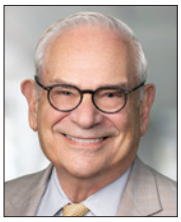
New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
MARCH 3, 2022

WHITE-COLLAR CRIME

Bad Intentions Are Not Enough: Second Circuit Reverses LIBOR Convictions in 'U.S. v. Connolly'



By **Elkan Abramowitz**

And **Jonathan S. Sack**

Since about 2011, the Department of Justice has devoted considerable effort to investigate and prosecute alleged manipulation of the London Inter-Bank Offer Rate (LIBOR). LIBOR is an interest rate benchmark that is so embedded in the global financial system that, despite much criticism, and even during DOJ's investigations and prosecutions, LIBOR has continued to be used by institutional borrowers and lenders, and will not be phased out fully until June 2023.

DOJ's efforts have led to civil and criminal charges against global banks, resulting in the payment of approximately $8.5 billion in fines and penalties, and the prosecution of over 20 individuals in the United States and the UK, including Matthew Connolly and Gavin Black of Deutsche Bank AG (DB). Connolly and Black pled not guilty and were convicted at trial in 2018. Despite being critical of the government's handling of the investigation, the district court denied motions for acquittal and for a new trial.

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In a stunning turn of events, the U.S. Court of Appeals for the Second Circuit reversed the convictions in *United States v. Connolly*, 24 F.4th 821 (2d Cir. 2022). The court found the evidence of guilt to be insufficient as a matter of law and directed the district court to enter judgments of acquittal. The Second Circuit held that the government had not proved—and could not prove at another trial—that Connolly and Black had made false statements, and thus they did not commit the wire fraud and conspiracy offenses for which they were indicted.

In this article, we first summarize the facts underlying the prosecution and then describe the detailed reasoning of the Second Circuit. We conclude by touching on several important takeaways from the holding. Above all, the decision draws attention to the limits of the mail/wire fraud statutes—laws that are quite expansive but can also be stretched too far when applied to conduct in financial markets, especially markets tied to opaque rules and practices like those in *Connolly*. The defendants' actions in *Connolly* may run afoul of notions of fair dealing, but that does not make their actions criminal.

LIBOR

LIBOR is shorthand for a set of daily interest rate benchmarks published in multiple currencies by the British Bankers Association (the BBA) until 2014—the period relevant to the Connolly case—and subsequently by a different publisher. LIBOR is intended to reflect the daily rate at which financial institutions can borrow money from one another. Sixteen banks, including DB, were chosen to set the U.S. currency LIBOR rates (the Panel Banks). The BBA required each Panel Bank to submit daily "t*he rate at which it could borrow funds,* were it to do so by asking for and then accepting inter-bank offers in reasonable market size" (emphasis added). The four highest and lowest submissions were eliminated, and the BBA published the mean of the remaining eight rate submissions as that day's LIBOR USD rates.

LIBOR was the benchmark for trillions of dollars in loans and derivative instruments. Small differences in LIBOR could have a large impact on the profitability of particular trades.

In the words of one commentator, traders "realized that, if it was worth $1,000,000 to their bank to have [LIBOR] be one basis point [i.e., one one-hundredth of a percent] lower, then it was worth $200,000 to their bonus to have [LIBOR] be one basis point lower." Matt Levine, *Money Stuff: Libor Was Made Up Anyway,* Bloomberg.com (Jan. 31, 2022).

Prosecution of Connolly and Black

A grand jury in the Southern District of New York returned an indictment that charged Connolly and Black with wire fraud and conspiracy. The government's theory was that DB made a "true" LIBOR submission each day unless Connolly or Black intervened to manipulate DB's submission. In the government's view, Connolly and Black requested higher or lower LIBOR submissions to defraud the BBA and DB's counterparties.

Connolly worked in DB's New York office as director of the cash and money market derivatives trading desk. Black was employed in DB's London office, including as director of that office's derivatives trading desks; his principal responsibility was to trade U.S. dollar money market derivatives.

Two DB colleagues, Michael Curtler and James King, were responsible for making the bank's daily LIBOR submissions. Curtler pled guilty to conspiracy to commit wire and bank fraud, and King entered into a non-prosecution agreement. Both men cooperated with the government and testified at trial.

The relationship between DB's trading desks and Curtler and King was central to the prosecution. The evidence showed that Curtler and King each had an individual spreadsheet called a "pricer," which used a "live data feed" from "the market" to "automatically update[] [rates] as the market data changed." They also manually "put in various factors" to reach the rates they "wanted to use internally." The pricers' primary function was to help determine the rates at which the cash desk would lend money to other DB units.

The pricers were also used to help calculate DB's LIBOR submissions. King made manual changes to his pricer directed "solely at the rate to be submitted for LIBOR." According to both King and Curtler, Connolly and Black requested that they submit LIBOR rates that were advantageous to DB's positions. For instance, Curtler testified that, in November 2005, Connolly requested a higher LIBOR rate because derivatives traders under Connolly expected to receive payments on notational amounts totaling approximately $15 billion. In August 2007, Connolly requested that the LIBOR rate be "as low as possible" as traders on his desk had "tons of pays coming up." King testified that he put a notation in his pricer when he received a request for a specific LIBOR rate. Both Curtler and King testified that they "knew" submitting self-interested LIBOR submissions was "wrong."

In this edition of their White-Collar Crime column, Elkan Abramowitz and Jonathan Sack first summarize the facts underlying the 'Connolly' prosecution and then describe the detailed reasoning of the Second Circuit. They conclude by touching on several important takeaways from the holding—above all, that the decision draws attention to the limits of the mail/wire fraud statutes.

When submitting DB's LIBOR rates, King departed from his "pricer" for reasons other than intervention by Connolly or Black. Each day, King consulted five interbank brokers to gauge their rates, and he testified that it was logical "to change" DB's LIBOR submission "rates . . . so that they lined up with what the brokers were predicting" because "the brokers have access to all the banks, they know where we can borrow money or they think they know where we can borrow money." Depending on the circumstances, King used his pricer, or went with the brokers' rates, or went in the middle. He felt that the reference in the BBA LIBOR Instruction (the "Instruction") to "reasonable market size," which the BBA did not define, "gave [him] flexibility as to where [he] could actually submit" DB's LIBOR submission.

Conviction and Post-Trial Motions

Following conviction at trial, Connolly and Black moved for judgments of acquittal. The defendants' chief argument during and after trial was that the government had failed to prove that they caused DB to make false submissions to the BBA. In their view, the submitted rates were not false because the Instruction asked for the rate at which DB could borrow money, and the government failed to prove that DB could not have borrowed money at the rates DB submitted.

The trial court denied the motions. In the court's view, "the question for the jury was whether Defendants made LIBOR submissions that reflected something other than honestly held estimates of the rate Deutsche Bank would have accepted in order to borrow funds." The court found that the government had introduced sufficient evidence to demonstrate that DB's LIBOR submissions

were false and "fraudulent because *each submission carried with it the implicit certification that it was determined according to the BBA's rules—which is not what happened*" (emphasis added). Instead, the submissions were "numbers that would help Deutsche Bank make money at its counterparties' expense." *United States v. Connolly,* 16 Cr. 370 (CM), 2019 WL 2125044, at *5 (S.D.N.Y. May 2, 2019).

Second Circuit Decision

The Second Circuit reversed Connolly's and Black's convictions because, in its view, the government had failed to prove that the rates submitted by DB to the BBA were false. The depth and intensity of the court's analysis of the evidence were striking. Based on that analysis, the court concluded that the government did not have a viable theory of guilt that could go to a jury and thus directed the district court to enter a judgment of acquittal.

The court focused on the precise phrasing and requirements of the Instruction issued by the BBA, which called for each Panel Bank to provide "the rate at which it could borrow funds, were it to do so by asking for *and then accepting* inter-bank offers in *reasonable market size*" (emphasis added). In the court's view, the hypothetical nature of the information sought by the Instruction—i.e., the rate at which Panel Banks could borrow funds—was highly significant. Although the cooperating witnesses testified that they "knew" what they were doing was "wrong," the government failed to prove that DB could not have borrowed money at the rate submitted. That failure was fatal.

The Second Circuit rejected the government's theory that DB had a single true rate which the defendants had caused to be manipulated and falsified. In a careful parsing of the evidence, the court explained that DB did not have a single pricer. King testified, for example, that he and Curtler manually made changes to their separate pricers. King spoke with the five interbank brokers daily. On some days he submitted his pricer's rate, on some days he submitted the broker rate, and on some days he submitted something in the middle.

Ultimately, the Second Circuit found that the pricers were not an impartial system for determining DB's LIBOR submissions which the defendants had fraudulently exploited. Connolly and Black acted out of self-interest when submitting certain LIBOR benchmarks, but that was irrelevant. The Instruction asked DB to submit "the rate at which it could borrow funds." From that Instruction, the Second Circuit concluded, "[i]f the rate submitted is one that the bank could request, be offered, and accept, the submission, *irrespective of its motivation,* would not be false" (emphasis added).

Federal fraud statutes, in short, were not meant to be a catch-all "designed to punish all acts of wrongdoing or dishonorable practices." A conviction under the federal wire fraud statute "is not warranted by the mere fact that the defendant's conduct was improper, objectionable, or even despicable."

Conclusion

Three aspects of this important decision stand out for us. First, guilty pleas or other resolutions by companies, particularly regulated financial institutions, do not necessarily indicate the strength of the government's case on the facts or the law. Companies have many good reasons to settle with the government. Here, a DB subsidiary pled guilty to one count of wire fraud, and DB entered into a deferred prosecution agreement, with attendant fines and penalties. When an individual challenges the government's case, the litigation may end up revealing that the conduct at issue was not as severe as the corporate settlements would indicate, or not even illegal.

Second, sharp commercial practice that is not praiseworthy, or honorable, is not necessarily a fraud under federal law. As elastic and sweeping as the mail and wire fraud statutes at times seem, their reach has limits, and courts will sometimes decide, as the Second Circuit did in Connolly, that the government has wrongly subjected sharp practice to criminal prosecution.

Third, the government appears to have sought to change market behavior by means of its LIBOR enforcement actions. But criminal prosecution may not be the most appropriate means of causing such change. The rules and practices surrounding LIBOR were recognized as being opaque and subject to manipulation. In some instances, and LIBOR may be one of them, the more appropriate exercise of government authority would be to change the rules themselves.

The idea of using civil and criminal enforcement to regulate corporate conduct has been widely debated. In *Connolly*, criminal prosecution led to a defeat for the government. We suspect that the proper reach of criminal enforcement generally and the fraud statutes specifically will continue to be tested.