty. One could argue that high-speed pinging violates that prohibition because the "ping" orders and trades deceive other market participants into unwittingly revealing confidential (i.e., material nonpublic) information about their *future* trading strategies, and that the HFT firms then misappropriate that information when they use it to jump ahead of large orders for trades. But such a claim would raise numerous issues of first impression, such as whether order anticipation programs using pings acquire "nonpublic" information, given that all market participants presumably could submit orders for trades (and thereby receive the same information) and given that analyzing the responses of other traders to one's orders for trades has not traditionally been viewed as illegal misappropriation of information, or even improper. That said, the CFTC has intimated that it is improper to engage in spoofing for the purposes of probing the market to obtain information that is unavailable to other traders. *In re* Bunge Global Mkts., CFTC No. 11-10, 2011 WL 1099346, at *1 (CFTC Mar. 22, 2011). As will be discussed in greater detail below, high-speed pinging does, however, appear to have characteristics that mirror other prohibited trading practices, such as wash trading and banging the close.

[353] Better Markets Comment Letter, *supra* note 21, at 3–4.

[354] Commodity Exchange Act § 4c(a)(2)(B) (codified at 7 U.S.C. §§ 6c(a)(1), 6c(a)(2), 6c(a)(2)(B) (2012)) ("It shall be unlawful for any person to offer to enter into, enter into, or confirm the execution of a transaction . . . involving the purchase or sale of any commodity for future delivery (or any option on such a transaction or option on a commodity) or swap if the transaction . . . is used to cause any price to be reported, registered, or recorded that is not a true and bona fide price.").

[355] Commodity Exchange Act § 4c(a)(5)(C) (codified at 7 U.S.C. § 6c(a)(5)(C) (2012) ("It shall be unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that . . . is, 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.").

or market information or reports;[356] and (4) Section 6(c)(1)[357] and CFTC Rule 180.1,[358] which prohibit reckless, fraud-based manipulation and incorporate federal common law under Exchange Act Section 10(b) and SEC Rule 10b-5.[359]

To the extent that high-speed pinging involves sending out a large number of "ping" orders to detect a large trade, with the majority of the "ping" orders immediately being cancelled, both before and after a large trade has been detected, the cancelled "ping" bids or offers for trade orders are non-bona fide prices that are reported to the market. Section 4c(a)(2)(B)'s prohibition on causing non-bona fide prices to be reported typically is used to combat noncompetitive prearranged trades, but the CFTC has invoked Section 4c(a)(2)(B) to combat spoofing on the grounds that spoofing involves the submission of "false orders."[360] Therefore, one could argue that at least some of the trades in a high-speed pinging scheme are "false orders" that are submitted solely to flush out other traders. The same logic would apply in analyzing high-speed pinging tactics regarding the prohibition in CEA Section 9(a)(2) and Rule 180.1(a)(4) against causing false, misleading, or inaccurate reports to be delivered. As mentioned earlier, in *Commodity Futures Trading Commission v. Atha*,[361] the District Court held that the scope of what constitutes "reports" should be interpreted broadly to include more than just formal and official reports to the CFTC.[362]

Further, the previous discussion of spoofing in the *Bungle Global Markets* and *Gelber Group* consent orders illustrates that the CFTC views sending orders for trades solely for the purpose of probing the market for a futures contract and without the intention of necessarily executing those

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[356] Commodity Exchange Act § 9(a)(2) (codified at 7 U.S.C. § 13(a)(2) (2012)) (stating that it is unlawful to, inter alia, "knowingly . . . deliver or cause to be delivered for transmission through the mails or interstate commerce by telegraph, telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning crop or market information or conditions that affect or tend to affect the price of any commodity in interstate commerce").

[357] 7 U.S.C. § 9 (2012) ("It shall be unlawful for any person, directly or indirectly, to use or employ, or attempt to use or employ, in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery on or subject to the rules of any registered entity, any manipulative or deceptive device or contrivance, in contravention of such rules and regulations as the [CFTC] shall promulgate . . . .").

[358] Prohibition Against Manipulation, 17 C.F.R. § 180.1 (2012).

[359] Michael J. Kaufman & John M. Wunderlich, *Messy Mental Markers: Inferring Scienter from Core Operations in Securities Fraud Litigation*, 73 OHIO ST. L.J. 507, 508–09 (2012). Incidentally, because price manipulation (or attempted price manipulation) claims under CEA Sections 6(c), 6(d) and 9(a)(2) have been used against manipulative schemes involving wash trades, banging the close, and spoofing, these provisions probably could be used against high-speed pinging as well, but the need to prove specific intent probably makes them ineffective tools for such a purpose as a practical matter.

[360] *In re* Gelber Grp., LLC, No. 13-15, 2013 WL 525839, at *3 (C.F.T.C. Feb. 8, 2013).

[361] 420 F. Supp. 2d 1373 (N.D. Ga. 2006).

[362] *Id.* at 1380–81.

orders as (1) giving the perpetrators an unfair advantage in the form of information "that [is] unavailable to other traders"[363] and (2) spreading "false and misleading"[364] prices in the market.

The CEA's new prohibition on spoofing—Section 6c(a)(5)(C)—defines spoofing as "bidding or offering with the intent to cancel the bid or offer before execution."[365] Given the high cancellation rates of trading by HFT firms, that behavior is arguably a component of many high-speed trading strategies, all of which are presumably illegal under Section 6c(a)(5)(C). Granted, one might argue that an HFT firm does not intend to cancel its trades before execution, but when cancellation rates creep into the seventy to ninety-fifth percentile of orders for trades, and when trading strategies are employed that make a high number of cancellations inevitable, such statements lack credibility.[366] Notably, a pattern of order cancellations is not even needed for a Section 6c(a)(5)(C) violation, in that only a single bid or offer with the intent not to be executed is sufficient (although a pattern of repeated order cancellations presumably could constitute circumstantial evidence of intent).[367]

Section 6c(a)(5)(C) also explicitly prohibits trading practices that are "of the character of" spoofing.[368] The CFTC's Interpretive Guidance did not say anything regarding what kinds of activities would be "of the character of" spoofing, but it presumably reaches more than spoofing, which, as mentioned, is already broadly defined in the statute. Ultimately, federal courts may help determine the exact scope of behavior that is "of the character of" spoofing, but high-speed pinging, in which a large number of orders for trades are inevitably cancelled in the process of seeking large trades, could well qualify as something that is "of the character of" spoofing, if not spoofing itself.

As mentioned, CEA Section 6(c)(1) and CFTC Rule 180.1 are supposed to draw from Exchange Act Section 10(b) and SEC Rule 10b-5

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[363] *In re* Bunge Global Mkts., Inc., CFTC Docket No. 11-10, 2011 WL 1099346, at *1 (C.F.T.C. Mar. 22, 2011).

[364] *Id.* at *4; *In re Gelber Grp.*, 2013 WL 525839, at *4.

[365] 7 U.S.C. § 6c(a)(5)(C) (2012); *see also* Sarah N. Lynch, *SEC Charges Trading Firm Owner, Others in 'Spoofing' Case*, REUTERS (Apr. 4, 2014), http://www.reuters.com/article/2014/04/04/us-sec-enforcement-spoofing-idUSBREA331DD20140404 ("[T]he FBI and [CFTC] each said they were looking more broadly into the practice of spoofing, as part of a wide-ranging investigation into strategies that may be deployed by high-frequency traders.").

[366] Intent may be inferred from the circumstances surrounding actions. Importantly, people may be presumed to intend the natural or probable consequences of their actions. *See, e.g.*, Giles v. California, 554 U.S. 353, 386 (2008) (Breyer, J., dissenting) (citing RESTATEMENT (SECOND) OF TORTS § 8A (1977)) ("The word 'intent' is used throughout . . . to denote that the actor desires to cause consequences of his act, or that he believes that the consequences are substantially certain to result from it.").

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

[368] 7 U.S.C. § 6c(a)(5)(C) (2012).

precedent.[369] Under Exchange Act 10(b) and SEC Rule 10b-5 precedent, banging the close and wash trading are viewed as illegal manipulative and deceptive devices.[370] Therefore, Rule 180.1 likely prohibits banging the close and wash trading as well.[371]

High-speed pinging and related tactics are arguably just as much fraudulent, manipulative, and deceptive devices as banging the close, wash trading, and other practices that are prohibited under the manipulation-as-fraud legal theory invoked in securities law precedent. Specifically, the CFTC could argue that the initial "ping" orders for trades are deceptive because the purpose of those initial trades is to locate a large trade and, once a large trade is discovered, to enable the HFT firm to engage in trading practices that raise or lower the price more than would have been the case in the absence of that HFT firm's manipulative and deceptive device (that is, in the absence of the high-speed pinging). Therefore, Rule 180.1 arguably prohibits high-speed pinging.[372]

High-speed pinging tactics have characteristics that are analogous to wash trading and banging the close, both of which are construed as manipulative and deceptive devices under SEC Rule 10b-5 decisional law, which is supposed to serve as a source of law for CFTC Rule 180.1. Both wash trading and banging the close use trades to create the illusion that there is more activity in the market than there actually is, or to deceive others as to the true nature of the trading activity in the market. Banging the close involves sending a high number of trades to affect the price of a derivative contract.[373] With high-speed pinging, an HFT firm uses trades at one price to "lure" another trader into revealing her intent to make a large trade, and then, once a large trade is detected, the HFT firm turns around and quickly buys up all of the liquidity in the contract in question, thereby

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[369] *See* 156 CONG. REC. S3348 (daily ed. May 6, 2010) (statement of Sen. Maria Cantwell) ("This language in this amendment is patterned after the law that the SEC uses to go after fraud and manipulation; that there can be no manipulative devices or contrivances.").

[370] *See, e.g.*, Santa Fe Indus., Inc. v. Green, 430 U.S. 462, 476 (1977) (discussing the Exchange Act's and courts' prohibition of manipulative practices "such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity"); LITIGATION RELEASE NO. 18718 (May 19, 2004), *available at* http://www.sec.gov/litigation/litreleases /lr18718.htm (defining "marking the close" as a manipulative trading practice).

[371] *See supra* Part III.A.I (noting that banging the close and wash trading have long been considered illegal under other provisions of the CEA).

[372] An HFT firm likely would argue that, by employing pinging strategies to detect a large trade and then speeding ahead of the large trade to buy or sell against it, they are simply assisting the natural forces of supply and demand to adjust the price of the futures contract or derivative to take into account the true demand for that contract, albeit at a highly accelerated pace.

[373] *See CFTC Glossary*, CFTC, http://www.cftc.gov/consumerprotection/educationcenter/cftc glossary/index.htm (last visited Oct. 22, 2014) (defining "Banging the Close," also called "Marking the Close").

raising or lowering the price for the other trader.[374] Thus, one could view the initial "ping" orders and trades as not true orders and trades, but merely decoys.[375] In this manner, high-speed pinging could be construed as a "manipulative or deceptive device" that would be prohibited by Exchange Act Section 10(b) and SEC Rule 10b-5, and, accordingly, CEA Section 6(c)(1) and CFTC Rule 180.1.

As mentioned above, Professor John C. Coffee, Jr. of Columbia Law School has observed that "new 'cunning devices' will surface from time to time, as fraud evolves and mutates" and that "Rule 10b-5 was intended to evolve to keep pace with the ingenuity of fraudsters."[376] Similarly, Professor Donald C. Langevoort of Georgetown University Law Center has noted that Rule 10b-5 "has long been praised as being sufficiently open ended so as to avoid presenting a blueprint for fraud, tempting the 'versatile inventions of fraud-doers.'"[377] Courts interpreting Rule 10b-5 have stressed that fraudulent schemes should not succeed simply because they are novel.[378] As such, the fact that high-speed pinging is a relatively recent phenomena that had not existed—or been prohibited—previously is of no issue if analysis of such tactics reveals that they are analogous to other prohibited manipulative or deceptive devices. Congress chose to model CEA Section 6(c)(1) after Exchange Act 10(b), and the CFTC chose to model Rule 180.1 after Rule 10b-5, to take advantage of the flexibility and adaptability of the SEC's primary tool to combat fraud. As discussed above, CEA Section 6(c)(1) was supposed to give "the CFTC a very important new weapon in its arsenal to combat ever-evolving forms of manipulative trading schemes that undermine public confidence in the proper functioning of these markets,"[379] and high-speed pinging arguably is one of the "ever-evolving forms of manipulative trading schemes" that the CFTC is supposed to police.[380] The CFTC's approach in the *JPMorgan* case, including its adoption of the securities law theory that market manipulation is a form of deception,[381] indicates that the futures regulator

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[374] *See* James J. Angel & Douglas McCabe, *Fairness in Financial Markets: The Case of High Frequency Trading*, 112 J. BUS. ETHICS 585, 588–89 (2013) (discussing the strategy of pinging).

[375] "Decoy" is defined, inter alia, as "someone or something used to lure or lead another into a trap; esp[ecially]: an artificial bird used to attract live birds within shot." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 300 (10th ed. 1993).

[376] Coffee, *supra* note 125, at 317.

[377] Langevoort, *supra* note 272, at S7 (quoting SEC v. Capital Gains Research Bureau, 375 U.S. 180, 199 (1963)).

[378] *See, e.g.*, Smallwood v. Pearl Brewing Co., 489 F.2d 579, 590 (5th Cir. 1974) ("The definitions of purchase and sale have sagged under the weight of courts' attempts to prevent ingenious minds from deflecting the statutory purposes of Section 10(b).").

[379] 156 CONG. REC. S3349 (daily ed. May 6, 2010) (statement of Sen. Lincoln).

[380] *Id.*

[381] *In re* JPMorgan Chase Bank, N.A., CFTC No. 14-01, Comm. Fut. L. Rep. P32838, 2013 WL 6057042, at *10 (CFTC Oct. 16, 2013) (quoting Gurary v. Winehouse, 190 F.3d 37, 45 (2d Cir. 1999)).

will seek to use its new authority flexibly and creatively, in keeping with how the SEC and federal courts have approached the securities law's antifraud prohibition.

In the end, Rule 180.1 is the strongest candidate to use in litigating high-speed pinging because of the favorable Rule 10b-5 precedent prohibiting analogous conduct, such as wash trading and banging the close, followed by Section 4c(a)(5)(C)'s prohibition on spoofing and trading practices that are "of the character of" spoofing.

The use of Rule 180.1, CEA Section 4c(a)(5)(C) and the other provisions mentioned above to combat high-speed pinging would not violate a defendant's due process rights concerning the need to provide adequate notice of the kind of conduct that is considered unlawful because, as explained in the preceding paragraphs, high-speed pinging is only unlawful to the extent that it is executed in a manner that mirrors existing trading practices that clearly violate the law, such as spoofing or wash trading. Notably, the Southern District of New York recently rejected a due process "adequacy of notice" argument in denying a motion to dismiss the CFTC's complaint in a case where a high-speed trader and his firm had been accused of engaging in a banging the close scheme.[382]

In any event, given the number of bids and offers for futures trades that are made in today's super-fast markets, it may be impossible for regulators or aggrieved traders to identify the perpetrators of high-speed pinging or front running.[383] The difficulty that likely would accompany re-constructing the details of specific high-speed pinging tactics after the fact

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[382] *See* CFTC v. Wilson, No. 13 Civ. 7884(AT), 2014 WL 2884680, at *15 (S.D.N.Y. June 26, 2014) ("Defendants' argument that they lacked adequate notice regarding the illegality of the alleged conduct is unpersuasive."). Based on the facts in the complaint, the defendants in the *Wilson* case also appear to have engaged in spoofing. *See* Complaint at 48, 57, 59, CFTC v. Wilson, No. 13 Civ. 7884(AT), 2014 WL 2884680 (S.D.N.Y. June 26, 2014) (referring to conduct involving the placement, and subsequent rapid withdrawal, of orders (i.e., bids) for trades); Robert Fallon, *Protecting a Position By "Banging the Close" and "Spoofing" Will Be Penalized—The CFTC*, JDSUPRA.COM (Nov. 22, 2013), http://www.jdsupra.com/legalnews/protecting-a-position-by-banging-the-cl-09829/ (detailing how Wilson and DRW "banged the close" by placing the majority of their bids during the Settlement Period and "spoofed by entering into those bids with no intent of consummating those transactions").

[383] Silla Brush, *High-Speed Trades Outpace CFTC's Oversight, O'Malia Says*, BLOOMBERG (May 7, 2014), http://www.bloomberg.com/news/2014-05-06/high-speed-trades-outpace-cftc-s-oversight-o-malia-says.html (stating that CFTC Commissioner Scott O'Malia said that "[t]he CFTC lacks the technology necessary to routinely oversee the millions of messages traders send every day to futures exchanges" but added that "[h]e is discussing with the financial industry how the agency 'should design the 21st-century mouse trap to spot disruptive and manipulative trading practices – at any speed'"); Better Markets Comment Letter, *supra* note 21, at 4 ("[T]his type of modern front-running behavior could not be caught by looking at trade data alone. Bids, offers, and – crucially – order cancellations would all be required to reconstruct the manipulative behavior. Moreover, it couldn't be found unless the regulator knew what to look for."); *see* LEWIS, *supra* note 15, at 81 (noting that, to fully understand trading in today's markets, one needs information concerning the timing of trades down to the microsecond, as records simply indicating the second in which a trade occurred do not paint an accurate picture of what happened in the market).

does not, however, make the conduct legal.

Lastly, an HFT firm that, in the course of sending out "ping" orders for trades, receives confirmations of its own orders on CME Globex a millisecond or two before the rest of the market,[384] or obtains trade data a few milliseconds faster than other investors because the HFT firm's servers are at CME's co-location facility in Aurora, Illinois,[385] or receives potentially market-moving crop reports and news releases milliseconds before other investors because the HFT firm purchases direct access to news releases and reports,[386] probably does not violate the CEA or CFTC Regulations by using that information to rapidly detect and trade ahead of another market participant's large trade. That is, the advance receipt of one's own order confirmations, news reports, or (thanks to co-location) trade data, by itself, probably would not make the conduct illegal because, as mentioned, high-speed pinging is unlawful to the extent that it is employed in a way that closely resembles existing prohibited practices, such as spoofing and wash trading, and not because the HFT firm engaging in the pinging is receiving information from the futures exchange sooner than other market participants.

Put another way, neither the act of purchasing co-location services from CME nor the extra speedy receipt of one's own trade order confirmations on CME Globex violate the CEA or CFTC Regulations.[387]

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[384] *See* Scott Patterson et al., *High-Speed Traders Exploit Loophole*, WALL ST. J. (May 1, 2013), http://online.wsj.com/news/articles/SB10001424127887323798104578455032466082920 ("The advantage often is just one to 10 milliseconds, . . . [b]ut that is plenty of time for computer-driven traders, who say they can structure their orders so that the confirmations tip which direction prices for crude oil, corn and other commodities are moving."). As mentioned, CME "has taken steps to reduce delays in the time between when clients, including high-speed traders, receive market data and when other firms get the same information." Scott Patterson, *CME Softens High-Speed Traders' Edge, Futures Exchange Moves to Reduce Delays in Market Information*, WALL ST. J. (May 13, 2014), http://online.wsj.com/news/articles/SB10001424052702303851804579559880884993894 (mentioning that CME's executive chairman stated "that there are still delays of as much as a millisecond in certain contracts").

[385] *See CME Co-Location and Data Center Services*, CME GROUP, http://www.cmegroup.com/trading/colocatio/co-location-services.html (last visited Sept. 9, 2014) (stating that one CME's Co-Location is located in Aurora, IL); *see also* Edgar Ortega Barrales, Note, *Lessons from the Flash Crash for the Regulation of High-Frequency Traders*, 17 FORDHAM J. CORP. & FIN. L. 1195, 1246 (2012) ("[T]he use of co-location services . . . give[s] users a split-second advantage over non-users.").

[386] *See, e.g.*, Scott Patterson, *Speed Traders Get an Edge*, WALL ST. J. (Feb. 6, 2014), http://online.wsj.com/news/articles/SB10001424052702304450904579367050946606562 (focusing on this issue from the perspective of the securities markets). While this *Wall Street Journal* article focused on this issue from the perspective of the securities markets, advance receipt of information about certain reports and news releases also could be useful to firms trading futures on commodities such as oil, natural gas, wheat, or stock indexes.

[387] But an HFT firm that engages in high-speed pinging in a manner that involves spoofing (or other illegal trading practices) most probably violates several provisions of the CEA and CFTC Regulation 180.1, for the reasons discussed above, regardless of whether that HFT firms have purchased co-location services or realized that it receives notice of its own trade executions before that information is displayed to other market participants.

As described above, CFTC Rule 180.1 prohibits "insider trading" in futures and derivatives if a person trades on the basis of material nonpublic information that was obtained either (1) in breach of a pre-existing duty arising from other laws, rules, agreements, understandings, or other sources, or (2) through fraud or deception.[388] As such, Rule 180.1 appears to broadly prohibit trading in futures on the basis of material nonpublic information that was obtained in breach of a pre-existing duty that was established by something as amorphous as an "understanding" or that was obtained by any means that could be persuasively characterized as fraudulent or deceptive. Accordingly, Rule 180.1's "insider trading" liability appears to be broader than the conception of insider trading in the securities markets, which requires a breach of a fiduciary duty or a duty of trust or confidence, and even broader than the scope of the *Dorozhko* decision's framework, which requires that the information was obtained with a deceptive fraudulent misrepresentation.

But even the broad reach of Rule 180.1's "insider trading" prohibition does not seem capable of capturing the conduct in question. Nothing indicates that an HFT firm's purchase of co-location services from CME, which are publicized and available to anyone willing to pay, is either a breach of a pre-existing duty or a form of fraud or deception. One could argue that a futures exchange that secretly gave advance notice of trade data to a select group of traders violated a pre-existing duty that was established by an "understanding" that it would treat all traders equally in regards to dissemination of such data, but that does not appear to be what is happening here. Based on news reports, the early receipt of one's own trade confirmations is a flaw in the system that anyone could observe and use in developing trading strategies. Further, as mentioned, CME actively markets its co-location services and provides them to anyone willing to pay. Allowing paying clients to co-locate their computers next to an exchange's matching engine does not appear to violate a pre-existing duty to other market participants as there does not appear to be any basis for an "understanding" that CME would not build a co-location facility and rent space in it. The same is true for HFT firms that buy direct access to news feeds: the practice does not appear to violate a pre-existing duty to anyone or, unless the sale and purchase of direct access to HFT firms has been concealed somehow, to involve fraud or deceit. All of these conclusions, of course, are notwithstanding the fact that some may view the sale of

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[388] *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41398, 41403 (July 14, 2011) ("[A] person who engages in deceptive or manipulative conduct in connection with . . . sale of any commodity in interstate commerce, or contract for future delivery on or subject to the rules of any registered entity . . . or by trading on the basis of material nonpublic information that was obtained through fraud or deception, may be in violation of final Rule 180.1.").

services that give HFT firms an informational head start over other investors to be unfair.[389]

V. SOME THOUGHTS ON THE SCOPE OF EXISTING PROHIBITIONS

The main purpose of this Article is to show that high-speed pinging is potentially illegal based on existing prohibitions in the CEA and CFTC Regulations. Although that outcome raises additional questions that are beyond the scope of this Article, a few deserve mention here. First, given that many (if not a majority of) HFT strategies involve extremely high order cancellation rates, the broad scope of CEA Section 4c(a)(5)(C), the anti-spoofing provision, arguably bans almost all HFT.[390] There does not appear to be any evidence that Congress, in passing the Dodd-Frank Act (which included Section 4c(a)(5)(C)), had intended to prohibit most HFT. The CFTC has not, however, attempted to use Section 4c(a)(5)(C) as a mechanism to prohibit all (or almost all) HFT, and thus seems to be choosing which cases to bring under this provision carefully. Because the definition of spoofing comes from the statute, there might not be much that can be done to limit the expansive reach of Section 4c(a)(5)(C), other than Congressional action or perhaps a CFTC rulemaking to further define—and restrict—the scope of the anti-spoofing prohibition. As it stands, Section 4c(a)(5)(C) arguably prohibits a wide swath of HFT strategies, including, but not limited to, high-speed pinging.

The second issue is that some of the statutory and regulatory provisions, as well as some parts of the federal common law of securities fraud, have been interpreted in ways that rid those provisions of any limiting principle, thereby capturing activities that are arguably beyond their scope. For example, SEC Rule 10b-5—which served as the model for CFTC Rule 180.1—has been interpreted to capture only fraudulent

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[389] There is no broad-based requirement that prohibits unfair conduct in the futures markets. The CFTC promulgated a "fair dealing rule" pursuant to the Dodd-Frank Act, but that rule—CFTC Regulation 23.433, 17 C.F.R. § 23.433 (2012)—only applies to swap dealers and major swap participants, requiring them to communicate with counterparties in a fair and balanced manner. The lack of a broad prohibition against unfairness may very well be due, at least in part, to the difficulty in determining what kinds of behaviors would be labeled as "unfair" (beyond conduct that would fall within existing prohibitions against fraud) and the desire to avoid potentially vague and ambiguous regulatory directives. *See* Gregory Scopino, *Regulating Fairness: The Dodd-Frank Act's Fair Dealing Requirement for Swap Dealers and Major Swap Participants*, 93 NEB. L. REV. 31, 49–50 (2014) (referring to the specifics of the requirements of the fair dealing rule and how it applies to communications).

[390] *See* Matt Levine, *Regulators Not Happy With Guy Whose Algorithm Tricked Some Other Algorithms*, DEALBREAKER (Jul. 22, 2013), http://www.dealbreaker.com/2013/07/regulators-not-happy-with-guy-whose-algorithm-tricked-other-algorithms/ ("If you put in an order knowing that there is a 98% chance that you will cancel it before execution, do you *intend* to cancel it before execution? Like, statistically you sure do. . . . So is every algorithmic trader spoofing all the time? I dunno, I'm sure you can find someone to tell you that the answer is yes.").

activity, but that restriction appears to have long since ceased to serve much of a limiting function given that, under the relevant decisional law, just about any undisclosed manipulative scheme can be equated with fraud.[391] The normal understanding of fraud[392] is that it involves deception,[393] which consists of, among other things, telling untruths. While "conduct itself can be deceptive," one can reasonably question how any order for a trade can be "true" or "false" in a market where the majority of the traders are non-human ATSs (i.e., "algo bots") and where, even more, many such traders hold on to their positions for only fractions of a second.[394] Under such circumstances, it becomes questionable as to how one can unequivocally state that a particular set of orders for trades are "false" (or result in "false" pricing signals to the market), or are in violation of Rule 180.1 or other statutory or regulatory provisions. How is one to distinguish the "true" high-speed orders for trades from the "false" ones? Is each ATS trying to deceive (and thereby defraud) all of the other ATSs in the market? And should the CFTC pursue civil enforcement actions in situations where the facts involve one ATS "deceiving" other ATSs?[395]

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[391] *See* discussion *supra* Part II.C. (referring to the securities law prohibition preventing insider trading).

[392] "Fraud," is defined, inter alia, as "the crime of using dishonest methods to take something valuable from another person," "[the] intentional perversion of truth in order to induce another to part with something of value or to surrender a legal right," and "an act of deceiving or misrepresenting." *Fraud*, MERRIAM-WEBSTER.COM, http://www.merriam-webster.com/dictionary/fraud (last visited Sept. 26, 2014). "Dishonest," is defined, inter alia, as "saying or likely to say things that are untrue," or "containing information that is untrue." *Dishonest*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/dishonest (last visited Sept. 26, 2014).

[393] "Deceit," is defined, inter alia, as "dishonest behavior : behavior that is meant to fool or trick someone." *Deceit*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/deceit (last visited Sept. 26, 2014). "Deception," is defined, inter alia, as "the act of making someone believe something that is not true" and "an act or statement intended to make people believe something that is not true." *Deception*, MERRIAM-WEBSTER, http://www.merriam-webster.com/dictionary/deception (last visited Sept. 26, 2014).

[394] In connection with the securities markets, former SEC Chair Mary Shapiro previously "expressed concerns" and "lament[ed that] the current volume of trading . . . is 'unrelated to the fundamentals of the company that's being traded.'" David S. Hilzenrath, *SEC Still Concerned About High-Frequency Trading*, WASH. POST, Feb. 23, 2014, at A14.

> "It's got very little to do with *whether you think IBM's* got a great business plan and solid earnings growth in its future . . . and a lot more to do with what's the minuscule aberrational price move that you can take advantage of because you've co-located your computer with the exchange and can jump on that in microseconds . . . . And that worries me in some ways."

Id. (quoting SEC Chairman Mary Schapiro). The same could be said in regards to futures contracts for stock indexes and various commodities.

[395] Of course, there are strong policy arguments as to why one would not want to give ATSs free reign to "fight" amongst themselves and thereby move the prices of futures and derivatives up and down at will. For example, to the extent that ATSs-directed trading is affecting the prices of futures and other derivatives contracts in oil and natural gas, such behavior could negatively impact the energy

Despite these philosophical concerns about the scope of liability for firms that use HFT strategies, to the extent that one argues that tactics such as high-speed pinging are not deceptive and therefore not illegal, the same arguments should apply to analogous conduct, such as wash trading, which has been considered an illegal form of fraud in the futures markets for more than seventy years, and also is considered a violation of Rule 10b-5.[396] At present, there does not appear to be any push to make wash trading, banging the close, and spoofing legal.[397] In fact, Congress took the opposite approach with the Dodd-Frank Act by modeling CEA Section 6(c)(1) after Exchange Act Section 10(b) and embracing the "judicial oak" of securities law precedent[398] that, among other things, construes market manipulation schemes as forms of fraud and deception.[399] Thus, as discussed above, to the extent that high-speed pinging falls within the

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markets. *See* Renee Caruthers, *High-Frequency Trading's Manoj Narang Fires Back at Critics*, TRADERS MAG., May 14, 2014 (quoting the chief of the chief of the investor protection bureau of the New York State Attorney General's Office as stating: "Some say this is HFT on HFT violence . . . It doesn't mean it's not harming the system").

[396] *See supra* note 333 and accompanying text (explaining that current legislation views banging the close and wash trading as "illegal manipulative and deceptive devices").

[397] For example, in connection with spoofing, i.e., placing and then immediately cancelling orders for trades, a report by the Federal Reserve Bank of Chicago stated the following:

> Under normal operating conditions, no market participant should be permitted to cancel an order before first obtaining an acknowledgement from the trading venue that the original order was received. We can envision no legitimate trading strategy where the practice of cancelling an order in this way would be necessary and any number of intentionally deceptive trading strategies where it would.

JOHN MCPARTLAND, FED. RESERVE BANK OF CHI., RECOMMENDATIONS FOR EQUITABLE ALLOCATION OF TRADES IN HIGH FREQUENCY TRADING ENVIRONMENTS 2–3 (2014) (footnote omitted), *available at* http://www.chicagofed.org/digital_assets/publications/policy_discussion_papers/2013/PDP2013-01-original.pdf. Indeed, even some HFT firms appear to believe that spoofing is improper. *See* Jeff Cox, *HFT Advocate: Get Rid of the Fake Bid-Makers*, CNBC (May 8, 2014, 2:20 PM), http://www.cnbc.com/id/101655914 (describing "spoofing" as "submitting anonymous bids then withdrawing them in a matter of seconds" because "[t]he idea is to push a price up briefly, get others to buy, [and] then sell[] shares at a higher profit," and stating that "HFT lobbyist Peter Nabicht" said that "[m]anipulation or spoofing hurts all legitimate market participants and those doing it should be removed from the markets. If you do many of the firms using HFT will be the first to stand up and cheer"). Even more, in August of 2014, HFT firm HTG Capital Partners was reported to have filed an arbitration case against another HFT firm, Allston Trading, for allegedly engaging in spoofing on one of CME's exchanges. Matthew Leising & Saijel Kishan, *Allston Accused by HFT Rival of Manipulating CME Prices*, BLOOMBERG (Aug. 30, 2014), http://www.bloomberg.com/news/2014-08-29/allston-accused-by-hft-rival-of-manipulative-trading.html.

[398] 156 CONG. REC. S3348 (daily ed. May 6, 2010) (statement of Sen. Cantwell).

[399] *See, e.g.*, Gurary v. Winehouse, 190 F.3d 37, 45 (2d Cir. 1999) ("In order to make out a claim under Rule 10b-5. . . the plaintiff must allege culpable deception in connection with the purchase or sale of a security.") (internal quotation marks omitted) (quoting Acito v. Imcera Grp., Inc., 47 F.3d 47, 52 (2d Cir. 1995). Indeed, as mentioned, federal prosecutors in Chicago even brought *criminal* charges against a high-frequency trader who is alleged to have violated the new anti-spoofing provision in the CEA. *See* Coscia Indictment, *supra* note 203. In the indictment, the prosecutors characterized spoofing as deceiving other market participants. *See, e.g.*, *id.* at ¶¶ 3 & 10.

ambit of such prohibitions, it is also likely banned.[400]

VI. CONCLUSION

Despite the common perception that high-speed pinging and related tactics are legal, four CEA provisions and one CFTC Regulation arguably prohibit at least some of those kinds of trading practices. Wash trading and banging the close are illegal manipulative and deceptive devices in the securities markets under Exchange Act 10(b) and SEC Rule 10b-5, and, therefore, are most probably prohibited under CEA Section 6(c)(1) and Rule 180.1 as well. High-speed pinging is arguably analogous to wash trading and banging the close. As such, high-speed pinging—in which "ping" orders and trades serve a role much like decoys to fool large traders into revealing themselves—might very well violate Section 6(c)(1) and Rule 180.1. Even more, high-speed pinging inevitably involves submitting, and then almost immediately cancelling, orders for trades, a fact that makes the practice likely a violation of the CEA's new anti-spoofing provision, if not other provisions banning false reports and the reporting of non-bona fide prices. In conclusion, HFT firms might arguably be the fastest sharks swimming in the oceans of financial data, but the CFTC and private plaintiffs might have nets—in the form of relevant statutory and regulatory provisions—capable of catching them.

[400] If this Article is somehow incorrect, and if none of the provisions relied upon above turn out to prohibit high-speed pinging, then the next question, which is beyond the scope of this Article, is whether Congress should amend the CEA (or whether the CFTC should promulgate a rule) to explicitly make high-speed pinging (or other forms of HFT conduct) illegal. For example, in connection with the securities markets, SEC Commissioner Kara Stein has stated, "[w]e should be carefully considering whether there has been illegal conduct. But we also need to revise or create new rules to stop conduct that we think should be illegal." Peter Schroeder, *Wall Street's Need for Speed Spurs Debate*, THE HILL (July 11, 2014), http://thehill.com/policy/finance/211970-wall-streets-need-for-speed-spurs-debate. While Stein was speaking in reference to the securities markets, Congress and the CFTC should likewise determine if specific trading practices in the futures and derivatives markets should be prohibited.