**UNITED STATES DISTRICT COURT**
**FOR THE NORTHERN DISTRICT OF ILLINOIS,**
**EASTERN DIVISION**

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| U.S. COMMODITY FUTURES TRADING COMMISSION<br>Plaintiff,<br><br>v.<br><br>IGOR B. OYSTACHER and 3 RED TRADING LLC,<br>Defendants. | Case No. 15-cv-9196<br><br>Hon. Amy J. St. Eve |

# IGOR OYSTACHER AND 3 RED TRADING, LLC'S MEMORANDUM OF LAW IN SUPPORT OF MOTION FOR JUDGMENT ON THE PLEADINGS

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## PRELIMINARY STATEMENT

Defendants Igor Oystacher and 3 Red Trading, LLC (collectively, "3 Red"), pursuant to FED. R. CIV. P. 12(c), hereby move for judgment on the pleadings. For the following reasons, the CFTC's claims fail as a matter of law.

*First*, the "spoofing" prohibition of the Commodity Exchange Act, 7 U.S.C. § 6c(5) (the "Spoofing Statute"), is unconstitutionally vague. This is a case of first impression on this issue. The CFTC has brought these claims despite the lack of any notice of what type of conduct may qualify as "spoofing" (as opposed to legitimate trading) and despite the lack of any notice or understanding of what type of conduct may qualify as "the character of or commonly known to the trade as 'spoofing.'" This lack of notice violates the due process rights of 3 Red, and provides the opportunity for arbitrary and capricious enforcement of the Spoofing Statute by the CFTC. The CFTC has had five years to try to rectify the vagueness of the Spoofing Statute by issuing a rule or regulation to prohibit trading practices that may constitute "spoofing," but it has failed to do so. Instead, it issued a non-binding policy statement that does nothing to cure the vagueness. And it makes no attempt to clarify that vagueness now. The reason why is simple: it cannot.

*Second*, for the same reasons that the Spoofing Statute is unconstitutionally vague as applied to 3 Red, Regulation 180.1 likewise fails to give adequate notice to 3 Red as to what conduct was prohibited thereunder.

*Third*, the CFTC's interpretation of the Spoofing Statute is contrary to Congressional intent.

*Fourth*, for many of the same reasons that the Spoofing Statute is unconstitutionally vague, the Spoofing Statute constitutes an unconstitutional delegation by Congress of its powers

to the CFTC (and, by extension, private litigants and the Courts), because it lacks an intelligible guiding principle.

For these reasons, the CFTC's claims fail as a matter of law. Accordingly, the Court should grant judgment on the pleadings in favor of 3 Red.

## BACKGROUND

### I. The Spoofing Statute

As part of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress added on July 21, 2010 a new provision to the Commodity Exchange Act (the "Act") that prohibits futures traders from engaging in "any trading, practice, or conduct that . . . is, is of the character of, or is commonly known to the trade as, 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution)." 7 U.S.C. § 6 c(a)(5)(C). Congress tasked the CFTC with the permissive obligation to "make and promulgate such rules and regulations as, in the judgment of the C[FTC], are reasonably necessary to prohibit the trading practices described in paragraph (5) and any other trading practice that is disruptive of fair and equitable trading.". 7 U.S.C. § 6c(a)(6) (2012 Yet, the Spoofing Statute itself is devoid of any indication (such as, for example, legislative history) as to how the CFTC should distinguish "spoofing" from customary trading or what "trading practices" may be prohibited as being "of the character of, or is commonly known to the trade as, 'spoofing.'"

Recognizing both the need for additional clarity and its ability to provide it if necessary and possible, the CFTC initially sought to promulgate rules that would inform market participants of how the CFTC would distinguish "spoofing" from customary trading. To that end, on November 2, 2010, the CFTC issued an Advanced Notice of Proposed Rulemaking. *See* Advance Notice of Proposed Rulemaking; Request for Comments: Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75

Fed. Reg. 67301-03 (Nov. 2, 2010 (the "ANPR").[1] The ANPR identified more than nineteen issues for public comment. Appropriately, they included:

- Whether to "provide additional guidance as to the nature of the conduct that is prohibited by" the Spoofing Statute;
- How to distinguish "spoofing" from legitimate trading activity;
- Whether "submitting or cancelling multiple bids or offers to create an appearance of market depth that is false" qualifies as "spoofing"; and
- How "to more clearly distinguish the practice of [']spoofing['] from the submission, modification, and cancelation of orders that may occur in the normal course of business."

*Id.* at 67302

Dozens of market participants provided input before the comment period closed on January 3, 2011. *See* Advanced Notice of Proposed Rulemaking; Notice of Termination: Antidisruptive Practice Authority, 76 Fed. Reg. 14826 (Mar. 18, 2011 ("Termination Notice").[2] Of particular relevance here, they conveyed that there was "no commonly-accepted definition of 'spoofing' throughout the industry." *See* Proposed Interpretive Order: Antidisruptive Practices Authority, 76 Fed. Reg. 14944 (issued Feb. 24, 2011; published Mar. 18, 2011) (the "Proposed

[1] Pursuant to Fed. R. Evid. 201(b)(2) and 44 U.S.C. § 1507, 3 Red requests that the Court take judicial notice of the ANPR, which is published in the Federal Register and also available on the CFTC's website. *See* 44 U.S.C. § 1507 ("The contents of the Federal Register shall be judicially noticed."); Fed. R. Evid. 201(b)(2) ("The court may judicially notice a fact that is not subject to reasonable dispute because it . . . can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.").

[2] Pursuant to Fed. R. Evid. 201(b)(2) and 44 U.S.C. § 1507, 3 Red requests that the Court take judicial notice of the Termination Notice, which is published in the Federal Register and also available on the CFTC's website. *See* 44 U.S.C. § 1507 ("The contents of the Federal Register shall be judicially noticed."); Fed. R. Evid. 201(b)(2) ("The court may judicially notice a fact that is not subject to reasonable dispute because it . . . can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.").

Order") at 14943, 14947;[3] *see also, e.g.*, Ex. A to Declaration of Michael S. Kim, attached hereto as Ex. 1 ("Kim Decl."), Comment Letter from John M. Damgard (President of FIA) (Dec. 23, 2010) ("Damgard Comment Letter") at 1, 3, 6 ("The term 'spoofing' is not one that has been commonly used in the futures and derivatives markets and there is no generally understood or accepted meaning of the term in this context"); Ex. B to Kim Decl., Comment Letter of Stuart J. Kaswell (General Counsel of Managed Funds Ass'n) at 7 (Dec. 28, 2010) ("'[S]poofing' is not a term that has ever been commonly used in the futures and derivatives markets. . . . [I]ts application in [those] . . . markets is not at all clear").[4] They therefore stressed the need for "additional Commission guidance [so] that any definition of 'spoofing' . . . would not capture legitimate trading behavior." *See* Proposed Order at 14947; *see also, e.g.*, Ex. C to Kim Decl., Comment Letter of Craig S. Donohue (CEO of CME Group) (Jan. 3, 2011) ("Donohue Comment Letter") at 8 ("The statute's definition of 'spoofing' . . . is too broad and does not differentiate legitimate market conduct from manipulative conduct that should be prohibited").

The CFTC also held a roundtable discussion on December 2, 2010. *See* Ex. D to Kim Decl., CFTC Staff Roundtable on Disruptive Trading Practices (December 2, 2010)

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[3] Pursuant to Fed. R. Evid. 201(b)(2) and 44 U.S.C. § 1507, 3 Red requests that the Court take judicial notice of the Proposed Order, which is published in the Federal Register and also available on the CFTC's website. *See* 44 U.S.C. § 1507 ("The contents of the Federal Register shall be judicially noticed."); Fed. R. Evid. 201(b)(2) ("The court may judicially notice a fact that is not subject to reasonable dispute because it . . . can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.").

[4] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of each of the comment letters, which were publicly submitted to the CFTC. *See, e.g.*, *Tovar v. Midland Credit Mgmt.*, No. 10CV2600 MMA MDD, 2011 WL 1431988, at *2 (S.D. Cal. Apr. 13, 2011) ("courts regularly take judicial notice of documents . . . that are . . . publicly filed with the administrative agency;" taking judicial notice of comment letters); *Green v. T–Mobile USA, Inc.*, 2008 WL 351017 at *2 (W.D.Wa.2008) (taking judicial notice of comments and petitions filed with the FCC).

("Roundtable Tr.").[5] Once again, multiple industry participants underscored that there was no industry consensus as to what "spoofing" was. *See* Roundtable Tr. at 64:3-8 ("[I] really don't know what spoofing is . . . and I'm not sure [i]f the definition of spoofing can be agreed upon by the ten people around this table") (Gary DeWaal); *id.* at 81:18-22 ("[T]he recurring theme in terms of spoofing that I hear is . . . I don't know how to define it, but I know it when I see it") (John Lothian); *id.* 96:19-97:1 ("[T]here seems to be a notion that somehow spoofing and the life of orders or the speed with which they're entered and canceled[] are . . . tightly connected and I don't think that that's necessarily the case") (Adam Nunes); *id.* at 111:16-18 ("[I]f you're putting orders out that are taking risk, can you be defined as spoofing?") (Adam Nunes).[6] In fact, the term "spoofing" had never been used in a futures industry treatise; did not previously surface in any futures industry statute, rule or regulation; and had not been construed by a court of law. *See, e.g.*, *id.* at 171:21-172:5 (Gregory Mocek). Nor was there anything else "commonly used in the industry to define the[]. . . terms . . . in the statute." *Id.* (Gregory Mocek). The speakers therefore expressed concern that absent workable standards, the CFTC might target well-intended cancellations that, with the benefit of hindsight, appear to resemble "spoofing." *See, e.g.*, *id.* at 41:5-42:5 (noting, in relevant part, that "[i]f rules are not clear, or if rules are backward looking,"

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[5] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the Roundtable Transcript. The Roundtable Transcript is publicly available on the CFTC's website and is comprised of public statements made to the CFTC. *See* http://www.cftc.gov/idc/groups/public/@swaps/documents/dfsubmission/dfsubmission24_120210-transcri.pdf (last accessed March 30, 2016); *see, e.g., Tovar v. Midland Credit Mgmt.*, No. 10CV2600 MMA MDD, 2011 WL 1431988, at *2 (S.D. Cal. Apr. 13, 2011) ("courts regularly take judicial notice of documents . . . that are . . . publicly filed with the administrative agency;" taking judicial notice of comment letters); *Green v. T–Mobile USA, Inc.*, 2008 WL 351017 at *2 (W.D.Wa.2008) (taking judicial notice of comments and petitions filed with the FCC).

[6] *See also id.* at 171:10-11 ("I'm not quite sure I know what spoofing is") (Gregory Mocek); *id.* at 166:12-17 ("[U]nlike pornography, I'm not even sure I know disruptive trading when I see it, and so there's a great deal more effort that's required for us to be able to get to the point where we can start thinking about what it really means") (Andrew Lo).

then there is a risk that orders may be "after the fact deemed to be disruptive" based merely on their apparent effects and not based on the requisite intent) (Don Wilson). Despite the industry's collective lack of an understanding of what "spoofing" is, the CFTC terminated the ANPR on March 18, 2011 without having promulgated a single rule or regulation.[7] *See generally* Termination Notice.

That same day, on March 18, 2011, the CFTC again recognized the industry's need for additional guidance when it issued a proposed interpretive order on the Spoofing Statute. *See* Proposed Order at 14944 ("The Commission is issuing this proposed interpretive order to provide market participants and the public with guidance on the scope of the statutory prohibitions set forth in section 4c(a)(5)"). Although the Proposed Order reiterated the market participants' concerns that the Spoofing Statute was vague and "susceptible to constitutional challenge," the Proposed Order failed to delineate how the CFTC would identify "legitimate, good faith attempt[s] to consummate a trade" versus those that may constitute "spoofing." *See* Proposed Order at 14947.

[7] The CFTC's termination of the ANPR coincided with a Senate Committee's demand for the CFTC to provide a detailed cost-benefit-analysis of other rules and regulations it had already promulgated under Dodd-Frank. Conveniently, in its response to the Senate Committee, the CFTC took no position as to whether it was required to conduct a cost-benefit-analysis for the "guidelines" it proposed in place of the ANPR. *See generally*, Ex. E to Kim Decl., U.S. Commodity Futures Trading Comm'n, Office of the Inspector Gen., A Review of Cost-Benefit Analyses Performed by the Commodity Futures Trading Commission in Connection with the Rulemakings Undertaken Pursuant to the Dodd-Frank Act, at 6 n.27 (2011). Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the fact that the CFTC took no position as to whether it was required to conduct a cost-benefit-analysis for the "guidelines" it proposed in place of the ANPR. The report was publicly submitted to a Senate Committee and is available on the CFTC's website. As such, it is subject to judicial notice because the facts therein "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2).

The Proposed Order then supplied a "non-exclusive" list of three examples that, in the CFTC's view, *do* qualify as "spoofing." *Id* Each of them referred to the "submi[ssion] *or* cancel[ation of]" of orders in the disjunctive. *Id* In light of these examples, it is apparent that the CFTC does not consider the "intent to cancel" to be a critical component of "spoofing" if the CFTC believes that the submission of orders, standing alone, can constitute "spoofing." In other words, the CFTC is trying to prohibit conduct that is beyond what is prohibited by the Spoofing Statute, because it does not necessarily involve an intent to cancel an order prior to execution.

One such example was the "submi[ssion] or cancel[ation of] multiple bids or offers to create an appearance of false market depth." *Id.* The CFTC pointed to a single source in support of its new contention that the "submi[ssion] or cancel[ation of] multiple bids or offers to create an appearance of false market depth" was an example of "spoofing." *See id.*, at n.51. That source on "spoofing," however, was a consent letter from the securities industry; not the futures industry. *See* Ex. F to Kim Decl., *Trillium Brokerage Services, LLC*, Letter of Acceptance, Waiver and Consent, No. 20070076782-01, from the Financial Industry Regulatory Authority (Aug. 5, 2010).[8] Notably, the consent letter fails to use the word "spoofing" even once. *See id*. It likewise fails to use the phrase "false market depth" or any similar iteration. *See id.* Moreover, the conduct described therein—which the CFTC apparently considered to be "spoofing" despite it not being identified as such—is markedly different that the supposed trading "pattern" alleged by the CFTC in its Complaint against Mr. Oystacher. *See id.*

[8] Pursuant to Fed. R. Evid. 201(b)(2) and 44 U.S.C. § 1507, 3 Red requests that the Court take judicial notice of the Letter of Acceptance, Waiver and Consent. The Letter of Acceptance, Waiver and Consent, as it was incorporated into the Proposed Order. *See* 44 U.S.C. § 1507 ("The contents of the Federal Register shall be judicially noticed."); Fed. R. Evid. 201(b)(2) ("The court may judicially notice a fact that is not subject to reasonable dispute because it . . . can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.").

Aside from introducing this supposed example of "spoofing" from the securities industry, the Proposed Order did not explain why the CFTC might conclude that a particular trade was not "part of a legitimate, good faith attempt to consummate a trade," but had rather been submitted for the purpose of "creat[ing] an appearance of false market depth." Again, the CFTC has shifted the intent requirement from an intent to cancel to some different form an intent that is not prohibited by the Spoofing Statute. Then, the Proposed Order described in one sentence a pliable enforcement policy pursuant to which the CFTC would supposedly "distinguish[] . . . between legitimate trading and 'spoofing' by evaluating all of the facts and circumstances of each particular case, including a person's trading practices and patterns." *See* Proposed Order at 14947*see also id.* (indicating that CFTC will ascertain intent by "evaluat[ing] the market context, the person's pattern of trading activity (including fill characteristics), and other relevant facts and circumstances").

The Proposed Order did not clarify the statute. As CFTC Commissioner Jill Sommers conveyed at the CFTC's open meeting on February 24, 2011, it "raised more questions than it answer[ed]." Ex. G to Kim Decl., Comments of Commissioner Jill Sommers, CFTC Open Meeting on the Twelfth Series of Proposed Rulemakings Under the Dodd-Frank Act at ¶ 7 (Feb. 24, 2011) ("Comments of Commissioner Sommers"), *available at* http://www.cftc.gov/PressRoom/SpeechesTestimony/sommerstatement022411.[9]. In this regard, Commissioner Sommers specifically noted that she and her colleagues at the CFTC "belie[ved] . . . that the language [of the statute] was too vague" and that "clarifying rules would be [both] necessary and appropriate." *Id.* at ¶ 5. She underscored that this was also "the message" that the

[9] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the Comments of Commissioner Sommers. The Comments of Commissioner Sommers are available on the CFTC's website, and the facts therein "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2).

CFTC had "received from the public in response to the ANPR and the roundtable." *Id.* Because "this [Proposed Order] does not cure that vagueness," Commissioner Sommers voted against it. *Id.* at ¶ 7. She also cautioned against what she believed was the true goal of the Proposed Order: "to retain maximum flexibility for Commission staff to investigate and prosecute alleged wrongdoing," at the expense of "provid[ing] the public and market participants with clear parameters distinguishing prohibited conduct from legitimate trading activity." *Id.*

In the wake of the Proposed Order, market participants echoed Commissioner Sommers' sentiments. They continued to call for "additional guidance and suggested that additional clarity was needed regarding how the Commission would interpret and apply" the Spoofing Statute. *See* Antidisruptive Practices Authority, Interpretive Guidance & Policy Statement, 78 Fed. Reg. 31890-01 at *31892 (May 28, 2013) (the "Policy Statement"). Yet again, commentators stressed that if the CFTC did not develop clear boundaries, then the Spoofing Statute would "capture legitimate trading practices that may be indistinguishable from the proposed prohibited conduct." *Id.*

The CFTC never issued any rule, final order or other meaningful guidance. Instead, it published on May 28, 2013, an "interpretive guidance and policy statement" that mostly parrots the Proposed Order. *See* Policy Statement at 31892. The Policy Statement does not conclude that there is any common understanding in the trade of what constitutes "spoofing" or set forth what that understanding might be. Nor does the Policy Statement even attempt to explain how the CFTC will identify conduct that is not "spoofing," but is somehow "of the character of" it.

## II. This Case

On October 19, 2015, the CFTC filed a two-count Complaint against 3 Red and Mr. Oystacher that purports to assert violations of the Spoofing Statute (Count I) and Section 6(c)(1) of the Act, 7 U.S.C. § 9(1) (2012), and Regulation 180.1, 17 C.F.R. § 180.1 (2014) ("Regulation

180.1") (Count II). *See* CFTC's Complaint (ECF No. 1) ("Compl.") The crux of the CFTC's claims is that Mr. Oystacher allegedly placed orders into the market to create the appearance of false market depth, and then cancelled those orders and flipped his position too fast for other participants to react.

In its Complaint, the CFTC makes clear that it is relying on each of the three prongs of the Spoofing Statute:

- "By this conduct and further conduct described herein, Defendants Oystacher, individually and on behalf of 3Red, and 3 Red have engaged, are engaging, or are about to engage in acts and practices that violate Section 4c(a)(5)(C) of the Act, 7 U.S.C. § 6c(a)(5)(C) (2012), **which makes it unlawful for any person to engage in trading or conduct on a registered entity that is of the character of or commonly known to the trade as "spoofing,"** . . . ." Compl. ¶ 6 (emphasis added).

- "Section 4c(a)(5)(C) of the Act, 7 U.S.C. § 6c(a)(5)(C) (2012), makes it unlawful for any person to engage in trading or conduct on a registered entity that **is of the character of or commonly known to the trade as "spoofing."** Section 4c(a)(5)(C) explains "spoofing" as "bidding or offering with the intent to cancel the bid or offer before execution." Compl. ¶ 16 (emphasis added).

- "Oystacher and 3 Red **engaged in spoofing during the relevant period by, among other things**, bidding or offering with the intent to cancel the bid or offer before execution . . . ." Compl. ¶ 94 (emphasis added).

Despite relying on the "the character of or commonly known to the trade as 'spoofing'" prongs of the Spoofing Statute, nowhere in the Complaint does the CFTC allege what type of conduct may be of "the character of" "spoofing" or "commonly known to the trade" as "spoofing." Instead, the CFTC attempts to bootstrap meaning to these provisions from its Policy Statement. Although the CFTC does not directly reference its Policy Statement, it refers to "false market depth" in no fewer than a dozen paragraphs in its Complaint. *See* Compl. ¶¶ 2, 3, 54(iii), 56, 58, 60, 66, 67, 69, 91, 94, 100, & 101.

On November 9, 2015, the CFTC moved for a preliminary injunction against 3 Red and Mr. Oystacher. *See* CFTC Mot. for Prelim. Inj., ECF No. 20-1 ("PI Motion"). The CFTC's

briefing and argument in support of its PI Motion underscore that its claims arise under "the character of or commonly known to the trade as 'spoofing'" prongs of the Spoofing Statute:

- "This Court should enjoin Oystacher from trading during the pendency of this action because **his conduct violates Section 4c(a)(5)(C) of the Act, 7 U.S.C. § 6c(a)(5)(C) (2012), which makes it unlawful for any person to engage in trading or conduct on a registered entity that is of the character of or commonly known to the trade as "spoofing"** - i.e., bidding or offering with the intent to cancel before execution . . . ." *See* PI Motion, at 2 (emphasis added).

- "Defendants violated Section 4c(a)(5) because **Oystacher's pattern of cancelling orders coupled with simultaneous flipping 'is and is of the character of … spoofing.**'" *See* PI Motion, at 21 (emphasis added).

On December 18, 2015, 3 Red filed its Answer and Affirmative Defenses in this Action. The Affirmative Defenses include arguments that the Spoofing Statute is unconstitutionally vague, that the CFTC's interpretation of it is arbitrary and capricious, and that the Spoofing Statute fails to provide adequate notice of what conduct is prohibited and thereby violate the due process rights of 3 Red and Mr. Oystacher. *See* Ans., Aff. Def. Nos. 3–6, ECF. No. 52.

The CFTC subsequently moved to strike all of 3 Red's affirmative defenses on January 15, 2016 (the "Motion to Strike"). *See* CFTC's Mot. to Strike, ECF No. 65. Therein, the CFTC did *not* offer any explanation as to what conduct may qualify as "the character of or commonly known to the trade as 'spoofing.'" Instead, the CFTC argued that "this Court should reject any arguments about the lack of notice in connection with a 'commonly understood meaning of "spoofing" in the world of futures trading,'" because Mr. Oystacher's alleged "conduct falls squarely within the plain terms of the statute prohibiting 'bidding or offering with the intent to cancel the bid or offer before execution' and mirrors the allegations in *Coscia*." *See id.* 13–14.

Since then, however, the CFTC has conceded that it is indeed asserting claims under "the character of or commonly known to the trade as 'spoofing'" prongs of the Spoofing Statute:

> **[T]he CFTC has not limited itself to one prong of the spoofing statute** and is thus entitled to present evidence showing that Defendants violated the prohibition against spoofing based on the plain definition in the statute and also by presenting evidence that **Mr. Oystacher's deceptive flipping pattern demonstrates characteristics of spoofing** and was identified by various market participants as 'spoofing.'

CFTC's Resp. to Mot. to Exclude Market Witnesses, at 4, ECF No. 126 (emphasis added).

## LEGAL STANDARD

A motion for judgment on the pleadings under Fed. R. Civ. P. 12(c) is evaluated using the same standard as a Fed. R. Civ. P. 12(b)(6) motion for failure to state a claim. *See Black & Decker, Inc. v. Robert Bosch Tool Corp.*, 500 F. Supp. 2d 864, 867 (N.D. Ill. 2007) (citing *R.J. Corman Derailment Servs., LLC v. Int'l Union of Operating Engineers, Local Union 150, AFL-CIO*, 335 F.3d 643, 647 (7th Cir. 2003). "In reviewing the sufficiency of a complaint under the plausibility standard announced in *Twombly* and *Iqbal*, we accept the well-pleaded facts in the complaint as true, but legal conclusions and conclusory allegations merely reciting the elements of the claim are not entitled to this presumption of truth." *McCauley v. City of Chicago*, 671 F.3d 611, 616 (7th Cir. 2011) (citing *Ashcroft v. Iqbal*, 129 S.Ct. 1937, 1951 (2009)). "After excising the allegations not entitled to the presumption, we determine whether the remaining factual allegations 'plausibly suggest an entitlement to relief.'" *Id.* (citing *Iqbal*, 129 S.Ct. at 1951). The "[f]actual allegations must be enough to raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555, (2007).

"To survive a Rule 12(c) motion, therefore, the factual allegations in the complaint must be sufficient to raise the possibility of relief above the speculative level, assuming that all well-pleaded allegations in the complaint are true." *Felsenthal v. Travelers Prop. Cas. Ins. Co.*, No. 12 C 7402, 2013 WL 469475, at *1 (N.D. Ill. Feb. 7, 2013) (citing *Twombly*, 550 U.S. at 555;

*Wozniak v. Argonne Nat'l Lab.*, No. 09–CV–7702, 2010 WL 3958426, at *3 (N.D. Ill. Oct. 1, 2010)). While evaluating a motion for judgment on the pleadings, the court may not look beyond the pleadings, except that the court may "take judicial notice of matters of public record." *United States v. Wood*, 925 F.2d 1580, 1582 (7th Cir. 1991).

## ARGUMENT

The Spoofing Statute prohibits three distinct forms of trading, practice, and conduct:

(1) "trading, practice, or conduct . . . that is . . . 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution);"

(2) "trading, practice, or conduct . . . that . . . is of the character of . . . 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution;" or

(3) "trading, practice, or conduct . . . that . . . is commonly known to the trade as . . . 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution)."

7 U.S.C. § 6c(a)(5)(C); *see generally Loughrin v. United States*, 134 S. Ct. 2384, 2389-90 (2014) (explaining that the use of the disjunctive "or" results in distinct statutory phrases). In this case, the CFTC attempts to assert claims against 3 Red and Mr. Oystacher based on each of the three prongs of the Spoofing Statute. *See generally* Compl.; *see also* CFTC's Resp. to Mot. to Exclude Market Witnesses, at 4, ECF No. 126 ("the CFTC has not limited itself to one prong of the spoofing statute"). Under each prong, however, the CFTC's claims fail as a matter of law. This is because (i) the Spoofing Statute is unconstitutionally vague; (ii) the CFTC's interpretation of the Spoofing Statute is contrary to Congressional intent; and (iii) the Spoofing Statute constitutes an unconstitutional delegation to the CFTC. In addition, for the same reasons that the Spoofing Statute is unconstitutionally vague and failed to give adequate notice of what conduct is prohibited, Regulation 180.1 likewise is unconstitutionally vague as applied to the allegations against 3 Red.

## I. Judgment on the Pleadings Under Federal Rule of Civil Procedure 12(c) Is Appropriate Because the Spoofing Statute Is Unconstitutionally Vague.

"[T]he void for vagueness doctrine addresses at least two connected but discrete due process concerns." *F.C.C. v. Fox Television Stations, Inc.*, 132 S. Ct. 2307, 2317 (2012). The first is "that regulated parties should know what is required of them so they may act accordingly." *Id.* The second is that "precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way." *Id.* To find a civil statute void for vagueness, the statute must be "so vague and indefinite as really to be no rule or standard at all." *Boutilier v. Immigration & Naturalization Serv.*, 387 U.S. 118, 123 (1967).

### A. Each of the Three Prongs of the Spoofing Statute Is Vague as Applied to the Allegations Against Mr. Oystacher.

Here, because the CFTC's claims arise under each of the three prongs of the Spoofing Statute, the Court should evaluate the extent to which each of the three prongs of the Spoofing Statute is unconstitutionally vague as applied to the allegations against Mr. Oystacher. The CFTC has urged the Court not to do this and instead limit its analysis to the first prong of the statute based on the disingenuous contention that Mr. Oystacher's alleged "conduct falls squarely within the plain terms of the statute prohibiting 'bidding or offering with the intent to cancel the bid or offer before execution' and mirrors the allegations in *Coscia*." *See* Motion to Strike, at 13–14. But, despite the CFTC's urging, this is not the same case as *Coscia* for a number of reasons. *Contra* Motion to Strike, at 13–14. As discussed below, there are no well-pled allegations of intent to cancel. *Compare* Compl., *with United States v. Coscia*, No. 14-cr-551, Indictment, at ¶¶ 14-19, ECF No. 1 ("Coscia Indictment") (N.D. Ill. Oct. 1, 2014) (alleging intent based on an algorithm that was pre-programmed to cancel immediately without any regard for market conditions). And, as is obvious on the face of the complaint (and as recently conceded by the

CFTC), the CFTC's claims do not rest squarely within the Spoofing Statute's parenthetical. *Compare* Compl., ¶ 94 and CFTC's Resp. to Mot. to Exclude Market Witnesses, at 4, ECF No. 126 *with* Motion to Strike, at 11-14 and *Coscia*, 100 F. Supp. 3d at 659. As a result, the Court should look to each of the three prongs of the Spoofing Statute as they are applied to the allegations against Mr. Oystacher to determine whether the Spoofing Statute is unconstitutionally vague.

Once the Court does so, it will become apparent that the Spoofing Statute is vague, because "it is unclear as to what fact(s) must be proved" to make out a claim under each prong. *See Fox Television Stations, Inc.*, 132 S. Ct. at 2317. And if it is unclear what facts must be proved to make out a claim, then there certainly is no basis to conclude that Mr. Oystacher received adequate notice of what conduct was forbidden under the Spoofing Statute. *See id.* ("A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required."). Moreover, if it is unclear what facts must be proved to make out a claim under the Spoofing Statute, then the CFTC essentially has free reign to make arbitrary and capricious decisions about what type of trading conduct they will prosecute under the statute. *See id.* ("precision and guidance are necessary so that those enforcing the law do not act in an arbitrary or discriminatory way"). As such, the Spoofing Statute is unconstitutionally vague, and the CFTC's claims fail as a matter of law.

**B. The "is spoofing" prong of the Spoofing Statute is vague, because it fails give notice of what type of trading conduct constitutes "spoofing" as opposed to legitimate trading.**

**i. The CFTC's claims do not fit squarely within the parenthetical, because there are no well-pled allegations of intent to cancel.**

The CFTC has not, and cannot, allege any direct evidence of any "intent to cancel." *Compare* Coscia Indictment, at ¶ 10 (alleging the defendant "designed his programs to cancel the

quote orders within a fraction of a second automatically, without regard to market conditions, even if the market moved in a direction favorable to the quote orders."). And merely alleging that Mr. Oystacher had the intent to cancel before execution, *see, e.g.*, Compl. ¶54(i), without supporting facts is insufficient to push the CFTC's claims into the realm of plausibility. *See McReynolds v. Merrill Lynch & Co.*, 694 F.3d 873, 886 (7th Cir. 2012); *McCauley*, 671 F.3d at 616-17. As they stand, the allegations about Mr. Oystacher's intent are conclusory. As a result, they are not entitled to the presumption of truth. *See McReynolds*, 694 F.3d at 886.

There is similarly a dearth of plausible allegations to suggest that Mr. Oystacher's alleged cancelations were the result of a preconceived intent to cancel as opposed to a lawful reason. *See McCauley*, 671 F.3d at 616 ("the complaint must contain 'allegations plausibly suggesting (not merely consistent with)' an entitlement to relief") (citations omitted). For instance, there is not a single allegation concerning how Mr. Oystacher would profit from this purported scheme. *Compare* Compl., *with* Coscia Indictment, at ¶¶ 2, 3, 8, 12, 15 (alleging how Coscia profited from the alleged spoofing scheme). Nor is there a single allegation about the market conditions (such as price volatility) at the times Mr. Oystacher cancelled his orders and flipped that would make his alleged conduct more consistent with the inference that he intended to cancel prior to execution than because of a change in market conditions. *Compare* Compl., *with* Coscia Indictment, at ¶ 10 (alleging the defendant "designed his programs to cancel the quote orders within a fraction of a second automatically, without regard to market conditions, even if the market moved in a direction favorable to the quote orders."). Similarly, the CFTC fails to make any allegations to support the notion that the alleged "pattern" in Mr. Oystacher's trading was unique to alleged spoofing events, as opposed to just being characteristic of how he normally trades even when not being accused of spoofing.

Moreover, the Complaint actually includes a number of allegations that cut *against* any inference that Mr. Oystacher intended to cancel the orders prior to execution. For example, the CFTC alleges that Mr. Oystacher placed the purported spoof orders "at or near the best bid or offer price." *See, e.g.*, Compl. ¶ 3. The CFTC also alleges, however, that "orders at the best available bid or ask price must be executed or removed before the pending orders at the next available best bid or ask price can be executed." *See, e.g.*, Compl. ¶ 24. In other words, Mr. Oystacher placed his orders at the price level where they were most likely to be filled. *Compare* Compl. ¶ 3, *with* Coscia Indictment, at ¶ 9 (noting that the defendant placed the alleged spoof orders "within three ticks of the best bid or offer price"). Although the CFTC generally alleges that Mr. Oystacher placed his orders "behind existing orders" "to avoid being filled," *see, e.g.*, Compl. ¶ 61, the figures alleged in the Complaint reveal that those existing contracts were between only 10% to 58% of Mr. Oystacher's contracts. *See* Compl. ¶ 64. It is simply not plausible to suggest that Mr. Oystacher was using existing orders as protection against getting filled when those existing orders were insufficient to protect the vast majority of Mr. Oystacher's contracts from being filled.

Ultimately, the allegations of the Complaint fail to make it any more plausible that Mr. Oystacher intended to cancel the orders prior to execution as opposed to simply changing his mind after order placement. Rather, the allegations are at least as consistent with the inference that Mr. Oystacher cancelled his orders as part of a legitimate trading strategy. When the conclusory allegations about intent are stripped away, it is obvious that the CFTC's claims do not fit squarely within the parenthetical.

**ii. The "is spoofing" prong of the Spoofing Statute must mean something other than what its language appears to convey.**

The CFTC's claims under the first prong of the Spoofing Statute fail as a matter of law, because it is unconstitutionally vague. The meaning of the "is spoofing" prong of the statute hinges on a term that appears in quotation marks. This is unusual in an Act of Congress, but ordinarily, such quotation marks might indicate an industry term of art. *See Utah v. Evans*, 536 U.S. 452, 464-68 (2002) (construing federal statute authorizing use of statistical method "known as 'sampling'" and noting that use of "the words 'known as' and the quotation marks that surround 'sampling' . . . suggests a term of art with a technical meaning"). Not so here. As the years of public debate following Dodd-Frank make plain, "spoofing" was not a meaningful referent in the futures industry. *See, e.g.*, Roundtable Tr. at 171:17-21 (stating that "after this morning's conversation," the answer to the question of whether there is "a common understanding or meaning to the terms that [are] . . . in the statute" is "no"); Damgard Comment Letter at 1 (referring to the Spoofing Statute as "an overly vague provision that is not clearly defined and prohibits activities that are also not subject to clear definition"); Roundtable Tr. at 154:20-155:1 (referring to the Dodd-Frank provision as "bad law" because "[i]t wasn't done with forethought as to an abusive practice that everybody had admitted was a problem in the marketplace"). This is why "spoofing" had never been mentioned in any prior industry statute, rule, or administrative guidance. *See, e.g.*, Roundtable Tr. at 171:9-172:7.

The parenthetical description in the statute (*i.e.*, "bidding or offering with the intent to cancel before execution") does not cure the vagueness of the text.[10] It is hardly clear that this

[10] Congress's inclusion of a parenthetical description implicitly acknowledges that "spoofing" was not an industry term of art with a uniform definition. If it were, then there would not have been any need to supply a description. Notably, Section 1a of the CEA sets forth extensive definitions for terms used in the statute. *See* 7 U.S.C. § 1a. "Spoofing" appears nowhere in Section 1a, even after the extensive revisions that Congress made to that section as part of Dodd-Frank.

description *defines* "spoofing."[11] *Contra* Motion to Strike, at 11-12. In fact, the description more likely offers an example of what may *sometimes* constitute "spoofing." Certainly, when Dodd-Frank was passed, the futures industry was flooded with bids and offers that algorithmic traders obviously intended to cancel before execution. This included, among others, stop-loss orders (which are set to buy or sell once a stock reaches a certain price), partial fill orders (of which only a portion of the order is executed and the remainder is cancelled), fill-or-kill orders (which are set to cancel if they are not executed immediately), orders placed for price discovery, and orders placed to test system parameters. *See* Ex. H to Kim Decl., CFTC Glossary, *available at* http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/index.htm (last visited May 9, 2016);[12] Ex. I to Kim Decl., Glossary, CME Group, *available at* http://www.cmegroup.com/education/glossary.html (last visited May 9, 2016);[13] Roundtable Tr. at 60:6-61:3, 78:19-79:1; *Balfour Maclaine, Inc. v. Nat'l Coin Exch., Inc.*, 697 F. Supp. 835, 839 (E.D. Pa. 1988) (discussing stop-loss orders); *Anspacher & Associates, Inc. v. Haugen*, No. 83 C

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[11] To the extent the Court finds it to be a definition, the intent component is not dispositive of the issue of the statute's constitutionality. *See, e.g.*, *Vill. Of Hoffman Estates v. Flipside, Hoffman Estates, Inc*, 455 U.S. 489, 499 (1982) ("[A] scienter requirement ***may*** mitigate a law's vagueness, especially with respect to the adequacy of notice to the complainant that his conduct is proscribed.") (emphasis added).

[12] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the CFTC Glossary. The CFTC Glossary is available on the CFTC's website, and the existence of the definitions therein "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2); *see, e.g., United States ex rel. Garbe v. Kmart Corp.* ("*Garbe*"), 73 F. Supp. 3d 1002, 1017 n.9 (S.D. Ill. 2014) (taking judicial notice of state Medicaid programs' glossaries of terms).

[13] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the CME Group Glossary. The CME Group Glossary is available on the CME Group's website, and the existence of the definitions therein "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2); *see, e.g., Garbe*, 73 F. Supp. 3d at 1017 n.9 (taking judicial notice of state Medicaid programs' glossaries of terms).

3253, 1987 WL 12670, at *1 (N.D. Ill. June 16, 1987) (discussing stop-loss orders); Roundtable Tr. at 60:6-61:3, 78:19-79:1. All of these orders fit what the CFTC characterizes as the definition of "spoofing," but were considered lawful in the futures industry. *See, e.g.*, Ex. J to Kim Decl., Order Qualifiers, CME Group, *available at* http://www.cmegroup.com/confluence/display/EPICSANDBOX/Order+Qualifiers (last visited May 9, 2016);[14] Ex. K to Kim Decl., Rulebook, CBOE Futures Exchange, LLC, *available at* https://cfe.cboe.com/publish/cferulebook/cferulebook.pdf (last visited May 9, 2016).[15] They still are today. *See, e.g.*, *id*.

This demonstrates that the Spoofing Statute must mean something other than what its language appears to convey. *See, e.g.*, *City of Chicago v. Morales*, 527 U.S. 41, 57 (1999) (holding that ordinance was vague regarding "what loitering is covered . . . and what is not" even though definition of "loitering" was plain, because city "cannot conceivably have meant to criminalize each instance [of loitering] with a gang member"); *Smith v. Goguen*, 415 U.S. 566, 573-74 (1974) (holding that language of statute was vague because it "fails to draw reasonably clear lines between the kinds of nonceremonial treatment [of the flag] that are criminal and those that are not"); *see also Ashton v. Kentucky*, 384 U.S. 195, 199 (1966) (finding vague a statute

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[14] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the CME Group Order Qualifiers. The CME Group Order Qualifiers are available on the CME Group's website, and the existence of the definitions therein "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2); *see, e.g.*, *Garbe*, 73 F. Supp. 3d at 1017 n.9 (taking judicial notice of state Medicaid programs' glossaries of terms).

[15] Pursuant to Fed. R. Evid. 201(b)(2), 3 Red requests that the Court take judicial notice of the fact that stop-loss orders, partial fill orders, and fill-or-kill orders are not prohibited by the CBOE Futures Exchange, LLC. The CBOE Futures Exchange, LLC Rulebook is available on the CBOE Futures Exchange, LLC website, and the lack of a rule therein "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2).

that was "sweeping in a great variety of conduct under a general and indefinite characterization, and leaving to the executive and judicial branches too wide a discretion in its application"). As such, because the text of the Spoofing Statute simply did not provide Mr. Oystacher any reasonable touchstone for identifying—or avoiding—prohibited conduct, it is unconstitutionally vague. *See, e.g.*, *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972) (reiterating that to be minimally clear, laws must "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly"); *United States v. Nat'l Dairy Prods. Corp*., 372 U.S. 29, 36 (1963) (suggesting that statutes without a meaningful referent in business practice or usage implicate vagueness concerns). Accordingly, the CFTC's claims under the first prong of the Spoofing Statute fail as a matter of law, because it is vague and does not enable industry participants like Mr. Oystacher to conform their trading to its requirements.

### C. The Spoofing Statute is vague, because it fails to give notice of what is "commonly known to the trade as" or "of character of" "spoofing."

The CFTC's claims also arise under the second and third prongs of the Spoofing Statute, which purport to outlaw conduct that "is of the character of . . . 'spoofing'" or "commonly known to the trade as, 'spoofing.'"[16] *See* Spoofing Statute. As such, in addition to evaluating the "is spoofing" prong, the Court should determine whether "the character of or commonly known to the trade" prongs of the Spoofing Statute are unconstitutionally vague.

#### i. There is no notice of what is "commonly known to the trade as" or is "of character of" "spoofing."

Since the Spoofing Statute outlaws "spoofing," in and of itself, conduct that "is of the character of . . . 'spoofing'" must be conduct that is *not* spoofing, but is somehow *like* spoofing.

[16] Moreover, as discussed above, when the conclusory allegations about intent are stripped away, all that remains are allegations of some "pattern" of flipping that the CFTC contends is of "the character of or commonly known to the trade as 'spoofing.'" As such, the CFTC's claims may very well arise *only* under the second and third prongs of the Spoofing Statute.

*See Colautti v. Franklin*, 439 U.S. 379, 392 (1979) (finding that "may be viable" was distinct from the defined term "viable" and rejecting arguments that "may be viable" meant the same thing or was an explication of the term "viable"). Likewise, conduct that is "commonly known to the trade as, 'spoofing'" must also be something *other* than "spoofing." *See id*. In other words, even if the Court were to construe the parenthetical as a constitutionally sound definition of "spoofing" (it should not), that definition would not remedy the vagueness of the "is of the character of . . . 'spoofing'" or "commonly known to the trade as, 'spoofing'" prongs of the statute. *See id*. (rejecting arguments that "may be viable" meant the same thing or was an explication of the defined term "viable").

Importantly, there is nothing in the statute, the legislative history or the Policy Statement that indicates how closely the non-spoofing must be to actual spoofing, or in what way. Nor is there is anything in the statute, the legislative history or the Policy Statement that indicates what conduct is "commonly known to the trade as, 'spoofing.'" In fact, quite the opposite, the Policy Statement recounts the industry's overwhelming consensus that there is no common understanding of "spoofing" in the futures trade. *See* Policy Statement at nn. 69-73. In that same vein, it is unclear whether conduct that is of the character of or commonly known as spoofing, but is not actually spoofing, would involve the intent to cancel before execution, or whether it would involve some other form of intent. As a result, this is not a situation where vagueness *may* be mitigated by a scienter requirement. *Contra* Motion to Strike, at 11.

Tellingly, in its Motion to Strike, the CFTC does *not* argue that there is such a thing as a "commonly understood meaning of 'spoofing' in the world of futures trading" or provide any suggestion as to what type of trading conduct may be of "the character of" "spoofing." Instead, the CFTC attempts to sidestep the issue by mischaracterizing the substance of its claims as

falling squarely and exclusively within the Spoofing Statute's parenthetical. *See* Mot. to Strike, at 11-12. They do not. To be sure, as is obvious from the face of the Complaint, the CFTC is expressly relying on "the character of or commonly known to the trade as 'spoofing'" prongs of the Spoofing Statute. *See* Compl. ¶¶ 6, 16, 94. The CFTC has since admitted this. *See* CFTC's Resp. to Mot. to Exclude Market Witnesses, at 3, 11, ECF No. 126.

Ultimately, if there was some consensus as to what conduct qualifies as the character of or is commonly known as spoofing, then surely, at the very least, the CFTC would have shared that insight with the Court here. For example, in *CFTC v. Trade Exch. Network*, 117 F. Supp. 3d 29 (D.C. 2015), the CFTC was willing and able to prove to a court what type of conduct was covered by "the character of, or is commonly known to the trade as" language with regard to a different subsection of 7 U.S.C. § 6c. In that case, the CFTC accused an Irish firm of violating 7 U.S.C. § 6c(b) (2012), which states:

> No person shall offer to enter into, enter into, or confirm the execution of, any transaction involving any commodity regulated under [the CEA] which ***is of the character of, or is commonly known to the trade as***, an 'option,' . . . contrary to any rule, regulation, or order of the Commission . . . .

7 U.S.C. § 6c(b) (emphasis added); *Trade Exch. Network*, 117 F. Supp. 3d at 34. As a defense, the firm argued that the financial instrument it offered was not of the character of or commonly known to the trade as an "option." *See id.* at 35

In response, the CFTC argued that that the financial instrument offered was of the character of and commonly known to the trade as a binary option. *See id.* at 35-36. To support its position, the CFTC directed the court to numerous authorities, including: "(1) a broad array of economic and industry treatises dating back more than 15 years; (2) the fact that binary options and cash-settled options currently trade on CFTC regulated markets; and (3) that the CFTC has

long asserted its jurisdiction publicly over binary options." *See CFTC v. Trade Exch. Network*, Case No. 1:12-cv-01902-RCL, ECF No. 53, at 4–5 (D.C. Apr. 3, 2015).

Ultimately, the court agreed with the CFTC that the financial instrument offered was known to the trade as and was of the character of a binary option, and therefore came within the purview of the Act. *See Trade Exch. Network*, 117 F. Supp. 3d at 36-38. In so holding, the Court was able to rely on: (1) case law; (2) an industry treatise; (3) a law dictionary; and (4) information provided on exchange websites. *See id.* 36.

By contrast, in our case, the CFTC has not pointed to any prior case law, treatises, or other authority to prove to the Court that its allegations against Mr. Oystacher constitute what is known to the trade or is of the character of spoofing.[17] This is because there is no authority that exists to define these prongs of the Spoofing Statute, or that would give notice to Mr. Oystacher of what conduct they prohibit. And without such notice, the resulting conclusion is that the Spoofing Statute is unconstitutionally vague. *See Fox Television Stations, Inc.*, 132 S. Ct. at 2317 & 2320.

### D. The Policy Statement Does Not Cure the Vagueness of the Spoofing Statute or Provide Adequate Notice

The Policy Statement cannot cure the Spoofing Statute's lack of adequate notice of what conduct it prohibits. As an initial matter, as applied to Mr. Oystacher, 87% of the charged trades occurred *prior* to the CFTC's issuance of its Policy Statement. *See Fox Television Stations, Inc.*, 132 S. Ct. at 2320 (finding defendant "lacked constitutionally sufficient notice" in the absence of

[17] Instead, the CFTC apparently wants to rest on the testimony of Mr. Oystacher's competitors to define what is commonly known to the trade as spoofing. *See* CFTC's Resp. to Mot. to Exclude Market Witnesses, at 3, ECF No. 126. That suggestion is improper for many reasons, not least of which because it would be an unconstitutional delegation as explained in Part C, *infra*.

agency decisions or agency guidance that it would target certain conduct as part of its enforcement policy).[18]

That said, neither the speed of cancellations nor the flipping of positions is mentioned in the Policy Statement, let alone identified as an example of either "spoofing" or "creating an appearance of false market depth." *See generally* Policy Statement at 31890-31897. Nor has the CFTC promulgated any rules to set minimum resting times for orders or require time delays for flips. In other words, putting aside the timing of its issuance, the Policy Statement failed to provide Mr. Oystacher with constitutionally sufficient notice that the CFTC would pursue an enforcement policy aimed at "flipping too quickly," or that it would look to these factors to establish the inference of intent to cancel. *See Fox Television Stations, Inc.*, 132 S. Ct. at 2320.

Further, the Court should reject the CFTC's attempt to bootstrap meaning to the Spoofing Statute from the Policy Statement. Although Congress delegated to the CFTC permissive authority to promulgate rules and regulations related to 7 U.S.C.A. § 6c(a)(5)(C), it has chosen not to. *See* Policy Statement, at 31897 n.4 ("At this time, the Commission is only providing interpretive guidance on the disruptive trading, practices, or conduct discussed herein. The Commission does not foreclose subsequent promulgation of rules and regulations pursuant to CEA section 4c(a)(6)."). Indeed, the CFTC initially issued an ANPR, but then withdrew the ANPR and replaced it with the Proposed Interpretive Guidance. What ultimately resulted was the

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[18] The Court should summarily reject the CFTC's contention that the Proposed Order provided adequate notice to Mr. Oystacher of what conduct it would view as being prohibited under the Spoofing Statute. *See CFTC* v. *Schor*, 478 U.S. 833, 845 (1986) ("It goes without saying that a proposed regulation does not represent an agency's considered interpretation of its statute and that an agency is entitled to consider alternative interpretations before settling on the view it considers most sound."); CFTC Q&A — Proposed Interpretive Order on Disruptive Trading Practices, *available at* http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/DF_24_DisruptiveTrading/index.htm (last visited Dec. 17, 2015) ("The Proposed Interpretive Order is a proposal — it does not bind the Commission or the public.").

Policy Statement, which is nothing more than a non-binding policy statement that lacks the force of law.[19]

As a non-binding policy statement, it does not warrant *Chevron* deference. *See Am. Fed'n of Gov't Employees v. Rumsfeld*, 262 F.3d 649, 656 (7th Cir. 2001) ("As the Supreme Court has clarified recently, *Chevron* deference only applies when 'it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.'") (quoting *United States v. Mead Corp*., 533 U.S. 218, 226 (2001)); *see also Christensen v. Harris Cty.*, 529 U.S. 576, 587 (2000) ("interpretations contained in policy statements, agency manuals, and enforcement guidelines, all of which lack the force of law—do not warrant *Chevron*-style deference"); *In re UAL Corp. (Pilots' Pension Plan Termination)*, 468 F.3d 444, 450–51 (7th Cir. 2006) ("After *Mead* and *Christensen*, the sort of opinion letters to which the Court deferred in *LTV* would receive, not *Chevron* deference, but respectful consideration under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944)."). To that end, the Court would be well within its discretion to find the CFTC's interpretation of the Spoofing Statute as stated in its Policy Statement to be unjustified. *See, e.g.*, *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) (making clear that informal agency interpretations are, at most, entitled to "respectful consideration," and only if the court considers them persuasive); *see also Pac. Gas & Elec. Co. v. Fed. Power Comm'n*, 506 F.2d 33, 40 (D.C. Cir. 1974) ("Although the agency's expertise and experience cannot be

[19] To the extent the CFTC takes the position and the Court finds that the Policy Statement is a binding, final agency action, then it violates the Administrative Procedures Act and 19(a)(1) of the Act. *See* 5 U.S.C. § 706(2)(A) (a reviewing court shall "hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law"); 7 U.S.C. § 19(a)(1) (requiring the CFTC to conduct a cost-benefit analysis before promulgating a rule).

ignored, the reviewing court has some leeway to assess the underlying wisdom of the policy and need not affirm a general statement of policy that merely satisfies the test of reasonableness"). Indeed, the CFTC's examples of "spoofing" in the Policy Statement are clearly broader than the scope of the Spoofing Statute because they prohibit some form of intent other than the intent to cancel prior to execution. For this reason, the CFTC's Policy Statement is not persuasive or entitled to any deference. *See MCI Telecomm'n Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218, 229, 114 S. Ct. 2223, 2231, 129 L. Ed. 2d 182 (1994) ("an agency's interpretation of a statute is not entitled to deference when it goes beyond the meaning that the statute can bear").

### E. Because the Spoofing Statute Is Vague, It Lends Itself to Arbitrary and Capricious Enforcement

As the comments from the market participants make clear, it is impossible to distinguish between legitimate and illegitimate conduct under the Spoofing Statute. *See* Policy Statement at nn. 71-72. As a result—and acknowledged by CFTC Commissioner Sommers—the Spoofing Statute lends itself to arbitrary and capricious enforcement, which is yet another reason why it is unconstitutionally vague. *See Fox Television Stations, Inc.*, 132 S. Ct. at 2320; *see also* Comments of Commissioner Sommers ("The goal should not be to retain maximum flexibility for Commission staff to investigate and prosecute alleged wrongdoing. That is what this Order does, and I cannot support this approach."). For instance, in this case (which is largely driven by the complaints of Mr. Oystacher's competitors that they purportedly did not have time to react to Mr. Oystacher's trading), the CFTC is essentially accusing Mr. Oystacher of flipping too quickly, even though Congress never clearly prohibited flipping or flipping too quickly in the Spoofing Statute. Ultimately, this case is a prime example of how the CFTC is able to capitalize on the vagueness of the Spoofing Statute to predicate its enforcement decisions on inferences

that it may sometimes opt to draw from normal trading practices, should it wish to construe them as badges of prohibited intent on an ad hoc basis.

## II. Judgment on the Pleadings Under Federal Rule of Civil Procedure 12(c) Is Appropriate Because Regulation 180.1 Is Unconstitutionally Vague as Applied to the Allegations against 3 Red.

The CFTC contends that 3 Red has violated Regulation 180.1 based on the exact same allegations that underlie the CFTC's claims under the Spoofing Statute. For the same reasons that the CFTC's claims do not fit squarely within the language of the Spoofing Provision, *see* Part I, *supra*, they do not fit squarely within the language of the Regulation 180.1. *Contra* Motion to Strike, at 2. Additionally, just as the Spoofing Statute did not provide adequate notice that 3 Red's alleged trading conduct was prohibited thereunder, *see* Part I, *supra*, Regulation 180.1 likewise fails to provide that notice as applied to the allegations against 3 Red in this case. That Regulation 180.1 and SEC Rule 10b-5 have certain parallels to each other is not in and of itself reason for this Court to uphold the constitutionality of Regulation 180.1. *See Walz v. Tax Comm'n of City of New York*, 397 U.S. 664, 678 (1970) ("It is obviously correct that no one acquires a vested or protected right in violation of the Constitution by long use, even when that span of time covers our entire national existence and indeed predates it."). Indeed, CME Groups, Inc., the Commodity Markets Council, and others have publicly expressed that they believe that "proposed Rules 180.1 and 180.2 are vague and fail to provide market participants with sufficient notice of whether contemplated trading practices run afoul of a prohibition. Further, CME Group and CMC believe that proposed Rule 180.1 is susceptible to constitutional challenge under the Due Process Clause." *See* Prohibition on the Employment, or Attempted Employment, of Manipulative and Deceptive Devices and Prohibition on Price Manipulation, 76 Fed. Reg.

41398-01 (July 14, 2010), at n.20 &21.[20] Accordingly, the CFTC's claims under Regulation 180.1 fail as a matter of law, because it is vague and does not enable industry participants like Mr. Oystacher to conform their trading to its requirements.

## III. Judgment on the Pleadings Under Federal Rule of Civil Procedure 12(c) Is Appropriate, Because The CFTC's Interpretation of the Spoofing Statute Is Contrary to Congressional Intent and Does Not Deserve Deference.

The CFTC's interpretation of the Spoofing Statute in this case both exceeds the text of the Spoofing Statute and transcends the scope of Congressional intent. As an initial matter, the CFTC essentially concludes that Mr. Oystacher was "spoofing" because he was flipping. *See* Compl., at ¶¶ 3, 55. The Spoofing Statute, however, focuses solely on cancellations. 7 U.S.C. § 6c(a)(5)(C) (2012). It does not mention flipping. *Id.* Furthermore, when Dodd Frank was passed, there was no industry authority that outlawed flipping or restricted the speed at which new orders could be placed in the futures markets following a cancellation. Regardless of what exactly Congress may have meant by "spoofing," then, it is clear that Congress did not intend for the CFTC to interpret that term as flipping "too quickly" or "too often" (as the CFTC has chosen to do here). Because the CFTC's interpretation of the Spoofing Statute is contrary to the text of the statute and Congressional intent, it does not deserve deference and should be rejected by the Court. *See Chevron, U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984) (making clear that deference to agency construction only applies if interpretation is consistent with Congressional intent); *Michigan v. EPA*, 268 F.3d 1075, 1081 (D.C. Cir. 2001) (noting that agency has "only those authorities conferred upon it by Congress"); *U.S. EPA v. Envtl. Waste*

[20] Pursuant to Fed. R. Evid. 201(b)(2) and 44 U.S.C. § 1507, 3 Red requests that the Court take judicial notice of the Final Rule, which is published in the Federal Register. *See* 44 U.S.C. § 1507 ("The contents of the Federal Register shall be judicially noticed."); Fed. R. Evid. 201(b)(2) ("The court may judicially notice a fact that is not subject to reasonable dispute because it . . . can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned.").

*Control, Inc.*, 698 F. Supp. 1422, 1439-40 (N.D. Ind. 1998) (underscoring that agency is only entitled to deference if its "interpretation is [both] reasonable and not in conflict with the expressed intent of Congress").

## IV. Judgment on the Pleadings Under Federal Rule of Civil Procedure 12(c) Is Appropriate, Because the Spoofing Statute Provides No Intelligible Principle and Is Therefore an Unconstitutional Delegation of Legislative Authority.

For essentially the same reasons that the Spoofing Statute is unconstitutionally vague, the Spoofing Statute and its corresponding grant of regulatory authority lack any intelligible principle and therefore effectuate an unconstitutional delegation of power to both the CFTC and the federal courts.

### A. The Non-Delegation Doctrine

Article I of the Constitution states that "All legislative Powers herein granted shall be vested in a Congress of the United States." U.S. Const. Art. I, § 1. Under the "non-delegation doctrine," "Congress is not permitted to abdicate or to transfer to others the essential legislative functions with which it is thus vested." *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 529 (1935). "The non-delegation doctrine is rooted in the principle of separation of powers that underlies our tripartite system of Government." *Mistretta v. United States*, 488 U.S. 361, 371 (1989).

While the Supreme Court has upheld grants of rulemaking power to executive or judicial actors, Congress must, at the very least, "lay down by legislative act an intelligible principle to which the person or body authorized to [act] is directed to conform." *J.W. Hampton, Jr., & Co. v. United States*, 276 U.S. 394, 409 (1928). In addition to maintaining a constitutional separation of powers, the purpose of this "intelligible principle" standard is to ensure that courts are able to "ascertain whether the will of Congress has been obeyed." *Id.*; *Skinner v. Mid-Am. Pipeline Co.*, 109 S. Ct. 1726, 1728 (1989). Furthermore, when a delegation involves the power "to make

federal crimes of acts that never had been such before and to devise novel rules of law in a field in which there had been no settled law or custom," as it does in this case,[21] the Supreme Court has suggested that the Constitution may require "more specific guidance." *See*; *Touby v. United States*, 500 U.S. 160, 165-66 (1991); *see generally Fahey v. Mallonee*, 332 U.S. 245, 249-50 (1947). An agency may not "cure an unlawful delegation of legislative power by adopting in its discretion a limiting construction of the statute" or by "declining to exercise some of that power." *Whitman v. Am. Trucking Ass'ns.*, 531 U.S. 457, 472-73 (2001). "The very choice of which portion of the power to exercise—that is to say, the prescription of the standard that Congress had omitted—would *itself* be an exercise of the forbidden legislative authority." *Id.* (emphasis in original).

The Supreme Court's landmark decision in *Schechter Poultry* is analogous to the instant case in several respects. In *Schechter Poultry*, the Supreme Court struck down a provision in the National Industrial Recovery Act (which, like the Dodd-Frank Act, was enacted in the wake of a "grave national crisis" demanding "a broad and intensive co-operative effort by those engaged in trade and industry") as an unconstitutional delegation of legislative power. *Schechter Poultry*, 295 U.S. at 526. The offending provision purported to delegate to the President the power to approve "codes of fair competition" submitted by private industry groups. *Id.* at 522. As a condition of approval, the President could impose additional conditions "for the 'protection of consumers, competitors, employees, and others, and in furtherance of the public interest.'" *Id.* at 523 (internal citation omitted). Violations of the codes could result in criminal penalties. *Id.* at 522.

[21] While the Spoofing Statute at issue in this case is a civil provision, the exact same "spoofing" language is used in the CEA to impose criminal liability. *See* 7 U.S.C. § 13(a)(2); *see also United States v. Coscia*, No. 14 CR 551, 2015 WL 6153602 (N.D. Ill. Oct. 19, 2015).

In invalidating the statute at issue in *Schechter Poultry*, the Supreme Court posed several fundamental questions, all of which are equally applicable to Spoofing Statute at issue in this case:

- Is there is any "adequate definition" of the subject to which the codes are to be addressed?
- Does the term "fair competition" refer to a category established in the law, and is the authority to make codes limited accordingly?
- Or is the term "fair competition" used as a convenient designation for whatever set of laws the formulators of a code for a particular trade or industry may propose and the President may approve as being wise and beneficent provisions for the government of the trade or industry?
- Would it be seriously contended that Congress could delegate its legislative authority to trade or industrial associations or groups so as to empower them to enact the laws they deem to be wise and beneficent for the rehabilitation and expansion of their trade or industries?

*Id.* at 530-31. Each of these questions applies with equal force to the Spoofing Statute.

**B. The Spoofing Statute Is an Unconstitutional Delegation of Power to the CFTC**

The Spoofing Statute and its corresponding grant of regulatory authority is an unconstitutional delegation of power to the CFTC because it (i) lacks an "adequate definition" of spoofing or any other "intelligible principle" and (ii) fails to limit the CFTC's authority accordingly.

**a. There is no adequate definition of spoofing and no "intelligible principle" in the Spoofing Statute.**

As discussed above, there is no drafting or legislative history revealing what Congress had in mind when it enacted the Spoofing Statute; there are no previous versions, no committee reports, no testimony by any witness during committee proceedings, and no discussion during congressional floor debates that might provide a guiding principle for CFTC regulation. Nor is there any relevant judicial precedent that sheds light on what Congress's intent might have been

at the time the Spoofing Statute was enacted. Thus, any intelligible principle for the exercise of power delegated by the Spoofing Statute must come, if at all, from the text of the Statute itself. *See Whitman*, 531 U.S. at 473 (recognizing agency regulations cannot cure unconstitutional delegation).

The language of the Spoofing Statute gives rise to only two potential limitations on the CFTC's delegated power to regulate "spoofing": the reference to what is purportedly "commonly known to the trade" as spoofing, and the parenthetical description of spoofing as "bidding or offering with the intent to cancel [a] bid or offer before execution." 7 U.S.C. § 6c(a)(5)(C). Neither of these purported limitations provides an intelligible principle, much less the more specific guidance required for criminal statute.

First, it is clear that there was no common industry understanding of the term spoofing at the time the Spoofing Statute was enacted. As discussed above at length, that was the primary lesson of the CFTC's aborted ANPR rulemaking procedures in 2011. *See, e.g.*, Policy Statement, at nn. 69-73. Tellingly, even with its fallback approval of the Policy Statement in 2013, the CFTC still never purported to identify any common industry understanding of "spoofing," but rather adopted a "know-it-when-you-see-it" standard that purports to consider "the market context, the person's pattern of trading activity [. . .], and other relevant facts and circumstances" in distinguishing legitimate from illegitimate trading activity. Policy Statement at 31,896. With no common industry understanding of the term "spoofing," the reference in the Spoofing Statute to what is "commonly known to the trade" as spoofing cannot be (and has not been) an intelligible limitation on the CFTC's authority. As in *Schechter Poultry*, the "commonly known to the trade" standard is simply a "convenient designation for whatever set of laws the

formulators of a code for a particular trade or industry may propose." *Schechter Poultry*, at 530-31.

Second, the parenthetical description of "spoofing" set forth in the statute is not an "adequate" definition of spoofing because, if read literally, it would capture routine, lawful market conduct that no one seriously contends could be unlawful. As discussed above, this was yet another lesson of the CFTC's ANPR process. *See* Policy Statement, at nn. 71-72. Because there can be no serious contention that the parenthetical description in the Spoofing Statute could actually be applied as written, it does not provide an intelligible principle for the CFTC to distinguish legitimate from illegitimate trading.

**b. The CFTC's regulatory authority is not limited to "spoofing."**

Even if there were an intelligible principle guiding the Spoofing Statute itself, which there is not, there is no such limitation on the scope of the CFTC's ***rulemaking*** authority. Far from restricting the CFTC's authority to proscribing "spoofing" conduct, Congress broadly authorized the CFTC to regulate "***any other trading practice that is disruptive of fair and equitable trading***." 7 U.S.C. § 6(a)(6). Like the codes of "fair competition" at issue in *Schechter Poultry*, this broad delegation confirms that the Spoofing Statute is nothing more than a "convenient designation" for "whatever set of laws" the CFTC deems "wise and beneficent" for the commodity futures industry. *Schechter Poultry*, 295 U.S. at 531; *id.* at 541 (rejecting statute that "set up no standards, aside from the general aims of rehabilitation, correction, and expansion").

### C. The CFTC's Suggestion to Rely on Witness Testimony to Interpret the Spoofing Statute Would Amount to an Unconstitutional Delegation of Legislative Authority.

Apparently recognizing that the Spoofing Statute lacks an "adequate definition" of spoofing or any other "intelligible principle," the CFTC has suggested that fact witnesses should be permitted to testify to fill this gap. *See, e.g.*, CFTC's Resp. to Mot. to Exclude Market Witnesses, at 4, ECF No. 126, ECF No. 126 ("In this case, the CFTC has not limited itself to one prong of the spoofing statute and is thus entitled to ***present evidence*** showing that Defendants violated the prohibition against spoofing based on the plain definition in the statute and also by ***presenting evidence*** that Mr. Oystacher's deceptive flipping pattern demonstrates characteristics of spoofing and was identified by various market participants as 'spoofing.'") (emphasis added). Were this court to interpret the Spoofing Statute based on fact witness testimony in this case, however, the Spoofing Statute would also constitute an unconstitutional delegation of power to private individuals outside the Government.

Congress may not empower industry groups—much less private individuals—"to enact the laws they deem to be wise and beneficent." *Schechter Poultry*, 295 U.S. at 537. A delegation of rulemaking authority to a private party "is legislative delegation in its most obnoxious form; for it is not even delegation to an official or an official body, presumptively disinterested, but to private persons whose interests may be and often are adverse to the interests of others in the same business." *See Carter v. Carter Coal Co.*, 298 U.S. 238, 311 (1936) (striking down statute that granted certain coal producers and miners power to issue rules governing minimum wages). Private parties "may not be entrusted with the power to regulate the business of another, and especially of a competitor." *Id.* "[A] a statute which attempts to confer such power undertakes an intolerable and unconstitutional interference with personal liberty and private property." *Id.*

If the Court were to interpret the Spoofing Statute based on the testimony of the fact witnesses in this case (or any other case), it would essentially make those witnesses the authors and editors of the ***law***, not the facts, and elevate their testimony to the force of law. Of course, it is black-letter law that witnesses may not testify about the proper interpretation of a statute because statutory interpretation is a matter of law for the Court to resolve, not a matter of fact to be proven by the parties. *See, e.g., In re Ocean Bank*, 481 F. Supp. 2d 892, 898 (N.D. Ill. 2007). Given that the CFTC's own rulemaking procedures were unable to define a common understanding or meaning of spoofing, it would be highly problematic for the federal courts to try to do so based on the testimony of witnesses who were hand-picked by the CFTC, who are competitors of 3 Red, and who have a potential financial interest in the outcome of this case. *Wayman v. Southard*, 23 U.S. 1, 42 (1825) (Justice Marshall explaining that "It will not be contended that Congress can delegate to the Courts, or to any other tribunals, powers which are strictly and exclusively legislative."); *Pittston Co. v. United States*, 368 F.3d 385, 398 (4th Cir. 2004) (recognizing that key purpose of non-delegation doctrine is ensure private entities "are not able to use their position for their own advantage [and] to the disadvantage of their fellow citizens").

Finally, reliance on the CFTC's witnesses to interpret the scope of the Spoofing Statute would be problematic for the additional reason that it would remove all political accountability. When power is delegated outside the Government, the lines of accountability are blurred, and Congress is able to diffuse responsibility for the formulation of policy. *See Free Enter. Fund v. Pub. Co. Accounting Oversight Bd.*, 130 S. Ct. 3138, 3155 (2010) ("Without a clear and effective chain of command, the public cannot determine on whom the blame or the punishment of a pernicious measure, or series of pernicious measures ought really to fall.") (internal quotation

marks omitted); *see also Loving v. United States*, 517 U.S. 748, 758 (1996) ("The clear assignment of power to a branch [of the Government . . .] allows the citizen to know who may be called to answer for making, or not making, those delicate and necessary decisions essential to governance."). Such a delegation would, in turn, undermine an important democratic check on Government decision-making. *Id.* Here, the CFTC's witnesses do not "function subordinately" to Congress, the CFTC, or even this Court. *See Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, at 399 (1940). "[D]elegating the government's powers to private parties saps our political system of democratic accountability," and "[t]his threat is particularly dangerous where both Congress and the Executive can deflect blame for unpopular policies by attributing them to the choices of a private entity." *Ass'n of Am. Railroads v. U.S. Dep't of Transp.*, 721 F.3d 666, 675 (D.C. Cir. 2013), *vacated on other grounds*, 135 S. Ct. 1225 (2015). Congress cannot exercise its Article I lawmaking power by effectively delegating rulemaking and statutory interpretation to private litigants and their witnesses.

## CONCLUSION

For these reasons, the Court should find that the CFTC's claims fail as a matter of law, and the Court should grant judgment on the pleadings in favor of 3 Red.

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Respectfully submitted,

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**CERTIFICATE OF SERVICE**

The undersigned, an attorney, hereby certifies that, on May 9, 2016, he caused a true and correct copy of the foregoing to be served upon all parties by electronically filing the same with the Pacer/ECF system.

/s/ Michael S. Kim
One of the Attorneys for Defendants