Update From The Coscia Trial

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Trace Schmeltz
Partner
Financial and Regulatory Litigation Group
Co-Chair, Fintech
Co-Chair

Yesterday, the United States began its prosecution of Michael Coscia of Panther Energy Trading LLC for allegedly engaging in "the crime of spoofing," as prosecutors framed it. We have blogged about this case before (here and here) and discussed it in the media in the following outlets: *Bloomberg News, Wall Street Journal Law Blog*, *Crain's Chicago Business* and the *Chicago Tribune*.

In his opening statement, Assistant United States Attorney Renato Mariotti tried to make high frequency trading rudimentary, understandable, and impactful for the jurors. He used very basic analogies and explanations, in order to build a simple case. According to Mariotti, Coscia manipulated markets by using two trading programs—"Flash Trader" and "Quote Trader"—to make it appear there was more supply or demand in the market than actually existed at any one time. Although he was mildly condescending in tone, his opening was clear and concise. He told jurors that the defendant had placed trades he intended to consummate using Flash Trader and that they were small trades to buy or sell a commodity. The defendant allegedly would use Quote Trader at the same time in order to take the opposite position (a sell, for example, if Flash Trader was making a purchase). The trade entered by Quote Trader trade would be much larger than that entered through Flash Trader and, in fact, much larger than any other trade in the market.

In addition, Mariotti explained, Quote Trader was preprogramed to cancel its trade in the event that either the Flash Trader order was filled or the Quote Trader trade was touched in the market. As Mariotti put it, the trades would be cancelled "Poof, like a flash." Mariotti said that, over the next several days, the government would prove that Coscia never intended for the trades placed by Quote Trader to be filled from several types of evidence:

- **The programmer's testimony**. The government expects the individual who programmed Quote Trader and Flash Trader (one of Coscia's employees) to testify that Quote Trader was designed to get a reaction from the market and then to cancel. As Mariotti explained it, Quote Trader would put a huge position on in order to get others to enter the market and then would cancel so that it would never be filled.
- **The programmer's handwritten notes**. Mariotti also noted that the government will offer contemporaneous handwritten notes prepared by

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the programmer at the time defendant Coscia was explaining to him what he wanted both Flash Trader and Quote Trader to do. Again, these notes evidently will show that Coscia intended all trades in Quote Trader to be cancelled and never filled.

- **E-mails between Coscia and the programmer.** The government evidently has e-mails between Coscia and the computer programmer further demonstrating Coscia's intent that Quote Trader would put on trades that would never be filled.
- **Michael Coscia's prior testimony.** Coscia has testified before the Commodity Futures Trading Commission about his algorithms. The government intends to use this prior testimony to show that the algorithms (Flash Trader and Quote Trader) were all Coscia's idea and that his algorithms were not intended to place legitimate trades.
- **Futures exchange representatives.** The government will offer testimony from futures exchange representatives as to how the algorithmic trading disrupted their markets.
- **Financial traders.** The Government will offer testimony from financial traders about how Coscia's trading negatively impacted them.

For his part, defense attorney Steven Peikin argued that Michael Coscia had engaged in a good-faith effort to trade based on years of his experience in the markets. According to Peikin, Coscia, as a market maker, always offered the best bid or offer on his trades—not the work of a fraudster trying to undercut the market. In addition, Coscia was attempting, based on his experience, to take advantage of price changes made in milliseconds by other high frequency traders. Here, Peikin's point appeared to be that Coscia's years as a market maker in slower markets led him to conclude that, in a high speed market, there would be legitimate price discrepancies that he could exploit. Peikin noted that Coscia had always seen more market activity when there was disproportionately low or high volume on one side of the market or the other. Accordingly, Coscia developed Flash Trader and Quote Trader to create such an imbalance—in order to foment market activity, but not to manipulate the market. Of course, it could be manipulative to use these algorithms to create an imbalance if, in fact, Coscia did not actually intend to execute the trades put on in Quote Trader. Recognizing this, Peikin also pointed out that Coscia's algorithms left trades "on" in the market much longer than other high frequency traders did. Over 8,000 of Coscia's trades, in fact, were executed upon. It seemed that his point was that Coscia's positions were "at risk" for being executed on because Coscia left them open for "plenty of time." As a result, his trades were not fraudulent. However, he did not say so explicitly. On these points, the defense has ground to make up. The prosecution's case is very simple—almost simplistic in presentation —while the defense case is nuanced. The defense needs to amplify what it means for a trade to be "at risk" for execution. The defense will, undoubtedly, have an expert who can testify that, even if a trade is out in the market for 100 milliseconds (your eye blinks in 300 milliseconds), it is at risk for execution. In a high-speed market, the defense is saying, this is sufficient to make that trade legitimate. On the other hand, the defense made a very simple point that ought to resonate with the jury. According to Peikin, the government will not offer a single witness who will testify that he or she purchased a futures contract for anything other than a legitimate market price. How then, the defense will undoubtedly argue, could Coscia be guilty for market manipulation if the market prices of futures were not impacted. Testimony from market participants—someone from Citadel—will be closely watched in this trial. Stay tuned for more. This is an interesting case with dramatic ramifications.