3. SECURITIES FRAUD

In this chapter and the following chapter on insider trading, we take the idea of fraud—developed fully in Chapter 2—and apply it to the matter of criminal fraud in markets for securities. These two chapters cover much of what is commonly thought of as "Wall Street crime," or what scholars think of as the criminal law aspect of financial market regulation. The fundamental concept of criminal fraud remains much the same, while the facts of the cases become a bit more complex and varied, given the rapid pace of innovation and the enormous incentives to discover new sources and means of profits in global financial markets.

Part A first sets forth the distinctive statutory and regulatory scheme for fraud that applies in securities markets—largely a product of the New Deal of the 1930s and its aftermath, as well as subsequent American financial crises. It then provides examples of recent criminal securities fraud cases that illustrate the application of the last chapter's principles about fraud to current securities dealing. Part B introduces the recurring scenario in securities cases of corporate accounting fraud, and provides a few examples of common methods for such fraud. Through materials from several high-profile cases, Part C takes up the problem of trading fraud by bankers—with particular attention to the heated controversy over the paucity of criminal prosecutions relating to the market in mortgage-backed securities that was at the center of the 2008 financial crisis.

A. The Statutes and the Basics

Securities fraud is a common theory of prosecution in cases of corporate crime for two reasons. First, when Congress reformed regulation of financial markets as part of the New Deal in the 1930s, it enacted comprehensive and potent federal laws against securities fraud, which have been made more powerful since. Second, the legal definition of "security" under federal law (a subject covered extensively in courses on securities regulation) is so broad that these anti-fraud laws cover most significant investment products used today, including stock, common debt instruments, and many forms of derivatives.

This section of these materials is as much about facts as law. You can't master the nuances of financial fraud in the corporate world without working on some of these cases, and maybe even having some training in accounting rules and practices—which can't be provided in an introductory course on corporate crime. Read the materials in the spirit of training yourself to be interested in financial cases, not afraid of them. Remind yourself: The people who designed this stuff are no smarter than you and likely less so. Also, take a course on securities regulation, even if it has a reputation for being harder than average in the law school curriculum. The practitioner of corporate crime must understand the basics of American financial markets and the regulatory structure that governs them.

Read the materials in this chapter—which include both judicial opinions and legal filings—as much to get a sense of the *methods* used to commit these sorts of crimes as

for the rules—which involve the same concepts about fraud explored in Chapter 2. The chief difference between the mail/wire fraud statutes and the securities fraud statutes and rules is jurisdiction: for securities fraud, the concept of "in connection with the purchase or sale of a security" replaces the concept of a mailing or wiring covered in the last chapter. Also, not surprisingly, given what we saw in Chapter 2, most or all courts have said that the concept of "intent to harm," whatever it may mean, is not applicable under the laws against securities fraud. *See, e.g., United States v. Tagliaferri*, 820 F.3d 568 (2d Cir. 2016).

What types of *behaviors* count as criminal fraud remains, more or less, the same problem.

One can roughly divide most common criminal securities fraud prosecutions into five categories:

(1) accounting fraud—cooking the books to defraud investors, most often purchasers and sellers of equity shares, about the value of the firm;

(2) investment fraud—ripping off investors' money, most famously through Ponzi schemes, which usually are not all that interesting legally: the conduct is one step removed from outright theft, with the perpetrator's express lies typically large, numerous, and flagrant. This chapter does not include any legal materials on Ponzi schemes but the psychology of both perpetrators and victims in such cases is very interesting, so perhaps find an evening to watch the HBO film about Bernard Madoff;

(3) "looting"—when managers divert corporate assets (such as apartments and airplane rides) for themselves and others;

(4) trading fraud—sellers and buyers of financial instruments, like mortgage-backed securities, defrauding each other, often while employed by the world's largest financial institutions; and

(5) the special scenario of insider trading, covered separately in Chapter 4.

Most of the criminal statutes and regulations governing securities fraud arrived in two waves: first, in the 1930s and 1940s, when New Deal legislation included the monumental framework of American securities law; and second, in the 2000s, when the aftermath of the Enron scandal and others produced extensive revisions in securities laws. The New Deal wave generated the 1933 Act (the "'33 Act" or "Securities Act"), which regulates the process of new offerings by issuers of securities and includes criminal penalties for some violations, and the 1934 Act (the "'34 Act" or "Exchange Act") which regulates the post-issuance trading of securities in secondary markets by all persons and includes criminal penalties for some violations. These enactments both created the Securities and Exchange Commission and empowered it to, among other

things, make regulations in furtherance of the legislation's objectives.[1] Thus, criminal securities fraud is defined by both statute and regulation. In the early 2000s, the Enron-era scandals produced the Sarbanes-Oxley Act, which included both stiffer punishments for criminal securities fraud and some additional (and substantially overlapping) definitions of criminal securities offenses. Most recently, the financial crisis of 2008-09 spawned the Dodd-Frank Act, which covered a variety of regulatory areas and included some changes in securities laws, particularly the addition of a whistleblower program for SEC enforcement.

The criminal provisions of these major pieces of legislation now appear in both Title 18 (federal crimes) and Title 15 (securities regulation) of the United States Code. You should be familiar with all of the statutes below. Find the key elements in them. What is the actus reus? What is the mens rea? What, if anything, is different on the face of these statutes from the mail and wire fraud statutes? In what ways might the mail and wire fraud laws and the securities fraud laws be used to cover some of the same conduct (as federal prosecutors often use them)?

15 U.S.C. §78j. Manipulative and deceptive devices (often referred to as "Section 10 of the '34 Act")

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[Pursuant to the regulatory powers that Congress granted to it through Section 10 of the '34 Act (above), the SEC enacted "Rule 10b-5" (below), which can fairly claim to be the most impactful and frequently litigated rule in the entire Code of Federal Regulations.]

[1] Basic familiarity with the principles and processes of federal administrative law in the United States is also an important tool for the practitioner of corporate crime.

17 C.F.R. § 240.10b-5. Employment of manipulative and deceptive devices (referred to as "Rule 10b-5")

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

15 U.S.C. § 78ff. Penalties

(a) Willful violations; false and misleading statements

> Any person who willfully violates any provision of this chapter (other than section 78dd-1 of this title), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than $5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding $25,000,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

18 U.S.C. § 1348. Securities and commodities fraud (enacted as part of the Sarbanes-Oxley Act)

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

(1) to defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities

Exchange Act of 1934 (15 U.S.C. 78o(d)); or

(2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); shall be fined under this title, or imprisoned not more than 25 years, or both.

18 U.S.C. § 1350. Failure of corporate officers to certify financial reports (enacted as part of the Sarbanes-Oxley Act)

(a) Certification of periodic financial reports.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

(b) Content.—The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

(c) Criminal penalties.—Whoever—

(1) certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $1,000,000 or imprisoned not more than 10 years, or both; or

(2) willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than $5,000,000, or imprisoned not more than 20 years, or both.

To illustrate the application of these statutes and rules, we begin with the saga of a securities fraud prosecution that relates to the now infamous market in mortgage-backed securities (MBS) and demonstrates how the law of securities fraud mirrors, overlaps, and sometimes differs with the various components of mail and wire fraud. Here you will see discussion in the securities trading context of important issues addressed in Chapter 2, including "intent to harm," "intent to defraud" (versus "good faith"), and materiality.

Why did the government have such a hard time sustaining the fraud convictions of this

trader, who was dealing (albeit after the financial crash of 2008) in a market widely believed by outsiders to have been infected by fraud?

UNITED STATES v. LITVAK, 808 F.3d 160 (2d Cir. 2015) (Litvak I)

STRAUB, Circuit Judge:

The charges in this case arise from Litvak's conduct as a securities broker and trader at Jefferies & Company ("Jefferies"), a global securities broker-dealer and investment banking firm. . . .

As a bond trader at Jefferies during the relevant time period, Litvak bought and sold RMBS [residential mortgage-backed securities] on Jefferies's behalf, sometimes as a middleman (holding the RMBS only briefly when facilitating a transaction between two other parties) and sometimes holding the RMBS for a longer period of time in Jefferies's "inventory." Between 2009 and 2011, Litvak made three types of misrepresentations to representatives of the counterparties with whom he transacted on Jefferies's behalf in order to increase Jefferies's profit margin on the transactions in which he engaged. First, he misrepresented to purchasing counterparties Jefferies's acquisition costs of certain RMBS. For example . . . Litvak falsely represented to Michael Canter, a representative of the AllianceBernstein Legacy Securities Fund ("AllianceBernstein Fund"), a PPIF, that Jefferies had purchased certain RMBS at a price of $58.00 (based on $100.00 face value), when in fact Litvak knew that Jefferies had purchased those securities at $57.50. Jefferies subsequently sold the securities to the AllianceBernstein Fund at a price of $58.00. Canter testified that this difference would have "mattered" and been "important" to him. If Jefferies and the AllianceBernstein Fund had instead transacted at a price of $57.50, the Fund would have paid approximately $60,000 less for the securities (the total cost was approximately $12 million).

Second, Litvak misrepresented to selling counterparties the price at which Jefferies had negotiated to resell certain RMBS. . . . Litvak falsely stated to a representative of York Capital Management ("York"), a hedge fund that owned certain RMBS, that Litvak had arranged for Jefferies to resell those securities to a third party at a price of $61.25 (based on $100.00 face value). Litvak and York's representative, Kathleen Corso, agreed that Jefferies would purchase the securities from York at a price of $61.00, in order to allow Jefferies to reap a $0.25 profit when resold to the third party at $61.25. However, Litvak had actually arranged for Jefferies to resell the securities to the third party at a price of $62.375. Indeed, York sold the securities to Jefferies at a price of $61.00 and Jefferies then resold the securities to the third party at a price of $62.375 (for a profit of $1.375). Corso testified that this difference would have been "important" to her. If Jefferies and York had instead transacted at a price of $62.125, providing Jefferies with a profit of $0.25, as Litvak had represented to Corso, Jefferies would have paid York approximately $228,500 more for the securities (the total cost was approximately $20 million).

Third, Litvak misrepresented to purchasing counterparties that Jefferies was functioning as an intermediary between the purchasing counterparty and an unnamed third-party

seller, where in fact Jefferies owned the RMBS and no third-party seller existed. . . . Litvak falsely represented to a representative of Magnetar Capital ("Magnetar"), a hedge fund, that Litvak was actively negotiating with a seller of certain RMBS (i.e., acting as a middleman) when, in fact, Litvak knew that Jefferies held the securities in its inventory. Litvak's negotiations with Vladimir Lemin, Magnetar's representative, began with Lemin's offer to purchase the securities at a price of $50.50. Litvak then described to Lemin a fictional back-and-forth between himself and an unnamed, non-existent third-party seller, which concluded with Litvak's false representation to Lemin that he had contemporaneously purchased the securities on Jefferies's behalf at a price of $53.00. Lemin then agreed for Magnetar to purchase from Jefferies the securities at a price of $53.25, in order to allow Jefferies to reap a $0.25 profit (or "commission") when resold. However, the securities purchased from Jefferies by Magnetar were actually held in Jefferies's inventory and had been acquired by Jefferies several days prior at a price of $51.25. Lemin testified that this distinction reflected "a very different situation" from that which he understood at the time of the transaction. If Jefferies and Magnetar had instead transacted at a price of $53.00, the agreed-upon transaction price of $53.25 less the understood $0.25 "commission" for Jefferies, Magnetar would have paid Jefferies approximately $14,000 less for the securities (the total cost was approximately $5.5 million). . . .

Litvak argues that the misrepresentations he made to counterparties during negotiations for the sale of bonds are immaterial as a matter of law because they did not relate to the bonds' value (as opposed to their price). Although the District Court did not squarely address this argument, it held that the trial evidence sufficiently supported a finding of materiality. We reject Litvak's argument because, on the trial record before us, a rational jury could have concluded that Litvak's misrepresentations were material. . . .

A misrepresentation is material under Section 10(b) of the Securities Exchange Act and Rule 10b–5 where there is "a substantial likelihood that a reasonable investor would find the . . . misrepresentation important in making an investment decision." *United States v. Vilar,* 729 F.3d 62, 89 (2d Cir. 2013). Where the misstatements are "so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance," we may find the misstatements immaterial as a matter of law. *Wilson v. Merrill Lynch & Co., Inc.,* 671 F.3d 120, 131 (2d Cir. 2011) (internal quotation marks omitted).

We conclude that, on the trial record before us, a rational jury could have found that Litvak's misrepresentations were material. The trial record includes testimony from several representatives of Litvak's counterparties that his misrepresentations were "important" to them in the course of the transactions on which the securities fraud charges were predicated, and that they or their employers were injured by those misrepresentations. This testimony precludes a finding that no reasonable mind could find Litvak's statements material. . . .

Litvak contends that the scienter element of Section 10(b) requires proof of

"contemplated harm" (or "intent to harm"), that the District Court erred in failing to so instruct the jury, and that the evidence adduced at trial was insufficient to permit a rational jury to find that Litvak had such intent. In ruling on Litvak's post-trial motions, the District Court reaffirmed its view that "intent to harm" is not an element of securities fraud. We agree.

"Liability for securities fraud [ ] requires proof that the defendant acted with scienter, which is defined as 'a mental state embracing intent to deceive, manipulate or defraud.'" *United States v. Newman*, 773 F.3d 438, 447 (2d Cir. 2014) (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12, 96 S. Ct. 1375, 47 L. Ed. 2d 668 (1976)), *cert. denied*, —— U.S. ——, 136 S. Ct. 242, 193 L. Ed. 2d 133 (2015). Litvak urges us to read "intent to deceive, manipulate or defraud," *Hochfelder*, 425 U.S. at 193 n.12, 96 S. Ct. 1375, in the same manner in which we have interpreted "intent to defraud" in the mail and wire fraud contexts (*i.e.*, as requiring proof of "contemplated harm"). Litvak's view, however, is contrary to our precedent. . . .

In sum, because "intent to harm" is not a component of the scienter element of securities fraud under Section 10(b), the District Court did not err in refusing to provide such an instruction to the jury and we need not inquire into whether the evidence was sufficient for the jury to conclude that such intent was proven. . . .

Litvak challenges the District Court's exclusion of "testimony and documents about the widespread use of similar negotiation tactics at Jefferies" which "would have shown that others at Jefferies engaged in the same conduct and that it was approved by supervisors and by Jefferies' compliance department." The "good faith" evidence Litvak proffered at trial may be separated into two categories: (1) evidence of Litvak's supervisors' knowledge or approval of *Litvak's* "price misrepresentation[s]" and "inventory misrepresentation[s]" and (2) evidence of Jefferies managers', including Litvak's supervisors, knowledge or approval of *other employees'* similar conduct. The District Court permitted the first category of evidence, allowing Litvak to adduce evidence that his supervisors "approved" or "encouraged" him to misrepresent price, cost, or a seller's identity because such evidence that "tend[s] to prove the absence of intent" and could provide a basis for the jury to make "a reasonable inference . . . that they should find no intent to defraud given the nature of what happened at Jefferies."

The second category of evidence was the subject of a lengthy colloquy between Litvak's counsel and the District Court. After the District Court called the relevance of this evidence into question, Litvak's counsel responded as follows:

> This is an ongoing alleged scheme . . . with the same supervisors in place for the entire time with repeated examples of the two types of alleged misrepresentations we have been talking about here. So, your Honor, I think that evidence that supervisors approve this conduct and participate in the conduct on a repeated basis is a fair basis upon which to infer that when Mr. Litvak did the very same thing, that the supervisors saw and approved of as standard operating procedure, that

> Mr. Litvak lacked the intent to defraud. That's a fair inference from that evidence. It is a circumstantial basis to infer that Mr. Litvak had a belief, as we have contended, that he was not committing fraud. . . .

(Litvak's counsel explain[ed] that "the supervisors understood what Mr. Litvak had done not to be fraudulent because it was approved [and] because [they] were sales tactics that were widely employed That's the environment in which Mr. Litvak is operating. It all goes back to state of mind."). The District Court rejected this argument and prohibited Litvak from adducing evidence of "other people at Jefferies engaging in the same type of conduct" or "any supervisor approving others engaging in the conduct" because such evidence is "*irrelevant* when it does not involve [Litvak]." . . .

Litvak sought to introduce evidence that, during the relevant time period, supervisors at Jefferies—including his supervisors—regularly approved of conduct identical to that with which Litvak was charged. The District Court characterized the proffered evidence as improperly "suggest[ing] that everybody did it and therefore it isn't illegal." But Litvak's counsel did not proffer the evidence for that purpose and such an argument in summation could have been properly proscribed by the District Court. As Litvak's counsel stated at trial, this evidence would provide "a fair basis upon which to infer that when Mr. Litvak did the very same thing, . . . the supervisors saw and approved of [it] as standard operating procedure." Such an inference would support Litvak's attempt to introduce a reasonable doubt as to his intent to defraud, *i.e.*, that he held an honest belief that his conduct was not improper or unlawful, a belief the jury may have found more plausible in light of his supervisors' approval of his colleagues' substantially similar behavior. . . . [T]he District Court exceeded its allowable discretion in concluding that this testimony was not relevant under the low threshold set forth by Federal Rule of Evidence 401 in determining whether Litvak "held an honest belief that his actions . . . were proper and not in furtherance of any unlawful activity," *see United States v. Brandt*, 196 F.2d 653, 657 (2d Cir. 1952) ("since [good faith] may be only inferentially proven, no events or actions which bear even remotely on its probability should be withdrawn from the jury unless the tangential and confusing elements interjected by such evidence clearly outweigh" its relevance (internal citation omitted)). . . .

The first expert witness Litvak proffered was Ram Willner. According to Litvak's expert disclosure to the government, Willner holds advanced degrees in business administration with a focus on finance, served as a professor at leading business schools, and gained "extensive experience in portfolio management in the fixed income asset class, including extensive experience in the analysis and purchase of Residential Mortgage Backed Securities" during his employment by, at various times, Bank of America, Morgan Stanley, PIMCO, and a hedge fund. . . .

Litvak contends that the District Court erred in barring Willner from testifying "about the process investment managers use to evaluate a security, and the irrelevance of the broker-dealer's acquisition price to that process, [which] was directly probative of whether Mr. Litvak's misstatements would have been material to a reasonable investor."

Before the District Court, Litvak proposed that Willner opine, in pertinent part, as follows:

> [T]hat where a manager follows rigorous valuation procedures, as was the case here, consideration of, or reliance on, statements by sell-side salesmen or traders concerning the value of a RMBS or the price at which the broker-dealer acquired it or could acquire it, are not relevant to that fund's determination with respect to how much to pay for a bond. In Mr. Willner's opinion, such statements from sell-side sales representatives or traders are generally biased, often misleading, and unworthy of consideration in trading decisions. Accordingly, such statements from sell-side sales representatives or traders are not material to a professional investment manager's decision-making.

Litvak also offered Willner to testify in respect of "the process of selecting and valuing RMBS for inclusion in an investment portfolio, including analytical tools and methods available to an investment manager, and the development of an investment thesis for a particular RMBS." The District Court excluded the entirety of Willner's proffered testimony.

The government defends the District Court's ruling on the ground that "[t]he materiality of Litvak's lies was for the jury to decide." But . . . the District Court did not exclude Willner's testimony on "ultimate issue" grounds. Rather, the District Court appears to have excluded all of Willner's proffered testimony on relevance grounds (relying on Rule 401, Rule 403, or possibly both), without ruling specifically on this part of Willner's proposed testimony.

We conclude that the District Court exceeded its allowable discretion in excluding Willner's testimony in respect of the process by which investment managers value RMBS and the likely impact on the final purchase price of a broker's statements made to a counterparty during the course of negotiating a RMBS transaction. These portions of Willner's testimony would have been highly probative of materiality, the central issue in the case. This is particularly true because of the meaningful distinction between the complex securities at issue in this case and the common equities and bonds traded in "traditional," efficient markets (e.g., shares of corporate entities traded on the New York Stock Exchange). The pricing of RMBS is "more complicated" because it "tend[s] to be more subjective, [is] available mainly or only from dealers, and [is] often based on models to as opposed to prices from prior transactions." Thomas P. Lemke, Gerald T. Lins & Marie E. Picard, Mortgage–Backed Securities § 5:14 (Westlaw 2015).

Consistent with this understanding, Willner's proffered testimony could have educated the jury (which was likely only familiar, if at all, with securities traded on public exchanges) about the highly-specialized field of RMBS trading. Because RMBS lack an efficient, transparent secondary market through which value can be determined objectively, traders set the value of the security, and hence the price each is willing to accept as a seller or buyer, by engaging in "rigorous valuation procedures" involving the

use of certain "analytical tools and methods." Thus, firms trading RMBS rely upon sophisticated computer-pricing models, often developed by professionals with applied-mathematics backgrounds, to determine the subjective "value" of the securities. Certain testimony at trial supported a conclusion that this process, and a determination of the amount an investment manager is willing to pay for a security, nearly always takes place prior to the manager approaching a dealer such as Jefferies, here represented by Litvak, to negotiate the price of that security.

With such testimony before it, a jury could reasonably have found that misrepresentations by a dealer as to the price paid for certain RMBS would be immaterial to a counterparty that relies not on a "market" price or the price at which prior trades took place, but instead on its own sophisticated valuation methods and computer model. The full context and circumstances in which RMBS are traded were undoubtedly relevant to the jury's determination of materiality.

Aside from Willner's testimony in respect of the nature of the RMBS market, there are few ways in which Litvak could put forth evidence to rebut the alleged victims' testimony that Litvak's misstatements were important to them, or otherwise counter the government's argument that a reasonable investor would have found Litvak's statements material. . . .

If we were to conclude otherwise, Litvak would be put in an untenable position whereby he could not introduce testimony that either (1) the specific statements at issue in the case would not be important to a reasonable investor (due to "ultimate issue" concerns) or (2) the types of statements at issue are generally not important to a reasonable investor. Litvak would be left only with the "victims" of his conduct as sources of potential testimony on this issue, an odd limitation where the jury is to evaluate materiality in an objective manner. We conclude that this error was not harmless. . . .

The prosecutors retried the *Litvak* case and secured a more limited conviction. Litvak again appealed, and again prevailed. On the second appeal, the court explained further how the particular nature and structure of the market in which Litvak operated were essential to evaluating whether the government had fairly proved the crime of fraud.

UNITED STATES v. LITVAK, 889 F.3d 56 (2d Cir. 2018) (Litvak II)

WINTER, Circuit Judge:

Jesse Litvak appeals from his conviction, after a trial by a jury before Chief Judge Hall, on one count of securities fraud pursuant to 15 U.S.C. §§ 78j(b), 78ff. This is the second time this matter has been before us. . . .

He challenges his conviction on the one count principally on the ground that his misstatements were, as a matter of law, immaterial to a reasonable investor in the market for residential mortgage- backed securities ("RMBS"). We reject that argument.

However, the district court erred in admitting evidence that the individual representing the counterparty in the transaction for which appellant was convicted believed appellant to be an agent acting on the counterparty's behalf. All parties agree that the belief in an agency relationship was erroneous and that appellant acted solely as a principal in the transaction underlying this appeal. Indeed, the testimony of the counterparty's representative indicated that the counterparty, his employer, had informed him that no agency relationship existed but that the representative disagreed. The district court instructed the jury that no agency relationship existed.

Because the applicable materiality test is an objective one, evidence of the idiosyncratic and erroneous belief of the counterparty's representative was irrelevant. The belief of the counterparty's representative in an agency relationship was, as discussed infra, the only evidence distinguishing appellant's count of conviction from those of the nine transactions on which he was acquitted. The evidence was, therefore, prejudicial, as our earlier opinion in this proceeding foreshadowed, and we cannot conclude with fair assurance that the jury would have convicted appellant absent such evidence. Accordingly, we vacate the judgment of conviction and remand. . . .

RMBS are marketed to large, sophisticated financial institutions. Because RMBS are not homogeneous—each has unique features affecting its value—they are not publicly traded on an exchange like NASDAQ or the New York Stock Exchange. At any given time, therefore, there is no public list of RMBS available for sale or of the financial terms of ongoing transactions. As a result, investors do not buy and sell RMBS directly. Instead, when institutional investors are interested in buying or selling RMBS, they contact registered broker-dealers such as Jefferies to find interested buyers or sellers. Investors may also buy and sell RMBS directly with broker-dealers that hold RMBS in their own accounts.

Most, if not all, institutional investor-buyers use computer models to establish the highest amount at which they would be willing to buy or sell a particular RMBS. These analyses can be quite complex. Factors considered include the priority level of the bond, the likely number of individuals that will prepay their mortgages, the likely number of mortgage defaults, the potential severity of the loss on a defaulted mortgage, the locations of the real property mortgaged, unemployment rates in those locations, the effectiveness of the home loan servicer in receiving payments, and the credit scores of individual homeowners.

RMBS are bought or sold through three methods, styled as: "inventory trades," "order trades," or "bids-wanted-in-competition trades" ("BWIC trades"). In an inventory trade, an investor buys a bond already held in a broker-dealer's account. In an order trade, a broker-dealer communicates with an interested buyer and seller and, if successful, effectuates a transaction in which a RMBS is transferred. A RMBS investor may approach a broker-dealer to express interest in buying or selling a RMBS in a certain price range. Or a broker-dealer may approach an investor to gauge its interest in buying or selling a bond in a certain price range. The broker-dealer owns the bond, but usually

briefly, in consummating the transaction between the two investors.

A BWIC trade was involved in the sole count on which appellant was convicted. A BWIC trade is similar to an order trade, except that a BWIC trade involves an auction in which a putative seller sends a bid-list to multiple broker-dealers. These broker-dealers solicit expressions of interest and price ranges from potential buyers. The broker-dealer then places a bid in the auction of a particular security. The bid price is selected by the broker-dealer and may well differ from prices suggested by putative buyers. If the broker-dealer's bid is successful, the broker-dealer buys the bond and then offers to sell it to the interested investor. Communications are generally carried out through online instant messages.

There are various quirks to how bond prices are quoted among market participants. First, bond prices are quoted in terms of the price per $100 of face value, not the total price. Second, bond prices that are not whole numbers are represented in "ticks," 1/32 of a dollar or approximately $0.03. For example, a bond priced at $79.75 is represented as 79-24. Further, a broker-dealer is compensated with reference to either the "all-in" or "on-top" price. An "all-in" price is the total price the investor is (the broker-dealer hopes) to pay a broker-dealer for a bond. It does not refer to the price at which the broker-dealer purchased the bond. An "on-top" price refers to the difference between the price the broker-dealer paid for the bond and the price at which the broker-dealer will sell the bond—the "on-top" price is the broker-dealer's profit. In "on-top" trades, the broker-dealer's profit is sometimes referred to colloquially as a "commission," "markup," or "spread." In general, inventory trades are quoted as "all-in" prices. Negotiations over order or BWIC trades may refer to the broker-dealer's acquisition cost and the "on-top" price.

An essential feature of all of these trades, however, is that the broker-dealer acts solely in its own interest as a principal. The broker-dealer continually tracks potential buyers and sellers, their interests in particular kinds of RMBS, and their ongoing acceptable price ranges. It seeks to profit from transactions in the securities by buying low and selling high. The size of the year-end discretionary bonus given to each broker-dealer's trader is largely based on the profitability of the individual's trades. The broker-dealer assumes the risk of buying the bond, and an institutional investor can refuse to purchase abond held by the broker-dealer even when the investor caused the broker-dealer to purchase it by an expression of interest, i.e., in an order or BWIC trade. Such an investor may also have no investment purpose but may intend to resell the bond immediately, and at a higher price, to another institution it knows to be interested.

A broker-dealer is not, therefore, an agent for its counterparties in these trades and owes them no special or fiduciary duty. In a sale by a counterparty to a broker-dealer, the counterparty has no legitimate expectation that the broker-dealer will resell the bond at the price paid to the counterparty. Similarly, in a purchase, the counterparty has no legitimate expectation of purchasing a bond at the price paid by the broker-dealer. Rather, the broker-dealer and counterparty each have their own price ranges in which

they will consummate their ends of the transactions. The final price is determined in an arms-length negotiation and, if agreed upon, will be somewhere in the overlap of price ranges.

Market participants protect themselves against behavior that departs from market norms of good faith largely without resort to expensive and time-consuming litigation. Institutional investors simply refuse to do business with perceived bad actors for either a period of time or indefinitely. This is referred to in the industry as placing an individual or firm in the "penalty box" and is "not out of the ordinary." . . .

Appellant, on behalf of Jefferies, was involved in selling a RMBS in a BWIC trade to Invesco Ltd., an investment management company with nearly $1 trillion of assets under management. On July 1, 2010, having received a bid-list of bonds from a putative seller, appellant circulated the bid-list to, inter alia, Brian Norris, who represented Invesco. Invesco's credit research team determined that Invesco would make a worthwhile profit on a particular RMBS on the list, SARM 2005-21 7A1, if the purchase price were at, or under, $80 per $100 of face value. Norris then suggested to appellant that he bid 79-24 for the bond, and further told appellant that he had "some room" to bid higher than 79-24.

Appellant purchased the bond and informed Norris that Jefferies won the auction, stating in an online chat that "[I] bid your level," that is, he bid 79-24. In fact, however, appellant bid and purchased the bond for 79-16. Norris then proposed to buy the bond from appellant for 79-30, asking "6 ticks cool? 79-30 to me?" Appellant accepted, saying "6/32s is great." The difference between fourteen ticks and six amounts to $73,018.53. The total amount Invesco paid Jefferies for the bond was approximately $23.6 million.

Before appellant's second trial, appellant made motions in limine to bar counterparty representatives from testifying that they believed appellant was acting as their agent. Notwithstanding the concession at oral argument on the first appeal, the government proposed to offer such testimony, and the district court allowed it. . . .

A misstatement in a securities transaction is material so long as there is "a substantial likelihood that a reasonable investor would find the . . . misrepresentation important in making an investment decision." *Id.* at 89. A misrepresentation is important if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988). . . .

The objective nature of the "reasonable investor" standard is of particular importance in this case. To prove materiality, the government relied heavily on the testimony of counterparty traders—purported victims—that they considered appellant's misstatements to be an important factor, among others, in their investment decisions. The district court believed it important that counterparty traders testify to "their own point of view." This approach is permissible in a case like this, but only so long as the

testimony about the significance of the content of a defendant's misstatements and each trader's "own point of view" is shown to be within the parameters of the thinking of reasonable investors in the particular market at issue. In other words, there must be evidence of a nexus between a particular trader's viewpoint and that of the mainstream thinking of investors in that market. Materiality cannot be proven by the mistaken beliefs of the worst informed trader in a market. . . .

However, on Count Four, there was sufficient evidence for a rational jury to find appellant's misstatements material beyond a reasonable doubt, whether or not Norris paid "the price he proposed to pay." As noted, the determination of the materiality of a misstatement or omission "is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor." *TSC Indus.,* 426 U.S. at 445, 96 S. Ct. 2126. A finding of materiality, therefore, requires a showing only of importance, not "actual reliance." . . .

Appellant also argues that his misstatements cannot, as a matter of law, be material because they were not relevant to the intrinsic value of the bond, at best affecting only "the negotiation over price." This argument appears to have been considered and rejected in *Litvak I*. Nothing in the record of the second trial causes us to reach a different result.

We cannot agree that, because statements about the price paid by the broker-dealer for a RMBS are not intended, or understood, as relevant to the intrinsic value of the bond, such assertions are not material as a matter of law. When the broker-dealer seeks a profit for its role in procuring and selling a security desired by a buyer, the profit becomes part of the price paid by the buyer. The value of the security may be the most important factor governing the decision to buy, but the price must be considered in determining whether the purchase is deemed profitable. The broker-dealer's profit is part of the price and lies about it can be found by a jury to "significantly alter[ ] the 'total mix' of information . . . available." *Basic*, 485 U.S. at 231–32, 108 S. Ct. 978 (internal citation omitted).

Appellant argues that the district court erred by admitting Norris's testimony that appellant was Invesco's agent, and that this evidence may have tipped the balance in favor of the jury's conviction on that count. We agree. . . .

In the first trial, the issue of whether appellant was acting as a principal or as an agent in the various charged transactions was disputed. Only at oral argument of the first appeal did the government concede that appellant was acting as a principal. Nevertheless, in the second trial and at the government's urging, the district court again admitted testimony from Norris that appellant was acting as Invesco's agent during the trade. The district court held that the testimony was relevant to the materiality of appellant's misstatements and to appellant's fraudulent intent. The court also noted that the testimony was unlikely to confuse or prejudice the jury because it went only to Norris's "own point of view." . . .

It is now undisputed that appellant never acted as Invesco's or Norris's agent during the trade in question. Appellant acted as a principal: Jefferies bought the bond from one

party, held it for a brief period of time, and then sold it to Invesco. The transaction was at arms-length, and appellant owed no fiduciary duties to the buyer. As the owner of the bond, Jefferies did not have to convey the bond to Invesco and assumed the risk that Invesco would walk away from the deal after Jefferies had bought the bond. . . .

While the individual views of a counterparty trader may usually be relevant to the nature of the market involved and as to the beliefs of a reasonable investor, a reasonable investor would not misperceive the role of a broker-dealer in the RMBS market. In fact, Norris received material from Invesco's legal and compliance department stating that, in transactions such as the one here, broker-dealers act as principals. His disagreement with that advice was unreasonable. Norris's indisputably idiosyncratic and unreasonable viewpoint is not, therefore, probative of the views of a reasonable, objective investor in the RMBS market. Even if Norris's testimony had relevance, the district court abused its discretion under Rule 403. Relevant evidence may be excluded "if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence." Fed. R. Evid. 403. At best, Norris's testimony about the supposed agency relationship had a high probability of confusing the jury by asking it to consider as relevant the perception of a counterparty representative that was entirely wrong. At worst, Norris's testimony on an agency relationship would mislead the jury based on the government's argument that a perceived relationship of trust showed materiality. This argument itself is flawed because it equates an indisputably incorrect personal belief with an objective test of materiality. . . .

In light of the jury's verdict, therefore, we cannot "conclude with fair assurance" that Norris's testimony did not "substantially influence the jury" in convicting appellant. We conclude that the district court's error in admitting testimony on agency was not harmless and requires a vacatur.

For an epilogue to *Litvak* that is telling on the concept of fraud, see *United States v. Gramins*, 939 F.3d 429 (2d Cir. 2019). The court, in affirming the convictions of another trader working in the same distressed RMBS market, described how defense counsel contested in summations whether intent to defraud—and specifically "consciousness of wrongdoing"—had been proven, based on whether or not defendants in the case had attended a compliance session of their firm at which Litvak's indictment and prosecution were described and traders were told "you can say this in a chat, but you can't say that."

B. Accounting Fraud

A recurring form of securities fraud is known as "accounting fraud." If you agree to buy my small farm after I've given you an inventory listing six pigs and, when you take possession, it turns out there were ever only two pigs on the farm, I've committed accounting fraud. If I do the same while instead selling you investment shares in my farm, then my accounting fraud might also be securities fraud.

Take that example to modern financial markets. Investors in most things, especially publicly traded corporations, rely on disclosures about assets, liabilities, profits, and losses as a way of valuing investments and making decisions whether to buy, sell, hold, or run for the hills. Economic theory says that people who want to raise funds from investors will engage in disclosure out of self-interest in order to attract investors. But there are problems with that theory, including that voluntary disclosure would be heterogeneous, making it hard for investors to compare one business to another.

In the United States, again thanks to the New Deal securities legislation, we have mandatory uniform disclosure for public companies and many other types of entities that wish to sell securities and have them traded on secondary markets. For public companies, disclosure principally occurs through their filing of required quarterly and annual reports ("10Qs and 10Ks") with the Securities and Exchange Commission that include detailed financial statements immediately available to the world on the web.

Investors, market analysts, and others who sell services to investors, rely heavily on financial data in assessing the value of companies. Those data therefore drive stock prices and debt costs. The accounting rules (known as "GAAP," for generally accepted accounting principles) are extensive and complex. Corporate insiders, whose compensation is usually tied to stock price and other metrics of financial performance, have an informational advantage with regard to the company's data. All of these factors combine to generate a motive to commit accounting fraud: misleading investors about the strength of the company by manipulating the company's financial data and/or the application of the accounting rules, which dictate what to report and how to report it.

Given the complexity of both modern corporate finance and the accounting rules, accounting fraud can take a wide variety of forms. This section is designed to give a sense of how accounting fraud works with just a few examples—two of them (Worldcom and Enron) being probably the most famous accounting fraud prosecutions in history.

UNITED STATES v. EBBERS, 458 F.3d 110 (2d Cir. 2006)

WINTER, Circuit Judge:

Bernard J. Ebbers appeals from his conviction by a jury on nine counts of conspiracy, securities fraud, and related crimes and from the 25-year jail sentence imposed by Judge Jones.

Ebbers was the Chief Executive Officer ("CEO") of WorldCom, Inc., a publicly traded global telecommunications company. During the pertinent times—from the close of the fourth quarter of the 2000 fiscal year through the first quarter of the 2002 fiscal year—he engineered a scheme to disguise WorldCom's declining operating performance by falsifying its financial reports. Although the scheme was multi-faceted, the fraud primarily involved the treating of hundreds of millions of dollars of what had always been recorded operating costs as capital expenditures for several fiscal quarters. After a seven week trial, the jury convicted Ebbers on all counts. He was sentenced to 25 years'

imprisonment, to be followed by 3 years' supervised release.

On appeal, Ebbers principally contends that the district court erred in permitting the government to introduce testimony by immunized witnesses while denying immunity to potential defense witnesses who were rendered unavailable to Ebbers by their invocation of the privilege against self-incrimination. He also claims that the court should not have given a conscious avoidance instruction and that the government should have been required to allege and prove violations of Generally Accepted Accounting Principles ("GAAP"). Finally, he challenges his sentence as based on an inaccurate calculation of losses to investors, as significantly greater than those imposed on his co-conspirators, and as unreasonable in length. We affirm.

There is an element of tragedy here in that it was not a lack of legitimate entrepreneurial skills that caused Ebbers to resort to fraud. Before WorldCom, he was, among other things, a teacher, coach, and warehouse manager. He was a motel operator when, in 1983, he first invested in Long Distance Discount Services ("LDDS"), a small long distance company in Mississippi. When LDDS was in danger of failing in 1985, Ebbers agreed to become its CEO and led it to profitability by merging with other long distance providers. In 1989, LDDS went public by merging with Advantage Companies, another telecommunications company that was listed on NASDAQ. In 1995, LDDS changed its name to WorldCom, Inc. After WorldCom acquired MCI, Inc., in 1998, it was a global company with subsidiaries in Brazil, Mexico, and Canada. WorldCom then tried to acquire Sprint, but the Justice Department and the European Union stopped the merger on antitrust grounds. Having exhausted the market for acquisition targets in the long distance business, WorldCom began to acquire web hosting services. By 2000, WorldCom had about 90,000 employees in 65 countries, and reported revenues of $39 billion.

As part of its business, WorldCom built a global network of fiber-optic cables and telephone wires to transmit data and telephone calls. It also leased capacity on other companies' network facilities to transmit data and calls. The cost of the leasing was WorldCom's single largest expense-styled "line costs." When the "dot-com bubble" burst in early 2000, WorldCom's business slowed dramatically as some of its dot-com customers were unable to pay their bills and demand for WorldCom's internet services declined. Anticipating growth rather than declining demand, WorldCom had added 10,000 new employees, continued to invest heavily in new equipment, and had taken on long-term line leases with fixed monthly payments. By the end of the third quarter of 2000, as its revenue growth decreased and its expenses increased, the company could no longer meet investors' expectations of revenue and profit growth.

By this time, Ebbers had powerful personal as well as occupational motives to see that investors' expectations were met and that WorldCom's stock price did not fall. Although Ebbers had become very wealthy since his earlier days, his consumption and investment habits outpaced his income. Ebbers had accumulated millions of shares of WorldCom stock but had borrowed over $400 million from banks, using his stock in WorldCom as

collateral. As WorldCom's stock price began to drop in 2000, Ebbers received margin calls from the banks, requiring him either to put up more stock as collateral or to pay back a portion of the money he owed. Because he had used much of the borrowed money to buy relatively illiquid assets, such as a ranch, timber lands, and a yacht-building company, Ebbers could not use those assets to meet the margin calls. As WorldCom's stock price continued to fall, Ebbers pledged more of his WorldCom stock until every share he owned was collateral for the loans. By October 2000, Ebbers entered into a forward sale transaction, allowing Bank of America to sell some of his WorldCom stock at a future date in exchange for $70.5 million in cash to pay off his margin debts. WorldCom assumed the liability for the debts to the banks in October 2000, requiring Ebbers to make payments directly to WorldCom in the amount the company owed the banks; the debts to WorldCom and to the banks were still secured by Ebbers' WorldCom stock.

As a public company, WorldCom was required to file quarterly financial statements and annual reports with the SEC. When it became clear that the company would be unable to meet analysts' expectations in the third quarter of 2000, Ebbers and WorldCom's Chief Financial Officer ("CFO") Scott Sullivan reviewed the monthly revenue reports and discussed the company's options. Sullivan told Ebbers that WorldCom's financial performance had deteriorated and that they should issue an earnings warning to investors. Ebbers refused. Sullivan then told Ebbers that to meet expectations the company would have to make an improper adjustment to the revenue figure. Ebbers replied that "[W]e have to hit our numbers." Sullivan instructed others to increase the publicly reported revenues by adding $133 million in anticipated under-usage penalties to the revenue calculation, even though he believed that those penalties were not likely to be collected.

Soon after, Sullivan learned that line cost expenses would be almost $1 billion greater than expected. He reported that to Ebbers, who reiterated that the company had to hit its quarterly earnings estimates. Sullivan instructed Controller David Myers and his subordinates Buford Yates, Betty Vinson, and Troy Normand to reduce line cost expense accounts in the general ledger while also reducing reserves in the same amounts, which lowered the reported line costs by about $828 million. As a result, WorldCom's reported earnings were increased by the same amount.

Vinson and Normand believed the entries were wrong and considered resigning. When Sullivan told Ebbers that the accounting staff might quit, Ebbers told Sullivan that "we shouldn't be making adjustments; we've got to get the operations of this company going; we shouldn't be putting people in this position." Ebbers then spoke to Controller Myers, apologizing for the position that Myers and his staff were put in. In November 2000, WorldCom lowered its future earnings estimates and offered new guidance to analysts.

WorldCom's revenues and line costs did not improve in the fourth quarter of 2000. In January 2001, Ebbers and Sullivan agreed that WorldCom would not be able to meet even the analysts' revised expectations if it reported its actual results. Sullivan asked

Ebbers if he would again reduce the earnings estimate given to analysts, but Ebbers refused to do so. Sullivan asked Myers to alter the reported revenue and expense numbers to meet expectations. The commissions paid to airlines as part of a marketing partnership were no longer removed from the reported revenues, increasing the revenue reported by about $42 million.

WorldCom's line cost expenses were $800 million above analysts' expectations. Sullivan directed Myers to bring the reported line costs in line with expectations. Myers and his staff then reduced the income tax reserve by $407 million, and altered other accounts until they were able to reduce the reported line costs by $797 million for the fourth quarter. Monthly reports sent to Ebbers, referred to at trial as the Monthly Budget Variation Reports ("MBVRs"), detailed the company's financial results and included the reduced line costs, giving the company an apparent gross margin of 78% in September 2000 and 74% in December 2000—margins that had never been achieved by WorldCom before. The 2000 annual report and Form 10-K also contained the false information.

In early 2001, WorldCom's line costs were still hundreds of millions of dollars higher than the company had predicted, again making it impossible to meet analysts' expectations without further manipulation of the company's financial reports. The staff had been asked to find ways to reduce line costs, but the proposed cost savings were far smaller than needed to meet expectations. When the first quarter ended, reserves had been largely exhausted and could no longer be used to reduce line costs. Sullivan suggested capitalization of the line costs, that is, shifting a portion of the costs out of reported current expenses into capital expenses. Because line costs had always been treated as operating expenses, their unannounced treatment as capital expenses would disguise the decline in earnings. Myers and his staff agreed to capitalize about $771 million in line costs, although they believed it to be improper. At a dinner in Washington in March 2001, Sullivan and Ebbers discussed the line cost problem. Sullivan told Ebbers that the planned allocation of current expenses to capital expenses—in an amount over $500 million—"wasn't right." Ebbers did not deter him from the allocation.

Ebbers approved the capitalization of line costs in a later conversation with Sullivan. He told Sullivan that "[w]e have to grow our revenue and we have to cut our expenses, but we have to hit the numbers this quarter." Sullivan told Myers to change the general ledger to capitalize a portion of the line cost expenses in an amount totaling hundreds of millions of dollars. Ebbers later told Sullivan to change the format of the reports to remove the line cost figures. When Ebbers spoke to analysts and the public about WorldCom's first quarter performance in the earnings conference call, he did not mention the change in how the company was booking line costs. Instead, he said "there were no storms on the horizon," urging them to "go out and buy stock."

Capitalizing WorldCom's line cost expenses left another problem unaddressed: revenues were not growing at the 12% annual rate that Ebbers had predicted. Missing the revenue growth target was likely to lower WorldCom's stock price. Sullivan, Ebbers, and a handful of other executives created a new program called "Close the Gap" to "get [the]

operating performance . . . up to the market guidance expectations" by finding new items to include in revenue. Each month, and sometimes more often, the business operations group presented revenue data to Ebbers in detail as part of the "Close the Gap" program. Sullivan told Ebbers that there was no basis for including many of the opportunities presented in the "Close the Gap" program in reported revenues. In a voicemail to Ebbers, Sullivan described some of the items eventually included in reported revenues as "accounting fluff," "one-time stuff," and "junk." In July 2001, Ebbers sent a memorandum to Chief Operating Officer ("COO") Ron Beaumont, who was involved in the "Close the Gap" program, asking him "[w]here we stand on those one time events that had to happen in order for us to have a chance to make our numbers." Ebbers and Sullivan were aware that the company's true results fell far short of analysts' expectations, but ordered the improper revenue accounting so that those expectations would be met.

Once again, Sullivan told Ebbers that the company could reach the analysts' estimates only by capitalizing a portion of its line costs. Ebbers attended one of the line cost meetings around this time, and explained to the employees there that his "lifeblood was in the stock of the company" and that if the price fell below about $12 per share, he would be wiped out financially by margin calls. Although the line costs had improved slightly since the previous quarter, the accounting staff still had to capitalize over $610 million in line costs in order to meet earnings estimates.

In the third quarter of 2001, WorldCom's actual revenue growth rate, as reported internally to Ebbers, had fallen to about 5.5%. However, Ebbers announced that WorldCom had sustained its 12% revenue growth rate when the third quarter results were reported. The "Close the Gap" program added several new revenue items, largely one- time items not previously counted in revenue. Sullivan told Ebbers that the purpose of the adjustments to revenue was to reach the 12% growth target. WorldCom's press release announcing the quarterly results quoted Ebbers as saying the company had "delivered excellent growth this quarter." During the earnings conference call with analysts, Ebbers said "[w]e were able to achieve very solid growth." However, over $700 million in line costs had to be capitalized to create the appearance of meeting the earnings target for the quarter.

At the time, WorldCom was in merger negotiations with Verizon. Concerned that Verizon might discover the capitalization of line costs and the revenue adjustments in the course of a due diligence inquiry, Ebbers abruptly ended the merger negotiations.

At the board meeting in June 2001, board members began to ask about the "Close the Gap" program when COO Ron Beaumont presented several slides on it to them. One board member approached Sullivan privately to question the program. When Sullivan broached the subject with Ebbers, Ebbers told Beaumont and Sullivan that the next board presentation should be at a higher level and not include "Close the Gap" information. Beaumont's next board presentation, in September 2001, did not include any information about the "Close the Gap" program.

By the fourth quarter of 2001, even the "Close the Gap" program could not generate enough one-time revenue opportunities to create double-digit revenue growth. Nor could the staff find ways to adjust the line cost expenses sufficient to hit the earnings target. After Myers capitalized over $941 million in line costs, the accounting staff still had to adjust the SG&A (sales, general, and administrative) expenses in order to reach the target. On the fourth quarter earnings conference call, Ebbers assured investors that "[w]e stand by our accounting," and later said in a CNBC interview that "[w]e've been very conservative on our accounting."

WorldCom's revenue declined in the first quarter of 2002. The accounting staff added new sources of revenue to improve the results but were unable to bring the revenue up to analysts' expectations. Sullivan informed Ebbers that even with the improper revenue adjustments and the capitalization of line costs, the company would be unable to meet investors' expectations that quarter. The accounting staff capitalized about $818 million in line costs, but WorldCom still had to announce that its results had fallen below investors' expectations. . . .

"A conscious-avoidance charge is appropriate when (a) the element of knowledge is in dispute, and (b) the evidence would permit a rational juror to conclude beyond a reasonable doubt that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact." "We review a claim of error in jury instructions *de novo,* reversing only where, viewing the charge as a whole, there was a prejudicial error."

At trial, Ebbers testified as follows:

> Q: Did you ever believe that any of the statements contained in those public filings were not true?
> A: No, sir.
> Q: Did you ever believe that WorldCom had reported revenue that it was not entitled to report?
> A: No, sir.
> Q: Did you ever believe that WorldCom had an obligation to announce changes in accounting practices that it had failed to announce?
> A: No, sir.
> Q: Did you ever believe that WorldCom was putting out bad numbers in its financial statements in any way at all?
> A: No.

He also denied that he knew about discrepancies in the actual and reported line costs; that Sullivan had told him he would make a transfer of line costs to lower the reported number; that he looked at the SG & A reports he was sent; that he knew of improper entries made in the books; that he knew of the special MonRev report given to the accountants; and that he thought any of the "Close the Gap" process was illegitimate. The first prong of the test, that knowledge be disputed, is therefore easily met.

The evidence that Ebbers either actually knew or was aware of the high probability that the financial statements were false was not limited to Sullivan's testimony, as Ebbers claims. Ebbers testified that he attended some of the line cost meetings, that he read the preliminary and final MonRev reports, and that he went to "Close the Gap" meetings with Sullivan and Beaumont. He also testified to practices that would allow a jury to find that he was consciously avoiding information: using a procedure for signing documents he didn't bother to read in full, including the 10-Ks, and tossing the management budget variance report in the trash without reading it.

The district court found that Ebbers' own testimony rendered the instruction proper, because, based on that testimony, a rational juror could find he was consciously trying to avoid knowledge that the financial reports were inaccurate. We agree. . . .

Ebbers argues that the government should have been required to allege and prove violations of GAAP [Generally Accepted Accounting Principles]. . . . He claims that where a fraud charge is based on improper accounting, the impropriety must involve a violation of GAAP, because financial statements that comply with GAAP necessarily meet SEC disclosure requirements. . . .

To be sure, GAAP may have relevance in that a defendant's good faith attempt to comply with GAAP or reliance upon an accountant's advice regarding GAAP may negate the government's claim of an intent to deceive. Good faith compliance with GAAP will permit professionals who study the firm and understand GAAP to accurately assess the financial condition of the company. This can be the case even when the question of whether a particular accounting practice complies with GAAP may be subject to reasonable differences of opinion.

However, even where improper accounting is alleged, the statute requires proof only of intentionally misleading statements that are material, *i.e.*, designed to affect the price of a security. If the government proves that a defendant was responsible for financial reports that intentionally and materially misled investors, the statute is satisfied. The government is not required in addition to prevail in a battle of expert witnesses over the application of individual GAAP rules. . . .

To be sure—and to repeat—differences of opinion as to GAAP's requirements may be relevant to a defendant's intent where financial statements are prepared in a good faith attempt to comply with GAAP. The rules are no shield, however, in a case such as the present one, where the evidence showed that accounting methods known to be misleading—although perhaps at times fortuitously in compliance with particular GAAP rules—were used for the express purpose of intentionally misstating WorldCom's financial condition and artificially inflating its stock price.

With regard to his sentence . . . , [a]t oral argument, the overall reasonableness of the sentence was raised by the court. Twenty-five years is a long sentence for a white collar crime, longer than the sentences routinely imposed by many states for violent crimes, including murder, or other serious crimes such as serial child molestation. However,

Congress has directed that the Guidelines be a key component of sentence determination. Under the Guidelines, it may well be that all but the most trivial frauds in publicly traded companies may trigger sentences amounting to life imprisonment—Ebbers' 25-year sentence is actually below the Guidelines level. Even the threat of indictment on wafer-thin evidence of fraud may therefore compel a plea. . . . However, the Guidelines reflect Congress' judgment as to the appropriate national policy for such crimes. . . . Moreover, the securities fraud here was not puffery or cheerleading or even a misguided effort to protect the company, its employees, and its shareholders from the capital-impairing effects of what was believed to be a temporary downturn in business. The methods used were specifically intended to create a false picture of profitability even for professional analysts that, in Ebbers' case, was motivated by his personal financial circumstances. . . .

Problem 3-1

After *Ebbers*, the Supreme Court had the following to say about conscious avoidance doctrine, which happens to have arisen in the context of a civil patent case that came before the Court:

"The doctrine of willful blindness is well established in criminal law. Many criminal statutes require proof that a defendant acted knowingly or willfully, and courts applying the doctrine of willful blindness hold that defendants cannot escape the reach of these statutes by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances. The traditional rationale for this doctrine is that defendants who behave in this manner are just as culpable as those who have actual knowledge. Edwards, The Criminal Degrees of Knowledge, 17 Mod. L. Rev. 294, 302 (1954) (hereinafter Edwards) (observing on the basis of English authorities that "up to the present day, no real doubt has been cast on the proposition that [willful blindness] is as culpable as actual knowledge"). It is also said that persons who know enough to blind themselves to direct proof of critical facts in effect have actual knowledge of those facts. . . .

While the Courts of Appeals articulate the doctrine of willful blindness in slightly different ways, all appear to agree on two basic requirements: (1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact. We think these requirements give willful blindness an appropriately limited scope that surpasses recklessness and negligence. Under this formulation, a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts. *See* G. Williams, Criminal Law §57, p. 159 (2d ed. 1961) ("A court can properly find wilful blindness only where it can almost be said that the defendant actually knew"). By contrast, a reckless defendant is one who merely knows of a substantial and unjustified risk of such wrongdoing, *see* ALI, Model Penal Code §2.02(2)I (1985), and a negligent defendant is one who should have known of a similar risk but, in fact, did not, see §2.02(2)(d)."

Global-Tech Appliances, Inc. v. SEB S.A., 563 U.S. 754 (2011).

(a) In light of this statement of the doctrine, was *Ebbers* a proper case for an instruction on willful blindness?

(b) Is the following fact pattern a proper case for a willful blindness instruction: Ebbers received the accounting reports from Sullivan, but chose not to read them because he was too busy "growing the company" and preferred to leave financial reporting to his staff.

Continuing with accounting fraud, the next case is one in which such a prosecution failed. Was the problem in this case the legal theory, the evidence, or both?

UNITED STATES v. GOYAL, 629 F.3d 912 (9th Cir. 2010)

CLIFTON, Circuit Judge:

Prabhat Goyal, former chief financial officer of Network Associates, Inc. ("NAI"), appeals from his convictions on fifteen counts of securities fraud and making materially false statements to auditors. The government alleged that NAI, under Goyal's supervision, violated generally accepted accounting principles ("GAAP") by recognizing revenue from certain software sales earlier than it should have. Goyal was indicted for concealing the allegedly improper accounting from NAI's outside auditors and for filing reports with the Securities and Exchange Commission that, because of NAI's accounting, allegedly misstated revenue in certain reporting periods between 1998 and 2000. Goyal argues that no jury could have found him guilty beyond a reasonable doubt, as the jury below did, based on the evidence the prosecution presented at trial. We agree, and we reverse his convictions on all counts.

From approximately 1997 to 2001, Goyal was chief financial officer of NAI. NAI, formerly known as McAfee, was and remains a major vendor of antivirus and network security software.

Before 1998, NAI used a "direct sales" business model, meaning that it primarily sold its software directly to end users. In 1998, the company added a "distribution channel" model, selling products through distribution companies. These distributors in turn sold NAI's software to retail stores that resold the software to end users.

The prosecution's case against Goyal challenged the accounting method that NAI used, under Goyal's supervision as CFO, to recognize revenue from sales to its largest domestic distributor, Ingram Micro. In particular, the government took issue with the accounting method NAI used to recognize large sales that it made to Ingram at the end of financial quarters between 1998 and 2000. Following a practice common in the software industry, which the government did not contend was illegal, NAI negotiated significant quarter-end deals with Ingram, called "buy-in" transactions, to help meet its quarterly revenue projections. To close these sales, NAI granted Ingram substantial discounts, rebates, and other favorable sales terms. One enticement that NAI offered Ingram in the last two quarters of 1998 and the first quarter of 1999, was a guarantee that its wholly owned subsidiary, NetTools, would repurchase unsold product from Ingram in specified amounts. NetTools would then sell the repurchased product to customers.

The government did not contend that any of the sales concessions that NAI gave Ingram in the buy-in deals were improper or that NAI claimed revenue that it never earned. Rather, the government objected to the timing of NAI's recognition of revenue from these deals. The government maintained that NAI violated GAAP by using "sell-in" accounting to recognize revenue from these deals earlier than it should have and thereby overstated its revenue. Under sell-in accounting, a manufacturer like NAI recognizes revenue when it ships products to its distributors (i.e., "sells in" to the distribution

channel). The manufacturer must estimate the amount of future rebates, discounts or returns and then reduce its stated revenue by this amount.

By contrast, a company using "sell-through" accounting recognizes revenue when its distributors sell the product to a reseller (i.e., "sells through" the distribution channel). Sell-through accounting recognizes revenue later than sell-in accounting does and nets out rebates, discounts, and returns. Thus the manufacturer does not need to estimate their effect on its revenue.

The jury convicted Goyal of one count of securities fraud and seven counts of making false filings with the SEC (collectively, "the securities counts"), and seven counts of making materially false statements to NAI's auditors at PricewaterhouseCoopers ("PwC") (the "lying-to-auditors counts"). . . .

All of the securities counts—one count of securities fraud and seven counts of making false filings with the SEC—required the government to prove that NAI materially misstated the revenue it earned in certain quarters and years through its choice of accounting method. NAI's reports of allegedly inflated revenue furnished the "untrue statement of material fact" required for each of the false filing counts, as well as the "misleading statement or omission of a material fact made with scienter" needed to sustain a fraud conviction under the general antifraud provision of § 10(b) of the Securities Exchange Act of 1934.

The government's contention that NAI materially overstated its revenue necessarily entailed two claims: (1) that NAI recognized revenue at a different time than it should have; and (2) that NAI's accounting produced artificially higher revenue figures in certain periods that "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Basic Inc. v. Levinson,* 485 U.S. 224, 231–32, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988). The government relied on GAAP to make its case, on the first point, that sell-through accounting was required in instances where NAI used the sell-in method. But we need not decide whether NAI actually violated GAAP, because the government clearly failed to carry its burden on the second point, materiality. The prosecution offered no evidence adequate to prove that any GAAP violations materially affected the revenue that NAI reported.

The government relied at trial on the parties' stipulations that applying sell-through accounting to NAI's entire business would have resulted in "a revenue figure that is materially less than the reported figure" for the periods charged in the false filing counts.

These stipulations are fatally overbroad, however, because the government did not contend that GAAP required NAI to use sell-through accounting for all sales. The government only offered evidence that sell-through accounting was required for the Ingram buy-in transactions, and the stipulations did not provide that applying sell-through accounting to those transactions alone would have made a material difference in any given period. Without evidence of how much less revenue NAI would have

recognized on the Ingram deals if it had used sell-through accounting, the jury had no basis to conclude that the misstatement of reported revenue resulting from the Ingram transactions was material. Even presuming, as we must, that the jury drew all reasonable inferences in the prosecution's favor, there was no way it could have properly inferred materiality from the evidence it had before it.

Confronted with this problem, the government argued after the verdict that the jury could have inferred materiality from the mere fact that the buy-in deals with Ingram were substantial. The dollar amounts in the purchase orders for these transactions, according to the government's calculations, "represented approximately 24% of the total revenue for NAI during 1998, 1999, and 2000" and "between approximately 7% to 40% of NAI's total revenue" on a quarterly basis.

But this argument failed to bridge the materiality gap because Goyal's jury had to make the materiality findings that his convictions required, and it never saw these figures. *See United States v. Rigas,* 490 F.3d 208, 231 n.29 (2d Cir. 2007) (declining, in a sufficiency-of-the-evidence challenge, to "consider in the first instance arguments regarding materiality that were not presented to the jury").

The jury could not have inferred materiality from this evidence even if it had seen it, because it was not the absolute magnitude of the buy-in deals that mattered. The jury needed to assess whether NAI's use of sell-in accounting for the Ingram transactions materially increased NAI's overall revenue when compared to using sell- through accounting. But the jury had no evidentiary basis for making the required comparisons. There was simply no evidence that the effect of using sell-in rather than sell-through accounting for the Ingram transactions was so substantial that it made a material difference. By the government's own calculations, non-Ingram sales always accounted for most of NAI's revenue. It would have been "mere speculation, rather than reasonable inference" for the jury to conclude that applying sell-through accounting to the revenue from the Ingram sales by themselves would have made a material difference in the company's total revenue figures. Because Goyal's jury had no competent evidence of materiality before it, it could not have properly convicted him on any of the securities counts. . . .

Even viewing the evidence in the light most favorable to the prosecution, no reasonable juror could have found Goyal guilty beyond a reasonable doubt of any of the charges against him. . . .

Chief Judge KOZINSKI, concurring:

This case has consumed an inordinate amount of taxpayer resources, and has no doubt devastated the defendant's personal and professional life. The defendant's former employer also paid a price, footing a multimillion dollar bill for the defense. And, in the end, the government couldn't prove that the defendant engaged in *any* criminal conduct. This is just one of a string of recent cases in which courts have found that federal prosecutors overreached by trying to stretch criminal law beyond its proper bounds. *See*

Arthur Andersen LLP v. United States, 544 U.S. 696, 705–08, 125 S. Ct. 2129, 161 L. Ed. 2d 1008 (2005); *United States v. Reyes*, 577 F.3d 1069, 1078 (9th Cir. 2009); *United States v. Brown*, 459 F.3d 509, 523–25 (5th Cir. 2006); *cf. United States v. Moore*, 612 F.3d 698, 703 (D.C. Cir. 2010) (Kavanaugh, J., concurring) (breadth of 18 U.S.C. § 1001 creates risk of prosecutorial abuse).

This is not the way criminal law is supposed to work. Civil law often covers conduct that falls in a gray area of arguable legality. But criminal law should clearly separate conduct that is criminal from conduct that is legal. This is not only because of the dire consequences of a conviction—including disenfranchisement, incarceration and even deportation—but also because criminal law represents the community's sense of the type of behavior that merits the moral condemnation of society. *See United States v. Bass*, 404 U.S. 336, 348, 92 S. Ct. 515, 30 L. Ed. 2d 488 (1971) ("[C]riminal punishment usually represents the moral condemnation of the community . . . ."); *see also Wade v. United States*, 426 F.2d 64, 69 (9th Cir. 1970) ("[T]he declaration that a person is criminally responsible for his actions is a moral judgment of the community. "). When prosecutors have to stretch the law or the evidence to secure a conviction, as they did here, it can hardly be said that such moral judgment is warranted.

Mr. Goyal had the benefit of exceptionally fine advocacy on appeal, so he is spared the punishment for a crime he didn't commit. But not everyone is so lucky. The government shouldn't have brought charges unless it had clear evidence of wrongdoing, and the trial judge should have dismissed the case when the prosecution rested and it was clear the evidence could not support a conviction. Although we now vindicate Mr. Goyal, much damage has been done. One can only hope that he and his family will recover from the ordeal. And, perhaps, that the government will be more cautious in the future.

The following excerpts from one of the Fifth Circuit's decisions in the Enron prosecutions give a fuller explanation of the nature of the Enron accounting fraud than the Supreme Court's decision dealing with the honest services fraud issue that we read in the last chapter.[2] Enron was really a conglomerate of different companies in the energy and related sectors, and much of the fraud had to do with how the company used financial engineering to move profits and losses across its major lines of business, and conceal losses in some of its newer businesses.

Recall that after former CEO Jeffrey Skilling won on the honest services fraud issue in the Supreme Court, he nonetheless lost on remand because the Fifth Circuit concluded that the evidence amply supported the charges of securities fraud also lodged against Skilling, which of course carried no requirement of proving a bribe or kickback, or other

[2] Disclosure: from January 2002 to April 2004, the author was a prosecutor with the DOJ's Enron Task Force and participated in several aspects of that large and lengthy legal affair, including the investigation and prosecution of the Arthur Andersen accounting firm for obstruction of justice (covered in Chapter 8) and the investigation and indictment of the case against Skilling.

elements of honest services mail or wire fraud.

UNITED STATES v. SKILLING, 554 F.3d 529 (5th Cir. 2009)

PRADO, Circuit Judge:

A jury convicted former Enron Corporation CEO Jeffrey K. Skilling ("Skilling") for conspiracy, securities fraud, making false representations to auditors, and insider trading. Skilling's rise at Enron began when he founded Enron's Wholesale business in 1990. In 1997, he became Enron's President and Chief Operating Officer and joined the Board of Directors. In February 2001, he became Enron's CEO, and on August 14, 2001, Skilling resigned from Enron.

About four months after Skilling's departure, Enron crashed into sudden bankruptcy. An initial investigation uncovered an elaborate conspiracy to deceive investors about the state of Enron's fiscal health. That conspiracy allegedly included overstating the company's financial situation for more than two years in an attempt to ensure that Enron's short-run stock price remained artificially high. With Congress looking on, the President appointed a team of investigators, the Enron Task Force. The investigation led to criminal charges against Skilling and many others.

According to the government, the conspiracy, led by Skilling and Ken Lay ("Lay"), Enron's CEO until Skilling took over (and again after his abrupt exit), worked to manipulate Enron's earnings to satisfy Wall Street's expectations. Other top Enron officials were key players in the unlawful scheme, including Richard Causey ("Causey"), the Chief Accounting Officer ("CAO"); Andrew Fastow ("Fastow"), the Chief Financial Officer ("CFO"); and Ben Glisan ("Glisan"), the Treasurer.

Several of Skilling's convictions stem from allegations of conspiracy and securities fraud. The government presented evidence that Skilling engaged in fraud in several of Enron's business endeavors. As an international, multi-billion dollar enterprise, Enron had elaborate financial dealings. At the time of its bankruptcy, the company was comprised of four major businesses: Wholesale, which bought and sold energy; Transportation and Distribution, which owned energy networks; Retail, or Enron Energy Services ("EES"), which sold energy to end-users; and Broadband, or Enron Broadband Services ("EBS"), which bought and sold bandwidth capacity. The government alleged that Skilling took specific fraudulent actions with respect to Wholesale, EES, and EBS.

Wholesale, the most profitable division, accounted for nearly 90% of Enron's revenue. The government presented evidence to show that the conspirators lied about the nature of Wholesale, calling it a "logistics company," even though it was a much more economically volatile "trading company." Construing Wholesale as a "logistics company" had important ramifications for how investors valued the division. In fact, Skilling reportedly told Ken Rice ("Rice"), EBS's CEO, that if investors perceived Enron as a trading company, its stock would "get whacked." The alleged artifice also included masking the losses of Enron's other struggling subdivisions by shifting the

losses to Wholesale. That made the struggling divisions appear financially sound and thus encouraged additional investment.

EES was a retail undertaking that Enron created to sell natural gas to customers in deregulated markets. Although Enron had high expectations for EES's profitability after its initial start-up period, EES did not meet these expectations. As of the fall of 2000, various utilities in California owed Enron substantial fees, which Enron had already booked as profits under its "mark-to-market accounting." The utilities, however, were suffering heavy financial losses and stopped paying these fees. Under general accounting rules, Enron should have recorded a loss of hundreds of millions of dollars based on the failure of the utilities to pay the fees, but Skilling and his co-conspirators tried to hide the harm by transferring the losses to Wholesale so that EES would continue to show promise, at least on paper.

The government claims that Skilling hid EES's other problems as well. For example, in early 2001, EES employees allegedly realized that Enron was not properly valuing EES's contracts and that, again because of Enron's use of mark-to-market accounting, Enron would need to record a loss of many millions of dollars. Skilling allegedly told David Delainey, who was in charge of EES, to "bleed the contract issues over time" instead of recognizing the loss all at once.

Skilling again concealed EES's losses within Wholesale in late March 2001, after the California Public Utilities Commission decided to add a surcharge to electricity. Enron lost hundreds of millions of dollars as a result of this surcharge because, under its contracts, it could not pass the extra fees on to its customers. After Skilling was consulted and signed off, Enron shifted the EES losses to Wholesale by transferring EES's risk-management books to Wholesale. Business at EES did not improve, and by August 2001, when Skilling left Enron, EES had lost over $700 million in that year alone. Enron failed to account for these losses properly, making EES appear to be in better financial shape than it really was.

EBS was Enron's attempt to enter the telecommunications industry. Enron invested more than $1 billion in EBS, but lost money every quarter as EBS struggled to meet earnings targets. The government claims that in 2000, EBS managed to reach its earnings targets, but only by means of transactions afield from its core business (such as selling and monetizing corporate assets). Skilling allegedly hid from investors EBS's failure to meet earnings targets through core business activities.

The government claims that Skilling knew EBS was struggling, at least based on its record of performance, but that he wanted to announce to the investing public that EBS was doing well and would do even better in 2001. Although EBS's executives said it was impossible, Skilling set EBS's earnings targets for 2001 to be a loss of only $65 million. EBS's personnel initially thought a loss estimate of nearly $500 million was more realistic, and, even with the best circumstances, they projected losses of at least $110 million. Rice, EBS's CEO, warned Skilling that the earnings targets for EBS were wrong, but Skilling apparently would not change them. Skilling told Rice that certain

international assets were not producing sufficiently and that "we really need to hang in there for a year or two until EES and EBS could pick up the slack," because Enron "didn't need any more bad news."

In 2001, EBS was projected to lose $35 million in the first quarter, but Rice quickly realized that losses would actually be around $150 million. Skilling allegedly found out but would not budge on earnings targets, instead authorizing EBS to fire employees and engage in more non-core business to boost revenues. It worked for the first quarter, although Rice likened the monetizations to "one more hit of crack cocaine on these earnings." EBS faired a little better in the second quarter of 2001, reporting losses of approximately $100 million. Given that EBS continued to lose money, however, Enron decided to merge EBS [with] Wholesale. Ultimately, Enron lost the entire $1 billion that it initially invested in EBS.

Many of the allegations of fraud also stem from Skilling's representations to investors about the financial standing of Wholesale, EES, and EBS. Skilling, as a high ranking corporate officer, held conference calls with investors to update them on the company's progress. The government claims that Skilling misled investors during these calls. For example, on January 22, 2001, Enron released its earnings report for the previous quarter, and Skilling told investors that "the situation in California [regarding the utilities] had little impact on fourth quarter results. Let me repeat that. For Enron, the situation in California had little impact on fourth quarter results." Skilling also stated that "nothing can happen in California that would jeopardize" earnings targets.

However, when he made these statements, Skilling allegedly knew that the California utilities likely could not pay the fees that Enron was expecting and that Enron might have to write off a loss of hundreds of millions of dollars. He also listened silently as Mark Koenig ("Koenig"), Enron's Director of Investor Relations, assured investors that non-core business revenues were a "fairly small" amount of EBS's earnings, which the government alleges was not actually the case.

Three days later, Skilling spoke at Enron's annual analysts conference, claiming that EES and EBS, like Enron's other major businesses, had "sustainable high earnings power." Skilling argues that this statement was merely harmless puffery. At the conference, he also reasserted that Wholesale was "not a trading business. We are a logistics company."

On March 23, 2001, Enron held a special conference call with analysts. Enron's stock price had been declining, and investors began surmising that EBS was having financial difficulties. Skilling comforted investors, saying that EBS was "having a great quarter" and that Enron was "highly confident" that EES would meet its earning target. According to the government, however, Skilling knew both divisions were in extreme financial turmoil.

On April 17, 2001, Skilling hosted another conference call in which he explained the transfer of EES's risk-management books to Wholesale by saying that there was "such

capacity in our wholesale business that we just weren't taking advantage of that in managing our portfolio at the retail side. And this retail portfolio has gotten so big so fast that we needed to get the best—the best hands working on risk management there." In fact, the government claims that Skilling used the transfer to hide losses. Skilling also said that the "first quarter results were great" at EES, even though they were down substantially, and he again praised EBS, explaining that there was a "very strong development of the marketplace in the commoditization of bandwidth" and "we're feeling very good about the development of this business." Skilling was silent again while Rice and Koenig understated EBS's non-core revenues.

On July 17, 2001, Skilling told investors that EES "had an outstanding second quarter" and was "firmly on track to achieve" its earnings targets. That quarter alone, EES lost hundreds of millions of dollars. Skilling reiterated that the EES reorganization was based on a concern for management efficiency, while the government contends that the only purpose of the EES reorganization was to hide EES's losses.

Skilling also allegedly committed fraud when he manipulated Enron's reserves to hit specific earnings targets in the fourth quarter of 1999, the second quarter of 2000, and the fourth quarter of 2000. Stock analysts made various projections regarding the earnings that Enron would announce each quarter, and the average of these estimates was known as the "consensus estimate." The government claims that Skilling was particularly committed to hitting or beating the consensus estimate. In January 2000, the consensus estimate for the fourth quarter of 1999 was earnings of 30¢ per share, which Enron could meet based on its earnings for that quarter. The day before the company was to announce its earnings, however, Koenig brought Skilling unwelcome news: the consensus estimate had jumped a penny per share. Skilling purportedly decided to announce earnings high enough to reach the estimate, even though the increase was not merited by any change in Enron's underlying financial portrait.

Skilling allegedly took a similar unwarranted action at the end of the second quarter of 2000.

At that time, the consensus estimate was 32¢ per share. A draft earnings report showed that Enron was going to announce earnings that met the estimate. Skilling, however, wanted to beat the consensus estimate by reporting 34¢ per share. To do that, he allegedly told Wholesale to increase its earnings by $7 million, and then by an additional $7 million. Wholesale acquiesced both times, reopening its books and adding $14 million from a reserve account that it had set aside to cover potential liabilities. The government claims that Enron did not have a business reason for using its reserves to increase Wholesale's earnings, instead doing so solely to exceed analysts' expectations.

The government contends that Skilling improperly used the reserve accounts again later that year. Wholesale's business was very profitable during the second half of 2000, and by late December it had placed over $850 million in reserves. The decision to put that money away was not based on feared future liabilities; instead, Wholesale set that money aside specifically to use in the event of an unfavorable consensus estimate. At the end of

the fourth quarter, Skilling ordered that Enron recall some of that money to guarantee that Enron could announce a specific level of earnings.

Another avenue of Skilling's alleged fraud came from his use of pseudo third-party entity LJM (and later LJM2) to improperly hedge its investments, doing so through four "secret" oral side deals. Fastow, Enron's CFO, proposed to Skilling and Causey that they create an entity to help Enron more easily meet market expectations. The impetus for creating LJM was the $200 million that Enron had received from an investment in a company called Rhythms Net. Enron wanted to book that money, but it was possible that the value of the investment would drop, meaning that the asset's expected value would have to be reduced. By transferring the asset to a pseudo third-party, however, Enron could hedge its investment without needing to pay market rates for this hedging service. The government claims that LJM became that pseudo third-party. Enron contributed $234 million of its own shares in seed money to form LJM. Fastow, who was LJM's general partner, contributed $1 million, and outside investors contributed $15 million.

Enron encountered a potential problem, however, with using LJM to hedge its investments.

Fastow faced a conflict of interest, because he was both Enron's CFO and LJM's general partner. Before Enron could sign a deal with LJM, Enron's code of conduct required the Office of the Chairman, which consisted of Skilling and Lay, to waive the conflict rules, and Enron would have to disclose this waiver in its Securities and Exchange Commission ("SEC") filings. The Office of the Chairman granted the waiver, but allegedly not without first creating controversy within Enron's senior leadership.

After forming LJM to hedge the Rhythms Net investment, Enron's first deal with LJM involved an interest in a Brazilian power plant, known as Cuiaba, that Enron sold to LJM in 1999. Enron was concerned that its South American unit would not meet its earnings targets, so it decided to sell its interest in Cuiaba to obtain additional revenue. Initially, Enron tried to find a third party to buy the interest in Cuiaba, but was unsuccessful. Skilling, the government claims, then called Fastow and tried to sell Enron's interest in Cuiaba to LJM. Fastow at first was not interested; not only was the asset a bad investment, there was no time for due diligence. Skilling allegedly replied, "Don't worry. I'll make sure that you're all right on the project. You won't lose any money." That oral understanding did not appear in the deal write-up, and the accountants treated it as a real sale, even though, based on the alleged oral understanding between Skilling and Fastow, it was not a legitimate sale.

Enron eventually bought back the Cuiaba interest, paying full value (notwithstanding depreciation) plus 13%. Allegedly to camouflage the deal by avoiding round numbers, LJM received an extra $42,000 above the 13%. To allay further scrutiny, before Enron bought back the interest, Fastow apparently "sold" his interest in LJM to Michael Kopper ("Kopper"), a former Enron executive. That way, Enron did not need to describe the Cuiaba buyback as a transaction with a related party. For this to work, however, Skilling needed to honor his secret oral promise to Fastow that LJM would not lose money on

the deal, despite Kopper becoming LJM's chief; the government claims that Skilling orally confirmed that he would do so.

The second allegedly fraudulent secret side deal between Enron and LJM involved the sale of Nigerian barges. The government claims that in the waning days of 1999, LJM warehoused assets for Enron, allowing Enron to claim earnings during 1999 while it arranged for permanent buyers after the end of the year. With respect to the Nigerian barges deal, in late 1999, Enron sought to sell its interest in a group of barges anchored off the coast of Nigeria to meet an earnings target at the end of the quarter. Most investors were nervous about putting money into Nigeria, so Enron could not find a buyer.

Skilling allegedly called Fastow into his office and asked for LJM to buy the barges, again saying he would "make sure" that LJM would not lose money. Fastow initially was reluctant, because he was trying to raise money for LJM and did not want to scare off investors. However, he told Skilling that LJM would purchase the Nigerian barges if Enron could not find another investor within six months.

Fastow, on behalf of Enron, then arranged for Merrill Lynch to buy the Nigerian barges from Enron. Although Merrill Lynch did not really want to purchase the barges, Fastow purportedly made an oral "guarantee"—although he likely did not use that word—that Merrill Lynch would have to hold the barges for only six months in return for a risk-free profit. Because Merrill Lynch's investment was not at risk, the government alleges that Enron improperly treated the transaction as a sale and should not have recorded any earnings from the deal. At the end of the six months, Enron still could not find another buyer, so LJM purchased the interest from Merrill Lynch, apparently without even negotiating over price. Causey allegedly assured LJM that it would earn a guaranteed return on the deal, meaning that there was no transfer of risk to LJM. In sum, the government asserts that the sale of the Nigerian barges was not a true sale and that Enron improperly recognized earnings from the deal.

The third secret oral side deal involved the "Raptors," which were special purpose entities ("SPE") that would hedge assets for Enron, meaning that if the assets decreased in value, a Raptor would cover the difference—at least on paper. The government asserts that for Enron to validly hedge an asset, a third party must own at least three percent of the SPE's equity, and that equity must be at risk. The government alleges that LJM acted as that "third party" even though it was not really a separate entity, agreeing to provide the equity that would beat risk.

The government contends that to fund the Raptors, LJM contributed $30 million and Enron spent $400 million of its own stock. Apparently, Fastow was at first against mixing LJM with the Raptors, but the government argues that Skilling convinced him through a "secret" side deal, whereby after funding the Raptors, LJM would recoup its $30 million and would receive an additional $11 million. To do this, Enron agreed to pay $41 million to the Raptors to purchase a "put" on the stock Enron had contributed to the Raptors. The Raptors then transferred that $41 million to LJM. In return, the Raptors had to pay Enron if the price of the stock Enron used to capitalize the Raptors

fell below a certain level. LJM thus had nothing at risk; if the hedged assets dropped in value, the hedging Raptor, not LJM, was liable for the loss, and LJM recouped the capital it initially invested in the Raptors, along with an additional $11 million.

To make this transaction work, however, Enron's accountants had to sign off. Arthur Andersen, Enron's external auditor, approved the $41 million payment to LJM once it was described as a return "on" capital to LJM and not a return "of" capital. The auditors allegedly were not told that LJM and Enron did not haggle over the value of the hedged assets or that LJM was not actually a true third party. The government terms this entire deal—both Enron's "put" and LJM's return promise to allow Enron to hedge an asset at any value—the "quid pro quo."

The Raptors were also involved in other transactions. For example, in 2000, Enron hedged EBS's investment in Avici, an internet company, into one of the Raptors. That asset, at its highest value, was worth around $160 million, but the value was decreasing. Enron allegedly hedged the Avici interest with a Raptor at its highest value. The asset plummeted in value over the next few months, but because of the allegedly fraudulent hedge, Enron did not record the loss. Under the government's theory, Skilling knew all about the deceit and even told Fastow to "[k]eep it up." The alleged fraud continued throughout 2000. In fact, by the end of 2000, another one of the Raptors lost more than $100 million because of similar hedging. In total, Enron's use of the Raptors allegedly kept nearly $500 million in losses off of Enron's books in 2000. . . .

When Skilling resigned from Enron in August 2001, Enron's internal financial numbers were ghastly. On September 6, 2001, Skilling allegedly called his broker and tried to sell 200,000 shares of Enron stock. The sale did not go through, however, because the SEC still listed Skilling as an Enron "affiliate." This designation meant that the broker had to disclose the sale to the SEC and the public, which Skilling wished to avoid. Skilling allegedly told his broker to wait to complete the transaction until he obtained a letter from Enron saying that he was no longer a part of Enron's management.

Skilling sent that letter to his broker on September 10. Because of the terrorist attacks of September 11, Skilling was unable to sell his shares until September 17, the first day the markets reopened. He allegedly called his broker on that day, reiterated his order to sell, and told him he did not want the people at Enron to know about it. When Skilling testified before the SEC in December 2001, he stated that he sold the shares because he became "scared" after the September 11 attack and that "[t]here was no other reason other than September 11th that I sold the stock." The government contends that Skilling's testimony was a lie and that the sale amounted to insider trading. . . .

Skilling . . . asserts that the district court erred in failing to provide the jury with adequate guidance on the legal meaning of "materiality" with regard to the charges against him. . . . Skilling first challenges the district court's materiality instruction on the ground that the court should have specifically instructed the jury on puffery. He sought to have the court tell the jury that even if a statement is false or misleading, it is mere "puffery" and therefore immaterial if it is "so lacking in specificity, or so clearly constituting the

opinions of the speaker, that no reasonable investor could find the statement important to the total mix of information he or she would consider when making an investment decision." Such statements, he notes, include "generalized, positive statements about [a] company's competitive strengths . . . and future prospects."

Although Skilling is correct that "an expression of opinion not made as a representation of fact," can constitute puffery, not all such statements of opinion are properly classified as puffery. Similarly, although Skilling correctly points out that "generalized, positive statements about [a] company's competitive strengths . . . and future prospects" can in some cases constitute immaterial puffery, such statements of opinion by corporate insiders are not *per se* immaterial. In *Virginia Bankshares, Inc. v. Sandberg,* 501 U.S. 1083, 1090, 1098, 111 S. Ct. 2749, 115 L. Ed. 2d 929 (1991), the Supreme Court considered statements that a merger proposal would give shareholders "a high value for their shares," and held that such statements could be deemed material. The Court explained,

> [i]t is no answer to argue, as petitioners do, that the quoted statement on which liability was predicated did not express a reason in dollars and cents, but focused instead on the "indefinite and unverifiable" term, "high" value, much like the similar claim that the merger's terms were "fair" to shareholders. The objection ignores the fact that such conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading. Provable facts either furnish good reasons to make a conclusory commercial judgment, or they count against it, and expressions of such judgments can be uttered with knowledge of truth or falsity just like more definite statements, and defended or attacked through the orthodox evidentiary process that either substantiates their underlying justifications or tends to disprove their existence In this case, whether $42 was "high," and the proposal "fair" to the minority shareholders, depended on whether provable facts about the Bank's assets, and about actual and potential levels of operation, substantiated a value that was above, below, or more or less at the $42 figure, when assessed in accordance with recognized methods of valuation.

Id. at 1093–94, 111 S. Ct. 2749 (footnote omitted). *Virginia Bankshares* thus instructs that conclusory statements of reasons, belief, or opinion—e.g., "high value" and "fair"—may be so contrary to the verifiable historical facts that they falsely "misstate the speaker's [true] reasons" and "mislead about the stated subject matter." Indeed, the Supreme Court expressly explained that "there is no room to deny that a statement of belief by corporate directors about a recommended course of action, or an explanation of their reasons for recommending it," can be material.

Skilling's statements about the financial health of Enron were similar to those deemed

potentially material in *Virginia Bankshares.* For example, at the 2001 analyst conference (count 23), Skilling claimed that all of Enron's businesses, including EES and EBS, were "uniquely strong franchises with sustainable high earnings power." He also characterized Wholesale as a "stable, high-growth business" and "not a trading business." Similarly, on the March 23, 2001 analyst call (count 24), he claimed EBS was having "a great quarter on the intermediation side of the bandwidth business." Summarizing EBS, he said that there was "essentially strong growth on the intermediation side, strong growth on the content services side, in terms of people, budgets, the whole thing."

The jury was entitled to find those and similar statements material. The government presented evidence of contrary, verifiable historical facts regarding the actual condition of EES, EBS, and Wholesale at the time Skilling made these statements: EES was facing a potentially enormous loss; EBS had an unsupportable cost structure, was losing money, was reducing the number of its employees, and had few customers or profitable deals; and Wholesale was number of its employees, and had few customers or profitable deals; and Wholesale was heavily dependent on unstable, speculative trading.

Moreover, in addressing the question of "whether statements of reasons, opinions, or beliefs are statements 'with respect to . . . fact[s]' so as to fall within the strictures of [the securities laws]," the Supreme Court has concluded that such statements by directors "are factual in two senses: [(1)] as statements that the directors do act for the reasons given or hold the belief stated and [(2)] as statements about the subject matter of the reason or belief expressed," These statements thus cannot, as a matter of law, be deemed immaterial puffery, and the district court was correct to leave the determination of their materiality to the jury. . . .

Problem 3-2

(a) From the *Ebbers*, *Goyal*, and *Skilling* cases, list methods one learns from these three examples by which corporate managers might manipulate the reported financial results of a public company. As to each method, which aspect(s) of financial performance is (are) being manipulated: the value of the company's assets, the extent of its liabilities (including debt), the amount of its income, or the amount of its expenses?

(b) Why did Ebbers get 25 years whereas Goyal received a virtual judicial apology? Why do some types of white collar criminal defendants seem more worthy of punishment than others?

(c) Is stock option compensation a good idea?

Problem 3-3

Now we are ready to analyze some complex fraud cases on our own, without the help of judicial opinions. The following is a criminal complaint filed on August 9, 2013 against a former employee of JP Morgan Chase & Co. in the so-called "London Whale" matter. After the prosecution began, the employee moved to Spain, where he successfully defeated extradition to the United States. (In addition, while the case dragged on for several years, the government's main witness decided to recant his testimony and write a book claiming he did nothing wrong.)

Had the defendant here been extradited, would the government have been likely to obtain a conviction? At what point did the defendant's actions arguably become an accounting fraud? Could the government have brought charges against any higher-level employees of JP Morgan in the same matter? What possible defense arguments might have been raised at trial?

COMPLAINT, UNITED STATES V. JAVIER-MARTIN ARTAJO NO. 13 MAG 1975 (S.D.N.Y. AUG. 9, 2013)

COUNT ONE

(Conspiracy to Falsify Books and Records, to Commit Wire Fraud and to Falsify SEC Filings)

1. From at least in or about March 2012, through and including in or about May 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, together with others known and unknown, willfully and knowingly, did combine, conspire, confederate, and agree together and with each other to commit offenses against the United States, to wit, (a) falsification of books and records, in violation of Sections 78m(b)(2)(A) , 78m(b)(5) and 78ff of Title 15, United States Code, and Title 17, Code of Federal Regulations, Section 240.13b2-1; (b) wire fraud, in violation of Title 18, United States Code, Section 1343; and (c) falsification of filings with the Securities and Exchange Commission ("SEC"), in violation of Title 15, United States Code, Sections 78m(a) and 78ff, and Title 17, Code of Federal Regulations, Sections 240.13a-l l and 240.13a-13.

Objects of the Conspiracy

False Books and Records

2. It was a part and an object of the conspiracy that JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, would and did, directly and indirectly, falsify and cause to be falsified books, records, and accounts of JP Morgan Chase & Company ("JPM") subject to Section 13(b)(2) of the Exchange Act of 1934, namely books, records, and accounts of JPM, an issuer with a class of securities registered pursuant to Section 12 of the Securities and Exchange Act of 1934, which

JPM was required to make and keep in reasonable detail, accurately and fairly reflecting the transactions and dispositions of the assets of JPM, in violation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1.

Wire Fraud

3. It was further a part and an object of the conspiracy that JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations, and promises, for the purpose of executing such scheme and artifice and attempting to do so, would and did transmit and cause to be transmitted by means of wire, radio, and television communication in interstate and foreign commerce, writings, signs, signals, pictures, and sounds, all in violation of Title 18, United States Code, Section 1343.

False SEC Filings

4. It was further a part and an object of the conspiracy that JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, made and caused to be made statements in reports and documents required to be filed with the SEC under the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, which statements were false and misleading with respect to material facts, all in violation of Title 15, United States Code, Sections 78m(a) and 78ff, and Title 17, Code of Federal Regulations, Sections 240.13a-11 and 240.13a-13. . . .

(Title 18, United States Code, Section 371.)

COUNT TWO

(False Books and Records)

5. From at least in or about March 2012, through and including in or about May 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, did, directly and indirectly, falsify and cause to be falsified books, records, and accounts subject to Section 13(b)(2) of the Exchange Act, namely books, records, and accounts of JPM, an issuer with a class of securities registered pursuant to the Exchange Act, which JPM was required to make and keep in reasonable detail, accurately and fairly reflecting the transactions and dispositions of the assets of JPM, to wit, MARTIN-ARTAJO falsified and caused others to falsify marks relating to JPM's securities positions in a synthetic credit portfolio in order to conceal hundreds of millions of dollars in losses.

(Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, Title 17, Code of Federal Regulations, Section 240.13b2-1 and Title 18, United States Code,

Section 2.)

COUNT THREE

(Wire Fraud)

6. From at least in or about March 2012, through and including in or about May 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, willfully and knowingly, having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations and promises, did transmit and cause to be transmitted by means of wire and radio communication in interstate and foreign commerce, writings, signs, signals, pictures, and sounds, to wit, for example, a telephone conversation on or about March 30, 2012, between London and New York, for the purpose of executing such scheme and artifice, to wit, MARTIN-ARTAJO's efforts to fraudulently manipulate the reported value of JPM securities positions in a synthetic credit portfolio in order to conceal hundreds of millions of dollars in losses.

(Title 18, United States Code, Sections 1343 and 2.)

COUNT FOUR

(False Filings With The SEC)

7. On or about April 13, 2012 and May 10, 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, made and caused to be made, statements in reports and documents required to be filed with the SEC under the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, which statements were false and misleading with respect to material facts, to wit, MARTIN-ARTAJO caused the submission to the SEC of an inaccurate Form 8-K for JPM on April 13, 2012, and an inaccurate Form 10-Q for JPM on May 10, 2012, for the fiscal quarter ending March 30, 2012.

(Title 15, United States Code, Sections 78m(a) and 78ff; Title 17, Code of Federal Regulations, Sections 240.13a-11 and 240.13a-13; and Title 18, United States Code, Section 2.)

BACKGROUND

Relevant Persons and Entities

8. At all times relevant to this Complaint, JPMorgan Chase & Company ("JPM") was a global financial services company headquartered in New York, New York. JPM is one of the oldest and largest financial institutions in the United States.

9. At all times relevant to this Complaint, JPM's common stock traded on the New York Stock Exchange.

10. At all times relevant to this Complaint, JPM was required to comply with the federal securities laws, which are designed to ensure that a company's financial information is accurately recorded and accurately disclosed to the public. Specifically, pursuant to the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, JPM was required, among other things, to make and keep books, records, and accounts that accurately and fairly reflected JPM's business transactions.

11. At all times relevant to this Complaint, JPM maintained a group within its Corporate/Private Equity segment known as the Chief Investment Office, or "CIO." CIO has offices in both New York and London, and at all times relevant to this Complaint had more than 100 traders. One of the purposes of CIO, as described by JPM, was to manage the bank's excess deposits (the amount deposited with the bank, minus the amount it had loaned) of its corporate and individual customers. In 2012, those deposits managed by CIO totaled approximately $350 billion.

12. Since approximately 2007, the CIO has traded in so-called synthetic credit derivative products. One common such product is known as a "credit default swap," or CDS. A CDS is, in essence, an insurance contract on an underlying credit risk. For example, Company A may issue corporate bonds. Company B can purchase those bonds, and therefore be exposed to the risk that Company A will default on its bond payments (credit risk). To insure against that risk, Company B can "buy protection" in the form of a CDS that insures against the risk of Company A's default. However, an investor such as Company B need not own the underlying bond in order to purchase (or sell) a CDS – it can trade in the credit default swaps by themselves. JPM's CIO did just that, and in particular – and as discussed further below – traded so-called CDS "indices," which are collections of CDSs that are packaged together, or sliced into segments and traded as "tranches."

13. CIO traded these credit indexes and tranches in what it called its Synthetic Credit Portfolio, or "SCP." By 2011, that portfolio had reached an approximate net notional size of $51 billion, and during the first quarter of 2012, it more than tripled in size to approximately $157 billion in net notionalpositions.

14. At all times relevant to this Complaint, JAVIER MARTIN-ARTAJO ("MARTIN- ARTAJO"), the defendant, was employed at JPM as a Managing Director, where he held the position of Head of Credit and Equity Trading for CIO. MARTIN-ARTAJO principally worked out of CIO's London office, although his duties also brought him to JPM's New York office. Among other things, MARTIN-ARTAJO oversaw CIO's SCP.

15. At all times relevant to this Complaint, CC-1 was employed as a Vice President for CIO and a trader for the SCP. CC-1 was based in JPM's CIO London office and reported to JAVIER MARTIN-ARTAJO, the defendant. CC-1 was responsible for the day-to-day "marking" of the CIO's positions in the SCP, a process described in more detail below.

16. At all times relevant to this Complaint, another co-conspirator not named as a defendant herein ("CW-1") was a CIO trader based in JPM's London office. CW-1 was the head trader of the SCP, and reported to JAVIER MARTIN-ARTAJO, the defendant.

17. The SCP was, over the years, very profitable for CIO and JPM. In 2009, its most profitable year, the SCP produced over $1 billion in revenue for JPM. The SCP also was profitable in 2010 and 2011. In fact, the SCP had last reported an unprofitable quarter in 2010, and had not reported significant quarterly losses since the first quarter of 2009. Since its inception in 2006, the SCP produced approximately $2 billion in gross revenues for JPM.

Background of CIO Trading Activities

18. As described above, the SCP principally consisted of a variety of different credit derivative securities, including credit indices and tranches. A credit index is a security that operates as a collection, or basket, of selected credit instruments. A particular credit index references a particular collection of selected credit instruments, often CDSs. As of March 2012, JPM records indicate that CIO held more than one hundred different types of credit indices, and among the largest positions in the SCP were three particular kinds of indices: the CDX.NA.IG, which references securities in investment grade corporations in North America; COX.NA.HY, which references securities in high yield North American corporations; and the iTraxx Europe, which references securities in investment grade companies in Europe.

19. Another type of security traded in the SCP was credit index tranches. A credit index tranche is an instrument that relates to a particular part of a credit index.

20. JPM traders who traded these types of securities—within CIO as well as the rest of the bank—were required at all times to price securities they held at their fair value, that is, on a "mark-to-market" basis, determined by reference to the current market price of the asset or liability, or the current market price for a similar asset or liability. The positions in the SCP were, and were required to be, marked on a daily basis. The marks were transmitted electronically by the trader setting the mark to the other bank personnel in the Operations Department, and ultimately became part of the bank's books and records.

21. Because credit indices and credit tranches are not traded over an exchange, JPM traders were required to look to other indicia in order to determine the fair value of the assets on their books. Traders would consult three principal sources of information in order to determine the fair value of the securities in the SCP: recently executed transaction prices in the security they were valuing, or in similar securities; buy and sell prices (known as "bids" and "offers") posted by dealers in the securities they were valuing, or for similar securities; and published averages of dealer bids and offers, including those published by financial information services such as MarklT and Totem, which provide, among other things, independently gathered valuation data. It was widely understood within JPM that traders were to consult these data points when setting prices for credit

indices and credit tranches within the SCP. Under bank policy and U.S. Generally Accepted Accounting Principles ("GAAP"), traders were required to set the value, or mark, for a particular security at a price at which they believed they could exit the position.

22. JPM's accounting policy stated that the "starting point for the valuation of a derivatives portfolio is mid-market." The policy also stated that for securities for which dealer quotes are available, the prices to be used for purpose of marking these securities "must be obtained [from dealers] at the same time each business day."

Overview of the Scheme to Defraud

23. From at least in or about March 2012, through and including in or about May 2012, JAVIER MARTIN-ARTAJO, the defendant, together with his co-conspirators, manipulated and inflated the value of position marks in the SCP in order to achieve specific daily and month-end profit and loss ("P&L") objectives; in other words, MARTIN-ARTAJO and his co-conspirators artificially increased the marked value of securities in order to hide the true extent of hundreds of millions of dollars of losses in that trading portfolio.

24. As a result of the scheme executed by JAVIER MARTIN-ARTAJO, the defendant, and others, there was a growing disparity between the values falsely ascribed to the positions in the SCP and what the traders truly believed the fair value of the positions to be. This gap reached hundreds of millions of dollars by the end of March 2012.

25. As a result of the scheme, JAVIER MARTIN-ARTAJO, the defendant, and his co-conspirators, falsely hid losses in the SCP, and caused JPM to (i) record false entries for the SCP for the first quarter of 2012; and (ii) report false quarter-end numbers for the first quarter 2012. MARTIN-ARTAJO and his co-conspirators persisted in this scheme of systematically and fraudulently valuing the securities in the SCP until at least May 2012.

26. Ultimately, in July 2012, JPM announced in a Form 8K that it would restate its first quarter results for net revenue by $660 million, reflecting its loss of confidence that the marks made by CC-1 at the direction of JAVIER MARTIN-ARTAJO, the defendant, "reflect good faith estimates of fair value."

MARTIN-ARTAJO and His Co-Conspirators Knowingly Mismarked Securities in Order to Hide Losses

27. For most of 2011 and into 2012, CIO traders had a practice of marking the securities in the SCP at or near the mid-point between the average bid and offer that the CIO received each day from a number of dealers who made a market in that particular security. The CIO traders sometimes referred to this mid-point as the "crude mid."

28. Beginning in or about January 2012, the value of the positions in the SCP—as reflected by the execution prices of actual transactions, the bids and offers received from dealers, and by the prices listed by MarkIT and Totem—began to move against the SCP's

positions, and the SCP began to lose money. At the end of January 2012, CC-1 marked the positions in the SCP at or near the crude mid, and the CIO reported approximately $130 million in mark-to-market losses in the SCP for the month.

29. The losses through January 2012 did not go unnoticed within the bank. When these losses were reported, the direct supervisor of JAVIER MARTIN-ARTAJO, the defendant, as well as the Chief Investment Officer became increasingly concerned, and inquired more regularly about the losses.

30. For example, on January 31, 2012, the supervisor of JAVIER MARTIN-ARTAJO, the defendant, sent him an e-mail expressing the "need to discuss the synthetic book [referring to the SCP]," noting that the current strategy did not seem to be working, stating that the "financial Performance [sic] is worrisome," and indicating the need to "urgently reevaluate" the core position. Thereafter, MARTIN-ARTAJO was directed to focus all his attention on the performance of the SCP.

31. Despite strategic trading changes that involved an increase in the net notional positions of the SCP, the losses in the SCP continued through February 2012. As the losses continued to mount, JAVIER MARTIN-ARTAJO, the defendant, was subject to continued and increasing scrutiny and pressure from the executives senior to him. MARTIN-ARTAJO, in turn, began pressuring CC-1 and CW-1, to mark the SCP's positions in such a way as to show smaller losses. MARTIN-ARTAJO also urged CW-1 and CC-1 to "defend the positions" by executing trades, and attempting to execute trades, at favorable prices. MARTIN-ARTAJO put particular pressure on CC-1 and CW-1 to "defend the positions" near the end of the month, when the SCP's positions would be subjected to closer scrutiny through JPM's internal price testing process, described below, and when the SCP's P&L would be looked at more closely by senior bank executives.

32. In marking the SCP's securities at month-end in February 2012, CC-1 began to set some of the marks farther from the crude mid, at a price more favorable to the CIO's profits, somewhat mitigating the losses being suffered in the SCP. Nonetheless, at the end of February, CIO reported (based on CC-l's marks) approximately $88 million in mark-to-market losses in the SCP for the month.

MARTIN-ARTAJO and CC-1 More Aggressively Hid CIO's Losses in March, Causing False Entries in the Bank's Books and Records Both Intra-Month and at Month-End

33. On March 1, 2012, the supervisor of JAVIER MARTIN-ARTAJO, the defendant, sent an email message to MARTIN-ARTAJO, suggesting that he "[f]ocus on the metrics and P+L of the synthetic book" and expressing a worry that, if the size of the SCP were reduced to accomplish a reduction in risk, "we will not be able to defend our positions . . ." and the SCP's profits would suffer.

34. In March 2012, the usual data points used to value the positions in the SCP—

bid and offer quotes from dealers, MarklT and Totem prices, and actual transaction prices—continued to move in a direction reflecting further losses in the SCP's positions. The losses mounted even as the CIO traders continued to dramatically increase the size of their positions in the SCP as part of a strategy designed in part to avert the losses.

35. In the beginning of March 2012, JAVIER MARTIN-ARTAJO, the defendant, directed CC-1 and CW-1, not to show any additional losses in the SCP if the losses were caused by the continued downward trend in the market data that the traders were receiving—but to continue to show gains. MARTIN-ARTAJO directed that, unless there was an identifiable and explainable market event that the traders could reference to explain the price movement—for example, a bankruptcy filing by one of the companies whose bonds were referenced in a credit index—no losses were to be reported in the marks or to the bank's management. MARTIN-ARTAJO claimed that this was what "New York"—that is, the bank's senior management in New York—wanted, explaining that those JPM officials did not want to see day-to-day market volatility.

36. On March 6, 2012, CW-1 told CC-1 in a recorded phone call, that CW-1 had just spoken with JAVIER MARTIN-ARTAJO, the defendant. CW-1explained to CC-1that MARTIN-ARTAJO had directed that "we have to try to show that the P and Lis stable" and "what Javier would like is that if you start to see some gains we have to report it", but that "what they don't want is for us to be down." CW-1 told CC-1 that MARTIN-ARTAJO was trying to make the argument to more senior management that the positions in the SCP should be retained. MARTIN-ARTAJO did not want more management to take away the SCP from CIO, or direct that CIO change its strategy, and reporting additional losses would undermine this objective.

37. CW-1 was uncomfortable following the direction from JAVIER MARTIN-ARTAJO, the defendant, not to report losses for more than a brief period of time, because as objective price data indicated that the SCP was losing money, the gap between where the SCP was marked and that relevant market data was growing larger and larger. By at least on or about March 9, 2012, CW-1 asked CC-1 to create a spreadsheet for the express purpose of tracking the difference between CC-l's manipulated marks on the one hand, and the crude mids—that is, the objective market data—on the other. CC-1 did so and, at CW-l's request, CC-1 sent a copy of that spreadsheet to MARTIN-ARTAJO.

38. For example, on March 15, 2012, CW-1 told CC-1 in the course of an online chat, to "Send the pnl," meaning to finalize and report within the bank the daily marks (and resulting P&L) for the SCP. CW-1 then asked CC-1,"Can u drop me here the breakdown of the lag [the difference between where the positions were marked and the crude mids], please? ... And send it to [MARTIN-ARTAJO by]email. ... put me in copy ... I refer to the spreadsheet." Later in the same chat, CW-1clarified: Send to me and Javier the spreadsheet where u store the breakdown of the difference between our estimates and crude mids."

39. Later that day, at approximately 6:45 p.m. Greenwich Mean Time, CC-1 sent an e-mail to JAVIER MARTIN-ARTAJO, the defendant, and CW-1, attaching a

spreadsheet. The spreadsheet had columns, among others, entitled "Date," "Distance," "iTraxx," "CDX.IG," "iTraxx.Main," "CDX.IG9 10y," "COX.HY," and "Distance YTD." For example, the spreadsheet reflected, among other columns not reproduced here, the following information:

Date	Distance
12-Mar-12	(203)
13-Mar-12	(207)
14-Mar-12	(269)
15-Mar-12	(292)

CC-l's spreadsheet, then, indicated one measure of the extent to which the SCP was mis-marked as of March 15, 2012: the marks made by CC-1, consistent with MARTIN-ARTAJO's instructions, left the SCP overstated by approximately $292 million as compared to where the book would have been marked had the traders continued their practice of marking to the crude mids.

40. Both CC-1 and CW-1 were aware of the instruction by JAVIER MARTIN-ARTAJO, the defendant, to stop reporting losses. During the March 15, 2012, chat referenced in paragraph 38, above, CC-1 reminded CW-1 that he was "not marking at mids as per a previous conversation." However, on March 15, 2012, it became clear that CC-1 and CW-1 had different ideas about how to accomplish MARTIN-ARTAJO's directive. CC-1 was trying to capture almost all the distance between the crude mids and the CIO marks by aggressively mis-marking one particular security, the CXD.NA.IG9-10Y, in which CIO held a large position. As a result, that one position was marked extremely far from the crude mid price—between 6 and 7 basis points away, which was far outside the bid-offer spread for that security, which was mis-marked by more than $300 million. CW-1 indicated to CC-1 that he did not think the way in which CC-1 was marking was "realistic" and questioned whether it could be defended. CC-1 thereafter acknowledged that he did not think his own mark for the CXD.NA.IG9-10Y was realistic, writing to CW-1: "I mean, im trying to keep a relatively realistic picture here ig9 10y put aside."

41. The following day, March 16, 2012, CC-1 had an online chat with CW-1. CC-1 stated that he was "at minus 4 [million] with a lot of effort." CC-1 offered to do better'' but CW-1 told CC-1 not to make the additional effort to disguise the loss. During the chat, CW-1 stated his frustration with JAVIER MARTIN-ARTAJO, the defendant, because the distance between the actual fair value of the securities in the SCP and the level at which CC-1 had marked the securities, was persisting and even growing: "I don't know where he [MARTIN-ARTAJO] wants to stop, but it's getting idiotic."

42. The same day, CW-1 emailed JAVIER MARTIN ARTAJO, the defendant, increased to 300 [million] and stated that the "divergence has now ... It has been like this

since the start of the year and the drift keeps going. I reckon we get to 400 [million] difference very soon." CW-1 was concerned that as the available market data showed increasing losses for the SCP, MARTIN-ARTAJO's direction to not report those losses was growing "idiotic"—the marks in the SCP for the largest positions were approaching the point at which they would need to be outside the bid-offer spread in order for the losses not to be reported. That is, CIO would have to value the securities at prices that not only failed to reflect fair value, but that were beyond what any broker would quote as a conceivable price.

43. Also on March 16, 2012, CW-1 relayed prices at which he had traded certain securities to CC-1. Based on those fresh transaction prices, CW-1, in an online chat with CC-1, told CC-1 that the marks for the CXD.NA.IG9, five year maturity, should be at 72; the marks for the CXD.NA.IG9, seven year maturity, should be at 88; and the marks for the CXD.NA.IG9, ten year maturity should be at 110. CC-1 responded that he agreed and would mark those securities as CW-1 had indicated. In fact, however, CC-1 skewed the marks in an even more favorable way for JPM than CW-1 had suggested: for the CXD.NA.IG9, five year maturity, at 70.25; for the seven year maturity, at 85.75; and for the ten year maturity, at 107.25 in each case, marking in a direction favorable to the SCP's P&L, and an additional two and three quarters basis points away from where CC-1 told CW-1 he would mark.

44. Between approximately March 16 and March 20, 2012, CW-1 urged JAVIER MARTIN-ARTAJO, the defendant, to reflect the losses in some way on the books of the bank: either by properly adjusting the marks in the SCP to reflect the true market data; or by taking a large, "one-off" loss to catch up to the market, possibly at month-end; or by taking some kind of other step to ensure that the bank's books were accurate. MARTIN-ARTAJO rebuffed these efforts. CW-1 and CC-1 subsequently discussed MARTIN- ARTAJO's refusal to have the losses reported, and the pressure this put on CC-1, who had responsibility for marking the positions on the SCP on a daily basis.

45. On March 20, 2012, CW-1 decided that the SCP's marks had to begin to reflect the market reality, that is, bigger losses in the SCP. CW-1 left a voicemail message for JAVIER MARTIN-ARTAJO, the defendant, saying that CW-1 thought that CIO "should start, start showing" the losses in the SCP. CW-1 then spoke with CC-1 and told CC-1 that the book should be marked in a way that reflected a loss for the day of $40 million, bringing the reported year-to-date losses to $275 million. CW-1 also prepared, for March 20, 2012, written commentary for the P&L report document that CC-1 circulated to CIO management every day, which warned, among other things, that the "lag in P&L is material ($600 – 800M)."

46. On March 20, 2013, JAVIER MARTIN-ARTAJO, the defendant, reacted angrily after he received the document reporting the single-day loss of $40 million. That same day, in a recorded call between MARTIN-ARTAJO and CW-1, MARTIN-ARTAJO asked "Why did you do that?" CW-1 replied, "I thought we should, you know, not do like minus 5 every day but just say okay boom you know there is something

happening." MARTIN-ARTAJO responded: "I don't understand your logic mate, I just don't understand. I told [my boss], he told me that he didn't want to show the loss until we know what we are going to do tomorrow [at a scheduled meeting with the Chief Investment Officer]. But it doesn't matter I know that you have a problem you want to be at peace with yourself ... I didn't want to show the P&L and [my boss] told me yesterday not to do it. So okay, we're just going to have to explain that this is getting worse, that's it." CW-1 then pointed out the portion of the commentary in which he had described the lag in P&L as reaching as high as $800 million, and MARTIN-ARTAJO responded: "You're losing your mind here, man, you're sending an email that you would get, what is this 800 [million] bucks ... [T]his is just what we explain tomorrow you don't need to explain in an email man ... [W]hy do you do it today when we are going to explain it tomorrow?" CW-1 replied that he and CC-1 reported the loss because "that's what we saw today ..." MARTIN-ARTAJO responded "listen the problem that, okay it's fine you've done it I cannot really tell you, you know, not to do this, you've done it because you feel you have to do it, that's okay. What I don't understand is at all is why are you explaining this, this way on the email? ... because this only creates, it just creates more tension you understand? It's not going to help me as much, right? ... What happens if [the Chief Investment Officer] tells me that we cannot keep going long?" MARTIN-ARTAJO went on to explain that "it just highlights that there are problems in the book" and that there was a chance that MARTIN-ARTAJO's immediate boss and the Chief Investment Officer would decide to have CIO unwind certain positions that MARTIN-ARTAJO wanted to keep.

47. Finally, JAVIER MARTIN-ARTAJO, the defendant, repeated that "I didn't want to show the P&L." CW-1 apologized, and MARTIN-ARTAJO responded that "you know, I think that you're an honest guy, you know, it's just that, I did not want you to do it this way, but I know you feel that the bid offer spreads are giving you a headache, and you want to release it this way."

48. On March 23, 2012, the market continued to move against the SCP. On that date, in a chat between CW-1 and JAVIER MARTIN-ARTAJO, the defendant, CW-1 stated that "we will lose more today ... this is going to happen across the book I reckon we have today a loss of 300M USING THE BEST BID ASKS . . . and 600m from [the crude] mids. . . ." In a different chat the same day, between CW-1 and CC-1, CC-1 stated that "it's around more than 500 anyway."

49. Later the same day, CC-1 reported to CW-1 that he had spoken with MARTIN-ARTAJO, and that "[w]e're gonna show between minus 5 and minus 10." CW-1 responded "ok, ok you tell Javier because it's not my business anymore, I don't want to know about it ... it pisses me off tell him ... tell him it's more than 500." Nonetheless, at the end of the day on March 23, 2012, CC-1 continued to falsely mark the book in such a way that the reported loss for the day was only $9.5 million. That was accomplished, in part, by marking one large position, the IG9 ten year maturity, considerably outside the bid-offer spread for that security. Indeed, even if the position had been marked at the aggressive beneficial edge of the bid-offer spread for the best available bid that day, the

SCP losses would have increased by $91 million over what CC-1 reported that day.

50. As CIO's daily marks bore less and less resemblance to the actual fair value of its book, CW-1 worked with others at CIO to create a PowerPoint presentation that set forth the risks and issues with the SCP. On March 29, 2012, a draft of the PowerPoint presentation was circulated to JAVIER MARTIN-ARTAJO, the defendant, CC-1, CW-1, and others at CIO. In a section entitled "Core Credit Book: summary," the document listed the following: "target ytd: -$750M." A separate slide of the presentation labeled "P&L explain" described the P&L as negative $800 million, with the bulk of the loss driven by losses in the CXD.NA.IG9 positions. However, the P&L submitted by CC-1 the following day showed a year-to-date loss of only $583 million, despite a very large loss on the last day of the month.

51. On March 30, 2012—the last business day of the first quarter of 2012—the early estimates of CC-1 showed the SCP down approximately $250 million for the day. CC-1 discussed this with CW-1, who in turn told JAVIER MARTIN-ARTAJO, the defendant. MARTIN-ARTAJO asked if the loss could be only $200 million; CW-1 reported this request to CC-1. Later in the day, CC-1 told CW-1 that he now estimated the loss for the day at approximately $200 million. CW-1 reported this number to MARTIN-ARTAJO. MARTIN-ARTAJO then asked if the loss number could be reduced to as low as $150 million; CW-1 responded that it was unlikely. MARTIN-ARTAJO then told CW-1 that he could leave for the day. While the SCP was typically marked at the London close of business, when CW-1 left at approximately 6:30 p.m. the books were still open, and they remained open despite inquiries to CC-1from others waiting for the final numbers, until almost 8 p.m. London time.

52. Throughout the day on March 30, 2012, JAVIER MARTIN-ARTAJO, the defendant, received repeated inquiries urgently seeking his best estimate as to what the day's loss would be, on behalf of the Chief Investment Officer in New York. At 8:15 p.m. GMT, MARTIN-ARTAJO indicated that "[w]e are going to close the books in one hour and still around -150 MM." Before the books were closed, CC-1 spoke with CW-1 in a recorded phone call, explaining some of the marks he was making. CW-1 urged CC-1 to stay within the bid-offer range, and that it was better to do "something cleaner with a ... you see ... a lesser result." Finally, at 8:41 p.m. GMT, CC-1 sent an email to MARTIN-ARTAJO and CW-1, indicating that "my latest estimate for today's Pnl is ($138M)." MARTIN-ARTAJO responded: "Excellent tks."

53. At March 2012 month-end, most of the marks for the largest SCP positions set by CC-1were at the far side of the bid-offer spread in the direction favorable to CIO, and some of CC-l's marks even fell outside of the spread. For example, CC-1 marked the ITRAXX.MN.S09 lOY fully 6.3 basis points off of the consensus pricing, when the bid/offer spread in ITRAXX was consistently less than 3 basis points throughout the day. Given the large size of the ITRAXX position in the SCP, this discrepancy resulted in an approximately $120 million P&L difference. Similarly, CC-1marked the CXD.NA.IG9-10Y approximately 2.5 basis points from the consensus price, whereas the bid/offer spread

was consistently no more than 2 basis points. This resulted in a more than $100 million P&L difference.

54. Indeed, according to a subsequent analysis performed by JPM's Investment Bank, the difference across the SCP between the marks entered by CC-1 on the one hand, and the consensus pricing, on the other, across the SCP amounted to a $767 million difference in CIO's favor as of the end of March.

The Mis-Marking of the SCP Continues in April

55. On Friday, April 6, 2012, Bloomberg and the Wall Street Journal published articles concerning CIO and its large positions in the credit derivatives market. On April 10, 2012—the first trading day after the articles were published—CC-1 circulated a P&L e-mail that reflected a daily loss of $5.7 million, after speaking with JAVIER MARTIN-ARTAJO, the defendant. About 90 minutes later, however, CC-1 circulated a second P&L e-mail. This one reflected a loss for the day of $395 million. The P&L commentary reflected no explanation for this change.

56. On April 13, 2012, CC-1 spoke with CW-1 in a recorded call, and indicated that his "problem is what type of reporting should I do ... you see, it's highly scrutinized now... [t]he market moves (inaudible) and I don't want to, I don't want to show something that is too false."

57. Toward the end of April, CIO had a series of collateral disputes with counter-parties, indicating that those brokers were marking positions materially differently than CIO. At that time, CC-1 exchanged text messages with CW-1. In the exchange, CW-1 told CC-1 to "[s]peak to Javier about this collateral mark issue" and that they would have to return to the mid "fairly quickly."

MARTIN-ARTAJO and His Co-Conspirators Hide the Mismarks by Taking Advantage of CIO's Valuation Control Group

58. At all times relevant to this Complaint, the CIO's Valuation Control Group ("VCG") was supposed to serve as an independent function within CIO, as it did in other parts of JPM. The VCG function was designed to serve as an independent check on the valuations assigned by traders to the securities that the traders were marking at month-end. In practice, however, the CIO VCG was neither independent nor rigorous.

59. Staffed in London with essentially a single employee (the "VCG Employee"), CIO VCG regularly received and relied upon trader views of the market, and reviewed selected broker price quotes provided by the traders. In addition, the VCG employed "thresholds" around its prices, which had the effect of tolerating some variance between the traders' marks and the VCG Employee's "independent" marks. In practice, however, the VCG Employee applied unreasonably wide thresholds, which had the effect (contrary to CIO VCG's written policy and U.S. GAAP) of tolerating trader prices that were outside of the bid-offer spread.

60. Finally, as designed, CIO VCG had no review role whatsoever concerning intra-month marks, which were left to the unfettered discretion of the traders, even though those marks were recorded in JPM's books and records.

61. As part of their scheme, JAVIER MARTIN-ARTAJO, the defendant, and his co-conspirators, took full advantage of the freedom that CIO's VCG function offered. JAVIER MARTIN-ARTAJO and other CIO traders, regularly interacted with the VCG Employee, provided their views of the market to the VCG Employee, and provided their selection of broker quotes to the VCG Employee, with the result that CIO VCG ultimately did not perform a meaningful check on the trader valuations.

62. For example, for February 2012, the VCG price-testing had initially identified a discrepancy between VCG's independent marks and CC-l's marks that would have resulted in a $95 million adjustment to the SCP's P&L. CC-1 subsequently provided a selection of broker price quotes and other information to the VCG Employee, and as a result, the VCG Employee reduced the difference to only $7 million—and then decided to pass no adjustment whatsoever to the February 2012 marks in the SCP.

63. JAVIER MARTIN-ARTAJO, the defendant, also made efforts to influence the CIO VCG view on the marks for the positions in the SCP. In the latter part of March 2012, CW-1 told MARTIN-ARTAJO that, because the marks were moving so far from the crude mids and approaching the outer bounds of the bid-offer spread, it was inevitable that the VCG Employee would report a large difference—which would have the effect of revealing the very losses that MARTIN-ARTAJO was determined to hide. MARTIN- ARTAJO told CW-1 that he would take care of the situation.

64. In or about April 2012, as part of the month-end price testing process, the VCG Employee noticed that the marking methodology for the SCP had appeared to change, from roughly the crude mids in January and February 2012, to the favorable outer bounds of the bid-offer spread for most of the SCP's largest positions in March 2012. The VCG Employee asked CC-1, the defendant, about the change to the new pattern of marking to the beneficial edge of the bid-offer spread; CC-1 replied: "Ask management."

65. In late April and the beginning of May 2012—after the press reports about CIO's large positions in the SCP, and still- increasing losses—JPM's senior management began looking more closely at the process the traders used to value the securities in the SCP. As part of that effort, on or about May 8, 2012, an employee within JPM's Controller's office (the "Controller Employee") began speaking with the CIO traders.

66. On or about April 29, 2012, the Controller Employee spoke with JAVIER MARTIN- ARTAJO, the defendant, about the month- end marks in the SCP. MARTIN-ARTAJO told the Controller Employee, in substance, "I'm a trader. I do not mark the books to U.S. GAAP. My job is to manage risk."

67. On or about May 8, 2012, the Controller Employee spoke with CW-1 about the marks for the positions in the SCP as of March 30, 2012. During that conversation, CW-

1 told the Controller Employee, in response to questions about the quarter-end marks for two particular positions, that those positions were marked incorrectly. As to one of the positions, CW-1 stated: "it's too wide,I agree, I agree. One to two basis points too wide." As to the other, the Controller Employee asked: "Broker mids were at 70 ... The quotes are between 70 and 71, and yet we are appearing at 72 spot 75." When asked, "what was the thought process behind putting us at 72 spot 75?" CW-1 responded: "[b]asically, I think we went too wide, I think we went too wide on this one."

68. Also on or about May 8, 2012, the Controller Employee called JAVIER MARTIN-ARTAJO, the defendant, to ask about the March month-end marks. MARTIN-ARTAJO acknowledged that in January, the SCP marks "were all either mid or somewhere close to mid," whereas the marks for March had "migrated ... to the aggressive side ... from mid to somewhere closer to being at the ... bounds of the bid or offer." Nonetheless, MARTIN-ARTAJO insisted that the SCP traders did not have a "bias," and that MARTIN-ARTAJO himself was not "particularly aggressive in March."

The April 13, 2012 Filing of JPM's Form 8-K and the May 10, 2012 Filing of JPM's Form 10-Q for the First Quarter

69. On or about April 13, 2012, JPM issued an earnings release setting forth its financial results for the first quarter 2012, which was filed on Form 8-K with the SEC. The earnings release, which JPM senior management described in a phone call with investors, disclosed JPM's consolidated financial results as well as results for its Corporate/Private Equity segment. Those results significantly understated the extent of the losses in the SCP, and as a result, the total losses in the Corporate/Private Equity segment.

70. On or about May 10, 2012, JPM filed its Form 10-Q with the SEC, setting forth its financial results for the first quarter 2012, and repeating the same financial results which it had stated on April 13, 2012 for the first quarter.

The July 2012 Restatement

71. On or about July 13, 2012, JPM filed a Form 8-K with the SEC announcing, among other things, that it would be restating its first quarter net earnings for income before income tax expense by $660 million and restating its net income by $459 million. That is, JPM's restatement had the effect of nearly doubling the total losses in the Corporate/Private Equity segment, from negative $563 million (originally) to negative $1.022 billion (restated).

72. Significantly, all of this write-down was attributable to the SCP and included position marks that JAVIER MARTIN-ARTAJO, the defendant, and others, manipulated and inflatedin connection with their scheme. In explaining the reason for the restatement, JPM stated, regarding CIO, that it "discovered information that raises questions about the integrity of the trader marks and suggests that certain individuals may have been seeking to avoid showing the full amount of the losses in the portfolio during

the first quarter." JPM also announced that "Management has determined that a material weakness existed in the Firm's internal control over financial reporting at March 31, 2012."

73. On or about August 9, 2012, JPM formally restated its first quarter financials, consistent with its July 13, 2012 announcement, by filing an amended 10-Q with the SEC. Among other things, JPM stated that it found that 107 of the 132 positions within the SCP were marked more favorably than the mid-market price at the end of the first quarter 2012, and that many of the positions were marked at the advantageous end of the bid-offer spread.

C. Trading Fraud and Bankers

Despite many public demands, very few criminal prosecutions were brought against the individuals and firms responsible for the transactions connected to the market for residential mortgage-backed securities (RMBS) that led to the collapse and near collapse of banks in 2008. Why was this the case? Some argue that it was the result of political influence by the banks. Others have argued that prosecutions would have only further destabilized an already fragile economy. The laws itself have also been blamed, due to their complexity and the difficulty prosecutors face when it comes to proving certain elements, such as criminal intent, to jurors unfamiliar with these sophisticated financial instruments. Additionally, managers in financial institutions often further insulate themselves from criminal liability through the use of pro forma disclosures that warn clients of risks.[3]

Even considering the difficulties with securities fraud prosecutions, should such theories have been pursued, at least with more resources devoted to investigative measures? A lot of people (including Steve Carell's character in *The Big Short*) certainly asked that question, and some are still asking it. However, recall that securities fraud cases can be pursued both criminally and civilly. What follows is the SEC's complaint in *SEC v. Tourre*, one important RMBS fraud case related to the financial crisis that was pursued civilly and then, in an unusual development for SEC cases, went to trial.

[3] Volumes have been written on this subject in the decade since. See, for example, SAMUEL W. BUELL, CAPITAL OFFENSES: BUSINESS CRIME AND PUNISHMENT IN AMERICA'S CORPORATE AGE (2016) (chapters 2 and 5); JESSE EISINGER, THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES (2017). For brief treatments of some of the issues, see Jeff Madrick & Frank Partnoy, *Should Some Bankers Be Prosecuted*, NEW YORK REVIEW OF BOOKS (Nov. 10, 2011), https://www.nybooks.com/articles/2011/11/10/should-some-bankers-be-prosecuted; Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted*, NEW YORK REVIEW OF BOOKS (Jan. 9, 2014), https://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions.

AMENDED COMPLAINT, SEC V. FABRICE TOURRE NO. 10-CV-3229 (S.D.N.Y. NOV. 22, 2010)

Plaintiff, the United States Securities and Exchange Commission ("Commission"), for its Amended Complaint alleges as follows:

OVERVIEW

1. This action alleges securities fraud by Fabrice Tourre ("Tourre"), an employee of Goldman, Sachs & Co. ("GS&Co"), based on materially misleading statements and omissions in connection with a synthetic collateralized debt obligation ("CDO") that GS&Co structured and marketed to investors. This synthetic CDO, ABACUS 2007-Acl, was tied to the performance of subprime residential mortgage-backed securities ("RMBS") and was structured and marketed by GS&Co in early 2007 when the United States housing market and related securities were beginning to show signs of distress. Synthetic CDOs like ABACUS 2007-Acl contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market.

2. GS&Co marketing materials for ABACUS 2007-Acl—including the term sheet, flip book and offering memorandum for the CDO—all represented that the reference portfolio of RMBS underlying the CDO was selected by ACA Management LLC ("ACA"), a third-party with experience analyzing credit risk in RMBS. Undisclosed in the marketing materials and unbeknownst to investors, a large hedge fund, Paulson & Co. Inc. ("Paulson"), with economic interests directly adverse to investors in the ABACUS 2007-Acl CDO, played a significant role in the portfolio selection process. After participating in the selection of the reference portfolio, Paulson effectively shorted the RMBS portfolio it helped select by entering into credit default swaps ("CDS") with GS&Co to buy protection on specific layers of the ABACUS 2007-Acl capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future. GS&Co and Tourre did not disclose Paulson's adverse economic interests or its role in the portfolio selection process in the term sheet, flip book, offering memorandum or other marketing materials provided to investors.

3. In sum, GS&Co and Tourre arranged a transaction at Paulson's request in which Paulson heavily influenced the selection of the portfolio to suit its economic interests, but failed to disclose to investors, as part of the description of the portfolio selection process contained in the marketing materials used to promote the transaction, Paulson's role in the portfolio selection process or its adverse economic interests.

4. Tourre was principally responsible for ABACUS 2007 AC1. Tourre devised the transaction, prepared the marketing materials and communicated directly with investors. Tourre knew of Paulson's undisclosed short interest and its role in the portfolio selection process. Tourre concealed Paulson's short interest and its participation in the portfolio

selection during the marketing, offering and sale of ABACUS 2007-Acl securities and security-based swap agreements. Tourre also misled ACA into believing that Paulson invested approximately $200 million in the equity of ABACUS 2007-Acl (a long position) and, accordingly, that Paulson's interests in the portfolio selection process were aligned with ACA's when in reality Paulson's interests were sharply conflicting.

5. The deal closed on April 26, 2007. Paulson paid GS&Co approximately $15 million for structuring and marketing ABACUS 2007-Acl. By October 24, 2007, 83% of the RMBS in the ABACUS 2007-Acl portfolio had been downgraded and 17% were on negative watch. By January 29, 2008, 99% of the portfolio had been downgraded. As a result, investors in the ABACUS 2007-Acl CDO lost over $1 billion. Paulson's opposite CDS positions yielded a profit of approximately $1 billion for Paulson.

6. By engaging in the misconduct described herein, GS&Co and Tourre directly or indirectly engaged in transactions, acts, practices and a course of business that violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) ("the Securities Act"), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) ("the Exchange Act") and Exchange Act Rule l0b-5, 17 C.F.R. §240.10b-5. Tourre also aided and abetted violations of Section 10(b) of the Exchange Act by GS&Co. This action seeks injunctive relief, disgorgement of profits, prejudgment interest, civil penalties and other appropriate and necessary equitable relief based on the unlawful conduct alleged herein. . . .

FACTS

A. GS&CO'S CORRELATION TRADING DESK

7. GS&Co's structured product correlation trading desk, located in New York City, was created in and around late 2004/early 2005. Among the services it provided was the structuring and marketing of a series of synthetic CDOs called "ABACUS" whose performance was tied to RMBS. GS&Co sought to protect and expand this profitable franchise in a competitive market throughout the relevant period. According to an internal GS&Co memorandum to the Goldman Sachs Mortgage Capital Committee ("MCC") dated March 12, 2007, the "ability to structure and execute complicated transactions to meet multiple client's needs and objectives is key for our franchise," and "[e]xecuting this transaction [ABACUS 2007-Acl] and others like it helps position Goldman to compete more aggressively in the growing market for synthetics written on structured products."

B. PAULSON'S INVESTMENT STRATEGY

8. Paulson & Co. Inc. ("Paulson") is a hedge fund located in New York City and founded in 1994. Beginning in 2006, Paulson created two funds, known as the Paulson Credit Opportunity Funds, which took a bearish view on subprime mortgage loans by buying protection through CDS on various debt securities. A CDS is an over-the-counter derivative contract under which a protection buyer makes periodic premium payments

and the protection seller makes a contingent payment if a reference obligation experiences a credit event.

9. RMBS are securities backed by residential mortgages. Investors receive payments out of the interest and principal on the underlying mortgages. Paulson developed an investment strategy based upon the belief that, for a variety of reasons, certain mid-and-subprime RMBS rated "Triple B," meaning bonds rated "BBB" by S&P or "Baa2" by Moody's, would experience credit events. The Triple B tranche is the lowest investment grade RMBS and, after equity, the first part of the capital structure to experience losses associated with a deterioration of the underlying mortgage loan portfolio.

10. CDOs are debt securities collateralized by debt obligations including RMBS. These securities are packaged and generally held by a special purpose vehicle ("SPV") that issues notes entitling their holders to payments derived from the underlying assets. In a synthetic CDO, the SPV does not actually own a portfolio of fixed income assets, but rather enters into CDSs that reference the performance of a portfolio (the SPV does hold some collateral securities separate from the reference portfolio that it uses to make payment obligations).

11. Paulson came to believe that synthetic CDOs whose reference assets consisted of certain Triple B-rated mid-and-subprime RMBS would experience significant losses and, under certain circumstances, even the more senior AAA-rated tranches of these so-called "mezzanine" CDOs would become worthless.

C. GS&CO AND PAULSON DISCUSS A PROPOSED TRANSACTION

16. Paulson performed an analysis of recent-vintage Triple B-rated RMBS and identified various bonds it expected to experience credit events. Paulson then asked GS&Co to help it buy protection, through the use of CDS, on the RMBS it had adversely selected, meaning chosen in the belief that the bonds would experience credit events.

17. Paulson discussed with GS&Co possible transactions in which counterparties to its short positions might be found. Among the transactions considered were synthetic CDOs whose performance was tied to Triple B-rated RMBS. Paulson discussed with GS&Co the creation of a CDO that would allow Paulson to participate in selecting a portfolio of reference obligations and then effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure.

18. A Paulson employee explained the investment opportunity as of January 2007 as follows:

> "It is true that the market is not pricing the subprime RMBS wipeout scenario. In my opinion this situation is due to the fact that rating agencies, CDO managers and underwriters have all the incentives to keep the game going, while 'real money' investors have neither the

> analytical tools nor the institutional framework to take action before the losses that one could anticipate based [on]the 'news' available everywhere are actually realized."

19. At the same time, Tourre and GS&Co recognized that market conditions were presenting challenges to the successful marketing of CDO transactions backed by mortgage-related securities. For example, portions of an email in French and English sent by Tourre to a friend on January 23, 2007 stated, in English translation where applicable: "More and more leverage in the system, The whole building is about to collapse anytime now... Only potential survivor, the fabulous Fab[rice Tourre... standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstruosities!!!" Similarly, an email on February 11, 2007 to Tourre from the head of the GS&Co structured product correlation trading desk stated in part, "the cdo biz is dead we don't have a lot of time left."

D. INTRODUCTION OF ACA TO THE PROPOSED TRANSACTION

20. GS&Co and Tourre knew that it would be difficult, if not impossible, to market and sell the liabilities of a synthetic CDO if they disclosed to investors that a short investor, such as Paulson, played a significant role in the portfolio selection process. By contrast, they knew that the identification of an experienced and independent third-party collateral manager as having selected the portfolio would facilitate the placement of the CDO liabilities in a market that was beginning to show signs of distress.

21. GS&Co and Tourre also knew that at least one significant potential investor, IKB Deutsche Industrie bank AG ("IKB"), was unlikely to invest in the liabilities of a CDO that did not utilize a collateral manager to analyze and select the reference portfolio.

22. GS&Co and Tourre therefore sought a collateral manager to play a role in the transaction proposed by Paulson. Contemporaneous internal correspondence reflects that GS&Co and Tourre understood that not every collateral manager would "agree to the type of names [of RMBS] Paulson want[s] to use" and put its "name at risk... on a weak quality portfolio."

23. In or about January 2007, GS&Co approached ACA and proposed that it serve as the "Portfolio Selection Agent" for a CDO transaction sponsored by Paulson. ACA previously had constructed and managed numerous CDOs for a fee. As of December 31, 2006, ACA had closed on 22 CDO transactions with underlying portfolios consisting of $15.7 billion of assets.

24. Internal GS&Co communications emphasized the advantages from a marketing perspective of having ACA associated with the transaction. For example, an internal email from Tourre dated February 7, 2007, stated: "One thing that we need to make sure ACA understands is that we want their name on this transaction. This is a transaction for

which they are acting as portfolio selection agent, this will be important that we can use ACA's branding to help distribute the bonds."

25. Likewise, an internal GS&Co memorandum from Tourre and others to the Goldman Sachs MCC dated March 12, 2007 described the marketing advantages of ACA's "brand-name" and "credibility":

> "We expect the strong brand-name of ACA as well as our market-leading position in synthetic CDOs of structured products to result in a successful offering."
>
> "We expect that the role of ACA as Portfolio Selection Agent will broaden the investor base for this and future ABACUS offerings."
>
> "We intend to target suitable structured product investors who have previously participated in ACA-managed cashflow COO transactions or who have previously participated in prior ABACUS transactions."
>
> "We expect to leverage ACA's credibility and franchise to help distribute this Transaction."

E. PAULSON'S PARTICIPATION IN THE PORTFOLIO SELECTION PROCESS

26. In late 2006 and early 2007, Paulson performed an analysis of recent-vintage Triple B RMBS and identified over 100 bonds it expected to experience credit events in the near future. Paulson's selection criteria favored RMBS that included a high percentage of adjustable rate mortgages, relatively low borrower FICO scores, and a high concentration of mortgages in states like Arizona, California, Florida and Nevada that had recently experienced high rates of home price appreciation. Paulson informed GS&Co that it wanted the reference portfolio for the contemplated transaction to include the RMBS it identified or bonds with similar characteristics.

27. On January 8, 2007, Tourre attended a meeting with representatives from Paulson and ACA at Paulson's offices in New York City to discuss the proposed transaction.

28. On January 9, 2007, GS&Co sent an email to ACA with the subject line, "Paulson Portfolio." Attached to the email was a list of 123 2006 RMBS rated Baa2. On January 9, 2007, ACA performed an "overlap analysis" and determined that it previously had purchased 62 of the 123 RMBS on Paulson's list at the same or lower ratings.

29. On January 9, 2007, GS&Co informed ACA that Tourre was "very excited by the initial portfolio feedback."

30. On January 10, 2007, Tourre sent an email to ACA with the subject line, "Transaction Summary." The text of Tourre's email began, "we wanted to summarize

ACA's proposed role as 'Portfolio Selection Agent' for the transaction that would be sponsored by Paulson (the 'Transaction Sponsor')." The email continued in relevant part, "[s]tarting portfolio would be ideally what the Transaction Sponsor shared, but there is flexibility around the names."

31. On January 22, 2007, ACA sent an email to Tourre and others at GS&Co with the subject line, "Paulson Portfolio 1-22-10.xls." The text of the email began, "Attached please find a worksheet with 86 sub-prime mortgage positions that we would recommend taking exposure to synthetically. Of the 123 names that were originally submitted to us for review, we have included only 55."

32. On January 27, 2007, ACA met with a Paulson representative in Jackson Hole, Wyoming, and they discussed the proposed transaction and reference portfolio. The next day, on January 28, 2007, ACA summarized the meeting in an email to Tourre. Tourre responded via email later that day, "this is confirming my initial impression that [Paulson] wanted to proceed with you subject to agreement on portfolio and compensation structure."

33. On February 2, 2007, Paulson, Tourre and ACA met at ACA's offices in New York City to discuss the reference portfolio. Unbeknownst to ACA at the time, Paulson intended to effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure. Tourre and GS&Co, of course, were fully aware that Paulson's economic interests with respect to the quality of the reference portfolio were directly adverse to CDO investors. During the meeting, Tourre sent an email to another GS&Co employee stating, "I am at this aca paulson meeting, this is surreal." Later the same day, ACA emailed Paulson, Tourre, and others at GS&Co a list of 82 RMBS on which Paulson and ACA concurred, plus a list of 21 "replacement" RMBS. ACA sought Paulson's approval of the revised list, asking, "Let me know if these work for you at the Baa2 level."

34. On February 5, 2007, Paulson sent an email to ACA, with a copy to Tourre, deleting eight RMBS recommended by ACA, leaving the rest, and stating that Tourre agreed that 92 bonds were a sufficient portfolio.

35. On February 5, 2007, an internal ACA email asked, "Attached is the revised portfolio that Paulson would like us to commit to – all names are at the Baa2 level. The final portfolio will have between 80 and these 92 names. Are 'we' ok to say yes on this portfolio?" The response was, "Looks good to me. Did [Paulson] give a reason why they kicked out all the Wells [Fargo] deals?" Wells Fargo was generally perceived as one of the higher-quality subprime loan originators.

36. On or about February 26, 2007, after further discussion, Paulson and ACA came to an agreement on a reference portfolio of 90 RMBS for ABACUS 2007-AC1.

F. GS&CO MISLED INVESTORS BY REPRESENTING THAT ACA SELECTED THE PORTFOLIO WITHOUT DISCLOSING PAULSON'S

SIGNIFICANT ROLE IN THE SELECTION AND ITS ADVERSE ECONOMIC INTERESTS

37. GS&Co's marketing materials for ABACUS 2007-AC1 were false and misleading because they represented that ACA selected the reference portfolio while omitting any mention that Paulson, a party with economic interests adverse to CDO investors, played a significant role in the selection of the reference portfolio.

38. For example, a 9-page term sheet for ABACUS 2007- AC1 finalized by GS&C on or about February 26, 2007, described ACA as the "Portfolio Selection Agent" and stated in bold print at the top of the first page that the reference portfolio of RMBS had been "selected by ACA." This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

39. Similarly, a 65-page flip book for ABACUS 2007-AC1 finalized by GS&Co on or about February 26, 2007 represented on its cover page that the reference portfolio of RMBS had been "Selected by ACA Management, LLC." The flip book included a 28-page overview of ACA describing its business strategy, senior management team, investment philosophy, expertise, track record and credit selection process, together with a 7-page section of biographical information on ACA officers and employees. Investors were assured that the party selecting the portfolio had an "alignment of economic interest" with investors. This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

40. Tourre had primary responsibility for preparing the term sheet and flip book.

41. The Goldman Sachs MCC, which included senior-level management of GS&Co, approved the ABACUS 2007-AC1 transaction on or about March 12, 2007. GS&Co expected to earn between $15 and $20 million for structuring and marketing ABACUS 2007-AC1.

42. On or about April 26, 2007, GS&Co finalized a 178-page offering memorandum for ABACUS 2007-AC1. The cover page of the offering memorandum included a description of ACA as "Portfolio Selection Agent." The Transaction Overview, Summary and Portfolio Selection Agent sections of the memorandum all represented that the reference portfolio of RMBS had been selected by ACA. This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

43. Tourre reviewed portions of the offering memorandum, including the Summary section, before it was sent to potential investors.

44. Although the marketing materials for ABACUS 2007-AC1 made no mention of Paulson or its role in the transaction, internal GS&Co communications clearly identified Paulson, its economic interests, and its role in the transaction. For example, the March 12, 2007 MCC memorandum describing the transaction stated, "Goldman is effectively working an order for Paulson to buy protection on specific layers of the [ABACUS 2007-

]AC1 capital structure."

G. GS&CO AND TOURRE MISLED ACA INTO BELIEVING PAULSON WAS LONG EOUITY

45. GS&Co and Tourre also misled ACA into believing that Paulson was investing in the equity of ABACUS 2007-ACI and therefore shared a long interest with COO investors. The equity tranche is at the bottom of the capital structure and the first to experience losses associated with deterioration in the performance of the underlying RMBS. Equity investors therefore have an economic interest in the successful performance of a reference RMBS portfolio. As of early 2007, ACA had participated in a number of CDO transactions involving hedge funds that invested in the equity tranche.

46. Had ACA been aware that Paulson was taking a short position against the CDO, ACA would have been reluctant to allow Paulson to occupy an influential role in the selection of the reference portfolio because it would present serious reputational risk to ACA, which was in effect endorsing the reference portfolio. In fact, it is unlikely that ACA would have served as portfolio selection agent had it known that Paulson was taking a significant short position instead of a long equity stake in ABACUS 2007-AC1. Tourre and GS&Co were responsible for ACA's misimpression that Paulson had a long position, rather than a short position, with respect to the CDO.

47. On January 8, 2007, Tourre attended a meeting with representatives from Paulson and ACA at Paulson's offices in New York City to discuss the proposed transaction. Paulson's economic interest was unclear to ACA, which sought further clarification from GS&Co. Later that day, ACA sent a GS&Co sales representative an email with the subject line "Paulson meeting" that read: "I have no idea how it went—I wouldn't say it went poorly, not at all, but I think it didn't help that we didn't know exactly how they [Paulson] want to participate in the space. Can you get us some feedback?"

48. On January 10, 2007, Tourre emailed ACA a ''Transaction Summary" that included a description of Paulson as the "Transaction Sponsor" and referenced a "Contemplated Capital Structure" with a "[0]% - [9]% pre-committed first loss" as part of the Paulson deal structure. The description of this [0]% - [9]% tranche at the bottom of the capital structure was consistent with the description of an equity tranche and ACA reasonably believed it to be a reference to the equity tranche. In fact, GS&Co never intended to market to anyone a "[0]% - [9]%" first loss equity tranche in this transaction.

49. On January 12, 2007, Tourre spoke by telephone with ACA about the proposed transaction. Following that conversation, on January 14, 2007, ACA sent an email to the GS&Co sales representative raising questions about the proposed transaction and referring to Paulson's equity interest. The email, which had the subject line "Call with Fabrice [Tourre] on Friday," read in pertinent part: "I certainly hope I didn't come across too antagonistic on the call with Fabrice [Tourre] last week but the structure looks difficult from a debt investor perspective. I can understand Paulson's equity perspective but for us to put our name on something, we have to be sure it enhances our reputation."

50. On January 16, 2007, the GS&Co sales representative forwarded that email to Tourre. As of that date, Tourre knew, or was reckless in not knowing, that ACA had been misled into believing Paulson intended to invest in the equity of ABACUS 2007-AC1.

51. Based upon the January 10, 2007, "Transaction Summary" sent by Tourre, the January 12, 2007 telephone call with Tourre and continuing communications with Tourre and others at GS&Co, ACA continued to believe through the course of the transaction that Paulson would be an equity investor in ABACUS 2007-AC1.

52. On February 12, 2007, ACA's Commitments Committee approved the firm's participation in ABACUS 2007-AC1 as portfolio selection agent. The written approval memorandum described Paulson's role as follows: "the hedge fund equity investor wanted to invest in the 0-9% tranche of a static mezzanine ABS CDO backed 100% by subprime residential mortgage securities." Handwritten notes from the meeting reflect discussion of "portfolio selection work with the equity investor."

H. ABACUS 2007-AC1 INVESTORS

i. IKB

53. IKB is a commercial bank headquartered in Dusseldorf, Germany. Historically, IKB specialized in lending to small and medium-sized companies. Beginning in and around 2002, IKB, for itself and as an advisor, was involved in the purchase of securitized assets referencing, or consisting of, consumer credit risk including RMBS CDOs backed by U.S. mid-and-subprime mortgages. IKB's former subsidiary, IKB Credit Asset Management GmbH, provided investment advisory services to various purchasing entities participating in a commercial paper conduit known as the "Rhineland programme conduit."

54. The identity and experience of those involved in the selection of a CDO portfolio was an important investment factor for IKB. In late 2006 IKB informed GS&Co and Tourre that it was no longer comfortable investing in the liabilities of CDOs that did not utilize a collateral manager, meaning an independent third-party with knowledge of the U.S. housing market and expertise in analyzing RMBS. Tourre and GS&Co knew that ACA was a collateral manager likely to be acceptable to IKB.

55. GS&Co offered and sold ABACUS 2007-AC1 notes to IKB. Tourre played a principal role in the offer and sale of the securities to IKB.

56. In February, March and April 2007, GS&Co sent IKB copies of the ABACUS 2007-AC1 term sheet, flip book and offering memorandum, all of which represented that the RMBS portfolio had been selected by ACA and omitted any reference to Paulson, its role in selecting the reference portfolio and its adverse economic interests. Those representations and omissions were materially false and misleading because, unbeknownst to IKB, Paulson played a significant role in the collateral selection and had financial interests in the transaction directly adverse to IKB. Neither GS&Co nor Tourre informed IKB of Paulson's participation in the portfolio selection process and its adverse

economic interests.

57. On or about February 15, 2007, GS&Co arranged for ABACUS 2007-AC1 marketing materials, including a term sheet and reference portfolio list, to be sent by email to IKB. Tourre was aware these materials would be delivered to IKB.

58. On February 19, 2007, at the direction of GS&Co personnel in New York, a GS&Co sales representative in London forwarded the marketing materials to IKB, explaining via email: "Attached are details of the ACA trade we spoke about with Fabrice [Tourre] in which you thought the AAAs would be interesting."

59. Tourre maintained direct and indirect contact with IKB in an effort to close the deal. On March 6, 2007, Tourre sent an email intended to press IKB to move forward with the transaction. The email stated, among other things, "This is a portfolio selected by ACA …" (Tourre subsequently described the portfolio in an internal GS&Co email as having been "selected by ACA/Paulson.") On March 19, 2007, an IKB representative sent an email to Tourre and others asking "what your plan for the ACA deal is?" On March 23 and 26, 2007, GS&Co arranged for additional ABACUS 2007-AC1 marketing materials to be sent to IKB. On March 27, 2007, IKB indicated that it intended to recommend purchase of the ABACUS 2007-ACI notes. Later on March 27, Tourre sent an email to IKB promising to send updated documents relating to the transaction. The email to IKB from Tourre concluded: "Stay tuned! And thanks for getting your approval so quickly on this."

60. On April 2, 2007, Tourre sent an email to IKB confirming that he would be sending IKB an offering circular for ABACUS 2007-AC1 blacklined to show differences from a previous ABACUS transaction. IKB sent an email to Tourre in response, asking Tourre to call. Later that day, Tourre sent an email to IKB attaching blacklined and clean copies of the ABACUS 2007- AC1 offering circular. On April 5, 2007, Tourre sent an email to IKB following up on the status of the transaction and stating, "as discussed please let me know if you have any issue with the preliminary offering circular, we can discuss on Monday or Tuesday of next week."

61. ABACUS 2007-AC1 closed on or about April 26, 2007. IKB bought $50 million worth of Class A-1 notes at face value. The Class A-1 notes paid a variable interest rate equal to LIBOR plus 85 basis points and were rated Aaa by Moody's Investors Services, Inc. ("Moody's") and AAA by Standard & Poor's Ratings & Services ("S&P"). IKB bought $100 million worth of Class A-2 notes at face value. The Class A-2 notes paid a variable interest rate equal to LIBOR plus 110 basis points and were rated Aaa by Moody's and AAA by S&P.

62. The ABACUS 2007-Acl offering memorandum stated that the offered notes would be "ready for delivery in book-entry form only in New York, New York," that the notes were being offered by GS&Co "in the United States" and that GS&Co, a New York-based broker-dealer, was "offering" and "selling" the notes. The closing for the ABACUS 2007-AC1 transaction took place at One Battery Park Plaza in New York, New

York. At the closing, GS&Co initially purchased the notes, received them through the book-entry facilities of the Depository Trust Company ("DTC"), located at 55 Water Street in New York, and then delivered the notes through the book-entry facilities of the DTC to a New York-based bank for further delivery.

63. At closing GS&Co delivered $150 million representing the purchase price of the notes by federal funds wire transfer to LaSalle Bank National Association ("LaSalle Bank"), as trustee for ABACUS 2007-Acl. LaSalle Bank was headquartered in Chicago, Illinois during the relevant period.

64. The representation by GS&Co that the ABACUS 2007-AC1 reference portfolio had been selected by an independent third-party with experience and economic interests aligned with CDO investors was important to IKB. IKB would not have invested in the transaction had it known that Paulson played a significant role in the portfolio selection process while intending to take a short position against ABACUS 2007-AC1. Among other things, knowledge of Paulson's role would have seriously undermined IKB's confidence in the portfolio selection process and led senior IKB personnel to oppose the transaction.

65. Within months of closing, the ABACUS 2007-AC1 Class A-1 and A-2 notes sold by GS&Co to IKB were nearly worthless. IKB lost almost all of its $150 million investment. Most of this money was ultimately paid to Paulson in a series of transactions between GS&Co and Paulson. Specifically, on or about April 26, 2007, an affiliate of Paulson entered into CDS with an affiliate of GS&Co pursuant to which Paulson purchased protection on the layers of the ABACUS 2007- AC1 capital structure corresponding to the Class A-1 and Class A-2 notes. These CDS were security-based swap agreements offered and sold by GS&Co. Tourre played a principal role in the offer and sale of these CDS.

66. Securities or security-based swap agreements relating to ABACUS 2007-AC1 were marketed to additional investors through GS&Co's structured products syndicate desk located in New York. The structured products syndicate desk, among other things, emailed a new issue announcement of the transaction to a number of institutional investors, inviting them to contact, among others, any one of seven GS&Co sales representatives in New York.

ii. *ACA/ABN AMRO*

67. ACA's parent company, ACA Capital Holdings, Inc. ("ACA Capital"), with its principal office in New York, provided financial guaranty insurance on a variety of structured finance products including RMBS CDOs, through its wholly-owned subsidiary, ACA Financial Guaranty Corporation, also with its principal office in New York. On or about May 31, 2007, ACA Capital sold protection on or "wrapped" the $909 million super senior tranche of ABACUS 2007-AC1 (through a Delaware-incorporated affiliate), meaning that it assumed the credit risk associated with that portion of the capital structure via a CDS in exchange for premium payments of approximately 50 basis points per year.

At approximately the same time, an affiliate of Paulson entered into a CDS with an affiliate of GS&Co pursuant to which it purchased protection on the super senior tranche of ABACUS 2007-AC1. These CDS were security-based swap agreements offered and sold by GS&Co. Tourre played a principal role in the offer and sale of these CDS.

68. ACA Capital was unaware of Paulson's short position in the transaction. It is unlikely that ACA Capital would have written protection on the super senior tranche if it had known that Paulson, which played an influential role in selecting the reference portfolio, had taken a significant short position instead of a long equity stake in ABACUS 2007-AC1.

69. The super senior transaction with ACA Capital was intermediated by ABN AMRO Bank N.V. ("ABN"), which was one of the largest banks in Europe during the relevant period. This meant that, through a series of CDS between ABN and a GS&Co affiliate and between ABN and ACA Capital that netted ABN premium payments of approximately 17 basis points per year, ABN assumed the credit risk associated with the $909 million super senior portion of ABACUS 2007-AC1's capital structure in the event ACA Capital was unable to pay. The CDS entered into by ABN and ACA Capital were security-based swap agreements offered and sold by GS&Co. Tourre played a principal role in the offer and sale of these CDS. For example, on April 5, 2007, Tourre sent an email to ABN soliciting its participation in a "super senior swap trade" on the ABACUS 2007-AC1 reference portfolio, which Tourre represented had been "selected by ACA." The email from Tourre to ABN summarized the financial terms of the proposed CDS transaction.

70. GS&Co also sent ABN copies of the ABACUS 2007-AC1 term sheet, flip book and offering memorandum, all of which represented that the RMBS portfolio had been selected by ACA and omitted any reference to Paulson's role in the collateral selection and its adverse economic interest. These representations and omissions were materially false and misleading because, unbeknownst to ABN, Paulson played a significant role in the portfolio selection process and had a financial interest in the transaction that was adverse to ACA Capital and ABN.

71. In addition, on or about April 26, 2007, ACA Capital purchased $42 million worth of ABACUS 2007-AC1 class A-2 notes at face value. GS&Co offered and sold the ABACUS 2007-AC1 notes purchased by ACA Capital. Tourre played a principal role on the offer and sale of these securities to ACA Capital. As described above, within months of the ABACUS 2007-AC1 closing, the notes were worthless.

72. At the end of 2007, ACA Capital was experiencing severe financial difficulties. In early 2008, ACA Capital entered into a global settlement agreement with its counterparties to effectively unwind approximately $69 billion worth of CDSs, approximately $26 billion of which were related to 2005-06 vintage subprime RMBS.

73. In late 2007, ABN was acquired by a consortium of banks that included the Royal Bank of Scotland ("RBS"). On or about August 7, 2008, RBS unwound ABN's

super senior position in ABACUS 2007-Acl by paying GS&Co $840,909,090. Most of this money was subsequently paid by GS&Co to Paulson.

After 13 hours of deliberations, a jury in the Southern District of New York, applying the civil preponderance-of-the-evidence standard, found Tourre liable for six of the seven counts brought against him by the SEC, though jurors were torn over whether Tourre was more "scapegoat" or "willing participant." (To be clear, being a "scapegoat" is not a legal defense, though it may have some jury appeal.) Ultimately, the SEC's lawyers prevailed by painting a picture of Wall Street avarice for a jury struggling to balance the fairness of pinning the blame on one cog in the machine and the greater need for the greed machine to be dismantled. For firsthand accounts of the jury's deliberations, see Susanne Craig, Ben Protess, & Alexandra Stevenson, *In Complex Trading Case, Jurors Focused on Greed*, N.Y. TIMES DEALBOOK (Aug. 2, 2013): https://dealbook.nytimes.com/2013/08/02/in-complex-trading-case-jurors-focused-on-greed.

Problem 3-4

Why didn't the Justice Department charge the Goldman Sachs ABACUS case as a *criminal* case against Tourre? Against the Goldman Sachs firm? Should the government have charged individuals and/or the firm criminally, in connection with ABACUS and/or other mortgage-backed securities trading?

Problem 3-5

In the following materials, you learn about another high-profile matter in recent corporate crime, the "LIBOR scandal." What was the government's theory of fraud in the LIBOR cases, as reflected in these settlement documents with the bank UBS? Read the UBS settlement documents and consider this question *before* you read the Second Circuit opinion that follows, in which the court explains its reasons for reversing criminal convictions in a prosecution involving a different bank enmeshed in the LIBOR scandal.

(The document that follows is a non-prosecution agreement (NPA) and accompanying statement of facts. This form of corporate criminal settlement was mentioned in Chapter 1 and will be discussed in further detail in Chapter 17.)

U.S. Department of Justice
Criminal Division

December 18, 2012

Gary R. Spratling, Esq.
Gibson, Dunn & Crutcher LLP
555 Mission Street, Suite 3000
San Francisco, CA 94105

David P. Burns, Esq.
Gibson, Dunn & Crutcher LLP
1050 Connecticut Ave NW
Washington, D.C. 20036

Re: UBS AG

Dear Mr. Spratling and Mr. Burns:

On the understandings specified below, the United States Department of Justice, Criminal Division, Fraud Section ("Fraud Section") will not criminally prosecute UBS AG and its subsidiaries and affiliates (collectively, "UBS"), with the exception of UBS Securities Japan Co., Ltd. ("UBS Securities Japan"), for any crimes (except for criminal tax violations, as to which the Fraud Section cannot and does not make any agreement) related to UBS's submissions of benchmark interest rates, including the London InterBank Offered Rate (known as LIBOR), the Euro Interbank Offered Rate (known as EURIBOR), and the Tokyo InterBank Offered Rate (known as TIBOR), as described in the attached Appendix A, which is incorporated in this Non- Prosecution Agreement ("Agreement").

It is understood that UBS admits, accepts, and acknowledges responsibility for the conduct set forth in Appendix A and agrees not to make any public statement contradicting Appendix A.

The Fraud Section and UBS further agree that as a term and condition of this Agreement, UBS Securities Japan will plead guilty to one count of wire fraud, in violation of Title 18, United States Code, Sections 1343 and 2, in accordance with the Plea Agreement that is attached as Appendix B, which is incorporated in this Agreement.

The Fraud Section enters into this Agreement based, in part, on its consideration of the following factors:

(a) UBS has made a timely, voluntary, and complete disclosure of the facts described in Appendix A.

(b) UBS conducted a thorough internal investigation of the misconduct described in Appendix A, reported all of its findings to the Fraud Section, cooperated fully with the Fraud Section's investigation of this matter, and sought to effectively remediate any problems it discovered.

1. Although UBS was not the first bank to provide the Fraud Section with helpful information, and its self-disclosure and cooperation commenced after the Fraud Section had obtained certain evidence implicating UBS and, in particular, efforts to manipulate Yen benchmarks, UBS made its self-disclosure before the Fraud Section had contacted UBS regarding the criminal investigation.

2. UBS provided highly valuable information that significantly expanded and advanced the criminal investigation. UBS's cooperation has been exceptional in many important respects. Through its internal investigation, UBS has sought to uncover and disclose evidence of misconduct without restricting the focus of its investigation to issues the government had already identified. Over the past two years, it has made substantial efforts to assist the government in obtaining access to sources of evidence located abroad, including documents and witnesses. UBS's extensive cooperation is a particularly significant and favorable consideration in the Fraud Section's decision to enter into this Agreement.

3. The Fraud Section received compelling information from UBS, as well as from regulatory agencies, demonstrating that in recent years, under its new senior leadership, UBS has made important and positive changes in its compliance, training, and overall approach to ensuring its adherence to the law. Moreover, UBS appears to have substantially improved the manner in which it responds to regulatory and criminal investigations and to its discovery of potential misconduct, as the Department of Justice has observed in this matter.

a. In order to ensure that misconduct of this nature does not recur, UBS has implemented a modified and significantly enhanced control framework for its LIBOR submission process and has expanded that program to encompass all other benchmark interest rate submissions. UBS has also implemented significant remedial measures in response to the misconduct discovered during this investigation.

b. The Fraud Section has also received favorable reports from the Swiss Financial Market Supervisory Authority ("FINMA") and the Japan Financial Services Authority (the "JFSA") describing, respectively, (1) positive progress that UBS has made in its approach to compliance and enforcement, and (2) UBS Securities Japan's effective implementation of the remedial measures previously imposed by the JFSA based on its findings relating to the attempted manipulation of Yen benchmarks.

This recent record is commendable, and partially mitigates the adverse implications of UBS's prior history of misconduct.

This Agreement does not provide any protection against prosecution for any crimes except as set forth above, and applies only to UBS and not to any other entities or to any individuals, including but not limited to employees or officers of UBS. The protections provided to UBS shall not apply to any acquirer or successor entities unless and until such acquirer or successor formally adopts and executes this Agreement.

This Agreement shall have a term of two years from the date of this Agreement, except as specifically provided below. It is understood that for the two-year term of this Agreement, UBS shall: (a) commit no United States crime whatsoever; (b) truthfully and completely disclose non- privileged information with respect to the activities of UBS, its officers and employees, and others concerning all matters about which the Fraud Section inquires of it, which information can be used for any purpose, except as otherwise limited in this Agreement; (c) bring to the Fraud Section's attention all potentially criminal conduct by UBS or any of its employees that relates to violations of U.S. laws (i) concerning fraud or (ii) governing securities and commodities markets; and (d) bring to the Fraud Section's attention all criminal or regulatory investigations, administrative proceedings or civil actions brought by any governmental authority in the United States against UBS or its employees that alleges fraud or violations of the laws governing securities and commodities markets.

Until the date upon which all investigations and prosecutions arising out of the conduct described in this Agreement are concluded, including the investigations of the matters listed in Appendix C, whether or not they are concluded within the two-year term specified in the preceding paragraph, UBS shall, in connection with any investigation or prosecution arising out of the conduct described in this Agreement: (a) cooperate fully with the Fraud Section, the Federal Bureau of Investigation, and any other law enforcement or government agency designated by the Fraud Section; (b) assist the Fraud Section in any investigation or prosecution by providing logistical and technical support for any meeting, interview, grand jury proceeding, or any trial or other court proceeding; (c) use its best efforts promptly to secure the attendance and truthful statements or testimony of any officer, agent or employee at any meeting or interview or before the grand jury or at any trial or other court proceeding; and (d) provide the Fraud Section, upon request, all non-privileged information, documents, records, or other tangible evidence about which the Fraud Section or any designated law enforcement or government agency inquires.

It is understood that, if the Fraud Section determines in its sole discretion that UBS has committed any United States crime subsequent to the date of this Agreement, or that UBS has given false, incomplete, or misleading testimony or information at any time, or that UBS has otherwise violated any provision of this Agreement, UBS shall thereafter be subject to prosecution for any federal violation of which the Fraud Section has knowledge, including perjury and obstruction of justice. Any such prosecution that is not time-barred by the applicable statute of limitations on the date of the signing of this Agreement may be commenced against UBS, notwithstanding the expiration of the statute of limitations between the signing of this Agreement and the expiration of the term of the Agreement plus one year. Thus, by signing this Agreement, UBS agrees that the statute of limitations with respect to any prosecution that is not time-barred on the date that this Agreement is signed shall be tolled for the term of this Agreement plus one year.

It is understood that, if the Fraud Section determines in its sole discretion that

UBS has committed any United States crime after signing this Agreement, or that UBS has given false, incomplete, or misleading testimony or information at any time, or that UBS has otherwise violated any provision of this Agreement: (a) all statements made by UBS or any of its employees to the Fraud Section or other designated law enforcement agents, including Appendix A, and any testimony given by UBS or any of its employees before a grand jury or other tribunal, whether prior or subsequent to the signing of this Agreement, and any leads derived from such statements or testimony, shall be admissible in evidence in any criminal proceeding brought against UBS; and (b) UBS shall assert no claim under the United States Constitution, any statute, Rule 410 of the Federal Rules of Evidence, or any other federal rule that such statements or any leads derived therefrom are inadmissible or should be suppressed. By signing this Agreement, UBS waives all rights in the foregoing respects.

The decision whether any public statement contradicts Appendix A and whether it shall be imputed to UBS for the purpose of determining whether UBS has breached this Agreement shall be in the sole discretion of the Fraud Section. If the Fraud Section determines that a public statement contradicts in whole or in part a statement contained in Appendix A, the Fraud Section shall so notify UBS, and UBS may avoid a breach of this Agreement by publicly repudiating such statement(s) within five business days after notification. This paragraph is not intended to apply to any statement made by any former UBS officers, directors, or employees. Further, nothing in this paragraph precludes UBS from taking good-faith positions in litigation involving a private party that are not inconsistent with Appendix A. In the event that the Fraud Section determines that UBS has breached this Agreement in any other way, the Fraud Section agrees to provide UBS with written notice of such breach prior to instituting any prosecution resulting from such breach. UBS shall, within 30 days of receipt of such notice, have the opportunity to respond to the Fraud Section in writing to explain the nature and circumstances of such breach, as well as the actions UBS has taken to address and remediate the situation, which explanation the Fraud Section shall consider in determining whether to institute a prosecution. It is understood that UBS, by a branch or agency located in Connecticut, agrees to pay a monetary penalty of $500,000,000. UBS must pay this sum to the United States Treasury within ten days of the sentencing of UBS Securities Japan, in connection with its guilty plea and plea agreement attached as Appendix B. The parties agree that any criminal penalties that might be imposed by the Court on UBS Securities Japan in connection with its guilty plea and plea agreement will be deducted from the $500,000,000 penalty agreed to under this Agreement. UBS acknowledges that no tax deduction may be sought in connection with this payment.

It is further understood that, as noted above, UBS has strengthened its compliance and internal controls standards and procedures, and that it will further strengthen them as required by FINMA, the U.S. Commodity Futures Trading Commission, the JFSA, the United Kingdom Financial Services Authority, and any other regulatory or enforcement agencies that have addressed the misconduct set forth in Appendix A. In addition, in light of active investigations by various regulators of the conduct described in Appendix A and the role that regulators such as those listed above

will continue to play in reviewing UBS's compliance standards, the Fraud Section has determined that adequate compliance measures have been and will be established. It is further understood that UBS will report to the Fraud Section, upon request, regarding its remediation and implementation of any compliance program and internal controls, policies, and procedures that relate to its submission of benchmark interest rates. Moreover, UBS agrees that it has no objection to any regulatory agencies providing to the Fraud Section any information or reports generated by such agencies or UBS relating to the submissions of benchmark interest rates. Such information and reports will likely include proprietary, financial, confidential, and competitive business information. Moreover, public disclosure of the information and reports could discourage cooperation, impede pending or potential government investigations, and thus undermine the objectives of the reporting requirement. For these reasons, among others, the information and reports and the contents thereof are intended to remain and shall remain non-public, except as otherwise agreed to by the parties in writing, or except to the extent that the Fraud Section determines in its sole discretion that disclosure would be in furtherance of the Fraud Section's discharge of its duties and responsibilities or is otherwise required by law. . . .

APPENDIX A
STATEMENT OF FACTS

This Statement of Facts is incorporated by reference as part of the non-prosecution agreement, dated December 18, 2012, between the United States Department of Justice, Criminal Division, Fraud Section, and UBS AG ("UBS"). The parties agree that the following information is true and accurate:

I. BACKGROUND

A. LIBOR, Euroyen TIBOR, and Euribor

1. Since its inception in approximately 1986, the London Interbank Offered Rate ("LIBOR") has been a benchmark interest rate used in financial markets around the world. Futures, options, swaps, and other derivative financial instruments traded in the over-the-counter market and on exchanges worldwide are settled based on LIBOR. The Bank of International Settlements has estimated that in the second half of 2009, for example, the notional amount of over-the-counter interest rate derivative contracts was valued at approximately $450 trillion. In addition, mortgages, credit cards, student loans, and other consumer lending products often use LIBOR as a reference rate.

2. LIBOR is published under the auspices of the British Bankers' Association ("BBA"), a trade association with over 200 member banks that addresses issues involving the United Kingdom banking and financial services industries. The BBA defines LIBOR as:

> The rate at which an individual Contributor Panel bank could borrow funds, were it to do so by asking for and then accepting inter-bank offers in reasonable market size, just prior to 11:00 [a.m.] London time.

This definition has been in place since approximately 1998.

3. LIBOR rates were initially calculated for three currencies: the United States Dollar, the British Pound Sterling, and the Japanese Yen. Over time, the use of LIBOR expanded, and benchmark rates were calculated for ten currencies, including the original three.

4. The LIBOR for a given currency is the result of a calculation based upon submissions from a panel of banks for that currency (the "Contributor Panel") selected by the BBA. Each member of the Contributor Panel submits its rates every London business day through electronic means to Thomson Reuters, as an agent for the BBA, by 11:10 a.m. London time. Once each Contributor Panel bank has submitted its rate, the contributed rates are ranked. The highest and lowest quartiles are excluded from the calculation, and the middle two quartiles (i.e., 50% of the submissions) are averaged to formulate the resulting LIBOR "fix" or "setting" for that particular currency and maturity.

5. The LIBOR contribution of each Contributor Panel bank is submitted to between two and five decimal places, and the LIBOR fix is rounded, if necessary, to five decimal places. In the context of measuring interest rates, one "basis point" (or "bp") is one-hundredth of one percent (0.01%).

6. Thomson Reuters calculates and publishes the rates each business day by approximately 11:30 a.m. London time. Fifteen maturities (or "tenors") are quoted for each currency, ranging from overnight to twelve months. The published rates are made available worldwide by Thomson Reuters and other data vendors through electronic means and through a variety of information sources. In addition to the LIBOR fix resulting from the calculation, Thomson Reuters publishes each Contributor Panel bank's submitted rates along with the names of the banks.

7. According to the BBA, each Contributor Panel bank must submit its rate without reference to rates contributed by other Contributor Panel banks. The basis for a Contributor Panel bank's submission, according to a clarification the BBA issued in June 2008, must be the rate at which members of the bank's staff primarily responsible for management of the bank's cash, rather than the bank's derivative trading book, consider that the bank can borrow unsecured inter-bank funds in the London money market. Further, according to the BBA, a Contributor Panel bank may not contribute a rate based on the pricing of any derivative financial instrument. In other words, a Contributor Panel bank's LIBOR submissions should not be influenced by its motive to maximize profit or minimize losses in derivatives transactions tied to LIBOR.

8. The Contributor Panel for United States Dollar ("Dollar") LIBOR from

at least 2005 through 2010 was comprised of 16 banks, including UBS. Presently, there are 18 banks on the Dollar Contributor Panel, including UBS. From at least 2005 to the present, UBS has also been a member of the Contributor Panels for, among other currencies, Yen LIBOR, Euro LIBOR, Swiss Franc LIBOR, and Pound Sterling LIBOR.

9. From at least 2005 to the present, UBS has also been a member of the Contributor Panel for the Euro Interbank Offered Rate ("Euribor"). Euribor is a reference rate overseen by the European Banking Federation ("EBF"), which is based in Brussels, Belgium. Since 2005, the Euribor Contributor Panel has been comprised of approximately 42 to 48 banks. Euribor is the rate at which Euro interbank term deposits within the Euro zone are expected to be offered by one prime bank to another, at 11:00 a.m. Brussels time.

10. Thomson Reuters, as an agent of the EBF, calculates and publishes the Euribor rates each business day. Each Euribor Contributor Panel bank submits its contributed rate to Thomson Reuters through electronic means, and then the contributed rates are ranked. The highest and lowest 15% of all the quotes are excluded from the calculation, and the remaining rates (i.e., the middle 70%) are averaged to formulate the resulting Euribor fix for each tenor. The published rates, and each Contributor Panel bank's submitted rates, are made available worldwide through electronic means and through a variety of information sources.

11. From at least 2005 until 2012, UBS was also a member of the Contributor Panel for the Euroyen Tokyo Interbank Offered Rate ("TIBOR"). TIBOR is a reference rate overseen by the Japanese Bankers Association ("JBA"), which is based in Tokyo, Japan. While UBS was a member of the panel, the Euroyen TIBOR Contributor Panel was comprised of 16 banks. The term "Euroyen" refers to Yen deposits maintained in accounts outside of Japan. Euroyen TIBOR is what Contributor Panel banks deem to be prevailing lending market rates between prime banks in the Japan Offshore Market as of 11:00 a.m. Tokyo time. Euroyen TIBOR is calculated by discarding the two highest and two lowest submissions, and averaging the remaining rates. The published rates, and each Contributor Panel bank's submitted rates, are made available worldwide through electronic means and through a variety of information sources.

12. Because of the widespread use of LIBOR and other benchmark interest rates in financial markets, these rates play a fundamentally important role in financial systems around the world.

B. *Eurodollar and Euroyen Futures Contracts, and Interest Rate Swaps*

13. Eurodollar futures contracts are traded on the Chicago Mercantile Exchange ("CME"), and are settled based on LIBOR. Eurodollar futures contracts are highly liquid, and each has a notional value of $1 million. A "Eurodollar" is a Dollar deposit with a bank outside of the United States. A Eurodollar futures contract is essentially the interest that would be paid on a Eurodollar deposit of $1 million for a

term of three months. Prior to the settlement date, the price of a 3-month Eurodollar futures contract is an indication of the market's prediction of the 3-month Dollar LIBOR on its settlement date. The actual settlement price of a 3-month contract is calculated as 100 minus the 3-month Dollar LIBOR on the settlement date. Most Eurodollar futures contracts settle on four quarterly International Monetary Market ("IMM") dates, which are the third Wednesday of March, June, September, and December. The last trading days are the second London bank business day prior to the third Wednesday (i.e., usually Monday) in those months. In 2009, according to the Futures Industry Association, more than 437 million Eurodollar futures contracts were traded on the CME.

14. Euroyen futures contracts are also traded on the CME and other exchanges around the world, and are settled based on Euroyen TIBOR. A Euroyen futures contract is essentially the interest that would be paid on a Euroyen deposit of ¥100,000,000 for a term of three months. The actual settlement price of a 3-month contract is calculated as 100 minus the 3-month Euroyen TIBOR on the settlement date. Most contracts settle on the four quarterly IMM dates. From 2007 through 2011, according to the CME, more than 758,000 Euroyen TIBOR futures contracts were traded on the CME.

15. An interest rate swap ("swap") is a financial derivative instrument in which two parties agree to exchange interest rate cash flows. If, for example, a party has a transaction in which it pays a fixed rate of interest but wishes to pay a floating rate of interest tied to a reference rate, it can enter into an interest rate swap to exchange its fixed rate obligation for a floating rate one. Commonly, for example, Party A pays a fixed rate to Party B, while Party B pays a floating interest rate to Party A indexed to a reference rate like LIBOR. There is no exchange of principal amounts, which are commonly referred to as the "notional" amounts of the swap transactions. Interest rate swaps are traded over-the-counter; in other words, they are negotiated in transactions between counterparties and are not traded on exchanges.

C. *UBS*

16. UBS AG is a financial services corporation with headquarters located in Zurich, Switzerland. UBS AG has banking divisions and subsidiaries around the world, including in the United States, with its United States headquarters located in New York, New York and Stamford, Connecticut. One of its divisions is the Investment Bank, which operates through a number of legal entities including UBS Securities Japan Co., Ltd.,—which is a wholly-owned subsidiary of UBS AG that engages in investment banking and wealth management. UBS employs derivatives traders throughout the world—including in Stamford, London, Zurich, and Tokyo—who trade financial instruments tied to LIBOR, Euribor and Euroyen TIBOR, including interest rate swaps and Eurodollar and Euroyen futures contracts ("derivatives traders").

17. UBS AG's Group Treasury section is the part of UBS AG that monitors and oversees the financial resources of the entire bank, including the bank's liquidity and funding. At all relevant times herein, Asset and Liability Management ("ALM") is

the part of the Investment Bank Division which managed the bank's liquidity buffer and issuance of new commercial paper and certificates of deposit. Group Treasury provided guidance to ALM on funding issues. The head of ALM worked for the Investment Bank Division.

D. UBS's LIBOR, Euroyen TIBOR, and Euribor Submissions

18. At various times from at least 2001 through June 2010, certain UBS derivatives traders—whose compensation from UBS was directly connected to their success in trading financial products tied to LIBOR, Euroyen TIBOR and Euribor—directly or indirectly exercised improper influence over UBS's submissions for those benchmark interest rates.

19. Up until September 1, 2009, UBS's LIBOR submissions were made by UBS derivatives traders. On September 1, 2009, ALM took over the LIBOR submission process from the derivatives trading desks. This change was the result of a decision of UBS's Compliance Department ("Compliance"), based on the conclusion that there was an inherent conflict of interest in having derivatives traders determine the daily benchmark submissions. Nevertheless, under this new policy, derivatives traders continued to provide input to ALM, which ALM submitters at times considered in determining UBS's LIBOR and Euribor submissions. Each day, approximately 15 minutes before ALM made its LIBOR and Euribor submissions, derivatives traders in a given currency would input their assessment of LIBOR and Euribor changes into a shared spreadsheet. The ALM submitters then considered that input along with the previous day's submission, but also factored in ALM's knowledge of UBS's cost of funds.

II. UBS'S MANIPULATION OF LIBOR, EUROYEN TIBOR AND EURIBOR SUBMISSIONS

20. From as early as 2001 through at least June 2010, certain UBS derivatives traders requested and obtained benchmark interest-rate submissions which benefited their trading positions. These derivatives traders requested, and sometimes directed, that certain UBS LIBOR, Euroyen TIBOR, and Euribor submitters submit benchmark interest rate contributions that would benefit the traders' trading positions, rather than rates that complied with the definitions of LIBOR, Euroyen TIBOR and Euribor. Those derivatives traders either requested or directed a particular LIBOR, Euroyen TIBOR or Euribor contribution for a particular tenor and currency, or requested that the rate submitter contribute a rate higher, lower, or unchanged for a particular tenor and currency. The derivatives traders made these requests in electronic messages, telephone conversations, and in-person conversations. The LIBOR, Euroyen TIBOR, and Euribor submitters regularly agreed to accommodate the derivatives traders' requests and directions for favorable benchmark interest rate submissions.

A. Yen LIBOR and Euroyen TIBOR

21. The market for derivatives and other financial products linked to benchmark interest rates for the Yen is global and is one of the largest and most active markets for such products in the world. A number of these products are traded in the United States—such as the Euroyen TIBOR futures contract traded on the CME—in transactions involving U.S.-based counterparties. For example, a meaningful portion of the total value of the transactions entered into by UBS's most successful Yen derivatives trader from 2007 through 2009 ("Trader-1") involved U.S.-based counterparties.

22. Beginning in 2006, in Zurich, Tokyo, and elsewhere, several UBS employees engaged in sustained, wide-ranging, and systematic efforts to manipulate Yen LIBOR and, to a lesser extent, Euroyen TIBOR, to benefit UBS's trading positions. This conduct encompassed hundreds of instances in which UBS employees sought to influence benchmark rates; during some periods, UBS employees engaged in this activity on nearly a daily basis. In furtherance of these efforts to manipulate Yen benchmarks, UBS employees used several principal and interrelated methods, including the following:

a) internal manipulation within UBS of its Yen LIBOR and Euroyen TIBOR submissions;

b) use of cash brokers to influence other Contributor Panel banks' Yen LIBOR submissions by disseminating misinformation; and

c) efforts to collude directly with employees at other Contributor Panel banks, either directly or through brokers, in order to influence those banks' Yen LIBOR submissions.

Details and examples of this conduct are set forth below.

1) Manipulation Within UBS of its Yen LIBOR and Euroyen TIBOR Submissions

a. Yen LIBOR

23. Instances of accommodating Yen derivatives traders' requests dated back at least to 2002, when UBS's Yen LIBOR submitter—later promoted to manage UBS's Yen and Swiss Franc derivatives trading desks—occasionally accommodated his/her supervisor's instruction for submissions to benefit the supervisor's Yen derivatives trading positions.

24. The manipulation of Yen LIBOR submissions to benefit UBS derivatives traders' positions began to occur far more frequently after July 2006, when UBS hired Trader-1, a Tokyo-based Yen derivatives trader. Beginning in September 2006, and continuing until soon before he left UBS in September 2009, Trader-1, and occasionally other UBS Yen derivatives traders, regularly requested that UBS Yen LIBOR submitters contribute LIBOR submissions to benefit their trading books. Trader-

1 and his/her colleagues engaged in this conduct on the majority of total trading days during this more-than-three-year period.

25. For example, on Monday, November 20, 2006, Trader-1 asked the UBS Yen LIBOR submitter ("Submitter-3"), who was substituting for the regular submitter ("Submitter-1") that day, "hi . . . [Submitter-1] and I generally coordinate ie sometimes trade if ity [sic] suits, otherwise skew the libors a bit." Trader-1 went on to request, "really need high 6m [6-month] fixes till Thursday." Submitter-3 responded, "yep we on the case there . . . will def[initely] be on the high side." The day before this request, UBS's 6-month Yen LIBOR submission had been tied with the lowest submissions included in the calculation of the LIBOR fix. Immediately after this request for high submissions, however, UBS's 6-monthYen LIBOR submissions rose to the highest submission of any bank in the Contributor Panel and remained tied for the highest until Thursday—as Trader-1 had requested.

26. In early 2007, a new UBS Yen LIBOR submitter ("Submitter-2") received training from Submitter-1, who was also a UBS manager and Yen derivatives trader. During that training, Submitter-2 was instructed that the primary factor in determining UBS's Yen LIBOR submissions each day was the UBS Yen derivatives traders' requests, which were to be accommodated. Submitter-2 followed that directive, and accommodated Trader-1 and other UBS Yen derivatives traders' requests for LIBOR submissions through July 2009, when Submitter-2's responsibilities at UBS changed.

27. From at least August 2007 and at various times through at least September 2009, the manager of one of the Yen derivatives trading desks in Tokyo exerted pressure on Yen LIBOR submitters to take derivatives traders' positions into account when setting Yen LIBOR. Yen derivatives traders routinely requested that the submitters contribute Yen LIBOR submissions to benefit their trading books, and the submitters, in accordance with the instructions from their superiors at UBS, accommodated derivatives traders' requests.

28. An example of such an accommodation occurred on March 29, 2007, when Trader-1 asked Submitter-1, "can we go low 3[month] and 6[month] pls? . . . 3[month] esp." Submitter-1 responded "ok", and then the two had the following exchange by electronic chat:

Trader-1:	what are we going to set?
Submitter-1:	too early to say yet . . . prob[ably] .69 would be our unbiased contribution
Trader-1:	ok wd really help if we cld keep 3m low pls
Submitter-1:	as i said before – i [don't] mind helping on your fixings, but i'm not setting libor 7bp away from the truth . . . I'll get ubs banned if i do that, no interest in that.

Trader-1: ok obviously [sic] no int[erest] in that happening either . . . not asking for it to be 7bp from reality anyway any help appreciated [.]

Trader-1 received the help he requested. Although Submitter-1's "unbiased contribution" of the 3-month Yen LIBOR submission would have been .69 that day, he lowered his/her submission to .67, as Trader-1 requested.

29. As another example, a series of electronic chats between March 12 and 17, 2008, demonstrates that Trader-1 caused UBS's Yen LIBOR submission to move 3 basis points over a 5 day period. On Wednesday, March 12, 2008, Trader-1 asked Submitter-2 to raise the 3-month Yen LIBOR submission from the previous day's .99 contribution, because "we have [$2 million] usd fix in 3[month] on Monday [March 17] per bp." Submitter-2 responded: "with yesterdays .99 i was already on the very high side. i need to go down a touch lower on the back to what happened yesterday . . . thought about .97." Trader-1 responded: "cool no chance of .98? anyway the actual fix is Monady [sic] [March 17] so that's the key day." Although Submitter-2 had intended to drop his/her LIBOR contribution down to .97 on March 12, he instead raised his/her LIBOR submission to .98. The following day, he raised it again to .99, and on Monday, March 17, the following exchange occurred:

Trader-1: been chatting with [your supervisor] . . . can we go . . . high 3[month] . . . obviously with the size of the fix today and confusion over levels if we could push it a bit more than usual it would be great

* * *

Submitter-2: Friday fixed 3mt at 0.09

Trader-1: thx [Submitter-2]

Submitter-2: shall I go fro [sic] 1%?

Trader-1: pls

Submitter-2: ok will do

As promised, Submitter-2 contributed a Yen LIBOR submission of 1% that day, 3 basis points higher than where he had intended to submit a few days earlier.

30. In a March 28, 2008 electronic chat between Trader-1 and Submitter-2, Trader-1 was again successful in manipulating UBS's LIBOR submission to benefit his trading positions:

Trader-1: just for my guide [Submitter-2] roughly wher are we going to set 3m and 6m?

Submitter-2:	3m0.92 6m 0.96
Trader-1:	can we go lower?
Submitter-2:	sure . . . dont think it will be that low though . . . but can do 090
	* * *
Trader-1:	so can we set 6m at .94 too? . . . 6m is much more urgent . . . most urgent of the lot
	* * *
Submitter-2:	i just put in 0.95 for 6mt
Trader-1:	ok . . . Thx

True to his/her agreement to accommodate Trader-1, Submitter-2 lowered UBS's 3-month Yen LIBOR submission from .92 to .90, and lowered UBS's 6-month submission from .96 to .95.

31. On some occasions, UBS Yen LIBOR submitters would also amend, if possible, previously submitted Yen LIBOR contributions to accommodate UBS's trading positions. For example, in an April 4, 2008 electronic chat between Trader-1 and Submitter-2, the following exchange occurred:

Trader-1:	have you put the libors in?
Submitter-2:	y[es] . . . any changes?
Trader-1:	oh was going to ask high 6m if not too late
Submitter-2:	i input 95 . . . which is on the lower side
Trader-1:	ok is it too late to change? . . . if not no drama
Submitter-2:	i try to change it now but cannot guarantee if it gets accepted
	* * *
Submitter-2:	just changed [sic] it to 0.98

The UBS 6-month Yen LIBOR submission that day was indeed .98, 3 basis points higher than Submitter-2's originally intended submission.

32. As another example, on June 29, 2009, Trader-1 contacted Submitter-2 by electronic chat, explaining that he had huge positions that day and asking, "can we [submit] 6 m libor high pls." Submitter-2 stated that based on the information he had, he would submit a 6- month Yen LIBOR of .7150. Trader-1 responded by asking, "can we go 74 or 75 [meaning .74 or .75] . . . we have [$2 million per basis point exposure] for

the next week." Submitter-2 agreed to accommodate this request, responding, "yes sure will. I go with .75 for you[.]" Thus, the submitter agreed to move his/her 6-month Yen LIBOR submission by 3.5 basis points that day to benefit the derivatives trader's position.

b. Euroyen TIBOR

33. From in or around 2007 through 2009, on some occasions, UBS Yen derivatives traders also requested that UBS Euroyen TIBOR submitters contribute TIBOR submissions to benefit their trading positions. The TIBOR submitters' manager, Submitter-1, routinely provided suggested TIBOR submissions based on the derivatives traders' positions, and the TIBOR submitters relied upon this input.

34. For example, in a November 8, 2007 electronic chat, Submitter-1, who was also a UBS Yen derivatives trader, instructed the TIBOR submitter: "pls remind me tomorrow . . . we need to move the 1mos tibor up . . . maybe +2 tomorrow . . . then 1 bp on each for a few days . . . swap guys having some fixings." The TIBOR submitter responded "ok, noted".

35. As another example, on July 23, 2009, Submitter-1 caused UBS's Euroyen TIBOR submissions to decrease for a different improper purpose. On that day, Submitter-1 had the Euroyen TIBOR submitter drop UBS's 3-month TIBOR submission by 4 basis points simply to damage Trader-1's positions, and not because that is where he perceived Yen cash was trading.

In an electronic chat with Trader-B at another Contributor Panel bank, Trader-1 explained how he would rectify the situation by manipulating TIBOR settings higher the following week:

> [Submitter-1, who caused TIBOR to drop] hates me and is going to zurich . . . [his/her] last day is Friday . . . so [s/he] tried to screw my pos[ition] . . . next week we have control . . . so will try to get it back up . . . or rather will do it . . . monday goes back up

Later that same day, in a separate electronic chat with a cash broker who handled transactions for Trader-1 ("Broker-A1"), Trader-1 described how he successfully reached out to the UBS TIBOR submitters to raise UBS's 3-month submission back up.

Trader-1:	main thing is 3m tibor . . . i went to meet the guys who set it today
Broker-A1:	you can asist there
Trader-1:	they just set where we ask
Broker-A1:	;-) perfect

c. The Role of UBS Managers

36. Certain UBS managers, and senior managers, were aware of the internal manipulation of Yen LIBOR and Euroyen TIBOR submissions by derivatives traders as described above. For example, Trader-1's manager knew, at least as early as 2007, that internal pressure was placed on UBS Yen LIBOR submitters, and occasionally the Euroyen TIBOR submitters, to contribute submissions to benefit the Yen trading book. Further, certain Zurich based managers and more senior managers heading the derivatives desks in all currencies were informed of the pressure the Yen trading desk placed on the LIBOR submitters to contribute Yen LIBOR to benefit the traders' positions.

37. The majority of UBS Yen LIBOR and Euroyen TIBOR submitters, Yen derivatives traders, and their supervisors – as well as the more senior managers at UBS who were aware of this conduct – knew that the manipulation of Yen LIBOR and TIBOR submissions was inappropriate, yet continued to encourage, allow, or participate in this conduct. For example, Trader-1's manager, a senior manager in the Investment Bank, the primary Yen LIBOR and TIBOR submitters, and other derivatives traders knew it is inappropriate, and contrary to the definition of LIBOR or TIBOR, to consider derivative trading positions when contributing LIBOR or TIBOR submissions. Indeed, in an October 9, 2008 email, Submitter-1 complained to several other managers that: "one of the things we signed up for when UBS agreed to join the fixing panel was the condition that fixing contributions shall be made regardless of trading positions."

38. Because UBS's Yen LIBOR submitters, derivatives traders, and their managers knew this conduct was improper, they tried to conceal the manipulation. For example, after an August 10, 2009 Trader-1 email request to lower 6-month Yen LIBOR, a LIBOR submitter ("Submitter-4") complained to Trader-1's manager that these requests should not be in writing. Moreover, Trader-1 would sometimes request that LIBOR submissions be moved in small increments over time to avoid detection.

39. Finally, and for the same reason, a UBS derivatives desk manager sought to obstruct the investigation into LIBOR manipulation. In December 2010, Submitter-4, the UBS derivatives desk manager who had supervised Submitter-2 in 2009, instructed Submitter-2 to lie when interviewed by UBS attorneys during the investigation into LIBOR manipulation. Among other things, the UBS manager instructed Submitter-2 to:

- falsely claim that the UBS Yen trading desks did not have any derivative positions with exposure to Yen LIBOR;
- avoid mentioning Trader-1;
- falsely indicate that the Yen LIBOR submission process did not take into account trading positions;
- falsely claim that they never moved the Yen LIBOR submissions to benefit the Yen trading desks;

- falsely claim that when contributing Yen LIBOR submissions, UBS tried to be "as close to the market as possible."

2) Use of Brokers to Manipulate Yen LIBOR

40. From at least 2007 and at various times through January 2010, two UBS Yen derivatives traders also used cash brokers to manipulate Yen LIBOR submissions by enlisting these brokers to disseminate misinformation to other Contributor Panel banks regarding Yen LIBOR.

41. Cash brokers track bids and offers of cash in the market and assist derivatives and money market traders in arranging transactions between financial institutions and other market participants. As a result of their positions as intermediaries, some of these brokers developed relationships with traders and LIBOR submitters at various Contributor Panel banks and often possessed knowledge of interbank money market activity. Accordingly, it is not unusual for LIBOR submitters to collect information from cash brokers regarding the availability and price of cash in the money markets and elsewhere. This information can influence the LIBOR submissions of Contributor Panel banks.

a. Use of Brokers to Disseminate Misinformation

42. Certain UBS Yen derivatives traders sought and received assistance from cash brokers by asking them to disseminate false market information to Yen LIBOR submitters at other Contributor Panel banks. In this way, recipients of such misinformation could be influenced, often unwittingly, to contribute Yen LIBOR submissions that benefited UBS Yen derivatives traders' positions.

43. Trader-1 did a large volume of business in the Yen derivatives market, and he used brokers at several firms to help arrange his trades. Trader-1 also used some of those brokers, in different ways, as part of his scheme to manipulate Yen LIBOR. Trader-1 engaged in this conduct beginning in 2007, after discussing the strategy with his manager.

44. Trader-1 carried out one significant part of this scheme through his dealings with Brokerage-A. Trader-1 used Brokerage-A to broker derivative trades, and Broker-A1 serviced Trader-1's account. Another broker at that firm, Broker-A2, distributed a daily email to the Contributor Panel banks, which included "SUGGESTED LIBORS" purporting to represent where that broker thought Yen LIBOR should be set that day based on his/her market knowledge and experience. Trader-1 used Broker-A1 to pass along requests to Broker-A2 to adjust these suggested LIBORs to benefit Trader-1's trading positions. Broker-A2, at least on some occasions, accommodated these requests. Trader-1's manager, who was well-aware of this manipulative tactic, later estimated that during one six-month period in 2007, this scheme was used on a daily basis and had a 50% to 60% success rate.

45. As an example, in a Wednesday, August 15, 2007 electronic chat, Trader-1 and Broker-A1 discuss Trader-1's desire to raise the published 6 month Yen LIBOR fix:

Trader-1: need to keep 6m up till tues then let it collapse

Broker-A1: doing a good job so far . . . as long as the liquidity remains poor we. Have a better chance of bullying the fix [.]

46. The next day, Thursday, August 16, 2007, Trader-1 reiterated his need for a high 6-month Yen LIBOR fix:

Trader-1: reall really really need high 6m

Broker-A1: yep think I realise that

* * *

Broker-A1: yes mate, will make myself useful

That day, consistent with Trader-1's request, Broker-A2 again raised his/her suggested LIBOR, this time by an additional 6.5 basis points, where it remained for several days.

47. Moreover, in a May 29, 2008 electronic chat, Trader-1 instructed Broker-A1 to "bring 3[-month LIBOR] down." Broker-A1, acting as an intermediary for Broker A2, responded "[Broker-A2] had knocked 3m down small (already v low and says if it goes any further he will lose credibility)."

48. Further, in a May 12, 2009 electronic chat, Broker-A1 notified Trader-1 that "[Broker-A2] has moved 6m libor up another 1/2bp and [unchanged] for 3m and 1m down small." Indeed, Broker-A2 modified his/her suggested LIBORs in precisely this fashion from the previous trading day.

49. These suggested LIBORs distributed from Brokerage A were influential; indeed, Broker-A2's suggestions appear to have been wholly adopted by Yen LIBOR submitters at three other Contributor Panel banks during certain time periods. For example, of the 523 total trading days between January 1, 2008 and December 31, 2009, there were 308 days in which suggested Yen LIBOR in all 8 tenors listed in Broker-A2's email were identical to those submitted by one Contributor Panel Bank ("Bank-E"). Further, there were many instances when Bank-E's Yen LIBOR submissions for all 8 tenors changed identically each day with the changes in Broker-A2'ssuggested LIBORs, often matching the suggestions to 5 decimal points.

50. Trader-1 was aware that Broker-A2's suggested LIBORs, when adjusted to benefit UBS's derivatives desk's positions, disseminated false information into the market. The following exchange occurred in an August 12, 2007 electronic chat between Broker-A1 and Trader-1:

Broker-A1: like [Broker-A2] said to me last night, he can try and tweak [Suggested LIBORs] by a point or 2 when its flying [sic] but if he marks too far from the truth the banks tend to ignore him.

Trader-1: ok no probs . . . any help is better than none!

51. Trader-1 also enlisted cash brokers to improperly influence other Contributor Panel banks' Yen LIBOR submissions through telephone conversations between brokers and Yen LIBOR submitters at the other panel banks. For example, in a February 9, 2009 electronic chat, Trader-1 asked Broker-C to cause a colleague to suggest to other Contributor Panel banks to lower their LIBOR submissions by stating that the broker's Yen accounts "look[ed] a little softer." While requesting that Brokerage-C disseminate this misinformation, Trader-1 identified at least two other brokerage houses that also assisted him in manipulating Yen LIBOR, and indicated that he would reward brokers for this type of assistance:

Trader-1: do you know your cash desk? . . . ie the guy who covers. Yen on your cash desk

Broker-C: yes mate i do

Trader-1: right now on i need you to ask him a favour on the fixes . . . i will make sure it comes back to you . . . i already do it with [Brokerage-A] . . . basically can you ask him to broke 3m cash ie libor lower for me today . . . i will look after you off the back of it . . . i do that for [Brokerage-B] too . . . so emphasise the importance to you . . . just suggest it looks a little softer to his accounts

Broker-C: ok mate I understand I will go and speak to him

Trader-1: stuff like that . . . thanks mate . . . is very important to me today

After a five minute break, the two resumed their electronic chat:

Broker-C: just spoke to them and they are on the case

Trader-1: ok mate much appreciated

52. As another example, in a February 25, 2009 electronic chat, Trader-1 instructed Broker-B: "low 1m and 3m . . . we must keep 3m down . . . try for low on all of em." Broker B responded "ok ill do my best for those tday." Trader-1 then asked Broker-B to arrange for a "massive" trade and Broker-B acknowledged that the trade would generate profits for him/her.

Trader-1: we can do 150 [billion] 2 yrs bro both sides . . . ask [Trader-A2] . . . will that help?

Broker-B: ok mate that will make us make budget for the month so massive yes

Later that morning, Broker-B had a recorded telephone conversation with the Yen LIBOR submitter at Bank-F ("Submitter-F"), requesting that the submitter lower Bank-F's 3-month Yen LIBOR submission, as follows:

Broker-B:	Could I ask you a small favor?
Submitter-F:	Yeah.
Broker-B:	Where are you going to set your Libor threes today?
Submitter-F:	Uh, same, 65.
Broker-B:	Is there any way you might be able to take it down [one basis point] cause I'm getting a big trade out of it? . . . I'm getting someone to do me a big trade if they said I can help 'em sort of get Libors down a little bit today.

Submitter-F had already entered the .65 3-month LIBOR submission on a form, which he had passed on to the Swiss Franc submitter sitting next to him. However, Submitter-F can be heard on the recorded conversation requesting the submitter next to him to lower Submitter-F's 3- month Yen LIBOR submission from .65 to .64, pursuant to Broker-B's request: "Yeah, okay. Could you make the threes .64 []?" Bank-F's 3-month LIBOR submission dropped from .65 to .64 that day, lowering the resulting LIBOR fix in favor of Trader-1's positions.

53. As another example, in a March 31, 2009 electronic chat, Trader-1 asked Broker-C to help influence 9 of the 16 Contributor Panel banks by convincing them to lower their LIBOR submissions from the previous day, thus lower the resulting 1-month and 3-month Yen LIBOR fix.

Trader-1:	mate we have to get 1m and 3m down . . . 1 m barely fell yesterday . . . real important
Broker-C:	yeah ok
Trader-1:	banks to have a go w in 1m are
Trader-1:	[Bank-F]
Trader-1:	[Bank-G]
Trader-1:	[Bank-H]
Trader-1:	[Bank-E]
Trader-1:	[Bank-I]
Trader-1:	[Bank-C]

Trader-1: [Bank-A]

Trader-1: [Bank-J]

Trader-1: and [Bank-K]

Trader-1: Pls

Broker-C: got it mate

That day, consistent with Trader-1's request, 6 of the 9 Contributor Panel banks listed above lowered their 1-month Yen LIBOR submissions relative to the previous day, and the resulting published 1-month Yen LIBOR fix dropped by a full basis point from the day before.

54. As another example, in a March 19, 2009 electronic chat, Broker-B confirmed that he accommodated Trader-1's request to influence Yen LIBOR submitters at other Contributor Panel banks:

Trader-1: need low everything pls try really hard to get [Bank-D] down

* * *

Broker-B: ok will try mate

Trader-1: ok try for [Bank-D] and the japanese and [Bank-G] as priority . . . pls

Broker-B: Kkk

Trader-1: thx . . . pls push really hard

48 minutes later, Broker-B resumed the chat, confirming that he had spoken to the banks:

Broker-B: yes already had a word with a couple of them [Bank-D] and [Bank-A] said they should be lower . . . workin on [Bank-G] and [Bank-J]

55. Trader-1 also used brokers to disseminate misinformation through a technique known as "spoof bids," whereby brokers, at Trader-1's request, would describe a potential opportunity to engage in certain money market transactions to Contributor Panel banks in an attempt to influence those banks' Yen LIBOR submissions. In truth, there was no intention of going through with the purported money market transactions, and the fictional bids were designed solely to influence Yen LIBOR. During a June 10, 2009 electronic chat, Trader-1 and Broker-B referred to this tactic when discussing efforts they would make that day to manipulate Yen LIBOR:

Trader-1: LOW 1m . . . LOW 3m . . . HIGH 6m . . . 6m is important today

mate . . . pls spoof bids

Broker-B: rite ok mate ill make a special effort

Later in the same chat, Broker-B remarked to Trader-1:

> mate yur getting bloody good at this libor game . . . think of me when yur on yur yacht in Monaco wont yu . . .

3) Efforts to Collude with Other Banks to Manipulate Yen LIBOR

56. From at least as early as January 2007 and at various times until at least approximately September 2009, Trader-1 communicated with derivatives traders at other Yen LIBOR Contributor Panel banks in an effort to manipulate Yen LIBOR to benefit his trading positions. Trader-1 requested that his counterpart traders at other Contributor Panel banks make requests to their respective Yen LIBOR submitters to contribute a particular LIBOR submission, or to move their submission in a particular direction (i.e., up or down). Trader-1 made these requests to his counterpart traders at other Contributor Panel banks on many occasions.

57. On February 2, 2007, Trader-1 described this method of manipulating LIBOR in an electronic chat with his counterpart Yen derivatives trader ("Trader-A1") at another Contributor Panel bank ("Bank-A"):

Trader-1: 3[month] libor is too high cause I have kept it artificially high

Trader-A1: how[?]

Trader-1: being mates with the cash desks, [another Contributor Panel bank, ("Bank-C") and I always help each other our too

Trader-A1: that's useful to know.

58. By April 2007, Trader-1 had requested Trader-A1 to solicit Bank-A LIBOR submitters to contribute submissions which benefited UBS's Yen trading positions. For example, in an April 20, 2007 electronic chat, Trader-1 stated to Trader-A1:

> I know I only talk to you when I need something but if you could ask your guys to keep 3m low wd be massive help as long as it doesn't interfere with your stuff . . . tx in advance

Approximately 30 minutes later, Trader-1 and Trader-A1 had the following chat:

Trader-1: mate did you manage to spk to your cash boys?

Trader-A1: yes u owe me they are going 65 and 71

Trader-1: thx mate yes I do . . . in fact I owe you big time . . .

Approximately 45 minutes later, after checking to see if Bank-A lowered its 3 month Yen LIBOR submission to 65, Trader-1 sent the following message to Trader-A1:

> Mate[y] they set 64! . . . that's beyond the call of duty!

59. Trader-1 also occasionally requested his counterpart derivatives trader ("Trader- B") at another Contributor Panel bank ("Bank-B") to have Bank-B contribute Yen LIBOR submissions to benefit UBS's Yen trading positions. For example, on May 21, 2009 Trader-1 asked Trader-B: "cld you do me a favour would you mind moving you 6m libor up a bit today, I have a gigantic fix." Trader-B—who also sometimes acted as the Yen LIBOR submitter for Bank-B—responded "I can do that." As promised, Trader-B raised Bank-B's 6-month Yen LIBOR submission by 6 basis points that day.

60. Trader-1 also asked his counterpart derivatives trader ("Trader-C") at a third Contributor Panel bank ("Bank-C") to have Bank-C contribute Yen LIBOR submissions to benefit UBS's Yen derivatives trading positions. For example, in a January 29, 2007 electronic chat with Trader-1, Trader-C asked: "[A]nything you need on libors today? High 6m would help me." Trader-1 responded, "high 3m I'll sort our 6m rate for you thanks." As promised, Trader-1 made a request to the UBS Yen LIBOR submitter for a high 6-month contribution.

61. As a final example, Trader-1 also contacted his counterpart derivatives trader ("Trader-D") at a fourth Contributor Panel bank, ("Bank-D"), in an effort to influence Bank-D's Yen LIBOR submissions in order to benefit UBS's trading positions. For example, in a June 28, 2007 electronic chat with Trader-D, Trader-1 asked: "pls ask ur mate for high 6m mate . . . wd be really really grateful." Trader-D responded: "will do, for the record he's def not my 'mate'! . . . but I'll [send him an electronic chat]." As requested, approximately 15 minutes later, Trader- D sent an electronic chat to the Bank-D Yen LIBOR submitter stating, "high 6m yen libor would be gd according to my brother!" The Yen LIBOR submitter responded, "WILL DO MY BEST."

62. Trader-1 knew that coordinating with other Contributor Panel banks to manipulate Yen LIBOR was wrong. In a July 22, 2009 electronic chat with Broker-A1, Trader-1 described his plan to coordinate Yen LIBOR submissions with other Contributor Panel banks over the next few weeks while staggering drops in submissions so as to avoid detection:

Trader-1: 11th aug is the big date . . . i still have lots of 6m fixings till the 10th

* * *

Broker-1: if you drop your 6m dramatically on the 11th mate, it will look v fish, especially if [Bank-D] and [Bank-B] go with you. I'd be v careful how you pay it, there might be cause for a drop as you cross into a new month but a couple of weeks in might get

people questioning you.

Trader-1: don't worry will stagger the drops . . . ie 5bp then 5bp

Broker-1: ok mate, don't want you getting into sh t

Trader-1: us then [Bank-B] then [Bank-D] then us then [Bank-B] then [Bank-D]

Broker-1: great the plan is hatched and sounds sensible

63. As early as February 2007, certain other UBS derivatives traders and submitters were aware of Trader-1's use of other Contributor Panel banks to manipulate the resulting published Yen LIBOR fix. For example, in a February 15, 2007 electronic chat between Trader-1 and Submitter-1, the following exchange occurred.

Trader-1: can we keep the fix down and let it jump tomorrow?

Submitter-1: i've asked [submitter who is filling in] to keep it low today . . . tomorrow u tell me what u prefer

Trader-1: ok if we can try to keep our move really really low wd be big help

Submitter-1: we do our very best . . . but will probably fall out [of the middle-two quartiles of submissions averaged to determine the LIBOR fix] anyway

Trader-1: ok you don't have anyone you know anywhere else you can have a word with? as a favour?

Submitter-1: got to pass i'm afraid . . . never having worked in london doesn't give me that edge; if i was [in the] same poz i'd ask you to have a word with [Bank C] ;-)

Trader-1: already done that . . . and [Bank A]

Submitter-1: good man

64. The following week, in a February 22, 2007 electronic chat, Trader-1 attempted to enlist Submitter-3 to contact other Contributor Panel banks to manipulate Yen LIBOR submissions to benefit UBS's Yen derivatives book:

Trader-1: ok hopefully we'll get the fixings down

Submitter-3: I try

Trader-1: thanks do you have any contacts in ldn you can ask also? ie other cash traders?

Submitter-3: other forward traders yes

Trader-1: thx [Submitter-3] any help appreciated . . . if they set libors!

. . .

B. The Euro

65. From at least as early as September 2005 through approximately June 2010, certain UBS Euro derivatives traders occasionally requested that Euribor submitters contribute submissions to benefit the derivatives traders' positions. UBS submitters often accommodated such requests.

66. For example, in an October 2, 2006 electronic chat between a UBS Euro derivatives trader and the UBS Euribor submitter, the submitter solicited the trader's preference for that day's submission, asking, "any special wishes for the fixing?" The trader responded, "I lose 120k of a received fix today . . . so low would be good." The trader then indicated that his/her request for low Euribor applied to both the 3-month and 6-month tenors, to which the submitter responded, "ok we go 42 and 57."

67. As a further example, in a June 25, 2009 internal UBS chat with 58 viewers, including UBS's representative on the BBA FX Money Market Committee ("UBS's BBA Representative"),[4] the Euribor submitter solicited UBS derivatives traders for their submission preferences, asking, "boys, we send the fixings in about 1hr, so let us know pls." A derivatives trader immediately responded with, "low 6s high 12s . . . please." The submitter responded, "noted."

68. The UBS Euribor submitter and UBS's BBA Representative knew this practice of submitting a Euribor contribution for the benefit of derivatives traders' positions was inappropriate. Indeed, as noted above, UBS's BBA Representative was tasked with monitoring such conduct to preserve the integrity of the submission process. Moreover, five minutes after the June 25, 2009 chat described in the previous paragraph, in a separate electronic chat between the Euribor submitter and UBS's BBA Representative, UBS's BBA Representative admonished: "JUST BE CAREFUL DUDE." The submitter responded, "I agree we shouldn't ve been talking about putting fixings for our positions on public chat."

69. UBS's Fall, 2009 transfer of responsibility for LIBOR and Euribor submissions to ALM did not prevent its derivatives traders from attempting to manipulate these benchmarks. For example, in a June 29, 2010 electronic chat between

[4] The BBA FX Money Market Committee consisted of representatives from the Contributor Panel banks, who met approximately once a month. According to the BBA, as to all currencies, the Committee was responsible for scrutinizing the LIBOR submissions, and the submission process, for discrepancies, and for developing the "best practice for bank reporting standards and adherence to those standards." According to internal UBS memoranda, beginning in June, 2008, UBS's BBA Representative had "overall responsibility for the integrity of the [LIBOR submission] process and for oversight and monitoring of the rates submitted by UBS."

the former Euribor submitter – who was still an active UBS Euro derivatives trader – and another UBS Euro derivatives trader, they stated:

Former Submitter:	u got 6mth fix position today?
Trader:	6mth fixing today? . . . nothing.
Former Submitter:	ok, gonna set fixing 1bp higher on the 6s for the turn then.
Trader:	didn't think you set it!
Former Submitter:	i don't but i give my opinion to the ALM desk . . . regarding change, higher/lower. . . .

C. *Implications of The Derivatives Traders' Requests*

70. When UBS derivatives traders made requests of UBS rate submitters in order to influence UBS's benchmark interest rate submissions, and when the submitters accommodated those requests, the manipulation of the submissions affected the fixed rates on various occasions.

71. Likewise, when UBS derivatives traders influenced the submissions of other Contributor Panel banks—either by (1) seeking and receiving accommodations from their counterparts at such banks, or (2) influencing the submissions from other banks with assistance from cash brokers who disseminated misinformation in the marketplace—the manipulation of those submissions affected the fixed benchmark rates on various occasions.

72. Indeed, the purpose of this activity was to manipulate benchmark submissions from UBS and other banks to influence the resulting fixes and thus to have a favorable effect on the derivatives traders' trading positions. Because traders' compensation was based in part on the profit and loss calculation of the trading books, derivatives traders' requests were intended to benefit their compensation as well.

73. Because of the high value of the notional amounts underlying derivatives transactions tied to LIBOR, Euroyen TIBOR and Euribor, even very small movements in those rates could have had a significant positive impact on the profitability of a trader's trading portfolio, and a correspondingly negative impact on their counterparties' trading positions.

74. UBS entered into interest rate derivatives transactions tied to LIBOR, Euroyen TIBOR and Euribor—such as derivatives, forward rate agreements, and futures—with counterparties to those transactions. Many of those counterparties were located in the United States. Those United States counterparties included, among others, asset management corporations, mortgage and loan corporations, and insurance companies. Those counterparties also included banks and other financial institutions in the United States or located abroad with branches in the United States.

75. In the instances when the published benchmark interest rates were manipulated in UBS's favor due to UBS's manipulation of its own or any other Contributor Panel bank's submissions, that manipulation benefitted UBS derivatives traders, or minimized their losses, to the detriment of counterparties, at least with respect to the particular transactions comprising the trading positions that the traders took into account in making their requests to the rate submitters. Certain UBS derivatives traders and rate submitters who tried to manipulate LIBOR, Euroyen TIBOR and Euribor submissions understood the features of the derivatives products tied to these benchmark interest rates; accordingly, they understood that to the extent they increased their profits or decreased their losses in certain transactions from their efforts to manipulate rates, their counterparties would suffer corresponding adverse financial consequences with respect to those particular transactions.

76. When the requests of derivatives traders for favorable LIBOR, Euroyen TIBOR and Euribor submissions were taken into account by the UBS rate submitters, UBS's rate submissions were false and misleading. Those false and misleading LIBOR and Euroyen TIBOR contributions affected or tended to affect the price of commodities, including futures contracts. Moreover, in making and in accommodating these requests, the derivatives traders and submitters were engaged in a deceptive course of conduct in an effort to gain an advantage over their counterparties. As part of that effort: (1) derivatives traders and submitters submitted and caused the submission of materially false and misleading LIBOR, Euroyen TIBOR and Euribor contributions; and (2) derivatives traders, after initiating and continuing their effort to manipulate LIBOR, Euroyen TIBOR and Euribor contributions, negotiated and entered into derivative transactions with counterparties that did not know that UBS employees were often attempting to manipulate the relevant rate. . . .

UNITED STATES v. CONNOLLY, 24 F.4th 821 (2d Cir. 2022)

KEARSE, Circuit Judge:

Defendants Matthew Connolly and Gavin Campbell Black appeal from judgments entered in the United States District Court for the Southern District of New York following a jury trial before Colleen McMahon, then-*Chief Judge*, convicting both defendants on one count charging a 2004-2011 conspiracy to commit wire fraud and bank fraud in violation of 18 U.S.C. § 1349, convicting Connolly on two counts of wire fraud in violation of 18 U.S.C. § 1343, and convicting Black on one count of wire fraud in violation of § 1343, all in connection with the submission of statements that could affect the London Interbank Offered Rate ("LIBOR"), on which many financial transactions rely. Connolly was sentenced principally to three concurrent terms of time served plus two years of supervised release (the first six months in home confinement), and was ordered to pay a $100,000 fine. Black was sentenced principally to two concurrent terms of time served plus three years of supervised release (the first nine months in home confinement) to be served in his native United Kingdom, and was

ordered to pay a $300,000 fine. On appeal, defendants contend principally that the evidence at trial was insufficient to prove that the LIBOR submissions at issue were false, material, or made with fraudulent intent.

The government cross-appeals to challenge defendants' sentences, arguing that it constituted plain error to permit Black to serve a sentence of home confinement in the United Kingdom without adequate assurance that such a term of overseas home confinement could be appropriately monitored. It argues that both defendants should be resentenced because if the monitoring of Black were inadequate, it would result in punishment less severe for Black than that imposed on Connolly, despite the district court's assessment that Black was more culpable than Connolly.

Finding merit in defendants' contentions that the evidence was insufficient to show that the LIBOR-related statements that they induced were false, we reverse their convictions and remand to the district court for entry of judgments of acquittal. We dismiss the government's cross-appeals as moot.

These prosecutions arise from the large-scale, widely publicized investigations conducted by financial regulators and prosecutorial authorities in the United States and the United Kingdom into the manipulation of LIBOR, described in detail in *United States v. Allen*, 864 F.3d 63, 69-76 (2d Cir. 2017) ("*Allen*"). The principal focus of the investigations was interest-rate derivatives, financial instruments that derive their value from changes or disparities in interest rates. Connolly and Black were charged with conspiring with others to commit wire fraud and bank fraud in violation of 18 U.S.C. § 1349, along with several substantive counts of wire fraud in violation of 18 U.S.C. § 1343, by inducing co-workers to submit to the British Bankers' Association ("BBA") false statements that could influence LIBOR rates, in order to increase their employer's profits--or decrease its losses--on existing derivatives contracts. . . .

LIBOR is an interest rate benchmark published daily by the BBA for loans of various durations (called loan "tenors")--typically ranging from overnight to one year--in each of the world's major currencies. LIBOR is meant to reflect, on a given day, the rates at which one bank can borrow money from other banks. As explained by Dr. Youle, one of the primary purposes served by LIBOR in modern markets is to provide a reference interest rate that financial instruments can incorporate to establish the terms of agreement. . . .

In order to arrive at a fixed LIBOR rate each day for the various loan tenors of each currency, the BBA relied on information contributed individually by selected banks that were active in the interbank market for that currency (a "LIBOR panel"). Under the heading "The BBA Libor fixing - definition," the BBA gave instructions to contributor banks with respect to their submissions as to rates ("BBA LIBOR Instruction"). . . .

During the relevant period, the LIBOR panel with regard to United States currency comprised 16 banks. In the BBA LIBOR Instruction, the "Instructions to BBA Libor Contributor Banks" stated that on each business day, between 11:00 and 11:10 a.m.,

London time, each panel bank--with respect to each of 15 loan tenors--was to submit for that panel's currency

> *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* just prior to 1100

[Government expert witness] Dr. Youle testified that in this BBA LIBOR Instruction, "'rate'" referred to the "interest rate"; "'funds'" referred to "cash"; offers in "'reasonable market size,'" referred to the "typical amount of borrowing" the bank would do, rather than to an "exact[ ] amount"; and the phrase "'were it to do so by asking for and then accepting'" called for an answer that was "hypothetical," not for information as to what, on that business day, "the bank actually did."

The process the BBA used to arrive at each U.S. dollar LIBOR fixed rate was as follows. Thomson Reuters, a data analytics company acting as the BBA's agent, received the 16 panel banks' rate submissions and eliminated from consideration, for each tenor, the four highest and the four lowest. The arithmetic average of the middle eight submitted rates--referred to as the "trimmed mean"--constituted the LIBOR daily "fix" for that tenor. The LIBOR fixes were then published by Thomson Reuters each day and transmitted by wire globally.

During the period 2004-2011, the LIBOR panel for United States currency included Deutsche Bank AG ("Deutsche Bank" or "DB"). Thus, shortly after 11 a.m. on each business day in London, DB, in accordance with the BBA LIBOR Instruction, was to make for each tenor a submission as to the rate at which DB could borrow cash in the interbank market.

Connolly was employed by DB in its New York City office. From at least 2005 until March 2008, he was director of the "Pool Trading Desk," *i.e.*, DB's combined cash and money market derivatives desk. In that capacity he supervised several derivatives traders, including Parietti. Connolly's principal responsibilities, however, were "fund[ing] the bank" and "running the cash desk."

Black, from approximately 1997 until 2015, was employed in DB's London office. During the period of the alleged conspiracy, he was a director of that office's Money Market Derivatives and Pool Trading Desks, and his principal responsibility was to trade U.S. dollar money market derivatives. Black was also a "market maker," which had the practical effect that, within DB, "anyone who wanted to trade an interest rate swap or a U.S. dollar derivative would go to Gavin Black and ask for the price in that particular swap." Because Black traded in financial products that were tied to LIBOR, his success was to some extent dependent on his ability to predict the movement of LIBOR.

Neither Connolly nor Black had responsibility for making DB's LIBOR submissions to the BBA. That job fell largely to London office employees Curtler and King. From 2003 to 2012, King's responsibilities included working on the U.S. dollar money market trading desk and on the cash desk, borrowing money in the interbank market in order to

fund DB's cash needs. Throughout his tenure at DB, King was supervised by Curtler, who, during the period relevant to this case, also supervised Black.

Curtler had a series of positions at DB. From about 2000, he too worked on the U.S. currency cash desk, trading dollars to secure funding for the bank. In 2005-2010, his principal responsibility was running the cash desk. He also traded derivatives--principally futures, options, and swaps products--that were tied to LIBOR, and was one of DB's "largest U.S. dollar derivatives traders." King likewise traded derivatives that were tied to LIBOR, and he was actively encouraged by Curtler to engage in such trading.

King served as the principal submitter of DB's U.S. dollar LIBOR rates to the BBA. When King was unavailable, Curtler was the most frequent "backup submitter" of those LIBOR rates.

King, who had received a non-prosecution agreement in exchange for his cooperation, testified as to the process by which he and his boss Curtler normally arrived at the LIBOR rates DB would submit to the BBA. King, as the person responsible for ensuring that DB always had sufficient cash to fund its operations, was in charge of borrowing cash from the interbank market and lending that money to DB's other units--referred to as "DBQ."

With respect to such internal loans, DBQ and the cash desk engaged in a bid-and-offer process, with DBQ asking to borrow at a proposed interest rate, and the cash desk offering the loan at a higher rate, typically "about 4 basis points" above the DBQ bid. In determining the rate of interest at which the cash desk would lend the U.S. dollars that DBQ needed to fund their operations, King used, *inter alia*, a spreadsheet that he and Curtler referred to as a "pricer." The pricer "had a live data feed to the market" and therefore was "automatically updated as the market data changed." The primary function of the pricer was to help King determine the rates at which the cash desk would lend money to DBQ.

King testified that other DB units had their own pricing tools, which in fact were more sophisticated than the one he used, because the derivatives traders needed to be able to make accurate interest-rate predictions in order for their DB transactions to be profitable. In addition, the cash desk "had to show ... a live price throughout London hours to everyone in the bank." But DBQ units with their own pricers were quite aware of current market conditions; so if those units believed an interest rate the cash desk was offering DBQ was unduly low, DBQ groups would borrow more money than they needed; and if they believed the cash desk was offering a rate that was unduly high, DBQ would deposit money with the cash desk to earn that rate.

Accordingly, the cash desk offers to DBQ needed to be realistic. King and Curtler would begin their day at 7 a.m. by noting the previous day's LIBOR rates and checking their respective pricers. Although King testified that he and Curtler used the same pricer, Curtler testified that he and King each had his own pricer, and that while similar, they

were not identical. Curtler said his pricer "didn't work exactly the same as Mr. King's pricer," and that they "didn't have a standard pricer that had to be used."

While the pricers automatically changed every day during the day with incoming market data, King and Curtler also proceeded to manually "put in various factors," "based on various things," and "added in various spreads *to reach the cash prices* that we--*that we wanted to use internally*" because "we had to make sure that the prices that we were showing on the spreadsheet were actual cash prices."

King testified that "for a long time" the cash desk's offering rates to DBQ were used as DB's LIBOR submission of the rates at which DB could borrow in the interbank market. Thus, the spreadsheet contained a column headed "LIBOR" to show what that day's DB LIBOR submissions would be.

However, because the cash desk's offers to DBQ "had to be accurate," King and Curtler were repeatedly "manual[ly]" "changing" items and "spreads in the pricer"; and since the LIBOR column was a function of DB's internal offered rate to DBQ, King's "manual change[s]" to arrive at "the internal rates" also changed "[DB's] LIBOR submission rates."

In addition, there were manual changes directed solely at the rate to be submitted for LIBOR. Asked how he made changes to LIBOR submissions "when ... requests" were received from DB's derivatives "traders," King testified that

> as part of the morning process, we would put in all the different factors into what every LIBOR submission should be. And then *that produced the column ... head[ed] "LIBOR." And then* I would *manually change the rate in or on the spreadsheet itself,* so put in sort of a plus or minus to make the change within the spreadsheets.

King testified that he also "added these spreads manually even on days when [he] didn't get a communication from one of the derivatives traders." . . . [T]he LIBOR rates were thus not based entirely on market data and were not automatically generated.

In addition to the above alterations in the pricer, King each day consulted, *inter alia*, five interbank cash brokers before settling on DB's LIBOR submissions. He testified that it was logical to "change the [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." But King said that while sometimes the rates the brokers were suggesting were all similar, "there [we]re periods when the rates are vastly different"; and then "[we] have to come up with something that we feel is a fair reflection of our rate." Thus, in submitting LIBOR rates, "some days [King] went with the pricer, some days [he] went with the broker, [and] some days [he] went with the middle." King testified that he believed that the reference to "reasonable market size" in the BBA LIBOR Instruction-

-a term the BBA did not define--"gave [him] flexibility as to where [he] could actually submit his LIBOR."

The above kinds of manual changes to the figures produced by the pricer were routinely made by King and Curtler to arrive at DB's LIBOR submissions with or without any requests having been made by DB derivatives traders for alterations of the LIBOR submissions.

King and Curtler testified that they sometimes received requests from Connolly or Black to make LIBOR submissions that would be beneficial to DB derivatives traders' positions, *i.e.*, "trader-influenced" LIBOR submissions. King testified that "Gavin Black occasionally asked me to manipulate the rates or to put in a submission that was higher or lower than I would have done *to benefit his trading position*," and that "Matthew Connolly on occasion made requests for me to change our LIBOR rates and *to benefit the trader's position*."

Curtler testified about a November 2005 email exchange with Connolly concerning a 1-month LIBOR, in which Connolly said "WE WOULD PREFER IT HIGHER...WE HAVE ABOUT 15 BB 1MO RECEIVES," meaning that DB's New York derivatives traders (supervised by Connolly) expected to receive payments on notional amounts totaling some $15 billion. Curtler, who apparently had estimated that DB's LIBOR submission for that tenor was "looking like 29"--*i.e.*, 4.29 percent--accommodated Connolly's request by submitting a rate of 4.295 percent rather than 4.29 percent and informed Connolly "we went in 295 for u." DB's 4.295 percent rate was one of the middle eight panel bank submissions; each of the other seven middle submissions was 4.29 percent. Thus, the trimmed middle constituting the 1-month LIBOR fix was 4.29063 percent, instead of 4.29 percent as it would have been if DB's submission had been 4.29 rather than 4.295.

The government also introduced other emails and electronic messages to DB's LIBOR submitters requesting modifications of the LIBOR submissions in order to benefit DB's existing trading positions. They included one from Black on May 15, 2008, requesting a low 1-month LIBOR rate because he was "paying on 18 [billion]"; another from Black on February 21, 2005, requesting a high 6-month LIBOR rate; one from Connolly on November 23, 2005, requesting that 3-month LIBOR "be as high as possible"; and an August 12, 2007 email from Connolly stating, "[i]f possible, we need in NY 1mo libor as low as possible next few days....tons of pays coming up overall." As a result of this last request, King's DB submission to LIBOR on August 13 was the lowest by any panel bank; and the DB submission on August 15 was four basis points below his estimate of what LIBOR would be.

Parietti was a DB derivatives trader supervised by Connolly. He testified that Connolly had instructed him that if "[y]ou have a big position fix into LIBOR," you should "[s]end an email to the cash guys in London, let them know which way around and how much you have, and then just let them do whatever they do." Curtler testified that when he and

King received such requests, he would *id*. at 1618). They would typically adjust the LIBOR submission by half a basis point.

King described the process by which he attempted to accommodate the traders' requests for higher or lower LIBOR submissions. In the pricer, he would focus on the relevant tenor in the LIBOR column; if the trader's request was for a higher LIBOR submission he would "click on that cell in the spreadsheet and then put in a plus and then ... change that rate manually to make it higher than the pricer was ... otherwise telling [him]." King could put in an adjustment formula, which would automatically accommodate the trader's requested alteration, regardless of whether "the market moved up or down." However, King also testified that on days when he received a request from a derivatives trader, he "still looked at the pricer estimates," he "still looked at the broker's suggestions," and he "still looked at what[wa]s going on in the market," because "before deciding what to do," he "had to figure out what was reasonable."

Curtler testified that he made LIBOR submissions that benefited his own DB trading positions: "[I]f we came up with a U.S. dollar LIBOR submission for that day and my position required the rate to be higher, we'd skew it to the upside, and the opposite if we wanted it low." By "we" Curtler included himself, King, Black, and other derivatives traders in DB's London and New York offices. Curtler acknowledged that "there were days where there would have been a wide range of offered rates." He testified, however, that they were not supposed to submit self-interested LIBOR submissions because it "would give us an unfair advantage in the market."

All three cooperators testified that they "knew" the practice of altering DB's LIBOR submissions to benefit DB trader positions was "wrong" at the time they engaged in it. King stated that "[i]t's intuitively wrong because we are, you know, as I say, taking advantage of the position. We are benefiting. There was a counterparty on the other side who doesn't know what we're doing and is being affected negatively by what we're doing." Parietti testified that "even if [LIBOR is] imprecise, hard to estimate, or vague, ... it's still wrong to base your submission on your bank's position instead of information about the cash market." All three cooperators testified that they never contemporaneously told anyone that they thought the practice was wrong. . . .

In the present case, in order to determine whether LIBOR submissions by King or Curtler that were affected by requests of Connolly or Black--undisputedly requests in aid of derivatives contracts held by them or by traders they supervised--constituted statements that were false, half-truths, or fraudulent omissions, we must begin by examining the BBA LIBOR Instruction with which the LIBOR submitters were to comply. We look principally to the language of the BBA LIBOR Instruction, to any accompanying elaboration or explanations of the BBA LIBOR Instruction, and to the government's evidence as to how DB's submitters arrived at their LIBOR submissions that were not trader-influenced. As the trial judge instructed the jury, "where, as here a[n alleged] scheme to defraud *is premised on an instruction--in this case from the BBA to the*

submitting bank--the government has the burden to *negate any reasonable interpretation of the instruction* that would make Deutsche Bank's submission responsive."

During the period at issue in this case, the BBA LIBOR Instruction directed each panel bank to state, as to each tenor of the currency at issue,

> 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* just prior to 1100.

As Dr. Youle testified, "rate" referred to interest rate, and "funds" referred to cash. The term "reasonable market size" was one that the BBA had not defined. Dr. Youle interpreted it as referring to the "typical amount of borrowing" the bank "would" do. The BBA stated that it had "intentional[ly]" declined to provide a definition, stating that "reasonable market size will vary according to prevailing liquidity and credit conditions as well as between currencies and even quoting banks," and that "it would appear that reasonable market size is a concept that is understood by all market participants."

The BBA LIBOR Instruction did not ask about an actual loan. Rather, it asked a question that was "hypothetical." A panel bank was to "estimat[e]" the interest rate at which the bank "could" borrow an amount of cash that it would typically borrow, "were it to do so by asking for and then accepting" inter-bank offers in London just before 11 a.m. . . .

The precise hypothetical question to which the LIBOR submitters were responding was at what interest rate "could" DB borrow a typical amount of cash if it were to seek interbank offers and were to accept. If the rate submitted is one that the bank could request, be offered, and accept, the submission, irrespective of its motivation, would not be false.

Defendants, of course, had no burden to produce any evidence. The burden was on the government to provide evidence to show that the LIBOR submissions made by King or Curtler after receiving requests from Connolly or Black were untrue. At the trial of these defendants, the government's three cooperating witnesses--King and Curtler who were LIBOR submitters, and Parietti who requested LIBOR submissions that would favor his existing derivatives trades--testified that they knew it was "wrong," "intuitively wrong" for LIBOR submissions to take into account the DB derivatives traders' existing positions. . . . Yet none of the witnesses testified that DB could not have borrowed a typical amount of cash at the rate stated in any of DB's LIBOR submissions. . . . [W]hether DB "could" do so was the precise question to which the LIBOR submissions were to respond, and was thus the key to whether a given submission was false.

Instead of producing evidence that DB could not borrow at the interest rates stated in the trader-influenced LIBOR submissions, the government relied on the theory . . . (a) that on each day, for each loan tenor, there was only one true interest rate that DB could submit, (b) that that rate was generated automatically by King's pricer, and (c) that that one true automatically generated rate was in fact what DB submitted except when King or Curtler received a request for a higher or lower number from Connolly or Black. Thus,

Dr. Youle, the government's expert, testified that "there was always an understanding that the[panel banks] would submit *the one* best estimate of *the true borrowing costs they had*." And Curtler testified--in part--that

> we set our LIBORs using a process that we used on the desk to come up with a number. That number was the Deutsche Bank's submission, and then if we took into account requests for traders, we altered that submission.

The government emphasized its one-true-number theory in summation--"*You borrow at the lowest rate*. *There's no range*"--and emphasized that DB had a "pricer" that generated the one true rate:

> You ... know, when it comes to the scheme, that *there was a pricer*. Remember that pricer .... You heard from different witnesses about it. And there might be different versions of it. This was what was manipulated. *There was actually a rate sitting on the pricer to submit to LIBOR*. And what the defendants and their coconspirators did was that they would, *on days where they had trading positions that would benefit*, they would *take the numbers and they would change them* and they would send them. *So they took what would otherwise have been an honest submission, they changed it, and they dishonestly sent the rates that benefited the trading positions*. . . .
>
> [I]n this case *the submitters actually had a number sitting right there on that pricer, and that's the number they would send*. It was a number. *And that's what they moved and changed dishonestly when they sent it to benefit the trading positions*. . . .

There are two principal respects in which the trial evidence, viewed as a whole, fails to support the foundations of the government's theory of falsity, *i.e.*, that there was (a) one true interest rate, (b) automatically generated by the pricer, (c) which was DB's LIBOR submission as generated except when there was a request from a trader. First, the testimony of the government's witnesses revealed that there were many factors other than the data automatically received by the pricer that informed DB's final LIBOR submission. Second, there were many loans available to DB, with varying interest rates; and as DB could agree to such rates, there was no one true rate that it was required to submit. . . .

It is true, as the government argues, that a scheme need not succeed in order to violate § 1343. *See*, *e.g.*, *Pasquantino*, 544 U.S. at 371, 125 S.Ct. 1766 ("[t]he wire fraud statute punishes the scheme, not its success" (internal quotation marks omitted)). But to come within the scope of § 1343 it must at least be a scheme to defraud. Here, the government failed to show that trader-induced LIBOR submissions did not reflect rates at which DB could have borrowed. If the submissions did reflect rates at which DB could have borrowed, they complied with the BBA LIBOR Instruction, and the LIBOR submissions were not false. . . .

The government's argument that we should uphold the convictions on the theory that trader-influenced submissions constituted statements of "opinion[s] not honestly held" suffers the same deficiency. While the government's three cooperating witnesses all testified that it was "wrong" to allow DB's LIBOR submissions to be influenced by existing derivatives trading positions because it gave them an "unfair advantage" over their counterparties, not one of the witnesses testified that the submissions that were actually made were not rates at which DB "could"--as defined by the BBA LIBOR Instruction--borrow.

Although the government states that the BBA's "instructions did not allow a panel bank, when submitting its honest estimate of its borrowing costs, to consider the submission's effect on the profitability of interest rate swaps or other derivatives positions held by the bank's traders," in fact the BBA LIBOR Instruction contained no such prohibition. In contrast, the BBA did evince a concern about collusion between panel banks. The BBA LIBOR Instruction expressly stated that "Contributor Banks shall input their rate without reference to rates contributed by other Contributor Banks." But there was no similar prohibition against banks' making their LIBOR submissions with consideration of the bank's own interest-rate-sensitive derivatives. Dr. Youle testified that LIBOR "was created in the '80s," and LIBOR's use as a reference point in interest-rate-based derivatives contracts became so popular that "trillions and trillions of dollars of contracts in notional value [have come to] depend on it." There can thus be no doubt that the BBA as an industry organization well knew that traders in interest-rate-sensitive derivatives are intently attuned to and concerned about LIBOR. Indeed, the BBA LIBOR Instruction expressly required submitters to use maturity dates calculated in conformity with "the *ISDA* Modified Following Business Day convention." (emphasis added)). "ISDA stands for International Swaps and Derivatives [A]ssociation."

Nor could a reasonable jury infer from Dr. Youle's testimony that the BBA LIBOR Instruction required DB to submit its "one best estimate." While Dr. Youle testified to "an understanding that [banks] would submit the one best estimate of the true borrowing costs they had," he did not link that understanding to the BBA LIBOR Instruction, which contains no similar qualification. . . .

Finally, we see no merit in the government's argument that a trader-influenced LIBOR submission constituted a "half-truth[ ]" on the theory that it carried an "implied certification" that there had in fact been no trader influence on the submission. As discussed earlier, the BBA LIBOR Instruction as it existed during the earlier period at issue in this prosecution, while explicitly barring collaboration between panel banks, said nothing to bar a panel bank's LIBOR submitters from receiving or considering input from that bank's employees who were derivatives traders. There being no guidance from the BBA as to intrabank input--especially given an explicit prohibition of int**er**bank input--a bank's submission of a LIBOR rate did not implicitly represent that there had been no consideration of the panel bank's existing trades. . . .

In sum, the government sought to prove falsity on the premise that the BBA LIBOR Instruction required DB to submit a particular interest rate, that such a rate was generated automatically by a DB pricer, and that LIBOR submissions that were influenced by requests from DB derivatives traders were false because those submissions were not the numbers automatically generated by the pricer. However, the government's main fact witnesses at trial, the LIBOR submitters, testified that there were numerous ways in which the pricer did not generate such numbers automatically because those witnesses regularly altered pricer data and spreads manually; that the LIBOR submitters regularly deviated from the pricer output--even as affected by the submitters' manual adjustments--in order to make LIBOR submissions that reflected interest rate estimates they had received from independent brokers; and that the LIBOR submitters engaged in all of these practices even on days when they had no requests from DB derivatives traders.

The government failed to produce any evidence that any DB LIBOR submissions that were influenced by the bank's derivatives traders were not rates at which DB could request, receive offers, and accept loans in DB's typical loan amounts; hence the government failed to show that any of the trader-influenced submissions were false, fraudulent, or misleading. . . . Accordingly, we reverse defendants' convictions for wire fraud. Further, given that the government failed to present evidence to show falsity in the trader-influenced submissions, defendants' convictions for conspiracy to commit wire fraud and bank fraud must also be reversed.

U.S. and British authorities brought prosecutions against some of the individuals involved in the LIBOR scandal, with mixed results. Four former Barclays bankers were sentenced in London to between thirty-three months and six and a half years for their part in the fraud after jurors rejected the defense's argument that the defendants were "just doing [their] job."[5] However, jurors appeared more sympathetic to two other Barclays traders who were acquitted of similar charges after the defense attacked one of the prosecution's experts and portrayed one of the defendants as a rookie trader who didn't get to "choose who were his tutors."[6]

Tom Hayes, a former Citigroup and UBS trader ("Trader-1" above), was also sentenced in the UK to 14 years in prison for his role as the ringleader of several traders responsible

[5] For more on the Barclays bankers' convictions, see Simon Bowers, *Libor-rigging trial: jury finds no defence in 'just doing my job'*, THE GUARDIAN (July 4, 2016), https://www.theguardian.com/business/2016/jul/04/barclays-libor-convictions-a-major-victory-for-sfo; *Libor-rigging trial: ex-Barclays traders jailed for two to six years*, THE GUARDIAN (July 7, 2016), https://www.theguardian.com/business/2016/jul/07/libor-rigging-trial-ex-barclays-traders-jailed-merchant-pabon-mathew-johnson.

[6] For more on the Barclays traders' acquittals, see Jane Croft & Carol Binham, *Former Barclays Traders Acquitted in SFO Libor Case*, FINANCIAL TIMES (Apr. 6, 2017), https://www.ft.com/content/77d5a24a-1aae-11e7-bcac-6d03d067f81f.

for the manipulation of LIBOR.[7] A large portion of Hayes's sentence stemmed from conspiracy charges—an issue complicated by the fact that six of the former cash brokers with whom Hayes was said to have conspired were acquitted by a London jury in a separate trial.[8] On January 29, 2021, Hayes was released, having served 5.5 years of his original sentence.

In the U.S., twelve individuals were charged, of which four went to trial. Two former Rabobank Group traders were found guilty, but the convictions were later overturned after the Second Circuit determined that their Fifth Amendment right against compelled self-incrimination had been violated when the DOJ used testimony that the defendants were compelled to give before the British Financial Conduct Authority (a matter discussed further in Chapter 12).[9] Two former Deutsche Bank traders, Matthew Connolly and Gavin Black, had their convictions reversed, as discussed by the Second Circuit above. In all, between the United States and the United Kingdom, 42 individual cases were charged criminally with 19 convictions produced. The remaining 23 individual cases resulted in acquittal, dismissal, or litigation that is still pending.

[7] For more on the Hayes trial, see Chad Bray, *Former Citigroup and UBS Trader Convicted in Libor Case*, N.Y. TIMES DEALBOOK (Aug. 3, 2015), https://www.nytimes.com/2015/08/04/business/dealbook/former-citigroup-and-ubs-trader-convicted-in-libor-case.html.

[8] For more on the acquittals, see David Enrich, *Six Ex-Brokers Acquitted of Libor Rigging in London*, WALL ST. J. (Jan. 27, 2016), https://www.wsj.com/articles/london-jury-acquits-six-brokers-of-libor-manipulation-frauds-1453908372.

[9] For more on the Rabobank traders, see Chad Bray, *Convictions of 2 Former traders in Libor Scandal Are Dismissed*, N.Y. TIMES DEALBOOK (July 19, 2017), https://www.nytimes.com/2017/07/19/business/dealbook/convictions-of-2-former-traders-in-libor-scandal-are-dismissed.html#:~:text=A%20United%20States%20appeals%20court,rate%20benchmark%20known%20as%20Libor.