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## *SEC Charges Bevy of Foreign Traders in Alleged Spoofing Ring*

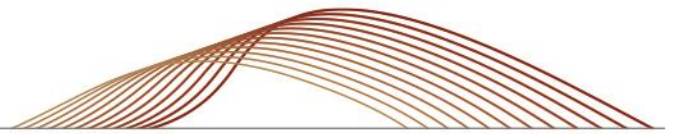
By [Michael L. Spafford](#), [John P. Nowak](#), [Daren F. Stanaway](#) & Kathryn Harris

Not to be outdone by the Commodity Futures Trading Commission's ("CFTC") flurry of recent spoofing charges, the Securities and Exchange Commission ("SEC") has once again jumped aboard the spoofing bandwagon, filing a complaint charging 18 China-based traders with spoofing and aiding and abetting under federal securities law.<sup>1</sup> The traders allegedly engaged in a market-manipulation scheme beginning in August 2013 and spanning more than six years, which artificially influenced the price of publicly traded securities numerous times, generating \$31 million in ill-gotten gains.<sup>2</sup> The U.S. Department of Justice ("DOJ") brought parallel charges against two of the traders for criminal conspiracy to commit securities fraud, arresting both of them.<sup>3</sup>

### **The Charges**

The SEC alleges that 18 traders, all residents of China, but four of whom have U.S. residences,<sup>4</sup> engaged in a wide-ranging stock manipulation scheme by using dozens of brokerage accounts at multiple firms to "artificially influence the prices of many publicly traded securities," with the intent of creating the "false appearance of trading interest and activity in particular stocks, thereby enabling them to reap illicit profits by artificially boosting or depressing stock prices."<sup>5</sup> The alleged scheme generally involved three steps: the traders (1) placed multiple small purchase or sale orders of stocks trading on U.S. exchanges (such as NASDAQ or the New York Stock Exchange ("NYSE"))<sup>6</sup> in one account (the "helper" account) to create upward or downward pressure on the stock price; (2) purchased or sold larger quantities of the stock in another account (the "winner" account) at prices artificially affected by the manipulative orders in the helper accounts, thereby profiting from these transactions; and (3) then canceled the outstanding orders in the helper accounts once the winning orders were filled (allegedly at artificial prices caused by the helper orders).<sup>7</sup> The traders also took a number of steps to cover their tracks, often holding the winner and helper accounts at different U.S. brokerage firms, sometimes using "nominee accounts" held in the names of other individuals and entities, and providing false explanations for their trading activity when U.S. brokerage firms flagged it as potentially manipulative.<sup>8</sup>

The SEC accordingly charged all 18 traders with (1) fraud in connection with the purchase or sale of securities, in violation of Exchange Act Section 10(b) and Rule 10b-5(a) and (c) thereunder (and aiding and abetting one another's violations thereof);<sup>9</sup> (2) fraud in the offer or sale of securities, in violation of Securities Act Sections 17(a)(1) and 17(a)(3) (and aiding and abetting one another's violations thereof);<sup>10</sup> and (3) market manipulation, in violation of Exchange Act Section 9(a)(2) (and aiding and abetting one another's violations thereof).<sup>11</sup> The SEC obtained an emergency asset freeze



against all 18 traders and also seeks disgorgement (plus prejudgment interest) and civil monetary penalties.<sup>12</sup> The SEC also charged the six relief defendants with unjust enrichment.<sup>13</sup> Separately, the DOJ filed criminal charges against two of the traders stemming from the same fact pattern, alleging conspiracy to commit securities fraud, in violation of 18 U.S.C. § 371.<sup>14</sup>

## Implications of the SEC and DOJ Charges

The SEC's recent charges against 18 individuals signal the agency's increased efforts to police illicit spoofing activity in the securities markets, and to exercise its authority to pursue foreign nationals and conduct that traverses U.S. borders (particularly where, as here, the conduct involves U.S. stock exchanges and U.S. brokerage firms). The DOJ's charges likewise signal a widening of the criminal authorities' spoofing focus beyond the futures markets.

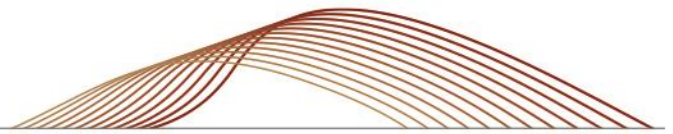
The SEC's and CFTC's spoofing enforcement regimes differ substantially, however. As an initial matter, federal securities laws do not contain provisions that specifically address spoofing, whereas the Commodity Exchange Act ("CEA") contains an express spoofing prohibition.<sup>15</sup> Instead, the SEC has regulated spoofing under its anti-manipulation and anti-fraud authority—most notably, Exchange Act Section 10(b) and Rule 10b-5,<sup>16</sup> which the CFTC deemed "distinct" and separate from the CEA's anti-spoofing provision,<sup>17</sup> and arguably contemplate a lesser scienter requirement.

Historically, courts have held that Exchange Act Section 10(b) and Rule 10b-5 require a showing of only recklessness,<sup>18</sup> whereas the CEA's anti-spoofing provision requires "intent" to cancel before execution.<sup>19</sup> Notwithstanding this incongruity, the SEC generally has pursued spoofing as intentional misconduct, which accords with the SEC's own description of spoofing as the intentional "use of non-bona fide orders, or orders that a trader does not intend to have executed, to induce others to buy or sell the security at a price not representative of actual supply and demand."<sup>20</sup> The *Chen* Complaint, for example, alleges "intentional[], knowing[], or reckless[]" misconduct in certain instances,<sup>21</sup> but in others alleges actions "with the intent to induce trading by others,"<sup>22</sup> and the underlying factual allegations concerning an elaborate scheme to spoof the market plainly describe intentional misconduct.<sup>23</sup>

Likewise, the DOJ's conspiracy charges paralleling the SEC's allegations mirror the DOJ's recent efforts to crack down on spoofing in the futures markets. Of these efforts, CFTC Enforcement Director James McDonald recently remarked: "[W]e have strengthened our relationship with the Department of Justice and the Federal Bureau of Investigation. We believe that a robust combination of criminal prosecution and regulatory enforcement is essential to achieving our goals of preserving market integrity and protecting our market participants."<sup>24</sup>

The *Chen* case is not the first time the SEC has pursued spoofing transcending U.S. borders; indeed, on October 1, 2019, a federal court approved final judgments in the SEC's case against a New York-based brokerage firm and its CEO, in which the SEC alleged facilitation of a spoofing scheme executed by one of the firm's customers, a Ukraine-based company, in the U.S. stock markets.<sup>25</sup> Accordingly, the *Chen* and *Wang* cases evidence the SEC's continuing interest in spoofing and build on a partnership emerging between the SEC and DOJ analogous to that between the CFTC and DOJ.

In short, the SEC's and DOJ's latest spoofing charges demonstrate both agencies' intent to take an aggressive approach to identifying and prosecuting spoofing and market manipulation; the CFTC is no longer the only regulator on the spoofing frontier. Accordingly, participants in both the securities and commodities markets, and entities otherwise subject to SEC, CFTC, or DOJ regulation, should take



steps to ensure that they have proper training and systems in place to enable proper prevention and detection of conduct that these regulators may perceive as spoofing or otherwise manipulative.



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<sup>1</sup> Complaint, *SEC v. Chen*, No. 19-cv-12127, ECF No. 1, at ¶ 5 (D. Mass. Oct. 15, 2019) (hereinafter “*Chen Complaint*”) (alleging violations of Sections 17(a)(1) and 17(a)(3) of the Securities Act of 1933 (“Securities Act”), 15 U.S.C. §§ 77q(a)(1), (3), and Sections 9(a)(2) and 10(b) of the Securities Exchange Act of 1934 (“Exchange Act”), 15 U.S.C. §§ 78i(a)(2), 78j(b), and Rules 10b-5(a) and (c) thereunder, 17 C.F.R. §§ 240.10b-5(a), (c)); see also Press Release, SEC, SEC Charges 18 Traders in \$31 Million Stock Manipulation Scheme, Litigation Release No. 24,648 (Oct. 21, 2019), <https://www.sec.gov/litigation/litreleases/2019/lr24648.htm> (hereinafter “SEC Press Release”).

<sup>2</sup> *Chen Complaint* ¶¶ 1, 46; SEC Press Release.

<sup>3</sup> Complaint, *United States v. Wang*, No. 19-mj-6485, ECF No. 1 (D. Mass. Oct. 14, 2019); see Affidavit in Support of Criminal Complaint, *Wang*, No. 19-mj-6485, ECF No. 1-4, ¶ 3 (together hereinafter “*Wang Complaint*”) (charging criminal conspiracy to commit securities fraud, in violation of 18 U.S.C. § 371); see also Press Release, DOJ, Two Chinese Nationals Charged with Stock Spoofing Conspiracy (Oct. 15, 2019), <https://www.justice.gov/usao-ma/pr/two-chinese-nationals-charged-stock-spoofing-conspiracy>.

<sup>4</sup> *Chen Complaint* ¶¶ 12-15.

<sup>5</sup> *Id.* ¶ 1.

<sup>6</sup> See, e.g., *id.* ¶¶ 50, 61.

<sup>7</sup> *Id.* ¶¶ 2, 47-48; see also *id.* ¶¶ 49-61.

<sup>8</sup> *Id.* ¶¶ 3, 62-68. For this reason, the SEC’s complaint also names six relief defendants, in whose names the other defendants opened brokerage accounts and traded in connection with the alleged scheme, sometimes using altered bank statements. *Id.* ¶¶ 30-37, 40-45, 71-77.

<sup>9</sup> *Id.* ¶¶ 78-83 (citing 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5).

<sup>10</sup> *Id.* ¶¶ 84-89 (citing 15 U.S.C. § 77q(a); 15 U.S.C. § 77o(b)).

<sup>11</sup> *Id.* ¶¶ 90-95 (citing 15 U.S.C. § 78i(a)(2)).

<sup>12</sup> SEC Press Release.

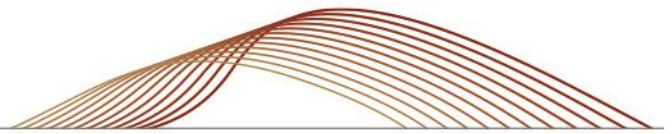
<sup>13</sup> *Chen Complaint* ¶¶ 96-98.

<sup>14</sup> *Wang Complaint* ¶ 3.

<sup>15</sup> 7 U.S.C. § 6c(a)(5)(C) (rendering it “unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity 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)”).

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- <sup>16</sup> Other statutes under which the SEC has pursued spoofing charges include Section 17(a) of the Securities Act, 15 U.S.C. § 77q(a); Section 9(a) of the Exchange Act, 15 U.S.C. § 78i(a); and the Securities Act's and Exchange Act's aiding and abetting provisions, 15 U.S.C. § 77o(b) and 15 U.S.C. § 78t(e). *See, e.g., Chen* Complaint ¶¶ 78-95.
- <sup>17</sup> CFTC Antidisruptive Practices Authority, 78 Fed. Reg. 31,890, 31,892 (May 28, 2013).
- <sup>18</sup> *See, e.g., SEC v. Obus*, 693 F.3d 276, 286 (2d Cir. 2012) (under Exchange Act Section 10(b), "scienter 'may be established through a showing of reckless disregard for the truth . . .'" (citation omitted); *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 929O, 124 Stat. 1376, 1862 (2010) (amending and expanding Exchange Act Section 20(e), 15 U.S.C. § 78t(e), which governs aiding and abetting liability, to prohibit reckless conduct, in addition to knowing conduct); 15 U.S.C. § 77o(b) (recklessness sufficient to establish aiding and abetting liability under the Securities Act).
- <sup>19</sup> 7 U.S.C. § 6c(a)(5)(C).
- <sup>20</sup> *In re Visionary Trading LLC*, Exchange Act Release No. 71,871, Investment Company Act Release No. 31,007, 2014 SEC LEXIS 1246, at \*4-5 (Apr. 4, 2014) (emphasis added).
- <sup>21</sup> *Chen* Complaint ¶ 79.
- <sup>22</sup> *Id.* ¶ 92.
- <sup>23</sup> *See, e.g., id.* ¶ 1 ("The design and intent of the Defendants' scheme was to create the false appearance of trading interest and activity in particular stocks, thereby enabling them to reap illicit profits by artificially boosting or depressing stock prices.").
- <sup>24</sup> Press Release, CFTC, Remarks of Director of Enforcement James McDonald During CFTC-DOJ Press Conference Call (Sept. 16, 2019), <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcdonald4>.
- <sup>25</sup> Press Release, SEC, SEC Obtains Final Judgments Against Lek Securities and CEO in Layering, Manipulation Case (Oct. 2, 2019), <https://www.sec.gov/news/press-release/2019-205>. The SEC's case against Lek's Ukraine-based customer and other individuals remains ongoing. *See id.*