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Spoofing Charges Don't Readily Translate To Private Actions

By **Laura Brookover** (November 16, 2018, 3:01 PM EST)

Laura Brookover

Financial regulators have ramped up enforcement activity targeting spoofing, which generally involves sending false signals of increased supply or demand to a contract market by placing and strategically canceling orders to trade. Private plaintiffs have recently filed putative class actions in Chicago and New York on the heels of these government enforcement efforts. The cases are Boutchard v. Gandhi et al. and Cognata v. JPMorgan Chase & Co. et al.[1]

Private spoofing actions like these are largely untested. The U.S. Commodity Futures Trading Commission and the U.S. Department of Justice actions on which they are based are fairly new themselves. But it is clear enough from these recent filings that government charges are not easily repackaged into private class allegations.

Two threshold hurdles for these new cases are apparent even before any analysis of the complexities of the underlying market conduct: The complaints fail to address a significant statute-of-limitations issue, and the class definitions are dramatically overbroad.

Two-Year Statute of Limitations

The private right of action established by the Commodity Exchange Act is subject to a two-year statute of limitations (while the government has a longer window of time to bring charges). It begins to run when a plaintiff has constructive or inquiry notice of the conduct, not actual notice. And while courts will toll the limitations period when there's fraudulent concealment, this may be difficult to allege and prove in the spoofing context.

A plaintiff generally must allege that the defendant took some affirmative step to conceal his conduct. In the realm of spoofing, though, concealment is the default. A built-in function of the exchange's order book is that orders to trade are anonymous. A spoofer doesn't need to take any extra step to conceal his actions. The commingling of a trader's orders with the rest of the anonymized order book accomplishes that for the trader. As for the spoof orders themselves, far from being concealed, their contents are open and visible to anyone who views the order book. Indeed, the point of a spoof order is that the rest of the market sees and reacts to it.

Both of the recent class action complaints were filed more than two years after the claimed spoofing.

The plaintiffs allege fraudulent concealment, but they don't identify any affirmative concealment actions taken by the defendants. Rather, they allege that spoofing is "self-concealing." But if the plaintiffs' theory is that all spoofing is fraudulently concealed for tolling purposes, the statute of limitations would be robbed of any effect. Some unique "plus factor" is necessary so that the fraudulent concealment exception doesn't become the de facto rule in these cases. It is possible to imagine a set of facts that could be alleged to satisfy such a requirement. But the theories offered in the recent complaints fail to point to any affirmative conduct aside from the alleged spoofing itself.

Spoofing Class Definitions

The potential profit from any single act of spoofing can be quite low. Bringing spoofing claims on a classwide basis is a way to transform the small amounts at issue from any one act of spoofing into a more substantial recovery. But it will not be easy to define an ascertainable and viable class in these cases.

Overbroad Classes

In the recent complaints, the class is defined as anyone who transacted in a particular market during a multiyear period. That is substantially overbroad.

To begin with, spoofing, unlike other types of market manipulation, has more concentrated effects. The price impact of spoofing conduct — if any — doesn't linger long. As a result, a class definition that covers every single participant in an entire market for a period of years would sweep in an overwhelming number of participants who were unaffected by spoofing (and some who unknowingly benefited from it). Indeed, the number of individuals in the putative class who lack standing would presumably far outstrip the number of those who do, especially in a high-volume market like the E-Mini S&P 500.

Merits-Based Classes

Theoretically, trade data from exchanges and futures commission merchants could be filtered in a way so as to find the counterparties to a defendant's spoofing transactions. This would address the overbreadth problem by narrowly tailoring the class definition to those actually impacted.

The trading pattern developed for the merits is the cleanest way to accomplish this. No trader spoofs all the time. The beating heart of a spoofing case is the trading pattern that is used to define and isolate the spoofing transactions. It is a set of objective criteria concerning things like order size, cancellation time and hit rate. These criteria both filter out the trader's bona fide trading activity and provide circumstantial evidence of intent. On the merits, the parties vigorously dispute whether the pattern allegations support intent to cancel, or whether conversely those criteria sweep in transactions that belie such intent — thereby casting doubt on the entire theory of liability.

In private class actions, the trading pattern could work overtime as the basis for the class definition as well. It would identify the spoofing transactions and provide a direct line to the counterparties to those transactions — collectively, the putative class. Figuring out the class members would entail simply running a specially coded program on exchange data.

The problem with this approach is that it marries the class definition with the merits. If the alleged trading pattern were to evolve during fact or expert discovery, the class definition would have to evolve in parallel. Otherwise, it would become over- or underinclusive, and the class' claims would not stand or fall together. While this result would be slightly different than a "fail-safe" class, it would suffer from similar feasibility issues.

Conclusion

This discussion only brushes the surface of potential limitations and class definition issues. And those two hurdles are just the beginning; a spoofing class action under the CEA faces countless other obstacles as well, both at class certification and on the merits. It remains to be seen whether private plaintiffs will get traction in their efforts to spin government enforcement charges into class action recoveries.

Laura Brookover is special counsel at Covington & Burling LLP. She previously served in the Division of Enforcement at the U.S. Commodity Futures Trading Commission, where she brought enforcement actions in federal courts across the country.

[1] Boutchard v. Gandhi et al., N.D. Ill. Case No. 18-cv-7041 (filed Oct. 19, 2018); Cognata v. JPMorgan Chase & Co. et al., S.D.N.Y. Case No. 18-cv-10356 (filed Nov. 7, 2018).