“Regulatory Creep” – Legal Issues in U.S. v. Thakkar



Thom Thompson

Contributing Editor

Thursday afternoon as part of the FIA Law & Compliance Conference, Marc Nagel, attorney advisor to the derivatives training firm Exchange Analytics, moderated a panel composed of attorneys Gary DeWaal and Renato Mariotti discussing the recent federal criminal charges against computer programmer Jitesh Thakkar.

The panel was sponsored by Thompson Coburn.  Mariotti, a partner at Thompson Coburn, and DeWaal, special counsel at Katten Muchin Rosenman, had a history of disagreeing about many aspects of the government’s case – the first federal spoofing case – which Mariotti, as a federal prosecutor in the Northern District of Illinois, successfully brought against Michael Coscia in 2015. DeWaal, a well known industry commentator, had expressed concerns over the years about prosecuting spoofing cases, including the one against Coscia, a commodities trader in the CME and ICE energy markets. DeWaal told the audience that he had expressed concerns at the time about the Justice Department bringing a case against Coscia since Coscia had just settled the CME and CFTC’s complaints and was accepting substantial punishments.

Given Mariotti’s and DeWaal’s history, there was obvious potential for disagreement at the session. The two came together, however, in shared worries about the case brought by the Department of Justice against Thakkar.

When Nagel introduced the panelists he also called the audience’s attention to Holly Campbell, the associate at Thompson Coburn to whom Nagel attributed much of the heavy lifting in the Thakkar proceedings.

DeWaal started off discussions by complaining about regulatory creep, the incremental expansion of jurisdictional reach, at the CFTC. The case against Thakkar was the most recent example. The government had charged Thakkar, a software vendor who was not a trader or otherwise alleged to be a direct participant, with spoofing. Mariotti later said that as the prosecutor in Coscia he had not charged the programmer who developed Coscia’s spoofing software.

DeWaal also pointed to the CFTC settlement with Deutsche Bank and one of its affiliates in a 2018 spoofing case where the Commission named as defendant the culprit subsidiary but also Deutsche Bank FCM for carrying the illegal trades. DeWaal also noted that the same regulatory creep is occurring on the securities side where the SEC, looking for someone to charge in the EtherDelta case against a decentralized crypto-token trading platform, charged the founder for setting up the platform.

DeWaal noted that at about the time the SEC announced the EtherDelta settlement, in what likely wasn’t a coincidence, CFTC Commissioner Brian Quintenz had said in a speech published on the CFTC website that the Commission may assert jurisdiction over persons who code certain kinds of smart contracts – self executing software programs – if those contracts are part of a fraudulent action.

Mariotti then described how Thakkar was found not guilty on the basis of the facts, not the law. He reviewed the pre-trial discussions and motions which forced the prosecution to abandon arguments that Thakkar should have known what Sarao, the spoofer, was up to. Also excluded was the so-called ostrich theory of culpability – the idea that Thakkar had willfully avoided finding out what the software he developed was going to be used for. Dismissal of the key conspiracy complaint was caused by Sarao’s own testimony that he did not think that Thakkar had had knowledge of Sarao’s spoofing strategies.

At any rate, both Mariotti and DeWaal are concerned about the CFTC’s determination to keep pursuing their case against Thakkar despite the dismissal of the Justice Department’s case as well as the judge’s characterization of the government’s evidence as “thin.” DeWaal also believes that the CFTC will continue charging third parties in spoofing cases unless and until they get stopped by a court.

In response to Nagel’s request for “take-aways” the panelists said there were some positive results from the CFTC’s actions. Firms are much more conscious about program designs. Their contracts with third party service providers are much more thoughtfully drafted. Managements are paying closer attention to algo design, and internal technology review committees are being taken more seriously. Noting that surveillance is important, DeWaal said that trading firms and their brokers had to watch out for patterns.

Nagel asked if the panelist thought that there was anything out there that we don’t know about from the enforcement side.  Both Mariotti and DeWaal agreed that there are third party liability issues out there that haven’t been considered yet. As DeWaal stated, “There are always issues out there.”