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Traders Double Down On Allegations Against CME Group

By **Jeff Sistrunk**

Law360, Los Angeles (July 23, 2014, 5:49 PM ET) -- CME Group Inc. was hit Tuesday with an amended class complaint by a group of traders in Illinois federal court that expands the traders' allegations that the operator of the world's largest futures exchange has given high-frequency traders preferential and illegal access to futures markets.

The 60-page second amended complaint adds additional details to flesh out a trio of traders' claims that CME and the Chicago Board of Trade — a designated contract maker that merged with the CME in 2007 — have entered into secret agreements with certain high frequency trading firms, creating a "two-tiered marketplace" that disadvantages the public and other futures market participants.

According to the plaintiffs, CME and CBOT for years sold purportedly real-time data on the price of U.S. debt instruments, agricultural products, energy, foreign exchange rates, metals and equity indexes to traders and other market participants, which is standard practice.

But traders Mark Mendelson, John Simms and William Charles Braman alleged the exchanges have also entered into "clandestine contracts" with HFTs, illegally selling them sneak peaks of price data and unexecuted order flow and then allowing them to trade on that data.

"Allowing some market participants the ability to trade ahead of large orders and effectively raising or lowering the price paid by institutions and everyone else is a tax on the public," the amended complaint said. "In reality, the advantages given to HFTs by the defendants effectively create a 'zero sum' trading scenario where the HFTs gain what the class loses by effectively allowing HFTs to skim an improper profit on every futures transaction."

A CME representative did not immediately respond to a request for comment Wednesday. CME previously called the suit baseless and vowed to fight the allegations, saying the original complaint was devoid of any supporting facts.

The second amended suit, which follows the **original April complaint** and a prior amended version, also adds as defendants four CME executives, including chairman and President Terrence A. Duffy. The plaintiffs alleged that the defendants violated the Commodity Exchange Act, Commodity Futures Trading Commission rules and regulations and the federal antitrust laws.

Much of the amended complaint focused on allegations that the exchanges have allowed certain HTFs to use an exploitable strategic advantage at the CME called the latency loophole, which allows market participants to know that orders they entered were executed and at what price, and to enter many subsequent orders, all before the rest of the participants learn the statuses of their initial orders.

HFTs use the advance knowledge to discern where large orders are positioned and to anticipate price movements by engaging in exploratory trading by pinging the market with the use of multiple small orders, according to the complaint.

The latency loophole was first brought to light through a media report, and Duffy and other CME executives subsequently made false and misleading statements to the media, investing public and class regarding the exploitation of the loophole by certain HFTs, the plaintiffs claim.

"As a result of defendants permitting and encouraging the use of the latency loophole by certain preferred HFTs, those preferred HFTs did make trades ahead of the public dissemination of information and made improper excess profits from such trades to the detriment of plaintiffs and the class," the complaint said.

Through clandestine contracts and incentive agreements, the defendants are allowing certain HFTs to trade at rates that are nonpublished and, in some instances, free, the suit said.

A confidential witness reported to plaintiffs' counsel knowledge of a clandestine rebate agreement between CME and a large-volume HFT firm that trades in the S&P500 E-Mini contract, arguably the most liquid and one of the most traded contracts in North America, according to the complaint.

The traders are seeking to represent a class of public investors who bought or sold futures contracts listed on CME or CBOT or used real-time futures market data purchased from the defendants between Jan. 1, 2005, and April 10, 2014, and who suffered trading and other financial losses based on the high-frequency traders' purportedly illegal and manipulative trading methods.

The plaintiffs are represented by R. Tamara de Silva of the Law Offices of R. Tamara de Silva and Victor E. Stewart and Robert W. Rodriguez of Lovell Stewart Halebian Jacobson LLP.

CME is represented by Jerrold E. Salzman, Charles F. Smith and Albert L. Hogan III of Skadden Arps Slate Meagher & Flom LLP.

The case is Braman et al. v. The CME Group Inc. et al., case number 1:14-cv-02646, in U.S. District Court for the Northern District of Illinois.

--Additional reporting by Ed Beeson. Editing by Chris Yates.