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Regulatory and Enforcement Alert

Conspiracy and Fraud—But Not "Spoofing"? Chicago Jury Sends Signal for Future Market Manipulation Prosecutions

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Yesterday, an Illinois federal jury convicted two former traders, Edward Bases and John Pacilio, for conspiracy to commit wire fraud, wire fraud and commodities fraud in connection with manipulative trading in precious metals futures. The government alleged that Bases and Pacilio sent false signals to the market by placing a genuine order on one side of the market; launching large orders on the opposite side of the market to feign demand; and—once the genuine order was filled—quickly cancelling the large orders.

Such trading activity is commonly referred to, and has, at various times, been prosecuted as "spoofing" under the Commodities Exchange Act (the "CEA"). Here, however, prosecutors charged only a single trading episode (occurring in 2014) as "spoofing" under the CEA—and, significantly, the jury acquitted as to that sole count—instead relying on general anti-fraud statutes in charging the lion's share of the alleged trading misconduct.

That charging decision may have been driven by the fact that most of the trading activity at issue[1] in the trial predated the effective date of the Dodd-Frank Wall Street Reform and Consumer Protection Act outlawing "spoofing"—and, to the extent it came after that effective date, was also outside of the five-year statute of limitations for spoofing.[2] While the former traders argued that the government was attempting to criminalize old conduct after the fact, the DOJ countered that spoofing constituted traditional fraud, which was prohibited before Dodd-Frank.

The Bases/Pacilio verdict was the second time in 12 months that a jury has found spoofing trading activity predating Dodd-Frank and/or outside of the five-year statute of limitations for CEA "spoofing" unlawful under traditional anti-fraud statutes. In September 2020, a Chicago jury convicted two other former traders, James Vorley and Cedric Chanu, for manipulative trading involving spoofing activity. Vorley was convicted on three counts of wire fraud, and Chanu was convicted on seven counts of wire fraud. Neither Vorley or Chanu was charged with traditional "spoofing" under the CEA.

This latest government verdict comes on the heels of several large settlements with financial institutions for spoofing where fines of hundreds of millions of dollars were imposed. Still, some commentators and courts

[1] Here, 14 of 17 specific trading episodes, spanning 2010 to June 2011.

[2] Conspiracy to commit wire fraud and wire fraud, if impacting a financial institution, are each subject to a 10-year statute of limitations.

question whether the traditional anti-fraud statutes, which prohibit any scheme to defraud by means of false or fraudulent pretenses, representations, or promises, should criminalize trading activity where orders are held open long enough to be hit. Indeed, on July 30, 2021, a Chicago federal trial court judge granted Vorley and Chanu bail pending the appeal of their case on the basis that they were entitled to a good faith jury instruction. The court found the good faith instruction presented a "substantial question" under the applicable statute that justified their continued release on bond.

Yesterday's verdict also underscores the importance of electronic communications, including "chats," in actions for manipulative trading, whether prosecuted as "spoofing" or traditional fraud. In both of the trials described above, DOJ presented chat messages in furtherance of the traders' intent to manipulate the market. For example, in Bases/Pacilio, Bases had written in one message to Chanu: "that does show u how easy it is to manipulate it sometimes," and in another message, "I f..k the mkt around a lot." By contrast, a New Haven jury acquitted former metals trader Andre Flotron in 2018 on one count of conspiracy to engage in commodities fraud following defense counsel's arguments that the trading data, by itself, was insufficient to demonstrate Flotron's intent.

Finally, the Bases/Pacilio prosecution reflects DOJ's willingness to utilize general anti-fraud statutes to reach spoofing conduct that may otherwise fall outside of the traditional five-year statute of limitations. The 10-year statute of limitations for conspiracy to commit wire fraud and wire fraud, "if the offense affects a financial institution," has been found by courts in the Second and Ninth Circuits to extend to offenses by financial institutions and their employees. These criminal actions focused on manipulative trading reinforce the importance of effective trade monitoring and surveillance for financial institutions, as well as frequent training for employees on trading patterns that can be viewed by the government as attempts to manipulate the market.

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