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

IN RE: CHICAGO BOARD OPTIONS EXCHANGE VOLATILITY INDEX MANIPULATION ANTITRUST LITIGATION *This Document Relates to All Actions*	Case No. 1:18-cv-04171 MDL No. 2842 Honorable Manish S. Shah

MEMORANDUM OF LAW IN SUPPORT OF
PLAINTIFFS' MOTION FOR EXPEDITED DISCOVERY
AND TO PARTIALLY MODIFY THE PSLRA DISCOVERY STAY

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INTRODUCTION

Plaintiffs' complaint plausibly demonstrates that unknown Doe Defendant traders have manipulated the financial instruments at issue in this case. But Plaintiffs have not been able to identify the traders responsible for this manipulation, despite their diligent investigation, because they have access only to *anonymized* trading data. The non-anonymized trading data that would allow Plaintiffs to identify the manipulators is in the possession of Defendants Cboe Global Markets, Inc., Cboe Futures Exchange, LLC, and Cboe Exchange, Inc. ("CBOE"), which operate the trading platforms on which the manipulation occurred. Plaintiffs respectfully request that this Court require CBOE to produce a narrowly targeted set of materials—per the proposed Requests for Production attached as Exhibit A—within 14 days of the Court's order granting the current motion, so that Plaintiffs can attempt to identify the Doe Defendant manipulators.

Plaintiffs appreciate that this Court previously expressed a preference to "test" Plaintiffs' claims before allowing discovery. That is why this request is being made *after* the filing of a consolidated complaint. The specificity and robustness of Plaintiffs' complaint allegations show that the Court need not wait for completion of the motion to dismiss process to know this is not a blind fishing expedition. Granting this motion is also appropriate because Plaintiffs' proposed discovery requests are narrowly targeted to their need to identify the Doe Defendants.

Plaintiffs' motion is necessary because otherwise the applicable statutes of limitations and repose might conceivably expire, and because the Doe Defendants may fail to preserve key evidence unless or until they are named. Under the present case schedule, briefing on Defendants' motion to dismiss will not be complete until January 28, 2019, and so the necessary discovery may not be provided until the summer of 2019 or later, with relevant evidence potentially being lost in the interim.

Plaintiffs have calibrated their discovery requests to minimize the burden on CBOE. Plaintiffs seek only trading data necessary to identify the Doe Defendant manipulators, and only for the settlement days during the class period; for most of that period, settlement occurred only once per month. CBOE can readily produce that information as it is required by law to maintain the trading data sought by Plaintiffs, and CBOE's public statements touting its surveillance systems indicate it can easily compile and provide it.

CBOE may argue that the PSLRA discovery stay prohibits the requested discovery. But there are ample grounds to modify the discovery stay to allow limited discovery, given that Plaintiffs are acting only to prevent the undue prejudice of being time-barred on their claims and to preserve evidence that otherwise might not be preserved.

BACKGROUND

This case concerns the manipulation of financial products linked to the VIX. The VIX is a financial index that measures the expected volatility of the S&P 500 over the next 30 days. *See* Dkt. No. 140 ("Compl.") ¶ 47. CBOE created the VIX and has built a franchise of proprietary financial products based on the VIX, including options contracts ("VIX Options") and futures contracts ("VIX Futures"). *Id.* ¶ 54. CBOE also holds an exclusive license on SPX Options—which are options on the S&P 500 Index and which are used to calculate the VIX. *Id.* ¶¶ 44. 51, 151, 156. CBOE's exchanges are the only places to trade these products. *Id.* ¶¶ 151, 156. Since its creation in 2004, the VIX has become a heavily used financial index that is now connected to billions of dollars' worth of financial derivatives that are traded every day. *Id.* ¶¶ 1, 153, 195. The VIX and related financial products are a "cash cow" for CBOE that accounts for approximately half of CBOE's revenue. *Id.* ¶ 154.

CBOE calculates settlement values for VIX Futures and VIX Options based on the trading price of SPX Options during a short window of time on specific days, known as the SOQ

auction. *See id.* ¶ 56, 78-79. As expounded upon in Section II below, the Complaint demonstrates that, even prior to discovery, there is abundant evidence that the values for VIX and related financial products have been manipulated for years, by way of manipulation of the settlement process. The present motion concerns the fact that Plaintiffs currently identify only CBOE by name as a defendant. Those claims are based on CBOE's awareness of the manipulation and its decision to prioritize its profits over protecting investors from a flawed VIX settlement process. *See id.* ¶¶ 135-93. The identities of the Doe Defendant traders responsible for manipulating VIX, however, are currently unknown because Plaintiffs do not have access to the trading records that would show who manipulated the VIX settlement process. CBOE has such trading records and a statutory obligation to maintain them. *See* 7 U.S.C. §§ 7(d)(10), (18).

ARGUMENT

I. THIS COURT SHOULD EXERCISE ITS BROAD DISCRETION TO PERMIT EXPEDITED DISCOVERY TO IDENTIFY THE DOE DEFENDANTS

District courts enjoy "broad discretion" to manage the "sequence of discovery." *Crawford-El v. Britton*, 523 U.S. 574, 598 (1998). They may authorize expedited discovery for "good cause"—that is, where "the need for expedited discovery, in consideration of the administration of justice outweighs the prejudice to the responding party." *Guava, LLC v. Does 1-5*, 2013 WL 3270663, at *2 (N.D. Ill. June 27, 2013). This standard requires evaluation of "the entirety of the record to date and the reasonableness of the request in light of all of the surrounding circumstances." *Id.* Relevant factors include "the purpose of requesting the expedited discovery," "the breadth of the discovery requests," and "the burden on the opposing party to comply with the requests." *Restoration Hardware, Inc. v. Haynes Furniture Co.*, 2017 WL 3597518, at *2 (N.D. Ill. Mar. 13, 2017).

A. The Purpose Of The Proposed Discovery Requests Is To Preserve The Timeliness Of Plaintiffs' Claims And Important Evidence

Plaintiffs will suffer at least two forms of prejudice absent expedited discovery to identify the trading firms responsible for the manipulation.[1]

First, any delay in being able to identify the manipulators creates risk that Plaintiffs' claims will be untimely. Plaintiffs seek to bring securities and commodities claims against the Doe Defendant manipulators. The securities claims are subject to a two-year statute of limitations and a five-year statute of repose, *see* 28 U.S.C. § 1658(b); *McCann v. Hy-Vee, Inc.*, 663 F.3d 926, 930 (7th Cir. 2011); the commodities claims are subject to a two-year statute of limitations, *see* 7 U.S.C. § 25(c).

Plaintiffs anticipate that the Doe Defendants, when named, will argue the statute of limitations began to run no later than May 2017—when an academic paper finding that VIX had likely been manipulated was made public.[2] *See* Compl. ¶¶ 88-89. This argument, if successful, could result in the dismissal of all of Plaintiffs' securities and commodities claims against the Doe Defendants unless they are named in an amended pleading prior to May 2019. Moreover, every day that passes without identifying the Doe Defendants may also result in portions of Plaintiffs' securities claims being rendered untimely by the five-year statute of repose. Plaintiffs

[1] Notably, even absent the prejudice due to a looming statute of limitations deadline or destruction of evidence, courts in this district routinely find good cause to allow expedited discovery to identify unknown defendants so that plaintiffs may pursue their claims. *See Dallas Buyers Club, LLC v. Does 1-28*, 2014 WL 3642163, at *2 (N.D. Ill. July 22, 2014); *Purzel Video GmbH v. Does 1-108*, 2013 WL 6797364, at *1 (N.D. Ill. Dec. 19, 2013); *reFX Audio Software, Inc. v. Does 1-111*, 2013 WL 3867656, at *1 (N.D. Ill. July 23, 2013); *see also*, *e.g.*, *North Atlantic Operating Company, Inc. v. JingJing Huang*, 194 F. Supp. 3d 634, 637 (E.D. Mich. 2016); *Malibu Media, LLC v. Doe*, 109 F. Supp. 3d 165, 169 (D.D.C. 2015).

[2] Plaintiffs attempted to enter into tolling agreements with all trader defendants named in any of the MDL proceedings in order to alleviate the statute of limitations issue. All of those defendants, except one, refused to do so.

strongly oppose any such arguments, but they should not be forced to bear the risk that a court would disagree.

Courts have ordered expedited discovery to prevent such undue prejudice. In *Vance v. Rumsfeld*, 2007 WL 4557812 (N.D. Ill. Dec. 21, 2007), the plaintiffs sought expedited discovery to identify individuals responsible for their arrest, detention, and mistreatment. *See id.* at *5. The court granted the discovery "because of the looming statute of limitations deadline" that "could effectively foreclose [plaintiffs'] ability to seek redress from the unknown defendants." *Id.* at *5. Similarly, in *Old Ladder Litigation Co. v. Investcorp Bank B.S.C.*, 2008 WL 2224292 (S.D.N.Y. May 29, 2008), the court found "sufficient justification for the limited expedited discovery being sought, as the statute of limitations may soon expire with respect to unnamed Defendants." *Id.* at *1. This Court should likewise allow the expedited discovery to ensure Plaintiffs' claims do not expire.

Second, the passage of time also presents the risk that the unidentified Doe Defendants may fail to preserve key evidence. While the CBOE should have trading data that can be used to identify them, it is likely the Doe Defendants will also have evidence regarding their own scienter, among other things, that would not be in the possession of CBOE. The Doe Defendants own chats, e-mails, and text messages will be material to Plaintiffs' ability to prove the trades were manipulative, among other things.[3] Bringing them into the case as soon as possible will help ensure all relevant materials are being preserved.[4]

[3] *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 (2007) (scienter required for securities fraud claims); *Ploss v. Kraft Food Grp., Inc.*, 197 F. Supp. 3d 1037, 1055 (N.D. Ill. 2016) (considering whether trader had "legitimate economic motive" for commodities manipulation claim).

[4] "Unlike the evidence in the parties' care, custody or control, the documentary evidence of third-parties is not expressly subject to any preservation Order and, inadvertently, or otherwise, such evidence may be destroyed before this Court rules on the pending dispositive

B. The Proposed Discovery Requests Are Narrowly Tailored To Identify The Doe Defendants

Plaintiffs' proposed document requests to CBOE ("Requests") are attached as Exhibit A hereto. There are only seven requests, and each one is narrowly tailored to obtain the minimum amount of information necessary to identify the Doe Defendants as quickly as possible. For instance, Plaintiffs seek data showing the SPX Options trades and quotes that were used to determine the VIX settlement price (Requests 1 and 2), because these will identify the traders who submitted trades or quotes during the settlement process that Plaintiffs allege was manipulated. Plaintiffs then seek data showing the SPX Options trades and quotes that *could* have been used to determine the VIX settlement price but were not (Request 3), to identify any manipulation that was attempted but failed due to internal rules (such as the "two zero-bid rule") imposed by CBOE. To make sense of these trade and quote data, Plaintiffs then seek (Request 4) the Cboe algorithm responsible for turning them into the VIX settlement prices.

Plaintiffs also seek data showing trades and quotes during just the first hour of open market trading (Requests 5 and 6) to be able to compare these to trades and quotes during the settlement process, and thereby to identify any trading or quoting during the settlement process that is anomalous or "off-market" as compared to market trading in the following hour. Finally, Plaintiffs seek a snapshot (at the close of market the day before a settlement day) showing the open VIX Options and VIX Futures positions of any traders who participated in the settlement process (Request 7). Knowing who stood to benefit from a given settlement process—because

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motion." *In re Grand Casinos, Inc. Sec. Litig.*, 988 F. Supp. 1270, 1272-73 (D. Minn. 1997) (noting "substantial concern that the ordinary document retention policies of some companies might well result in the destruction of relevant files during the ordinary course of business"); *see In re Heckmann Corp. Sec. Litig.*, 2011 WL 10636718, at *4 (D. Del. 2011) (similar).

they had open positions in expiring VIX Options and VIX Futures—will help identify those with a motive to manipulate that process, and thus also the Doe Defendants.

C. The Proposed Discovery Requests Are Narrowly Tailored To Minimize Any Burden On CBOE

With respect to the burden on CBOE to comply with the requests, Plaintiffs have limited the requests as much as possible consistent with the purpose of obtaining only the information necessary to identify the Doe Defendants. The Proposed Discovery Requests are limited to transaction data and a CBOE algorithm necessary to make sense of same, and do not include any documentary evidence (e.g., e-mails, memos, etc.) that would require responsiveness or privilege review. And the requests are limited in time—they focus only on settlement days. For most of the class period, these settlement days occurred only *once a month*. The Proposed Discovery Requests thus seek trading data for only a fraction of the trading days during the class period overall. The narrow scope of the requests undermines any contention that responding to them will present an undue burden on CBOE.

CBOE is able to provide the requested data, including because CBOE is required by federal law to maintain such data. The Commodity Exchange Act requires CBOE to adopt "rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information . . . to provide evidence of any violations of the rules of the contract market" (such as manipulation). 7 U.S.C. § 7(d)(10); *see id.* § 7(d)(5)(B) (requiring CBOE to have "the capacity and responsibility to prevent manipulation . . . through . . . comprehensive and accurate trade reconstructions"); § 7(d)(18) (requiring CBOE to "maintain records of all activities relating to the business of the contract market" for at least five years); *see also* CBOE Rule 15.1-15.10. Thus, CBOE must not only maintain the trading records that Plaintiffs seek, but also must do so "in a manner that enables

[CBOE] to use the information" to identify any instance of manipulation. *Id.* § 7(d)(10). Confirming the existence and accessibility of this data, CBOE publicly touts its "surveillance systems" that "monitor market activity." Compl. ¶ 140. Indeed, earlier this year when the financial press questioned whether the VIX had been manipulated during the SOQ process on a particular day, it took CBOE only five days to issue a letter to its customers reporting its analysis of the relevant trading data.[5]

II. EVEN WITHOUT THE BENEFIT OF A FULL MOTION TO DISMISS, IT IS CLEAR THIS IS NOT A FISHING EXPEDITION

Plaintiffs are mindful of the Court's desire to "test" the allegations before allowing discovery. But the parties will not complete briefing on CBOE's forthcoming motion to dismiss until the end of January 2019. And then it will take time for the Court to resolve that motion (including, perhaps, after scheduling oral argument), then still-more time for Plaintiffs to serve their requests, negotiate and resolve any objections, have the data pulled and loaded, have it analyzed, and then turn the results into a proposed amended complaint. In light of the claims potentially lost every day that passes, and with even more claims becoming riskier as of May 2019, Plaintiffs respectfully request that the Court not wait for resolution of CBOE's motion to dismiss to allow their limited discovery.

Plaintiffs understand that the Court may be concerned that discovery at this point constitutes some form of "fishing expedition"—the hopeful casting of allegations merely to get discovery to see whether some, or even any, of those allegations can be substantiated. But even a cursory review of Plaintiffs' 88-page Complaint confirms that is not what is happening here.

[5] *See* Letter from Ed Tilly (Cboe Chairman and CEO) and Chris Concannon (Cboe President and COO) to Customers and Members of the Trading Community (Apr. 23, 2018), *available at* https://markets.cboe.com/resources/release_notes/2018/Letter-from-Ed-Tilly-and-Chris-Concannon.pdf.

The Complaint details the existence of a host of anomalous trading patterns in the precise SPX Options whose trading prices are used to calculate the settlement prices for VIX Options and Futures during the short window of time in which the VIX settlement price is calculated. *See* Compl. ¶¶ 88-134.

For example, the trading volume of SPX Options (used to determine the settlement price for VIX Futures and Options) is generally higher on settlement days than on non-settlements days. *Id.* ¶¶ 96-98. Further, and counterintuitively, put trades on SPX Options increased in volume as they became *more* out of the money (i.e., worth less) on settlement days, contrary to what one would expect. *Id.* ¶¶ 99-105. This anomaly (of increased trading on VIX settlement days of the SPX Options worth less) was especially present for the type of SPX Options that had the greatest weight in the SOQ process (and thus the greatest impact on the settlement value of expiring VIX Options and Futures). *Id.* ¶¶ 106-108. There are no trading anomalies, however, for SPX Options that are not used to calculate those settlement prices, *id.* ¶¶ 109-11, or at times other than the brief window when those prices are being calculated, *id*. ¶¶ 121-24.

The data also show that unknown traders were trading strategically to avoid or circumvent rules that CBOE had in place to govern the universe of trades that would be factored into the VIX settlement price, and thereby ensuring that the data *those traders wanted*—and not the data CBOE would otherwise have used—determined the value of expiring VIX Options and Futures. *Id.* ¶¶ 112-20. Just as important is the damning fact that many of these patterns *changed* after regulators and the news media began shining a spotlight on potential manipulation of the VIX—consistent with the Doe Defendants reigning in their manipulation due to an increased fear of getting caught. *Id.* ¶¶ 125-134.

Experienced regulators have echoed concerns that VIX has been manipulated. On February 14, 2018, former CFTC Commissioner Bart Chilton stated that the allegation that the VIX was manipulated "rings true to me," and added that "there's certainly enough smoke." *Id.* ¶ 9. On February 16, 2018, former SEC Chairman Harvey Pitt echoed the comments of former Commissioner Chilton during an appearance on CNBC, stating "it's quite clear that [the VIX]'s options can be manipulated. . . . [T]he Cboe, as the marketplace, should have sprung into action." *Id*. The CFTC, SEC, and FINRA also have reportedly opened investigations into the manipulation of VIX. *See id*. Plaintiffs' allegations thus state plausible claims for manipulation under the commodities and securities laws, and warrant discovery to identify the manipulators.

Plaintiffs are not trying to litigate herein the full merits of their allegation that the SOQ process was manipulated. Rather, they are merely pointing out that the robust mix of facts make it plain that this is not a blind fishing expedition. This is a serious case, the value of which to the Class may be undermined if the requested early discovery is not granted.

Notably, while of course not conceding the point, CBOE has made clear that its forthcoming motion to dismiss will focus on questions unique to it—and thus, irrelevant to the viability of claims against the Doe Defendants. For instance, CBOE has referenced, among others arguments, that it is absolutely immune from liability—a defense that no Doe Defendant would have a basis to assert. Dkt No. 161, at 2. CBOE also apparently will claim that Plaintiffs' securities laws claims are preempted as against CBOE because it is a regulated entity—again, an argument the Doe Defendants cannot make. *Id.* And CBOE has suggested that, as a mere trading platform, it did not know that the Doe Defendants' trades were being done for improper purposes. *Id*. Resolution of that issue would not address whether the Doe Defendants—the actual manipulators—had the requisite states of mind. Only as an afterthought does CBOE

mention the possibility that it will argue Plaintiffs failed to allege manipulation. *Id.* That CBOE admits it will move to dismiss primarily on issues far removed from whether Plaintiffs' allegations pass a "test" of reasonability vis-à-vis the Doe Defendants is another reason why the Court need not wait for resolution of that motion before deciding the discovery issue.

III. THERE ARE AMPLE GROUNDS TO MODIFY THE PSLRA STAY

The PSLRA provides that, "[i]n any private action arising under this chapter, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party." 15 U.S.C. § 78u-4(b)(3)(B). The requested discovery is appropriate under the exceptions expressly articulated in the PSLRA.

First, the Proposed Discovery Requests are particularized. For discovery to be "particularized," it must be "subject to readily definable constraints" or comprise requests for a "relatively-limited amount of materials"; a plaintiff cannot make a "blanket request for all potentially-relevant materials." *Pension Tr. Fund for Operating Eng'rs v. Assisted Living Concepts, Inc.*, 943 F. Supp. 2d 913, 915 (E.D. Wis. 2013); *see Koncelik v. Savient Pharms., Inc.*, 2009 WL 2448029, at *1 (S.D.N.Y. Aug. 10, 2009) ("[A] discovery request is particularized when it is directed at specific persons and it identifies specific types of evidence that fall within its scope."). Here, Plaintiffs have identified the discrete and specific evidence they believe is required to identify the Doe Defendants—namely, particular CBOE trading records, from particular points or periods of time, on particular days during the class period.

Second, as discussed above, allowing Plaintiffs to seek limited discovery to identify the unknown manipulators is necessary to prevent "undue prejudice" from the potential loss of claims due to the passage of time. *See In re Odyssey Healthcare, Inc.*, 2005 WL 1539229, at *1 (N.D. Tex. June 10, 2005) (acknowledging that PSLRA stay could cause undue prejudice and

should be lifted where a "claim . . . could be threatened . . . by a statute of limitations"); *Hufnagle v. Rino Int'l Corp.*, 2011 WL 2650755, at *2 (C.D. Cal. July 6, 2011) (lifting PSLRA stay to allow discovery of defendants' service addresses because undue prejudice would arise from "a substantial delay in this lawsuit [due to non-service] that might ultimately result in a defendant escaping liability"); *In re China Educ. Alliance, Inc. Sec. Litig.*, 2011 WL 3715969, at *4 (C.D. Cal. Aug. 22, 2011) (similar).

Third, the PSRLA on its face also refers to a need to preserve evidence. 15 U.S.C. § 78u-4(b)(3)(B). *Koncelik* is particularly instructive. The plaintiffs there requested that the PSLRA stay be lifted for the purpose of requiring defendants to identify third parties likely to possess relevant evidence so that the plaintiffs could serve preservation subpoenas on those corporations. *See* 2009 WL 2448029, at *1.[6] The court granted the motion to prevent the plaintiffs from "being prejudiced by the loss of evidence." *Id.* at *2. This Court should do the same.

CONCLUSION

For the foregoing reasons, the Court should partially modify the PSLRA discovery stay, and require CBOE to produce the materials requested in Exhibit A within 14 days of the Court's order granting this motion. Plaintiffs have conferred with CBOE, and they object to the relief sought in this motion.

Dated: October 24, 2018 Respectfully submitted,

[6] Courts sometimes, when considering whether "undue prejudice" will arise if the PSLRA stay is not lifted to allow discovery of third party documents that might otherwise be destroyed, find such prejudice can be avoided by plaintiff's sending preservation letters or subpoenas to those third parties. *See, e.g.*, *In re Heckmann Corp. Sec. Litig.*, No. 10-378-LPS-MPT, 2011 WL 10636718, at *5 (D. Del. Feb. 28, 2011). Sending such letters or subpoenas is less feasible here, obviously, because Plaintiffs cannot yet identify all relevant third parties. It would also not ameliorate the risk posed by any statutes of limitations or repose.

By: */s/ Jonathan C. Bunge*

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