



UNITED STATES OF AMERICA  
Before the  
COMMODITY FUTURES TRADING COMMISSION

	)	
	)	<b>CFTC Docket No. 15-33</b>
<b>In the Matter of:</b>	)	
	)	<b>ORDER INSTITUTING</b>
	)	<b>PROCEEDINGS PURSUANT TO</b>
<b>TeraExchange LLC,</b>	)	<b>SECTIONS 6(c) AND 6(d) OF THE</b>
	)	<b>COMMODITY EXCHANGE ACT</b>
<b>Respondent.</b>	)	<b>MAKING FINDINGS AND</b>
	)	<b>IMPOSING REMEDIAL</b>
	)	<b>SANCTIONS</b>

**I.**

The Commodity Futures Trading Commission (“Commission”) has reason to believe that TeraExchange, LLC (“Tera”), a provisionally registered swap execution facility (“SEF”), has violated Section 5h(f)(2) of the Commodity Exchange Act (“Act”), 7 U.S.C. § 7b-3(f)(2) (2012), and Commission Regulation (“Regulation”) 37.203, 17 C.F.R. § 37.203 (2014). The Commission, therefore, deems it appropriate and in the public interest that a public administrative proceeding be, and hereby is, instituted to determine whether Tera engaged in the violations set forth herein and to determine whether any order should be issued imposing remedial sanctions.

**II.**

In anticipation of the institution of an administrative proceeding, Tera has submitted an Offer of Settlement (“Offer”), which the Commission has determined to accept. Tera acknowledges service of this Order Instituting Proceedings Pursuant to Sections 6(c) and 6(d) of the Commodity Exchange Act, Making Findings and Imposing Remedial Sanctions (“Order”).<sup>1</sup>

<sup>1</sup> Tera consents to the entry of this Order, the use of these findings in this proceeding and in any other proceeding brought by the Commission or to which the Commission is a party; provided, however, that Tera does not consent to the use of the Offer, or the findings in this Order consented to in the Offer, as the sole basis for any other proceeding brought by the Commission, other than a proceeding in bankruptcy or to enforce the terms of this Order. Nor does Tera consent to the use of the Offer or this Order, or the findings consented to in the Offer or this Order, by any other party in any other proceeding.

### III.

The Commission finds the following:

#### A. Summary

On October 8, 2014, two traders executed a transaction in a non-deliverable forward contract based on the relative value of the U.S. Dollar and Bitcoin, a virtual currency (the “Bitcoin swap”). Six minutes later, the two traders executed a fully offsetting transaction in the Bitcoin swap for the same price and notional amount. As a result, the two transactions (the “October 8 transactions”) constitute both wash trading and prearranged trading in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2012).

Tera arranged the two transactions with the understanding that the parties, who did not know of each other’s identities, would execute “a round-trip trade with the same price in, same price out (i.e. no P/L [profit/loss] consequences)[.]” Tera employees were on Skype calls with the two traders as they executed the transactions. The two traders involved were the only market participants on Tera’s SEF who had completed the membership process and had received trading privileges on the SEF.

On October 9, 2014, Tera issued a press release, stating that “TeraExchange announced today the first bitcoin derivative transaction to be executed on a regulated exchange.” Tera intended for its press release and a related statement by its then-president to create the impression of actual trading interest in the Bitcoin swap.

Section 5h(f)(2)(B) of the Act, 7 U.S.C. § 7b-3(f)(1) (2012) and Regulation 37.203(a), 17 C.F.R. § 37.203(a) (2014), obligate Tera to establish and enforce rules prohibiting wash trading and prearranged trading on the SEF. Instead, Tera actively arranged for the two traders to enter into prearranged wash trades.

#### B. Respondent

**TeraExchange, LLC** is a Delaware limited liability company, with its principal place of business in Summit, New Jersey. Tera has been registered provisionally with the Commission as a SEF since September 19, 2013, with its application for permanent SEF registration pending.

#### C. Facts

Tera is operating a SEF pursuant to a grant of temporary registration by the Commission’s Division of Market Oversight (“DMO”) effective September 19, 2013.

Tera compiled a rulebook governing the operation of the SEF and trading on the SEF by market participants. Tera requires all participants on its SEF to comply with the SEF’s rulebook. Tera’s rulebook states, in relevant part, that

“[n]o Participant shall create fictitious transactions or wash transactions or execute any such Order with knowledge of its nature. No Participant shall place or accept Orders in the same Instrument where the Participant knows or

reasonably should know that the purpose of the Orders is to avoid taking a bona fide market position exposed to market risk (transactions commonly known or referred to as wash sales).”

On September 11, 2014, Tera filed with DMO a submission self-certifying the Bitcoin swap for trading on its SEF. Tera began offering the Bitcoin swap for trading on September 12, 2014. Valuations of the Bitcoin swap are determined by reference to an index of bids, offers, and executed transactions on a number of Bitcoin exchanges (the “Tera Bitcoin index”).

Tera’s rulebook requires a market participant to complete an onboarding process, including the completion of an exchange user license agreement (“EULA”), before being granted membership and being allowed to trade any product on the Tera SEF. As of October 8, 2014, only two market participants (“Firm A” and “Firm B”) had completed the onboarding processes to trade on the Tera SEF.

On October 7, 2014, an employee of Tera sent an email to an authorized trader for Firm B (“Trader B”), which had recently completed the onboarding process. The Tera employee stated that Tera had “a counterparty [Firm A] who would like to do a trade.” The Tera employee said “we would like to test the pipes by doing a round-trip trade with the same price in, same price out, (i.e. no P/L [profit/loss] consequences) no custodian required.” On a call that afternoon with the Tera employee, Trader B agreed to the trade, scheduled for the following day.

On the morning of October 8, 2014, Tera employees initiated Skype calls with both Trader A and Trader B to walk them through the trade. At 9:22 a.m., Trader A initiated a transaction to buy a Bitcoin swap with a notional amount of \$500,000 at a defined price, which Trader B accepted. Six minutes later, Trader A initiated a transaction to sell a Bitcoin swap with a notional amount of \$500,000 and at the same defined price, which Trader B also accepted.

The two transactions on October 8 canceled each other out. The transactions were offsetting, were intended to negate, and did negate, any market risk and achieved a “wash” result. The transactions did not create any bona fide position in the Bitcoin swap. Further, Tera did not charge a transaction fee or commission to either party, meaning that there were no transaction costs associated with the two transactions.

On October 8, 2014, the National Futures Association (“NFA”) (which provides regulatory services for Tera) and the CFTC’s Division of Market Oversight (“DMO”) separately contacted Tera regarding the two offsetting transactions. Tera told DMO and the NFA that the purpose of the transactions was to “test the pipes.”

Nevertheless, on October 9, 2014, Tera issued a press release, stating that “TeraExchange announced today the first bitcoin derivative transaction to be executed on a regulated exchange.” Tera employees forwarded drafts of the press release to Trader A and made some edits at his

request.<sup>2</sup> Also on October 9, 2014, Tera’s then-president appeared at a meeting of the Commission’s Global Markets Advisory Committee (“GMAC”), where he stated that trades had occurred in the Bitcoin swap the day before.

The October 8 transactions were the only transactions in the Bitcoin swap executed on the Tera SEF as of the date of this Order and provided an opportunity for Tera to state publicly that trading in the Bitcoin swap had occurred. Tera intended for its press release and statements at the GMAC to create the impression of actual trading interest in the Bitcoin swap. As a result, neither Tera’s press release nor the statements at the GMAC indicated that the October 8 transactions were pre-arranged wash sales executed solely for the purpose of testing Tera’s systems.

These facts should be distinguished from a situation where a SEF or other designated contract market runs pre-operational test trades to confirm that its systems are technically capable of executing transactions and, to the extent that these simulated transactions become publicly known, makes it clear to the public that the trades do not represent actual liquidity in the subject market.

#### **D. Legal Discussion**

##### **1. Compliance with SEF Core Principles**

As a condition of registration, SEFs are obligated to comply with the SEF Core Principles under the Act. Section 5h(f)(1) of the Act, 7 U.S.C. § 7b-3(f)(1) (2012). SEF Core Principle 2 requires that a SEF shall “establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules[.]” Section 5h(f)(2)(B) of the Act, 7 U.S.C. § 7b-3(f)(2)(B) (2012).

A Commission regulation providing additional guidance on compliance with SEF Core Principle 2 requires SEFs to “prohibit abusive trading practices on its markets... Specific trading practices that shall be prohibited include...wash trading [and] pre-arranged trading[.]” Regulation 37.203(a), 17 C.F.R. § 37.203(a) (2014).

##### **2. Prohibition on Wash Trading and Prearranged Trading**

Market participants are prohibited from engaging in “wash trading” and “prearranged trading” in swaps under Section 4c(a) of the Act, which makes it unlawful to enter a transaction that “is, is of the character of, or is commonly known to the trade as, a ‘wash sale’ or ‘accommodation trade’...or is a fictitious sale or is used to cause any price to be reported, registered, or recorded that is not a true and *bona fide* price.” 7 U.S.C. § 6c(a)(2).<sup>3</sup> Congress

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<sup>2</sup> Following conversations with counsel for the Commission, Tera voluntarily removed the October 9 press release from its website.

<sup>3</sup> As relevant here, pursuant to Section 2(a)(1)(A) of the Act, 7 U.S.C. § 2(a)(1)(A) (2012) the Commission has exclusive jurisdiction over “transactions involving swaps...traded or executed on a... swap execution facility pursuant to section 5h”. In addition, the swap offered by Tera is not subject to any exceptions to the CFTC’s jurisdiction. Regardless, Tera’s submission

enacted Section 4c(a) of the Act to prevent collusive trades conducted away from the market. *See, generally, Merrill Lynch Futures, Inc. v. Kelly*, 585 F.Supp. 1245, 1251 n.3 (S.D.N.Y. 1984). As a result of wash trading and fictitious sales, “perceived market volume [is] distorted, and the market’s price discovery function hindered.” *In the Matter of Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,743 (CFTC December 10, 1997) (citing *In the Matter of Citadel Trading Co. of Chicago, Ltd.*, [1986-1987 Transfer Binder] Comm. Fut. L. rep. (CCH) ¶ 24,085 at 32,191 (CFTC May 12, 1986)).

A wash trade “is a transaction made without an intent to take a genuine, *bona fide* position in the market, such as a simultaneous purchase and sale designed to negate each other so that there is no change in financial position.” *Reddy v. CFTC*, 191 F.3d 109, 115 (2d Cir. 1999). “In order to establish that a wash sale has occurred, the [Commission] must initially demonstrate that the transaction at issue achieved a wash result. The factors that show a wash result are (1) the purchase and sale (2) of the same delivery month of the same futures contract (3) at the same (or a similar) price.” *In re Piasio*, [1999-2000 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 28,276 at 50,685 (CFTC Sept. 29, 2000) (citing *In re Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,993 at 37,653 (CFTC Jan. 25, 1991)), *aff’d*, *Piasio v. CFTC*, 54 F. App’x 702 (2d Cir. 2002); *see also Wilson v. CFTC*, 322 F.3d 555, 559 (8th Cir. 2003) (same).

In addition, the Commission “must demonstrate that the [defendant] intended to negate risk or price competition,” and “that at the time [the defendant] chose to participate in the transaction he knew that the transaction was designed to achieve a wash result in a manner that negated risk.” *In re Piasio*, Comm. Fut. L. Rep. (CCH) ¶ 28,276 at 50,685 (citing *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,213 at 35,003 (CFTC Apr. 14, 1988), *aff’d as to liability, Gimbel v. CFTC*, 872 F.2d 196 (7th Cir. 1989), and *In re Bear Stearns & Co.*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,994 at 37,665 (CFTC Jan. 25, 1991)); *see also Reddy*, 191 F.3d at 119 (“[T]he [Commission] must prove intent to establish a violation of . . . Section 4c of the” Act). The Commission need not, however, prove *both* intent to negate risk *and* intent to negate price competition; one or the other is sufficient to sustain a

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self-certifying the Bitcoin swap for trading stated that “[a]s with all products listed for trading on TeraExchange, trading in the USD/Bitcoin Swap will be subject to compliance with the Act, Regulations and the TeraExchange Rulebook[.]” Therefore, Tera consented to the application of the Act, including the prohibitions on wash trading and pre-arranged trading under Section 4c(a) of the Act, to trading in the Bitcoin swap.

Section 4c(a) of the Act applies to transactions involving the purchase or sale of any commodity for future delivery or swap that, *inter alia*, may be used to “hedge any transaction in interstate commerce in the commodity[.]” As a non-deliverable forward contract, the Bitcoin swap may be used to hedge transactions in interstate commerce in Bitcoin. Further, Bitcoin is a commodity under Section 1a of the Act, 7 U.S.C. § 1a (2012), and is therefore subject as a commodity to applicable provisions of the Act and Regulations.

claim under Section 4c(a), 7 U.S.C. § 6c(a) (2012). *See, e.g., In re Gimbel*, Comm. Fut. L. Rep. (CCH) ¶ 24,213 at 35,003 n.7.

Prearranged trading is also a form of fictitious sales. *In the Matter of Gilchrist*, [1990-1992 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,933 at 37,653 n26 (C.F.T.C. Jan. 25, 1991). Prearranged trading involves “the use of trading techniques that give the appearance of submitting trades to the open market while negating the risk of price competition incident to such a market.” *Harold Collins*, [1986-1987 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 22,982 at 31,902 (CFTC April 4, 1986), *rev'd on other grounds sub nom. Stoller v. CFTC*, 834 F.2d 262 (2d Cir. 1987). A series of transactions may constitute prearranged trading where “[e]ach individual trade was initiated with the understanding that it would be matched such that, when the prearranged transaction was complete, the...traders would have no market position and the net financial position of the group would be zero.” *In re Gimbel*, [1987-1990 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 24,213 at 35,004 (CFTC Apr. 14, 1988). The two accounts involved in a trade do not need to be owned by the same individual or entity for the trade to constitute a fictitious sale. *See, e.g., Thomas Collins*, [1996-1998 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶ 27,194 at 45,743 (CFTC December 10, 1997).

### **3. The October 8 Transactions Constitute Wash Trading and Prearranged Trading**

The October 8 transactions in the Bitcoin swap constitute wash trading. Trader A and Trader B effected a wash result by the purchase and sale of the same product with the same tenor and notional amount for the same price.<sup>4</sup> Trader A and Trader B entered into the transaction with the knowledge that the transactions were designed to achieve a wash result in a manner that negated risk, as demonstrated in the Tera employee’s October 7 email to Trader B that the trades would have “no P/L consequences.” Because Trader A and Trader B were the only participants in the Bitcoin swap market at the time of the transactions, neither bore any price risk as their transactions would set the only prices in the market.

Further, Trader A and Trader B, as facilitated by Tera employees, prearranged the two October 8 transactions. Trader A and Trader B initiated the transactions “with the understanding that it would be matched such that” the net financial result would be a nullity. While Trader A and Trader B did not communicate directly with each other regarding the two transactions, Tera’s involvement allowed Trader A and Trader B to prearrange the transactions while negating any market risk.

As a result, the October 8 transactions constitute both wash trading and prearranged trading in violation of Section 4c(a) of the Act, 7 U.S.C. § 6c(a) (2012).

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<sup>4</sup> The tenor of a swap is the period of time that the swap is in effect. As such, tenor is equivalent to the contract month of a futures contract.

#### **4. Tera Failed to Deter, and in Fact Facilitated, Wash Trading and Prearranged Trading in the Bitcoin Swap**

Tera was obligated under Core Principle 2 to establish and enforce rules to prohibit wash trading and prearranged trading on the SEF. Instead, Tera actively facilitated wash trading and prearranged trading by bringing together two market participants with the express purpose of entering into two offsetting transactions. Tera told Trader B that the transactions would be “a round-trip trade with the same price in, same price out, (i.e. no P/L [profit/loss] consequences)[.]” Further, Tera employees were on the telephone with both Trader A and Trader B during the October 8 transactions to help walk the traders through the transactions.

Tera also ensured that the two transactions would have no transaction costs by not charging any fees to Trader A or Trader B. Tera assured Trader B that no custodian would be required, meaning that neither party would be required to post collateral for the trades.

By failing to enforce its rules against wash trading, and in fact actively arranging a wash trade, Tera failed to comply with its obligations under SEF Core Principle 2 and Regulation 37.203(a), 17 C.F.R. § 37.203(a) (2014). Further, as a result of the wash trading and prearranged trading, Tera’s trading platform submitted reports of the two transactions to a swap data repository which made the reports public. The reports of the two transactions created a misleading impression of trading volume in the Bitcoin swap.<sup>5</sup>

#### **IV.**

#### **FINDINGS OF VIOLATIONS**

Based on the foregoing, the Commission finds that Tera violated Section 5h(f)(2) of the Act, 7 U.S.C. § 7b-3(f)(2) (2012), and Regulation 37.203, 17 C.F.R. § 37.203 (2014), on October 8, 2014.

#### **V.**

#### **OFFER OF SETTLEMENT**

Tera has submitted the Offer in which it, without admitting or denying the findings and conclusions herein:

- A. Acknowledges receipt of service of this Order;
- B. Admit(s) the jurisdiction of the Commission with respect to all matters set forth in this Order and for any action or proceeding brought or authorized by the Commission based on violation of or enforcement of this Order;

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<sup>5</sup> As set forth above, at p. 4, these facts distinguish Tera’s actions from a situation where a SEF runs pre-operational test trades which it makes clear are not *bona fide* transactions.

- C. Waives: the filing and service of a complaint and notice of hearing; a hearing; all post-hearing procedures; judicial review by any court; any and all objections to the participation by any member of the Commission's staff in the Commission's consideration of the Offer; any and all claims that it may possess under the Equal Access to Justice Act, 5 U.S.C. § 504 (2012) and 28 U.S.C. § 2412 (2012), and/or the rules promulgated by the Commission in conformity therewith, Part 148 of the Regulations, 17 C.F.R. §§ 148.1-30 (2014), relating to, or arising from, this proceeding; any and all claims that it may possess under the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, §§ 201-253, 110 Stat. 847, 857-868 (1996), as amended by Pub. L. No. 110-28, § 8302, 121 Stat. 112, 204-205 (2007), relating to, or arising from, this proceeding; and any claim of Double Jeopardy based upon the institution of this proceeding or the entry in this proceeding of any order imposing a civil monetary penalty or any other relief.
- D. Stipulates that the record upon which this Order is entered shall consist solely of the findings contained in this Order, to which Tera has consented; and
- E. Consents, solely on the basis of the Offer, to entry of this Order that:
  - 1. Makes findings by the Commission that Tera violated Section 5h(f)(2) of the Act, 7 U.S.C. § 7b-3(f)(2) (2012), and Regulation 37.203, 17 C.F.R. § 37.203 (2014);
  - 2. Orders Tera to cease and desist from violating Section 5h(f)(2) of the Act, 7 U.S.C. § 7b-3(f)(2) (2012), and Regulation 37.203, 17 C.F.R. § 37.203 (2014);
  - 3. Orders Tera and its successors and assigns to comply with the undertakings consented to in the Offer and set forth below in Part VI of this Order.

Upon consideration, the Commission has determined to accept Tera's Offer.

## VI.

### Accordingly, IT IS HEREBY ORDERED THAT:

- A. Tera shall cease and desist from violating Section 5h(f)(2) of the Act, 7 U.S.C. § 7b-3(f)(2) (2012), and Regulation 37.203, 17 C.F.R. § 37.203 (2014);
- B. Tera and its successors and assigns shall comply with the following conditions and undertakings set forth in the Offer:

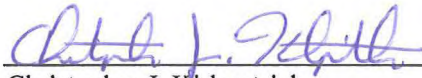
Public Statements: Respondent agrees that neither it nor any of its successors and assigns, agents or employees under its authority or control shall take any action or make any public statement denying, directly or indirectly, any findings or



conclusions in this Order or creating, or tending to create, the impression that this Order is without a factual basis; provided, however, that nothing in this provision shall affect Respondent's: (i) testimonial obligations; or (ii) right to take legal positions in other proceedings to which the Commission is not a party. Respondent's successors and assigns shall undertake all steps necessary to ensure that all of its agents and/or employees under its authority or control understand and comply with this agreement.

**The provisions of this Order shall be effective as of this date.**

By the Commission.



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Christopher J. Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission

Dated: September 24, 2015