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Government Secures its First Win under Dodd-Frank Anti-spoofing Provisions

By Leke Badivuku, J.D. Candidate 2018 | December 2, 2015

The Department of Justice ("DOJ") has secured a criminal conviction in its first case concerning the manipulation of high-frequency markets by "spoofing" orders purposefully designed to influence movement within those markets. Michael Coscia was convicted of six counts of commodity fraud under 18 U.S.C. § 1348 and six counts of "spoofing" under 7 U.S.C. § 6c(a)(5)(C) after a reported jury deliberation lasting only one hour.

To Spoof or Not to Spoof, that is Now a Criminal Question

"Spoofing" has been the subject of much analysis and criticism after the 2010 Flash Crash Crisis. High-frequency trading ("HFT"), propagated by automated trading algorithms calculating and executing buys and sells in a millisecond's worth of time, depend on a host of assumptions to properly capture profits. While HFT has been criticized for increasing short-term volatility, it constitutes over half of trade volume in U.S. equities and has become a dominant strategy by financial players.

"Spoofing" can be characterized as an attempt to take advantage of HFT assumptions. In a simplified scenario, a spoof attempts to convince the market of a sudden change in supply or demand by inputting large orders on one side of the market. In turn, this convinces HFT algorithms that a market change is real. After that, as the market reacts to this large order, the spoofer puts in a small order on the other side of the change that gets filled by other parties and then follows up by canceling the larger order. The market will eventually correct itself, but in the short-term, the spoofer will have gained a small profit.

While spoofing had previously been subject to fines by market exchanges and agencies such as the Commodities Future Trading Commissions ("CFTC"), new anti-spoofing regulations in the Dodd-Frank Act have made spoofing a criminal offense.

U.S. v. Coscia

Michael Coscia is the first to be indicted under the new Dodd-Frank Act provisions. The indictment essentially alleged that Coscia spoofed large orders for six commodities future transactions and utilized software solicited specifically for the purpose of spoofing in a deliberate attempt to misrepresent market shifts and turn a profit. The DOJ alleged Coscia had profited approximately to the tune $1.6 million overall as a result of his spoofing strategy. However, in their indictment, the Government sought to show that six specific transactions, with profits ranging from $60 - $560 each, were done via spoofing with the intent to commit fraud. Presumably, the indictment was crafted purposively to be limited to transactions that the Government could prove were "spoofing," as opposed to the more ambiguous definition of spoofing known colloquially throughout trading communities.

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Coscia filed a motion to dismiss on the grounds that he could not be subject to the anti-spoofing provisions because the statutes were impermissibly vague and that he had not made any material misrepresentations necessary for fraud by submitting trade orders. However, the court denied the motion and allowed Coscia's indictments to proceed to trial.

The Government received a better than expected affirmation of its test case. As Bloomberg Business notes, Coscia was likely a test case for the new anti-spoofing provisions. After an especially quick verdict, prosecutors may finally get the confidence needed to fully pursue Navinder Singh Sarao, indicted this past September for spoofing activities that allegedly contributed to the 2010 Flash Crash Crisis. Though Singh is currently fighting extradition, prosecutors now have better footing after the Coscia case to ramp up criminal enforcement against spoofing and individuals like Singh who are suspected of using this tactic to game the system.