

**DETECTING DISRUPTION IN THE DERIVATIVES MARKETS:
A REVIEW OF THE CFTC'S NEW AUTHORITY OVER DISRUPTIVE
TRADING PRACTICES**

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Almost three years ago, in July 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) amended section 4c(a) of the Commodity Exchange Act (CEA), to add three types of prohibited transactions deemed to be “disruptive of fair and equitable trading”—trading that violates bids and offers, trading with reckless disregard for orderly executions during the closing period, and so-called “spoofing.”¹ The enforcement division of the Commodity Futures Trading Commission (CFTC) trumpeted its new authority, claiming that the Dodd-Frank Act had given the agency a “bigger arsenal of weapons.”² Nonetheless, in the more than eighteen months since amended section 4c(a) became effective,³ the CFTC has yet to file or settle a single enforcement case alleging violations of amended section 4c(a).

Market participants in the ever-growing commodities and swaps markets should not take comfort in this delay. As demonstrated by the cases discussed in this Article, the lack of CFTC enforcement of amended section 4c(a) appears to be a function of timing rather than a reflection of regulatory disinterest. Indeed, the CFTC has brought charges in the past based on all three types of trading activity that the CEA now expressly prohibits.

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¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 747, 124 Stat. 1376, 1739 (2010).

² Christopher Doering, *New CFTC Enforcement Chief Vows to be Aggressive*, REUTERS, May 5, 2011, available at <http://www.reuters.com/article/2011/05/05/financial-regulation-cftc-enforcement-idUSN059778220110505.c>

³ These provisions took effect on July 16, 2011. See Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 67,301, 67,302 (proposed Nov. 2, 2010) (requesting comments as part of advance notice of proposed rulemaking and explaining that the provisions amending section 4c(a) will take effect 360 days after the enactment of the Dodd Frank Act, which took place on July 21, 2010).

These prosecutions are likely to continue, and the CFTC will probably pursue them with more frequency as a result of the amendments under Dodd-Frank.

The amendments to section 4c(a) generate two principal questions: first, what types of trading activity will the CFTC likely target as violations of the amended statute? Second, what must the CFTC prove to establish those violations? This Article attempts to answer these questions by explaining the key language in the amendment, including how the CFTC plans to interpret it, and by examining recent enforcement activity in the commodities industry to identify trends in the cases, including defenses the CFTC is likely to reject.

I. THE CFTC’S NEW AUTHORITY UNDER SECTION 4c(a) OF THE CEA

As amended by Dodd-Frank, section 4c(a) of the CEA (entitled “Prohibited Transactions”) includes the following section:

- (5) Disruptive practices.—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—
- (A) violates bids or offers;
 - (B) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
 - (C) 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).⁴

The CFTC was not required to promulgate rules to make these provisions effective, and it has not done so. Instead, it sought public comments on a list of questions related to the scope and nature of the prohibitions,⁵ and then issued a proposed interpretive order (Proposed Interpretive Order) to explain how it intends to enforce amended section 4c(a).⁶ A final interpretive order has not been released, but the Proposed Interpretive Order is effective until superseded by a subsequent order.

As explained below, although two of the three sub-parts under amended section 4c(a) appear to refer to specific trade practices, the boundaries for all three prohibitions remain largely undefined.

⁴ 7 U.S.C. § 6c(a)(5) (2012).

⁵ See Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, *supra* note 3, at 67,301.

⁶ Antidisruptive Practices Authority, 76 Fed. Reg. 14,943 (proposed Mar. 18, 2011) [hereinafter Proposed Interpretive Order].

A. A Trader Who “Violates Bids or Offers” Faces Strict Liability under Section 4c(a)(5)(A)

Unlike the latter two prohibitions in amended section 4c(a)(5), each of which specifies a level of intent necessary to establish a violation, the prohibition of trading that “violates bids or offers” appears to create a strict liability offense because it does not indicate whether a trader must act with any degree of culpability.⁷ The CFTC has adopted this same reading of the statute, and plans to bring enforcement actions for violations of section 4c(a)(5)(A) regardless of the trader’s intent.⁸ In other words, traders who violate bids or offers may face regulatory enforcement regardless of whether they do so intentionally or negligently (or even through no fault of their own). The CFTC’s stance reflects its opinion (and its interpretation of Congress’s apparent opinion) that there is no legitimate reason for a trader to violate bids or offers.

But what exactly does it mean to “violate[] bids or offers”? Although the statute does not provide a definition, the CFTC plans to interpret this phrase as prohibiting a person from “buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price.”⁹ The CFTC, however, does not view section 4c(a)(5)(A) as creating a “best execution standard across multiple trading platforms and markets,” some of which may have different bid-ask spreads for the same contracts.¹⁰ Thus, for example, even if the lowest offer for a near-month WTI Crude Oil futures contract on the Chicago Mercantile Exchange (CME) is below the lowest offer for the same contract on the IntercontinentalExchange (ICE), buying the contract on ICE would not constitute a violation of the prevailing offer on CME.

Two other key limitations help clarify this offense. First, the CFTC does not intend to apply the prohibition on violating bids and offers to traders’ attempts to “buy the board.”¹¹ That is, a trader legitimately may enter an order to purchase or sell such a large quantity of contracts, and at prices either higher or lower than the best existing bid or offer, that the trader’s order executes against all resting quotes, provided that the trader does so in accordance with the exchange’s rules.¹² Second, the CFTC’s Proposed Interpretative Order suggests that the prohibition on violating bids and offers applies only when a trader has control over the bids or offers she selects.¹³ Thus, trades made on an electronic trading platform that uses automated order-matching software should not give

⁷ 7 U.S.C. § 6c(a)(5).

⁸ Proposed Interpretive Order, *supra* note 6, at 14,946.

⁹ *Id.* at 14,945–46.

¹⁰ *Id.* at 14,946.

¹¹ *Id.*

¹² *Id.*

¹³ *Id.* The concept of “control” may prove elusive. For example, does control exist if a developer programs an algorithm that is not susceptible to change or modulation by a trader?

rise to liability under this section to the extent that such software precludes parties from buying higher or selling lower than prevailing market prices.

Based on these final two limitations, it would appear that the majority of traders operating on electronic exchanges need not be overly concerned about inadvertently violating section 4c(a)(5)(A). The same cannot be said in the over-the-counter (OTC) markets, where traders may seek to negotiate privately with a counterparty for various reasons, including the size of the trader's position or a past business relationship. If a negotiated transaction in these markets occurs outside the range of current bids or offers, one of the two parties may be in violation of section 4c(a)(5)(A). Despite acknowledging the public's concern about how this provision will be applied in OTC markets,¹⁴ the CFTC has declined to offer guidance on this point. Thus, the risk of strict liability remains for traders in OTC markets.

B. The Prohibition of Conduct that Disregards “Orderly Execution” under Section 4c(a)(5)(B) is Akin to a Stripped-Down Ban on Manipulation

The second “disruptive practice” added by the Dodd-Frank Act—trading that demonstrates “intentional or reckless disregard for the orderly execution of transactions during the closing period”—creates the most risk for market participants of the three new prohibitions for several reasons. First, it focuses specifically on trading activity during the closing period, which is one of the most actively traded periods during the trading day.¹⁵ The concentration of trades at the end of the trading day leads to greater movements in price, which in turn attracts the attention of regulators. Now that the CEA expressly targets trading misconduct during the settlement period, the CFTC may be more willing to issue section 4g requests for information in the wake of large price movements.¹⁶

Second, and more importantly, the amendment to section 4c(a) does not define the phrase “orderly execution of transactions” or identify examples of activities that “disregard” such executions.¹⁷ The CFTC likewise does not offer any definitions or examples in its Proposed Interpretive Order.¹⁸ It merely identifies the “parameters” that exist in an orderly market, including “a rational relationship between consecutive prices, a strong correlation between price changes and the volume of trades, levels of volatility that do not materially reduce liquidity, accurate relationships between the price of a derivative and the underlying” and “reasonable spreads between contracts for near

¹⁴ See *id.* at 14,945 nn.29 & 33 (citing comment letters).

¹⁵ David Cushing & Ananth Madhavan, *Stock Returns and Trading at the Close*, 3 J. FIN. MARKETS 45, 46, 66 (2000) (measuring impact of increased end-of-day trading on stock prices), available at <http://www.sciencedirect.com/science/article/pii/S1386418199000129>.

¹⁶ See generally 7 U.S.C. § 6g (2012) (describing the trading records that must be maintained and available for inspection).

¹⁷ *Id.* § 6c(a)(5)(B).

¹⁸ See Proposed Interpretive Order, *supra* note 6.

months and for remote months.”¹⁹ Yet none of these “parameters” appears logically to relate to a specific type of conduct. They are closer in kind to the factors courts consider in manipulation cases in deciding whether “artificial prices” existed in the market.²⁰ Unlike in manipulation cases, however, a trader need not specifically intend to cause artificial prices²¹ to violate section 4c(a)(5)(B). It is enough if the trader recklessly disregards the risk that her trades could cause disorderly executions—that is, the defendant is so careless as to the risk of causing disorderly executions that it is difficult to believe she “was not aware of what [s]he was doing.”²² As a result, this section presents a more appealing enforcement option for the CFTC in manipulation cases that lack an obvious price effect or contemporaneous evidence of manipulative intent.

Finally, the CFTC’s Proposed Interpretive Order expands significantly the scope of trading that could violate section 4c(a)(5)(B) by suggesting that offending transactions could include (1) the mere submissions of bids and offers,²³ (2) trades done *outside* of the closing period,²⁴ and (3) cash market transactions in physical commodity markets where the contracts in question are used to establish a settlement price for a futures contract or swap.²⁵

C. The Prohibition of “Spoofing” under Section 4c(a)(5)(C) Targets Order-Entry Misconduct, but May Cover Legitimate High-Frequency Trading Activity

The final disruptive practice added by the Dodd-Frank Act—so-called “spoofing”—is the only one defined in the CEA. According to section 4c(a)(5)(C), spoofing occurs when a trader enters a bid or offer “with the intent to cancel the bid or offer before execution.”²⁶ In other words, to establish a violation of this provision, the CFTC apparently must prove that a trader did not intend for her order to be filled. Whether the order is eventually filled is irrelevant; it is the trader’s intent at the time the order is submitted that determines the violation.²⁷

But how can the CFTC prove the necessary intent given that every order, once

¹⁹ *Id.* at 14,946.

²⁰ *See, e.g.,* *Sanner v. Bd. of Trade of Chi.*, No. 89 C 8467, 2001 WL 1155277, at *4 (N.D. Ill. Sept. 28, 2001).

²¹ *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg. 41,398, 41,407 (July 14, 2011) (to be codified at 17 C.F.R. pt. 180) (articulating the traditional four-part test for commodities manipulation).

²² *See* Proposed Interpretive Order, *supra* note 6, at 14,946, n.40 (citing *Drexel Burnham Lambert, Inc. v. Commodity Futures Trading Comm’n*, 850 F.2d 742, 748 (D.C. Cir. 1988 (quoting *First Commodity Corp. v. Commodity Futures Trading Comm’n*, 676 F.2d 1, 7 (1st Cir. 1982))).

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.* at 14,946 n.42.

²⁶ 7 U.S.C. § 6c(5)(C) (2012).

²⁷ *See* Proposed Interpretive Order, *supra* note 6, at 14,947.

submitted, is at risk of being executed? In certain cases, the CFTC may be able to rely on contemporaneous evidence of the trader's intent, such as emails, instant messages, or phone recordings in which the trader confirms that she plans to submit and cancel her orders before execution. If no such evidence exists, the CFTC likely will rely on circumstantial evidence of the trader's intent. Such evidence could include the number and pattern of orders submitted, the length of time orders remained active before being cancelled, the nature of the trading methodology, or the viability of the order in the first place (that is, whether the price of the order was close to the market price at the time of submission). Moreover, as discussed below, in cases involving automated trading, the CFTC is likely to demand that algorithmic code be provided for purposes of ascertaining intent. In essence, the CFTC will need to show that the most logical inference to be drawn from the trader's activity is that she entered orders with the intent to cancel them before execution.

The intent calculus is clearly more difficult in the case of high-frequency traders. According to the CFTC's draft definition from October 2012, high-frequency trading is a form of automated trading that uses computer algorithms to produce a high rate of orders, quotes or cancellations.²⁸ Mary Schapiro, the former chairman of the U.S. Securities and Exchange Commission, has estimated that high-frequency traders cancel "at least 90 percent of their orders."²⁹ As such, these traders undoubtedly know at the time they submit their orders that they will cancel many, if not most, of them before execution. Knowledge of a high likelihood of cancellation is not the same as intent to cancel, but it could come close. Consider, for example, a high-frequency trading algorithm (controlled by an individual trader) that submits a large group of orders at one time at varying price points, some of which have no reasonable chance of being executed based on market prices at the time of entry. Why has the trader (or the algorithm) included orders unlikely to be filled? Did they enter the orders to provide cover for other, illegitimate trading activity? In a slightly different scenario, what if the trader programs the algorithm to immediately cancel all outstanding orders after a certain number of executions have occurred? In that case, is the trader not entering orders with intent to cancel most of them before execution? To answer some of these questions, the CFTC may need to review the computer code behind the trading algorithm, which, from the CFTC's perspective, could provide more circumstantial evidence of intent. For these reasons and others, high-frequency traders could become a frequent target for the CFTC in enforcing the prohibition on spoofing in section 4c(a)(5)(C).

²⁸ Working Group 1, Subcomm. on Automated and High Frequency Trading, CFTC Technology Advisory Comm. 4 (Oct. 30, 2012), http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/tac103012_wg1.pdf (last visited Feb. 21, 2013).

²⁹ Jesse Westbrook, *SEC Considers Rules for High-Frequency Traders After Plunge*, BLOOMBERG (Sept. 7, 2010), <http://www.bloomberg.com/news/2010-09-07/sec-weighs-new-rules-for-high-frequency-traders-after-may-6-market-plunge.html>.

In addition, though this section specifically bans “spoofing,” it also prohibits a more general category of conduct that is “of the character” of spoofing.³⁰ In an apparent attempt to give meaning to this phrase, the CFTC in its Proposed Interpretive Order provided examples of conduct that does not necessarily fit the “intent to cancel” definition of spoofing but will still violate section 4c(a)(5)(C), 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; and (iii) submitting *or* cancelling multiple bids or offers to create an appearance of false market depth.³¹

Again, however, these are only examples. By prohibiting conduct “of the character” of spoofing, the Dodd-Frank Act left it to the CFTC to determine what other types of order-entry misconduct to prosecute under section 4c(a)(5)(C).

II. DRAWING GUIDANCE FROM PRIOR ENFORCEMENT ACTIONS INVOLVING CONDUCT NOW PROHIBITED BY SECTION 4c(a)

Although the Dodd-Frank Act added three new prohibited practices to CEA section 4c(a), the practices themselves are not new, nor is the CFTC’s stance on their legality. As discussed below, both the CFTC and self-regulatory agencies have brought charges in the past based on the same conduct now expressly prohibited under Dodd-Frank. These cases provide additional insight into the type of conduct the CFTC may prosecute in the future under CEA section 4c(a)(5).

A. The CFTC Believes the Violation of Bids and Offers is a Serious Enough Offense to be Charged as Market Manipulation

The CFTC has filed just one enforcement action based on a trader’s violation of bids and offers—*In the Matter of Anthony J. DiPlacido*³²—but that case is also the only market manipulation case the agency has ever successfully litigated to final judgment. In *DiPlacido*, the CFTC accused the respondent, a registered floor broker on the New York Mercantile Exchange (NYMEX) trading on behalf of his client, Avista, Inc., of

³⁰ 7 U.S.C. § 6c(5)(C).

³¹ Proposed Interpretive Order, *supra* note 6, at 14,947 (emphasis added).

³² Anthony J. DiPlacido, CFTC Docket No. 01-23, 2008 WL 4831204 (Nov. 5, 2008), *aff’d sub nom.* DiPlacido v. Commodity Futures Trading Comm’n, 364 Fed. Appx. 657 (2d Cir. 2009) (summary order). Though *DiPlacido* is the only CFTC case based clearly on a trader’s violation of bids or offers, it is possible that exchanges have brought disciplinary proceedings against members for violation of exchange rules prohibiting this same conduct. *See* Complaint at 11–12, U.S. Commodity Futures Trading Comm’n v. Welsh, No. 12 CV 1873, 2012 WL 846664 (S.D.N.Y. Mar. 14, 2012) (alleging that defendant instructed NYMEX floor clerk to violate exchange rules “prohibiting buying at a price higher than the prevailing bid-ask spread” in his attempt to manipulate prices upward).

attempting to manipulate and successfully manipulating the price of certain electricity futures contracts traded on NYMEX in violation of sections 6(c), 6(d) and 9(a)(2) of the CEA.³³ In particular, the CFTC alleged that DiPlacido traded in large quantities during the closing period and either offered at prices below the prevailing bid price in the pit (i.e., violated bids), or bid at prices higher than the prevailing offer prices (i.e., violated offers).³⁴

The Administrative Law Judge found DiPlacido liable for attempted and actual manipulation,³⁵ and the CFTC affirmed. The U.S. Court of Appeals for the Second Circuit later affirmed the CFTC's decision by summary order.³⁶ Among other things, the CFTC concluded that DiPlacido's repeated violation of bids and offers was sufficient to establish (1) that he acted with manipulative intent because his conduct had "no apparent economic rationale,"³⁷ and (2) that his conduct produced artificial prices because he necessarily "paid more than he had to" for the contracts and thus injected artificial forces in the market.³⁸ The CFTC relied on a 1971 decision by its predecessor agency as support for both of these conclusions even though the respondent in that case was not found to have violated any bid or offer.³⁹

The CFTC's decision in *DiPlacido* supports its stated intent in the Proposed Interpretive Order to treat the offense of violating bids and offers in section 4c(a)(5)(A) as a strict liability offense. Indeed, the CFTC can point to an adjudicated decision by the full Commission—affirmed by the Second Circuit, no less—holding that there is no legitimate reason for a trader to violate bids or offers.⁴⁰ DiPlacido tried to challenge this presumption in his case, arguing that his conduct did have a legitimate purpose: he was trading aggressively in order to help his client quickly unwind its hedge of positions in other markets.⁴¹ But the CFTC and the Second Circuit rejected this argument without any discussion, and likely will do so again in the future if it is raised in defense of charges that a trader violated bids or offers under section 4c(a)(5)(A). In other words, although a single transaction may be part of a much larger, complicated trading strategy, that does

³³ *DiPlacido*, 2008 WL 4831204, at *1–2.

³⁴ *See id.* at *3–8.

³⁵ *Id.* at *1.

³⁶ *DiPlacido*, 364 Fed. Appx. at 659.

³⁷ *DiPlacido*, 2008 WL 4831204, at *28.

³⁸ *See id.* at *31 (quoting David G. Henner, 30 Agric. Dec. 1151, 1194 (U.S.D.A. 1971)).

³⁹ *See* David G. Henner, 30 Agric. Dec. 1151 (U.S.D.A. 1971). The respondent in *Henner* "bought the board" in the closing seconds of the trading day and then immediately bid for an additional futures contract (later executed) at a price higher than any trades that day—but no offers were standing at that point, so none were "violated." *See id.* at 1161–62 The Department of Agriculture held that the respondent's conduct amounted to manipulation because he had "intentionally paid more than he would have had to pay . . . for the purpose of causing the closing quotation [to increase]." *Id.* at 1174.

⁴⁰ *See DiPlacido*, 2008 WL 4831204, at *26.

⁴¹ *See* Reply Brief for Petitioner at 14, *DiPlacido*, 364 Fed. Appx. 657 (No. 08-5559-ag), 2009 WL 7768656, at *13.

not excuse the trader from liability for violations arising out of the transaction.

B. The CFTC Faces a Much Easier Route to Prosecuting Disorderly Trading during the Closing Period

The most reasonable interpretation of the new prohibition of trading that disregards orderly executions during the closing period is that Congress was trying to make it easier for the CFTC to prevent conduct more commonly known as “marking” or “banging” the close. According to the CFTC, “banging the close” is

[a] manipulative or *disruptive trading practice* whereby a trader buys or sells a large number of futures contracts during the closing period of a futures contract (that is, the period during which the futures settlement price is determined) in order to benefit an even larger position in an option, swap, or other derivative that is cash settled based on the futures settlement price on that day.⁴²

The CFTC previously charged this type of activity as manipulation.⁴³ For example, in its case against the now-defunct Amaranth Advisors LLC, the CFTC alleged that the hedge fund, its affiliates, and a key employee sold an excessive number of natural gas futures contracts during the closing period with the intent of lowering the futures settlement price because they knew that a lower settlement price would benefit the defendants’ even larger short position in natural gas swaps.⁴⁴ The CFTC charged the defendants with attempted manipulation, and eventually settled those charges for \$7.5 million after the court denied the defendants’ motion to dismiss.⁴⁵

The *Amaranth* settlement, though a positive result for the CFTC, did not improve the agency’s record in adjudicated manipulation cases,⁴⁶ where the CFTC has prevailed just once in its nearly 40-year history.⁴⁷ As explained by CFTC Commissioner Bart Chilton in 2009, prior to the enactment of the Dodd-Frank Act:

Proving manipulation under current law is so onerous as to be almost impossible. Under current law, the CFTC is required to prove “specific

⁴² See *CFTC Glossary*, U.S. COMMODITY FUTURES TRADING COMM’N, http://www.cftc.gov/consumerprotection/educationcenter/cftcglossary/glossary_b (last visited Mar. 11, 2013) (emphasis added).

⁴³ See, e.g., U.S. Commodity Futures Trading Comm’n v. Amaranth Advisors L.L.C., 554 F. Supp. 2d 523, 528 (S.D.N.Y. 2008); Christopher Louis Pia, CFTC No. 11-17, 2011 WL 3228315, at *1 (July 25, 2011); Complaint at 2, U.S. Commodity Futures Trading Comm’n v. Welsh, No. 12 CV 1873, 2012 WL 846664 (S.D.N.Y. Mar. 14, 2012).

⁴⁴ *Amaranth Advisors*, 554 F. Supp. 2d at 528.

⁴⁵ U.S. Commodity Futures Trading Comm’n v. Amaranth Advisors L.L.C., No. 07 Civ. 6682(DC), 2009 WL 3270829 (S.D.N.Y. Aug. 12, 2009).

⁴⁶ See, e.g., 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.”).

⁴⁷ See *DiPlacido v. Commodity Futures Trading Comm’n*, 364 Fed. Appx. 657 (2d Cir. 2009).

intent” to create an artificial price—a price not responsive to the forces of supply and demand. . . . Specific intent to manipulate is not always equivalent to intent to deceive—it requires something more, and it’s also very difficult to prove the existence of an “artificial price.” All in all, it makes for a very difficult legal burden, not to mention that it leaves a lot of wiggle room for mischief that is clearly prohibited by the Act.⁴⁸

In contrast to the specific intent standard described by Commissioner Chilton and required in “banging the close”-type cases brought prior to the Dodd-Frank Act,⁴⁹ the CFTC can now prosecute disorderly trading during the closing period under section 4c(a)(5)(B) and establish a violation by showing that the defendant acted recklessly.⁵⁰ The difference between these two standards of intent cannot be overstated. Whereas recklessness requires proof that the defendant’s conduct was highly unreasonable, specific intent requires proof that the defendant’s subjective goal was to bring about the prohibited result. Thus, for example, while a defendant carrying out a legitimate trading strategy cannot, as a matter of law, act with the specific intent to cause disorderly executions during the closing period, the same strategy could be deemed reckless—thereby satisfying section 4c(a)(5)(B)—if the defendant ignored the likely effect of her conduct.⁵¹ For this reason, the CFTC is likely to file far more cases based on misconduct during the closing period than it has in the past.

It should also be noted that the CFTC has not restricted its authority under section 4c(a)(5)(B) to “banging the close” cases. Though several market participants suggested in response to the CFTC’s notice of proposed rulemaking that the prohibition under section 4c(a)(5)(B) be limited to manipulative conduct similar to “banging the close,”⁵² the CFTC declined to adopt such a limitation. Thus, while prior “banging the close” cases are instructive, they do not cover the range of possible violations of section 4c(a)(5)(B).

⁴⁸ Bart Chilton, Comm’r, Commodity Futures Trading Comm’n, “De Principatibus” (Oct. 21, 2009), <http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-28> (last visited Mar. 11, 2013); *see also* Jerry W. Markham, *Manipulation of Commodity Futures Prices—The Unprosecutable Crime*, 8 YALE J. ON REG. 281, 356–57 (1991) (“The small number of cases brought and the very small number of respondents who have been subject to significant sanctions, particularly in contested cases, suggest that manipulation is virtually an unprosecutable crime. This is due to the difficulty of meeting the standards of manipulation Even where a gross manipulation occurs, the government is still faced with the imposing burden of proving that the price was artificial and that the trader was attempting to create an artificial price rather than exploiting a market situation based upon natural forces.”).

⁴⁹ *See, e.g., Amaranth Advisors*, 554 F. Supp. 2d at 532–34.

⁵⁰ 7 U.S.C. § 6c(a)(5)(B) (2012).

⁵¹ *See* Proposed Interpretive Order, *supra* note 6, at 14,946.

⁵² *Id.* at 14,946 n.39 (citing a letter from the Futures Industry Association as one example).

C. The CFTC has Charged “Spoofing” under Two Other Sections of the CEA, but Neither Section Clearly Fits the Violation

Of the three new prohibited practices under amended section 4c(a)(5), the prohibition on “spoofing” is arguably the one with the clearest history of prior enforcement by the CFTC, as well as by exchanges. In the past two years, the CFTC has settled two enforcement actions based on conduct now defined in the CEA as spoofing,⁵³ and the CME and Chicago Board of Trade (a designated contract market within CME Group) have settled three such actions.⁵⁴ In all but one of these matters,⁵⁵ the conduct in question occurred prior to the enactment of the Dodd-Frank Act—that is, prior to the time the CEA specifically prohibited spoofing.⁵⁶

The alleged spoofing violations in all of these cases occurred during the pre-opening session on CME’s electronic trading platform, Globex. Orders cannot be executed during this 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 Indicative Opening Price (IOP) using data from the unexecuted orders sitting 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.⁵⁷

The traders sanctioned by the CFTC and CME Group each sent (and later cancelled) large orders into Globex during the pre-opening session at varying prices. The orders moved the IOP up or down, depending on the prices in the orders. Although other

⁵³ Gelber Group, LLC, CFTC Docket No. 13-15, 2013 WL 525839 (Feb. 8, 2013); Bunge Global Markets, Inc., CFTC Docket No. 11-10, 2011 WL 1099346 (Mar. 22, 2011).

⁵⁴ Michael Wisniewski, CME File No. 11-08127 (Aug. 6, 2012) (on file with authors); Gelber Group LLC, CME File No. 09-06442-BC (Nov. 17, 2011) (on file with authors); Kyle McBain, CBOT File No. 10-04622-BC (Nov. 14, 2011) (on file with authors).

⁵⁵ McBain, CBOT File No. 10-04622-BC.

⁵⁶ While the CEA did not expressly prohibit spoofing prior to the Dodd-Frank Act, the offense was clearly on the minds of regulators at the exchange level. In January 2010, for example, CME Group issued an advisory notice reminding market participants that “all orders entered on Globex during the pre-opening are expected to be entered in good faith for the purpose of executing bona fide transactions,” and threatening disciplinary action for all attempts to identify market depth or manipulate the IOP by entering and cancelling orders in the pre-opening session. Advisory Notice, CME Group, Improper Conduct With Respect to Pre-Opening Orders Entered on CME Globex, Advisory No. CME Group RA1001-5 (Jan. 11, 2010), http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/CMEGroup_RA1001-5.html; see also Advisory Notice, CME Group, Improper Conduct With Respect to Pre-Opening Orders Entered on CME Globex, Advisory No. CME Group RA1103-5 (Sept. 20, 2011), http://www.cmegroup.com/rulebook/files/CME_Group_RA1103-5.pdf.

⁵⁷ See *Gelber Group, LLC*, 2013 WL 525839, at *2; *Bunge Global Markets*, 2011 WL 1099346, at *1–2.

market participants could see the movement in the IOP, they had no way of knowing how many orders were being entered into Globex and at what prices. The sanctioned traders, on the other hand, were able to discern the depth of support at different price levels because they knew the IOP had moved in response to their orders. If, for example, the sanctioned trader sent an order to purchase 100 contracts at \$1.00 and saw that the IOP moved less for that order than it had for an order at \$1.05, the trader would know that there was more market depth at \$1.00. The traders then used this information to make trading decisions after the market opened.⁵⁸

In the two CFTC enforcement actions, *Bunge Capital Markets* and *Gelber Group*, the CFTC charged the respondents with violating sections 4c(a)(2)(B) and 9(a)(2) of the CEA.⁵⁹ Section 4c(a)(2)(B) makes it unlawful to cause a non-bona fide price to be reported,⁶⁰ and section 9(a)(2) makes it unlawful to cause false, misleading or knowingly inaccurate reports to be delivered that affect the price of a commodity.⁶¹ Neither of these sections, however, clearly fits the charge of spoofing. In particular, section 4c(a)(2)(B) requires a “transaction,”⁶² 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,”⁶³ 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. Thus, more so than with the other new disruptive practices added to the CEA, the new prohibition on “spoofing” provides a cleaner path for CFTC enforcement than existed prior to the Dodd-Frank Act.

In terms of conduct that the CFTC might charge as being “of the character of” spoofing, cases from the securities industry may offer some guidance. Spoofing in the securities industry is a bit different than in the commodities industry in that it is considered a form of market manipulation and requires that certain orders be executed.⁶⁴ In particular, a securities trader engages in spoofing when she “creates a false appearance of market activity by entering multiple non-*bona fide* orders on one side of the market, at generally increasing (or decreasing) prices, in order to move that stock’s price in a direction where the trader intends to induce others to buy (or sell) at a price altered by the non-*bona fide* orders.”⁶⁵ Often, the trader will cancel any orders that have not been filled

⁵⁸ See *Gelber Group, LLC*, 2013 WL 525839, at *2; *Bunge Global Markets*, 2011 WL 1099346, at *1–2.

⁵⁹ *Gelber Group, LLC*, 2013 WL 525839, at *3–4; *Bunge Global Markets*, 2011 WL 1099346, at *3–4.

⁶⁰ 7 U.S.C. § 6c(a)(2)(B) (2012).

⁶¹ *Id.* § 13(a)(2).

⁶² *Id.* § 6c(a)(2)(B).

⁶³ *Id.* § 13(a)(2).

⁶⁴ See, e.g., *Biremis Corp.*, Exchange Act Release No. 34-68456, 2012 WL 6587520, at *2 (Dec. 18, 2012); Joseph R. Blackwell, Securities Act Release No. 33-8030, 2001 WL 1408738, at *2 (Nov. 5, 2001).

⁶⁵ *Biremis Corp.*, 2012 WL 6587520, at *2.

after she sells (or buys) at artificially high (or low) prices.⁶⁶ This activity is different than the offense of spoofing now prohibited in the CEA because it does not necessarily require a trader to enter orders with the intent to cancel them before execution. Nevertheless, the activity appears sufficiently related to fall under the category of conduct “of the character of” spoofing. The activity thus may give rise to a violation of section 4c(a)(5)(C) if it occurs in the commodities industry.

CONCLUSION

Although it remains to be seen exactly how the CFTC will enforce the new prohibitions of disruptive trading practices found in section 4c(a)(5) of the CEA, the CFTC’s Proposed Interpretative Order and past record of enforcement activity together provide some answers. Congress clearly intended to make it easier for the CFTC to police disruptive trading activity in the derivatives industry, and appears to have accomplished this goal. It is only a matter of time until the CFTC puts its new authority to work.

⁶⁶ *See id.* at *7.