UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA v. JAMES VORLEY and CEDRIC CHANU, Defendants.	No. 18 Cr. 35 (Tharp, J.)

MEMORANDUM IN SUPPORT OF DEFENDANTS' MOTION TO DISMISS THE INDICTMENT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

<u>Cases</u>

Statutes

Federal Rules

Other Authorities

Defendants James Vorley and Cedric Chanu (collectively, "Defendants") respectfully submit this memorandum of law in support of their motion to dismiss the indictment for failure to state the charged wire fraud offenses. *See* Fed. R. Crim. P. 12(b)(3)(B)(v).

PRELIMINARY STATEMENT

This motion presents a dispositive legal question of first impression: whether the government can prosecute "spoofing" under the wire fraud statute, 18 U.S.C. § 1343. The answer to that question is no, because spoofing—defined as placing an order to buy or sell "with the intent to cancel" the order before it is filled—does not involve a false or misleading statement.[1]

Defendants are former Deutsche Bank employees who traded precious metal futures on the COMEX exchange. The indictment charges Defendants with wire fraud and conspiracy to commit wire fraud, based entirely on the allegation that Defendants engaged in manual spoofing from about December 2009 to about November 2011.

Last year, the Seventh Circuit affirmed a high-frequency trader's spoofing conviction under subsection 1 of the commodities fraud statute, 18 U.S.C. § 1348(1). In doing so, the court expressly noted that § 1348(1), unlike § 1348(2), does not require the prosecution to prove a false statement. *United States v. Coscia*, 866 F.3d 782, 796 (7th Cir. 2017) ("'False representations or material omissions are not required' for conviction under [§ 1348(1)].") (quoting *United States v. Mahaffy*, 693 F.3d 113, 125 (2d Cir. 2012)); *see also United States v. Coscia*, 100 F. Supp. 3d 653, 659-60 (N.D. Ill. 2015) (holding that a false statement is not an element of a § 1348(1) violation); *compare* 18 U.S.C. § 1348(2) (requiring the prosecution to show that the defendant used "false or fraudulent pretenses, representations or promises").

[1] The Dodd-Frank Act defined "spoofing" as placing an order to buy or sell "with the intent to cancel" the order before it is filled, and the Act categorized spoofing as a "disruptive practice," not a fraudulent one. 7 U.S.C. § 6c(a)(5)(C).

By contrast, the Seventh Circuit has held repeatedly, in an unbroken line of precedent, that "the making of a false statement or material misrepresentation" is *always* a "necessary element" of mail or wire fraud. *Williams v. Aztar Ind. Gaming Corp.*, 351 F.3d 294, 299 (7th Cir. 2003); *see also United States v. Stephens*, 421 F.3d 503, 507 (7th Cir. 2005) (holding that, to establish a "scheme to defraud" under the mail and wire fraud statutes, the prosecution must prove "the making of a false statement or material misrepresentation" (quoting *Aztar*)); *United States v. Sloan*, 492 F.3d 884, 890 (7th Cir. 2007) (same, quoting *Stephens*); *United States v. Powell*, 576 F.3d 482, 490 (7th Cir. 2009) (same, quoting *Sloan*); *United States v. Sheneman*, 682 F.3d 623, 628-29 (7th Cir. 2012) (same, quoting *Powell*). Indeed, this point of law is so black letter that it is enshrined in the Seventh Circuit's pattern jury instructions. *See* Seventh Cir. Pattern Crim. Jury Instr., § 1341, 1343, at p. 402 (2017 ed.) ("[T]he government must prove . . . beyond a reasonable doubt . . . [that] [t]he scheme to defraud involved a materially false or fraudulent pretense, representation, or promise[.]").

In this case, the government concedes on the face of the indictment that Defendants placed on the COMEX exchange real, at-risk orders that (1) specified a price and volume, and (2) if filled by a counterparty, resulted in a consummated transaction. Nonetheless, in an effort to support its invocation of the wire fraud statute, the government argumentatively claims that certain of Defendants' orders—namely, orders that Defendants allegedly hoped to be able to cancel before a counterparty filled them—communicated false information regarding supply and demand and implied a false representation regarding Defendants' intent to trade. *See* Indictment, ¶¶ 5, 11. The indictment labels these "Fraudulent Orders." *Id.* ¶ 4. But simply assigning that label cannot, as a matter of law, undo the effect of the government's necessary concession that the so-called "Fraudulent Orders" were real, at-risk orders that, despite the indictment's conclusory characterizations, neither communicated false supply or demand nor implied anything (false or otherwise) about Defendants' subjective hopes or intent.

No court has ever held that spoofing constitutes wire fraud or involves any false or misleading statement. In each spoofing prosecution that has been fully litigated, including *Coscia*, the government has ended up proceeding under the Dodd-Frank Act anti-spoofing provision, 7 U.S.C. § 6c(a)(5)(C), and/or subsection 1 of the commodities fraud statute, 18 U.S.C. § 1348(1).[2] Indeed, in *Coscia* the government tellingly disclaimed any argument that spoofing violates the *false statement* prong of the commodities fraud statute, 18 U.S.C. § 1348(2)—effectively a recognition, if not a concession, that spoofing does not involve the making of a false statement. *See* Gov't Opp. to Def. Post-Trial Mtns., *United States v. Coscia*, No. 14-cr-551 (N.D. Ill. Jan. 29, 2016), ECF No. 110, at 5 ("The government made clear, prior to trial, that it was not proceeding under subsection 2 of 18 U.S.C. § 1348, which requires a false statement."); *id.* ("[T]he government was not required to prove a false statement. . . . [Section 1348(1) of] the commodities fraud statute can be violated without a false statement."); Gov't Appellee's Br., *United States v. Coscia*, No. 16-3017 (7th Cir. Oct. 6, 2016), ECF No. 29, at 41 (acknowledging that spoofing can be prosecuted as commodities fraud only because 18 U.S.C. § 1348(1) "does not require a false

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[2] *See, e.g.*, *United States v. Coscia*, No. 14-cr-551 (N.D. Ill.); *United States v. Flotron*, 17-cr-220 (D. Conn.); *see also, e.g.*, *United States v. Thakkar*, No. 18-cr-36 (N.D. Ill.) (pending; charges limited to conspiracy to violate the Dodd-Frank Act); *United States v. Mao*, No. 18-cr-606 (S.D. Tex.) (pending; charges limited to conspiracy to commit commodities fraud, commodities fraud, and Dodd-Frank Act violations). Another spoofing prosecution pending in this District before Judge Lee involves charges of commodities fraud and spoofing, in addition to a single conspiracy count charging a conspiracy to commit both commodities and wire fraud. *See United States v. Bases & Pacilio*, No. 18-cr-48 (N.D. Ill.) (pending; charges contain no stand-alone wire fraud count).

statement”).[3] *A fortiori,* absent a false statement, spoofing is not within the ambit of the wire fraud statute.[4]

Why then did the government charge this case as a wire fraud, rather than under § 1348(1) or the Dodd-Frank Act’s anti-spoofing provision? The answer lies in the government’s cynical and misguided effort to keep powerfully exculpatory evidence out of this case.

As the government well knows, in December 2011—just a few months after the Dodd-Frank Act’s anti-spoofing provision became effective in July 2011—Deutsche Bank implemented a compliance monitoring program specifically designed to identify and remediate any trading activity that might run afoul of this new law. Prior to implementing this program, Deutsche Bank advised its traders, including Defendants, both orally and in writing, that it would be monitoring *all* of their trading activity, chats, phone calls, and other communications for compliance with all applicable laws, regulations, and bank policies. Thereafter, employing a special algorithm designed to screen trades for potential spoofing, Deutsche Bank’s Compliance Department flagged and then affirmatively “cleared” as legally compliant hundreds of Defendants’ trades, *including many of the same trades that the government initially alleged in this case were willful violations of the Dodd-Frank Act and other laws.*

[3] The government did the same in its recent, failed commodities fraud prosecution of a manual trader in the District of Connecticut. *See* Hearing Tr., *United States v. Flotron*, No. 17-cr-220 (D. Conn. Mar. 14, 2018), ECF No. 131, at 79:18-21 (“[W]e’re going to proceed under 1348, prong (1), which requires a scheme to defraud, not the material misrepresentations, promises and omissions.”).

[4] The government has, on occasion, extracted wire fraud pleas out of defendants in connection with spoofing, but it has always done so in connection with a companion charge of commodities fraud under § 1348(1), a violation of the Dodd-Frank Act, or both. The government, of course, cannot use pleas to establish that particular conduct violates the wire fraud statute. *Cf. Skilling v. United States*, 561 U.S. 358 (2010) (rejecting an interpretation of the wire fraud statute that the government previously had used to obtain dozens, if not hundreds, of honest services fraud pleas).

After the Complaint was unsealed, defense counsel affirmatively presented this exculpatory evidence to the Department of Justice's Fraud Section in Washington, D.C. Rather than forgo its prosecution, the government decided instead to pare back dramatically the seven-year conspiracy period that it had alleged in the Complaint. Whereas the Complaint had charged a conspiracy ending in 2015, the indictment charges a conspiracy ending in November 2011 (immediately before Deutsche Bank's anti-spoofing monitoring program went into effect). *Compare* ECF No. 1, at 1, *with* ECF No. 12, ¶¶ 2, 21, 23. Yet, to prosecute Defendants for conduct ending seven years ago, without the prosecution being obviously time barred, the government's only option was to drop the spoofing and commodities fraud counts charged in the complaint and proceed solely with a *wire fraud* conspiracy. This is because the Financial Institutions Reform, Recovery and Enforcement Act ("FIRREA") extends the statute of limitations to ten years for a wire fraud that allegedly "affects a financial institution," but it does not provide any extension to the limitations periods for commodities fraud (six years) or Dodd-Frank violations (five years).[5]

The government has latitude in deciding how to charge a criminal case. That latitude, however, does not include the right to shoehorn this case into the wire fraud statute simply because the slice of conduct the government has chosen to prosecute would, if charged under any other law, be time barred. Accordingly, the indictment should be dismissed.

BACKGROUND

Defendants are former Deutsche Bank precious metals traders. The indictment arises out of their trading of precious metals futures contracts on the COMEX exchange.

[5] *See* 18 U.S.C. § 3293(2). To bring the wire fraud charges within FIRREA, the indictment alleges that Defendants' alleged spoofing "affected" Deutsche Bank, Defendants' employer, in several ways. *See* Indictment, ¶ 14. Whether these allegations satisfy FIRREA's requirements is not an issue that the Court needs to resolve on this motion to dismiss.

1. The COMEX Exchange

Precious metals futures contracts are bought and sold on the COMEX, an online futures contracts exchange, operated by the private company CME Group, Inc. COMEX traders, such as Defendants, placed anonymous orders in the form of "bids" to buy and "offers" to sell. Indictment, ¶ 1(j). When a trader places a bid, he specifies the price and volume at which he is willing to buy; when a trader places an offer, he specifies the price and volume at which he is willing to sell. "An order [is] 'filled' or 'executed' when a buyer's bid price and a seller's offer price for a particular contract [size] matche[s]." *Id.* ¶ 1(l). A trader is required to "honor" his bid or offer unless it has "been withdrawn from the market." COMEX Rulebook, Rule 522, *available at* https://www.cmegroup.com/content/dam/cmegroup/rulebook/NYMEX/1/5.pdf. A trader can withdraw his bid or offer from the market either by modifying it (which effectively places a new order) or cancelling it. A trader can even program his order to cancel automatically if it is not "immediately" filled.[6] *Coscia*, 866 F.3d at 795 (describing "fill-or-kill" orders).

The COMEX's "order book . . . display[s] a certain number of visible price levels on both the bid and offer sides, as well as the total volume of anonymous orders . . . at each of those visible price levels." Indictment, ¶ 1(k). Not all orders are visible in the order book, however. Traders can place so-called "iceberg orders," where "the total amount of the order [is] divided into a visible portion," which can be seen in the order book, and a portion that remains invisible until "the visible portion . . . [is] filled." *Id.* ¶ 1(m); *see also Coscia*, 866 F.3d at 800 (stating that iceberg orders

[6] In a market dominated by "high-frequency" traders, who use computer algorithms to place and respond to thousands of orders per minute at virtually the speed of light, cancellation of orders is the norm, and execution of orders the exception. *See* Mary Schapiro, Chairman, U.S. Sec. and Exchange Comm'n, "Strengthening Our Equity Market Structure" (speech of Sept. 7, 2010), *available at* https://www.sec.gov/news/speech/2010/spch090710mls.htm (observing that high-frequency traders cancel 90 percent of their orders).

"are designed to obscure the true extent of supply or demand that lurks beneath the order book" (internal quotation marks omitted)).

2. The Indictment's Allegations

The indictment alleges that Defendants, in concert with each other and sometimes in concert with a more junior Deutsche Bank trader named David Liew, manually placed "orders for precious metals future contracts on one side of the market that, at the time they placed the orders, they intended to cancel before execution . . . ." Indictment, ¶ 4. The indictment argumentatively labels these "the 'Fraudulent Orders.'" *Id.* The indictment alleges that Defendants placed the so-called Fraudulent Orders with the intent to "artificially manipulate and move the prevailing [market] price in a manner that would increase the likelihood" that orders Defendants had placed "on the opposite side of the market"—what the indictment calls "the 'Primary Orders,'" *id.* ¶ 9—"would be filled."[7] *Id.* ¶ 10.

The indictment alleges that, when they appeared in the visible order book, the so-called Fraudulent Orders "induce[d] . . . traders into trading precious metals futures contracts at prices, quantities, and times that they would not have otherwise . . . ." *Id.* ¶ 3. The indictment, however, does not allege that the so-called Fraudulent Orders were fake. To the contrary, it is undisputed that all of the so-called Fraudulent Orders were real orders that, whatever Defendants' subjective intent might have been, were at risk and capable of being filled to the same extent as any other order of the same price and volume that was on the market at the same time. Indeed, the government concedes this on the face of the indictment itself. *Id.* ¶ 14(i)(b) (acknowledging the "financial risk that the Fraudulent Orders would be filled"). Furthermore, the indictment does not

[7] The government does not allege, nor could it credibly do so, that it is illegal for a trader to place orders on both sides of the market. To the contrary, such trading activity is commonplace on the COMEX for a variety of legitimate reasons.

allege that Defendants ever placed an order that they intended to refuse to honor if another party filled it.

SUMMARY OF THE ARGUMENT

While there is some precedent holding that spoofing, which Congress specifically addressed in the Dodd-Frank Act's anti-spoofing provision, also violates subsection 1 of the commodities fraud statute, 18 U.S.C. § 1348(1), no court has ever held that this same conduct can be prosecuted as a wire fraud. To convict a defendant of wire fraud or conspiracy to commit wire fraud, as opposed to commodities fraud under § 1348(1) or spoofing in violation of Dodd-Frank, the government must prove beyond a reasonable doubt that the alleged "scheme to defraud involved a materially false or fraudulent pretense, representation, or promise[.]" Seventh Cir. Pattern Crim. Jury Instr., § 1341, 1343, at p. 402 (2017 ed.); *see also infra*, at 2 (collecting Seventh Circuit cases addressing this essential element).

In its effort to shoehorn this case into the wire fraud statute, the government resorts to alleging legal conclusions that, because they are contradicted both by other allegations in the indictment and by undisputed facts, the Court is not bound to accept. *See, e.g.*, *United States v. Risk*, 843 F.2d 1059, 1061 (7th Cir. 1988). First, the indictment alleges that the so-called Fraudulent Orders were *themselves* "false and misleading representation[s] of supply and demand" because they were "orders [Defendants] did not intend to trade." Indictment, ¶ 5. Second, the indictment alleges that, in placing the so-called Fraudulent Orders, Defendants made an *implied* false representation to the market "that [Defendants] were intending to trade the Fraudulent Orders when, in fact, . . . [Defendants] intended to cancel [the orders] before [they were filled]." *Id.* ¶ 11. Both of these theories fail as a matter of law.

As to the first theory, as the government concedes on the face of the indictment, *see* Indictment, § 14(i)(b), all of the so-called Fraudulent Orders were real, at-risk orders that were capable of being filled, and often were filled, before Defendants could cancel them. And there is no allegation that Defendants refused to honor any orders that were filled. Thus, the most that the undisputed facts allow the government to say is that the supply or demand that the so-called Fraudulent Orders created was *fleeting*, which obviously is not the same thing as being *false*.[8] And, if creating *fleeting* supply or demand constituted the making of a "false statement," then all high-frequency algorithmic traders—who routinely place and then cancel orders far more quickly and frequently than manual traders like Defendants can—would be making false statements thousands of times per day and exposing themselves to wire fraud prosecutions essentially at a prosecutor's whim.[9] That cannot be the law.

As to the government's second theory of falsity, the indictment does not allege any facts—because none exist—that could support a finding that a COMEX order inherently makes an implied representation about *anything*, let alone the trader's subjective hopes and intentions about the potential future cancellation of that order. What the government *actually* is alleging in this case is that Defendants placed real, at-risk orders on opposite sides of the market and *failed to disclose* to other COMEX traders, to whom Defendants owed no fiduciary duty, that Defendants hoped they would be able to manually cancel certain of those orders at precisely the right moment—after high-

[8] It should be noted that the indictment does not even specify how long the so-called Fraudulent Orders remained on the market before being cancelled.

[9] Orders placed on the COMEX are subject to acceptance only "while outstanding" and may be "withdrawn from the market" for any reason at any time. *See* COMEX Rulebook, Rule 522, *available at* https://www.cmegroup.com/content/dam/cmegroup/rulebook/NYMEX/1/5.pdf ("In electronic trading, while outstanding, all or any part of any bid or offer is subject to immediate acceptance by any trader. Members are required to honor all bids and offers which have not been withdrawn from the market.").

frequency-trading algorithms, capable of responding to offers and bids almost instantaneously,[10] filled the smaller orders that Defendants had placed on one side of the market but before they filled the larger ones they had placed on the other side.

Even assuming for the sake of argument that such a nondisclosure theory might provide a basis to proceed under § 1348(1), it does not state an offense under the wire fraud statute, because a "mere failure to disclose, absent something more," does not constitute "fraud under the mail and wire fraud statutes . . . ." *Reynolds v. East Dyer Dev. Co.*, 882 F.2d 1249, 1252 (7th Cir. 1989); *see also United States v. Weimert*, 819 F.3d 351, 357 (7th Cir. 2016) (dismissing a wire fraud charge based on defendant's failure to disclose that his bid "was a 'stalking horse' bid," because "omissions about a buyer's or seller's negotiating positions" are not actionable under the wire fraud statute even if they "mislead the other party about the prices and terms they are willing to accept"). If the government were allowed to plead around this important limitation to the wire fraud statute through semantics, it would destroy the limitation entirely, essentially "put[ting] federal judges in the business of creating . . . common law crimes," *Reynolds*, 882 F.2d at 1252, and violating constitutional principles of fair notice.

LEGAL STANDARD

An indictment must be dismissed if it fails to state an offense. Fed. R. Crim. P. 12(b)(3)(B)(v); *see also United States v. Tomkins*, No. 07-cr-227, 2009 WL 590237, at *2 (N.D. Ill. Mar. 6, 2009) ("An indictment must allege facts which, if proven, constitute the crime charged." (citing *United States v. Gimbel*, 830 F.2d 621, 624 (7th Cir. 1987)). Conclusory allegations of the essential elements of the charged offense cannot save an indictment from dismissal under Rule 12.

[10] *See, e.g.*, Michael J. McGowan, *The Rise of Computerized High Frequency Trading*, 2010 Duke L. & Tech. Rev. 16, at *2 (2010) (noting that high-frequency trading systems are able to execute trades "at close to the speed of light").

Rather, an indictment must be dismissed if the undisputed facts "[do] not conform to the allegations in the indictment" and preclude the government from "fulfill[ing] the elements" of the charged offense. *Risk*, 843 F.2d at 1061 (affirming the dismissal of the indictment because, although the indictment's conclusory allegations "fulfill[ed] the elements of a [structuring] violation . . . the government's own facts proffered to the defendant and the district court" precluded the government from proving that offense); *see also United States v. Flores*, 404 F.3d 320, 325-26 (5th Cir. 2005) (holding that a court may dismiss an indictment "based on the resolution of a legal question in the presence of undisputed facts").

ARGUMENT

I. The Indictment Fails to Allege Wire Fraud, Because It Fails to Allege a False Statement.

To convict a defendant of wire fraud, the government must prove that the defendant participated in "a scheme to defraud . . . ." *Sheneman*, 682 F.3d at 628. The objective "scheme to defraud" element is separate and distinct from the subjective "intent to defraud" element. *Id.*; *see also* Seventh Cir. Pattern Crim. Jury Instr., § 1341, 1343, at p. 402 (2017 ed.).

For purposes of the wire fraud statute, "a scheme to defraud requires 'the making of a false statement or material misrepresentation . . . .'" *Sheneman* at 628–29 (quoting *Powell,* 576 F.3d at 490); *see also Sloan*, 492 F.3d at 890 (same, quoting *Powell*); *Stephens*, 421 F.3d at 507 (same, quoting *Sloan*). Put another way, without a false statement or misrepresentation, there simply is no wire fraud.[11]

[11] The false statement element can be satisfied through a showing that the defendant engaged in "concealment of material information." *United States v. Colton*, 231 F.3d 890, 899 (4th Cir. 2000). But this requires the government to prove more than "mere silence." *Id.* Rather, the government must allege and show that the defendant engaged in additional "deceptive acts or contrivances intended to hide information, mislead, avoid suspicion, or prevent further inquiry into a material

The elements of the wire fraud statute are, in this sense, distinct from and far more exacting than the elements of subsection 1 of the commodities fraud statute, 18 U.S.C. § 1348(1), under which the government successfully prosecuted algorithmic spoofing in *Coscia*.[12] Instead, the elements of 18 U.S.C. § 1343 parallel those of § 1348(2), reliance on which the government expressly renounced in that prosecution. *See Coscia*, 866 F.3d at 796 (affirming the defendant's commodities fraud conviction because "[f]alse representations or material omissions are not required for conviction under [18 U.S.C. § 1348(1)]"); *see also* Hearing Tr., *United States v. Flotron*, No. 17-cr-220 (D. Conn. Mar. 14, 2018), ECF No. 131, at 79:18-21 (government counsel, in a prosecution of an alleged manual spoofer, advising the district court that the government was proceeding only under § 1348(1), and not § 1348(2), because the former does not require proof of "material misrepresentations, promises and omissions").

Here, the undisputed facts foreclose the government from satisfying the false statement requirement of the wire fraud statute.

A. The So-Called Fraudulent Orders Were Not "False and Misleading Representations of Supply and Demand."

The Court can swiftly dispose of the indictment's conclusory allegation that the so-called Fraudulent Orders were *themselves* "false and misleading representation[s] of supply and demand" because they were "orders [Defendants] did not intend to trade." Indictment, ¶ 5. The government's allegation is not based on fact, but rather is an audacious attempt to re-define what "supply and demand" is.

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matter." *Id*. The indictment does not allege concealment, nor could it. Thus, the viability of the indictment rises and falls on whether spoofing *per se* involves the making of a false statement.

[12] They are also more exacting than those of the Dodd-Frank Act's anti-spoofing provision, which does not require the government to prove false statements, a scheme to defraud, or fraudulent intent. *See* 7 U.S.C. § 6c(a)(5)(C).

Simply as a matter of market structure, "supply" is the number of offers, and "demand" the number of bids, on the market at any given time. In other words, an offer is genuine supply, and a bid is genuine demand, for however long it is on the market and capable of being filled. The genuineness of supply or demand cannot turn on whether the trader *hopes* the offer or bid will be filled, nor on how long the trader expects or intends to keep the offer or bid on the market. Even if a trader cancels his order quickly after placing it, that means only that the supply or demand that his order created was *fleeting*, which obviously is not the same thing as being *false*. As a matter of logic, this must be true regardless of what the trader's *subjective intentions* were at the time he placed the order.[13]

The government concedes on the face of the indictment that all of Defendants' offers and bids, including the so-called Fraudulent Orders, were real orders that were exposed to actual market risk. *See* Indictment, § 14(i). They were capable of being filled by any other COMEX trader for as long as they remained on the market, and there is no allegation that Defendants ever refused to honor an order they placed. Thus, for as long as they remained on the market, the so-called Fraudulent Orders were indisputably genuine (*i.e.*, not false) "supply and demand" to the same extent as any other order of like price and volume. *Cf.* COMEX Rulebook, Rule 522, *infra* (providing that an order must be "honored" only so long as "it remains on the market").[14]

[13] Ironically, if any type of order falsely represents supply and demand, it is the so-called "iceberg order" with which the government apparently takes no issue. Iceberg orders are so named because the trader placing an iceberg order makes only a *portion* of it visible to the market. *See* Indictment, ¶ 1(m). Consider, for example, a trader who is looking to sell 100 lots of gold at $1,000 per lot and he does so via an iceberg order that makes only 10 lots visible to the market. In those circumstances, the trader has in fact increased the supply at the $1,000 price level by 100 lots, but the market initially sees a supply increase of only 10 lots. The government has never argued, and no court has ever suggested, that this makes an iceberg order a false statement of supply or demand.

[14] The government's theory begs the question of whether the genuineness of supply or demand turns not merely on the trader's intent, but also on how long the order ultimately remains on the market. What if an order, which the trader placed with the intent to cancel, remains on the market

Coscia neither holds nor suggests otherwise. The court in *Coscia* did not hold that spoof orders constitute "false representations" of supply and demand. Indeed, the government on appeal did not even make that argument, and in the district court the government expressly abjured it. Instead, the government argued only that the defendant's spoof orders were "deceptive," expressly distinguishing this from a "false statement" requirement. Gov't Appellee's Br., *United States v. Coscia*, No. 16-3017 (7th Cir. Oct. 6, 2016), ECF No. 29, at 43, 46 ("Defendant was not charged with . . . wire fraud . . . . A false statement is not required under § 1348(1), only deceptive conduct is."); Hearing Tr., *United States v. Flotron*, No. 17-cr-220 (D. Conn. Mar. 14, 2018), ECF No. 131, at 79:18-21 (government counsel advising the district court that "we're going to proceed under 1348, prong (1), which requires a scheme to defraud, not the material misrepresentations, promises and omissions"). And, in affirming the defendant's conviction under § 1348(1), the court still went out of its way to distinguish the defendant's spoofing scheme, which involved use of a computer algorithm to shield his spoof orders from any actual market risk, from situations where real, at-risk orders are used to convey a misimpression of the market's direction. *See Coscia*, 866 F.3d at 797 n.64 (discussing *United States v. Radley*, 659 F. Supp. 2d 803 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011)).

The court's decision in *Radley*, 659 F. Supp. 2d 803, the case that the court in *Coscia* distinguished, is instructive. The defendants in *Radley* were British Petroleum ("BP") employees who traded propane futures contracts. The indictment charged them with wire fraud, based on the

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for one second (roughly 500 times longer than a trading algorithm needs to respond to and fill it)? What about one minute? Or how about one hour—for example, would an offer that remains on the market for one hour constitute "false" supply, simply because the trader had placed it with the intent to cancel? The government's answer to that question either is yes, which is absurd, or it is no, which means its theory invites the sort of arbitrary line drawing that the Supreme Court has directed courts to avoid with respect to the mail and wire fraud statutes. *See, e.g.*, *Skilling*, 561 U.S. at 411 n.44. Either answer reveals the fallacy of the government's theory.

allegation that they "misled the market about the true supply of February 2004 TET propane by presenting 'show' offers designed to falsely convey that BP wished to sell propane and simultaneously present[ing] multiple [anonymized] bids to buy on [a popular electronic trading platform], creating the impression that multiple counterparties wished to buy propane." *Id.* at 807. The indictment further alleged that defendants engaged in this trading tactic to create "artificially high [TET propane] prices." *Id.* The district court nevertheless dismissed the wire fraud charge for failure to state an offense, concluding that the "indictment [did] not allege a single lie or misrepresentation." *Id.* at 815. The court deemed irrelevant that "counterparties may have assumed that the 'stacked bids' [on the anonymized electronic trading platform] came from multiple counterparties," and not just from BP. *Id.* at 815. The bids "were actually bids, and when they were accepted, defendants actually went through with the transactions," thereby precluding a finding of a false representation. *Id.*

As in *Radley*, the government concedes on the face of its indictment that all of Defendants' orders, included the so-called Fraudulent Orders, were real orders—they were subject to financial risk, were capable of being filled, and, when filled, were honored.[15] Those undisputed fact are fatal to the government's "false supply and demand" theory.

B. Defendants Did Not, By Virtue of Placing an Order, Implicitly Represent to the Market That They Intended for the Order to Be Filled.

The Court should likewise reject as a matter of law the government's conclusory allegation that Defendants, simply by virtue of placing orders on the COMEX, made false *implied*

[15]As such, the indictment does not and could not allege either that any of Defendants' orders were equivalent to riskless "wash sales," *Laureys v. Comm'ner*, 92 T.C. 101, 124 (U.S. Tax Ct. 1989) (recognizing that "wash sales are not legitimate" because they are the most "extreme case" of a "riskless" transaction), or that Defendants made "promise[s] with the intent not to keep [them]," *Perlman v. Zell*, 185 F.3d 850, 852 (7th Cir. 1999).

representations to the market that they were "intending to trade" the orders when, in fact, they allegedly were hoping to be fast enough to cancel the orders before they got filled. Indictment, ¶ 11.

The limited circumstances in which the Seventh Circuit has found *implied* false representations sufficient to trigger wire fraud liability bear no resemblance to either the indictment's allegations or the undisputed facts here. For example, in *United States v. Dial*, 757 F.2d 163, 168 (7th Cir. 1985), the court held that, where a commodities broker is "a fiduciary of his customers," he "implicitly represent[s] to them that he [will] try to get [them] the best possible price [on their trades]," and thus may be prosecuted for wire fraud if he instead secretly allocates the most favorably priced trades to his personal trading account. And, in *Stephens*, the court held that an Accenture employee's submission of a "request for funds on [a corporate] expense report" made an "implied representation that [the expensed charges] were for purposes related to work," because he had an obligation as a fiduciary of Accenture to abide by the company's written policy that it "had no liability . . . and that employees were required to directly pay" corporate credit card balances attributable to non-work-related expenses. *Stephens*, 421 F.3d at 505, 507.

No such similar circumstances exist here. Unlike the defendants in *Dial* and *Stephens*, who were fiduciaries accused of making implied representations to their principals, Defendants were not fiduciaries of the other COMEX market participants. Rather, Defendants were *competitors* of the potential counterparties to Defendants' COMEX orders. The absence of a fiduciary relationship precludes any argument that Defendants' orders made implicit representations of anything. *Cf. Williams v. United States*, 458 U.S. 279, 284 (1982) (holding that the act of presenting a check to a bank does not make an implied "representation as to the state of [presenter's] bank balance"); *United States v. Steffen*, 687 F.3d 1104, 1116-17 (8th Cir. 2012) (rejecting the government's theory that the defendant's "draw request to the Bank . . . implicitly represented that all of the representations and warranties in the security and loan agreements were true and correct in all material respects," and affirming the dismissal of the indictment for failure to state a wire fraud offense); *United States v. Finnerty*, 533 F.3d 143, 149-50 (2d Cir. 2008) (rejecting the government's argument that a New York Stock Exchange trading specialist implicitly represented to the market that his trades were in compliance with the NYSE's interpositioning rules); *Bondi v. Bank of Am.* (*In re Parmalat Sec. Litig.*), 412 F. Supp. 2d 392, 402 (S.D.N.Y. 2006) ("[A] transaction is a transaction, not a communication.").

The government's implied false representation theory, if accepted, would require federal courts (and also lay juries) to make arbitrary determinations about what facts a trader is implicitly representing when he places an order, essentially "put[ting] federal judges in the business of creating . . . common law crimes." *Reynolds*, 882 F.2d at 1252. Today, the government is alleging that an order implies the absence of any subjective hope or intention to be fast enough to cancel the order before it can be filled. Tomorrow it might allege that an order implies the absence of any intention to *modify an order* (*i.e.*, raising or lowering the offer or bid price) to avoid being filled. And then the day after that it might allege that it implies something else, too. This could continue ad infinitum, until a federal court finally says stop. The lack of any coherent limiting principle to an implied false representation theory of wire fraud liability is why courts have refused to adopt it outside the fiduciary context, where the scope of the fiduciary duty itself serves as the limiting principle.

The Seventh Circuit's holding in *Sullivan & Long v. Scattered Corp.*, 47 F.3d 857 (7th Cir. 1995), where the court affirmed the dismissal of a variety of securities fraud and RICO claims, controls. The defendant was a short seller of the stock of a bankrupt company undergoing a reorganization. *Id.* at 858-59. The defendant "sold short huge quantities" of the company's stock. *Id.* at 858. "It sold short, in fact, tens of millions of such shares a week, for a total . . . of 170 million shares, far more than the 122 million . . . shares outstanding." *Id.* The plaintiffs' complaint focused on "[t]he excess of shares sold short over total shares outstanding," alleging that the defendant made implied false representations in violation of the wire fraud statute. *Id.* In affirming the district court's dismissal of the complaint, the court distinguished the defendant's extreme short-sale transactions, all of which involved "real buyers," from situations where parties "*fictitiously* trade the same shares back and forth at higher and higher prices to fool the market into thinking that there is a lot of buying interest in the stock." *Id.* at 864 (emphasis added). The court rejected out of hand the plaintiff's theory that "every short seller implicitly warrants that it won't sell short in such quantity as to jeopardize its financial solvency." *Id.* The court held that the defendant had "made no representations, true or false, actual or implicit, concerning the number of shares that it would sell short." *Id.*

So too here. As in *Sullivan & Long*, and as the indictment concedes, all of Defendants' orders were "at financial risk." Just as the defendant in *Sullivan & Long* made no implied representations about when it would stop short-selling more shares, Defendants did not make any implied representations about how long they planned to keep any of their orders on the market or whether they hoped to be able to cancel them in time to avoid them being filled.

C. The Government Is Improperly Attempting to Prosecute as a Wire Fraud a Non-Fiduciary's Mere "Failure to Disclose."

At bottom, what the government actually is alleging in this case is that Defendants placed orders on both sides of the market and *failed to disclose* to the market that they had placed certain orders (*i.e.*, the so-called Fraudulent Orders) not because they hoped for those orders to be filled, but rather because they hoped the market would react by executing against the so-called "Primary

Orders." Even if that theory would be viable under subsection 1 of the commodities fraud statute, 18 U.S.C. § 1348(1), Seventh Circuit law makes clear it is not viable under the wire fraud statute.

"Not all conduct that strikes a court as sharp dealing or unethical conduct is a 'scheme to defraud'" for purposes of the mail and wire fraud statutes. *Weimert*, 819 F.3d at 356 (holding that the statutes cannot "be stretched to criminalize deception about a party's negotiating positions, such as a party's bottom-line reserve price or how important a particular non-price term is"). A "mere failure to disclose, absent something more," does not constitute "fraud under the mail and wire fraud statutes . . . ." *Reynolds*, 882 F.2d at 1252; *see also United States v. Ellis*, 50 F.3d 419, 424 (7th Cir. 1995) (same, citing *Reynolds*). A nondisclosure of material information, without more, is sufficient to sustain a wire fraud charge only where the defendant had a "fiduciary duty to disclose [the] information" at issue. *United States v. Dick*, 744 F.2d 546, 550 (7th Cir. 1984).

The circumstances of this case are the very last in which a nondisclosure theory of wire fraud could apply. Individuals who trade on the COMEX have no fiduciary duties to one another. They are sophisticated competitors, not customers. The high-frequency traders that the indictment alleges the so-called Fraudulent Orders "induced," Indictment, ¶ 3, are the most sophisticated of all, utilizing complex computer algorithms that their investment bank and hedge fund employers guard like state secrets.

The Court should not allow the government to avoid the Seventh Circuit's nondisclosure precedents through conclusory pleading. Those precedents serve the critical purpose of limiting the scope of the mail and wire fraud statutes, so that federal courts do not create common law crimes and defendants receive fair notice. *Cf. Bondi*, 412 F. Supp. 2d at 402 ("Permitting [the plaintiff] to characterize transactions as misrepresentations would broaden [the mail and wire fraud statutes] considerably. For example, a plaintiff could describe an omission by a defendant as an act or transactions, and thus bring a [RICO] claim [predicated on a mail or wire fraud violation] without alleging the necessary duty to disclose.").

II. The Wire Fraud Statute Would Be Unconstitutionally Vague If It Were Construed to Apply to Defendants' Alleged Trading Conduct.

The Seventh Circuit in *Coscia* rejected the defendant's void-for-vagueness challenge to the Dodd-Frank Act's spoofing provision. *See Coscia*, 866 F.3d at 790-795. The Seventh Circuit's decision, however, does not speak to whether the *wire fraud* statute would be unconstitutionally vague if construed to apply to Defendants' alleged manual spoofing scheme.[16] The Dodd-Frank Act's anti-spoofing provision is plain on its face that spoofing is a "disruptive practice" that violates 7 U.S.C. § 6c(a)(5)(C), and Coscia's algorithmic spoofing scheme fell "well within the core of the anti-spoofing provision's prohibited conduct . . . ." *Coscia*, 866 F.3d at 795. Neither is true with respect to the indictment's wire fraud charges against Defendants.

"It is a basic principle of due process that an enactment is void for vagueness if its prohibitions are not clearly defined." *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972). The void-for-vagueness doctrine "requires that a penal statute define the criminal offense [(1)] with sufficient definiteness that ordinary people can understand what conduct is prohibited and [(2)] in a manner that does not encourage arbitrary and discriminatory enforcement." *Kolender v. Lawson*, 461 U.S. 352, 357 (1983). The "touchstone" of the notice prong "is whether the statute, either standing alone or as construed, made it reasonably clear at the relevant time that the defendant's conduct was criminal." *United States v. Lanier*, 520 U.S. 259, 267 (1997). To satisfy the requirements of due process, a criminal statute must include "ascertainable standards of guilt" such

[16] The defendant in *Coscia* did not bring on appeal an as-applied, void-for-vagueness challenge to his commodities fraud conviction, and the Seventh Circuit did not address the issue *sua sponte*.

that people "of common intelligence [are not] required to guess at the meaning of the enactment." *Winters v. New York*, 333 U.S. 507, 515 (1948).

Neither the plain language of the wire fraud statute nor any judicial decision provided Defendants fair notice during the charged conspiracy from December 2009 to November 2011 that spoofing consisting solely of real, at-risk orders involved the making of a materially false representation to the market. Congress did not specifically criminalize spoofing until the Dodd-Frank Act went into effect in July 2011, and even then it described spoofing merely as a "disruptive practice." 7 U.S.C. § 6c(a)(5)(C). There had never been a spoofing prosecution under *any* statute prior Michael Coscia's indictment in 2014. When the Seventh Circuit was forced to grapple with spoofing in *Coscia*, it affirmed the defendant's commodities fraud conviction on the grounds that 18 U.S.C. § 1348(1), unlike the wire fraud statute, does not require the prosecution to prove "[f]alse representations or material omissions." *Coscia*, 866 F.3d at 798. To this day, no court has ever declared that placing a real, at-risk order constitutes the making of a *false representation* merely because the trader placed the order with the subjective intent to cancel it. Indeed, the case law holds just the opposite. *See infra* at 14-20; *Coscia*, 866 F.3d at 797 n. 64 (distinguishing *Radley*).

If the Seventh Circuit in *Coscia* was unwilling to conclude, and the government in *Coscia* unwilling even to argue, that the defendant's algorithmic spoofing involved the making of a false representation, how could it have been "reasonably clear" to Defendants seven years earlier that placing real, at-risk orders could violate the wire fraud statute? The only thing that is clear is the answer to the question: it could not have been.

The Court, of course, need not hold that the wire fraud statute is unconstitutionally vague as applied to Defendants' alleged trading conduct. This is because, for the reasons stated in Part I above, the Court can and should conclude that the wire fraud statute does not apply to Defendants' alleged trading conduct at all.

CONCLUSION

For the foregoing reasons, the indictment should be dismissed in its entirety.

Dated: November 14, 2018

Respectfully submitted,

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