ALERT MEMORANDUM

Second Circuit's Reversal of Convictions in *U.S. v. Connolly* Signals Limits of Wire Fraud as a Tool to Police Financial Market Conduct

On January 28, 2022, the Second Circuit reversed the convictions of two former Deutsche Bank traders for wire fraud in connection with the bank's LIBOR submissions, which federal prosecutors had alleged were—as a result of the defendants' actions—false, misleading, or made with fraudulent intent. In its opinion, the Second Circuit found that even if the defendants' actions were morally wrong, prosecutors had not presented sufficient evidence to permit a finding of falsity.[1]

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Background

In *U.S. v. Connolly*, the Department of Justice brought wire fraud and conspiracy charges against former Deutsche Bank traders, Matthew Connolly and Gavin Campbell Black. The prosecution was one in a series by U.S. and UK regulators in connection with investigations into the manipulation of the London Interbank Offered Rate ("LIBOR"). LIBOR is a financial benchmark used to determine the available borrowing rates each day in the interbank market and is relied upon in financial transactions across the world.[2] In order to determine the daily LIBOR rate, the British Bankers' Association ("BBA") assembled a panel of banks, each of which was to submit to the BBA the rate at which it could borrow funds for each given day.[3] The BBA would then release a fixed

[1] No. 19-3945 (2d Cir. Jan. 27, 2022).
[2] *United States v. Allen*, 864 F.3d 63, 69-70 (2d Cir. 2017).
[3] *Id.* at 69-71.

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LIBOR rate based on the submissions.[4] Starting in 2013, British and American authorities began investigating the panel banks' manipulation of the LIBOR rate.

During a jury trial in the Southern District of New York in 2018, prosecutors presented evidence that Connolly and Black pressured Deutsche Bank's LIBOR submitters to make LIBOR submissions that were favorable to the bank's derivatives traders' positions.[5] The three Deutsche Bank employees who testified for the government at trial told the jury that they knew altering the bank's LIBOR submissions to benefit its trader positions was wrong.[6] The jury found Connolly and Black guilty of wire fraud and conspiracy to commit wire fraud.[7] While both defendants moved for judgments of acquittal, arguing that the government's evidence was insufficient to prove falsity, the district court denied their motions, finding the government had presented sufficient evidence to prove falsity because the submissions "were not calculated according to the [BBA's] prescribed considerations, but were instead numbers that would help Deutsche Bank make money at its counterparties' expense."[8] The defendants appealed their convictions to the Second Circuit.

The Second Circuit's Decision

The Second Circuit reversed Connolly and Black's convictions, making three significant findings:

First, the Court held that the government's theory of falsity incorrectly assumed that there was, at any given point, one true interest rate that should have been reflected in Deutsche Bank's LIBOR submission, and that it was the rate generated by Deutsche Bank's internal pricer.[9] Rather, the Court concluded, the evidence showed that loans made on the same day with differing interest rates due to the amounts of principal demonstrated that there was not one true interest rate.[10] Further, the Court found, Deutsche Bank's LIBOR submitters considered many factors other than the data automatically generated by the pricer in forming their LIBOR submissions—in fact, one of the submitters testified that the main purpose of the pricer was not to determine the LIBOR submission, but merely to provide the submitter with a starting point.[11] The Court also noted that a spreadsheet the submitter used to calculate the submission required manual input by the submitter in certain cells, showing the submission calculation did not rely entirely on automatic pricer data.[12] The submitters also testified about other external economic factors they used and brokers they sought input from in order to calculate their submissions.[13]

Second, the Court found that Deutsche Bank's LIBOR submissions in question were not false merely because they were influenced by Connolly and Black.[14] In support of its finding, the Court looked to the language of the BBA LIBOR instruction with which LIBOR submitters had to comply.[15] The Court recognized that if Deutsche Bank could, hypothetically, borrow money at the rate it submitted, then the submission was not false, "irrespective of its motivation."[16] Because none of the witnesses at trial testified that Deutsche Bank could *not* have borrowed cash at the rate in its LIBOR submissions, the Court held that such submissions were not false.[17]

Third, the Court rejected the government's argument that a LIBOR submission that was influenced by a trader constituted a "half-truth" because it carried an "implied certification" that it had not been so influenced.[18] Looking again to the BBA instruction, the Court found that although submitters were explicitly prohibited from colluding with other panel

[4] *Id.*
[5] *Supra* n.1, at 17-18.
[6] *Id.* at 21.
[7] *Id.* at 22.
[8] *United States v. Connolly*, No. 16 CR. 370 (CM), 2019 WL 2125044, at *5 (S.D.N.Y. May 2, 2019).
[9] *Supra* n.1, at 44.
[10] *Id.* at 39, 44-46.
[11] *Id.* at 39-41.
[12] *Id.*
[13] *Id.* at 40-44
[14] *Id.* at 35.
[15] *Id.* at 33.
[16] *Supra* n.14.
[17] *Id.* at 36.
[18] *Id.* at 52 (quoting government's brief).

banks to rig rates, it did not prohibit LIBOR submitters "from receiving or considering input from that bank's . . . derivatives traders[,]" nor did the BBA's LIBOR Code of Conduct for Contributing Banks, adopted in 2013, prohibit such behavior.[19]

The Court concluded by stating that even if "[the] defendants' efforts to take advantage of [Deutsche Bank's] position as a LIBOR panel contributor in order to affect the outcome of contracts to which [it] had already agreed may have violated *any reasonable notion of fairness*," the government had nonetheless failed to prove such conduct violated the relevant wire fraud statute.[20]

Implications

Remarkably, with the Second Circuit's reversal in *U.S. v. Connolly*, every single U.S. trial conviction arising out of allegations of fixing LIBOR benchmarks has now been overturned.[21] In 2017, the Second Circuit also overturned the convictions of two Rabobank employees, Anthony Allen and Anthony Conti, in relation to alleged LIBOR manipulation, and while the reversal was due to prosecutors' misuse of the defendants' compelled testimony, the government had relied on the same argument at trial: that there was one true LIBOR rate, and submitters' reliance on input from Rabobank's derivatives traders rendered the bank's submissions false.[22]

These decisions follow a trend, and illustrate the difficulty that prosecutors face in using broad fraud statutes, like 18 U.S.C. § 1343, to regulate financial markets or police undesirable conduct that stops short of what might traditionally be characterized as fraud.

As the Second Circuit's opinion recognized, the Supreme Court has reversed convictions for otherwise wrongful conduct that it found did not meet the statutory requirements for a violation.[23] The same can be said in the securities fraud context: the Second Circuit has held that public issuers cannot be liable for securities fraud for providing historically accurate financial data to investors, even if suspected misconduct may have contributed to the financial results.[24] An issuer is also not obligated to disclose something the reasonable investor would "very much like to know" unless there is a freestanding duty for the issuer to do so.[25] It stands to reason, then, that other financial actors who act in self-interest can also do so without their actions constituting fraud.

Prosecutors have also faced challenges relying on other broad theories in similar cases. For example, in *U.S. v. Usher*, three former traders were indicted in January 2017 for Sherman Act violations in connection with their alleged collusion with other traders to fix rates in the FX Spot Market.[26] At trial, the government relied on testimony from a former trader, who told the jury that the traders had a gentlemen's agreement to avoid trading to each other's disadvantage,[27] and Bloomberg chats in which the defendants marveled at their financial success as a result of the agreement.[28] However, in the end, the jury acquitted the defendants, believing the government's argument about the defendants' misconduct, but not finding that such misconduct met the statutory elements for a violation of antitrust law.[29] "It's not that we didn't believe these gentlemen did what they did, but in the end there was not enough evidence to warrant it," the jury foreman told the

[19] *Id.* at 52-53.
[20] *Id.* at 54 (emphasis added).
[21] Dave Michaels, *All U.S. Trial Convictions in Crisis-Era Libor Rigging Have Now Been Overturned*, Wall Street Journal (Jan. 27, 2022), https://www.wsj.com/articles/all-u-s-trial-convictions-in-crisis-era-libor-rigging-have-now-been-overturned-11643310178.
[22] *Supra* n.2, at 74-75.
[23] *Supra* n.1, at 32 (citing *Williams v. U.S.*, 458 U.S. 279 (1982) and *Fasulo v. United States*, 272 U.S. 620 (1926)).
[24] *Plumber & Steamfitters Loc. 773 Pension Fund v. Danske Bank A/S*, 11 F.4th 90, 98-99 (2d Cir. 2021).
[25] *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993).
[26] *United States v. Usher*, No. 17 CR. 19 (RMB), 2018 WL 2424555, at *1 (S.D.N.Y. May 4, 2018).
[27] Stewart Bishop, *'Cartel' Traders Cleared Of Forex-Rigging*, Law360 (Oct. 26, 2018), https://www.law360.com/articles/1096181.
[28] Stewart Bishop, *Ex-UBS Forex Trader Says 'Cartel' Used Chats To Collude*, Law360 (Oct. 12, 2018), https://www.law360.com/articles/1091973.
[29] Supra n.27.

press. "[I]n the end were making a verdict based on the charges and how the judge instructs us to do that."[30]

Collectively, these cases illustrate the difficulty that the government faces in ultimately securing, and defending, convictions when using general criminal laws to prosecute conduct that does not involve a violation of well-established market rules. In recent years, the government has relied on such theories to secure substantial resolutions with major companies and financial institutions, leveraging threats of indictments to secure criminal resolutions for what some would characterize as, at most, regulatory violations, and more often violations of amorphous standards of decency. Where such cases have actually proceeded to trial (typically against individual defendants with strong incentives to put the government to proof in litigation), the government has been met with considerably less success. While companies and individuals facing criminal charges nonetheless face grave decisions on how to proceed in the face of potential indictments, the outcome in *U.S. v. Connolly* and cases preceding it suggest that the government faces significant obstacles when it seeks to push the boundaries of criminal law into the realm of regulating market conduct.

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[30] *Id.*