The LIBOR Trials: An Example of Prosecution Overreach?

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Table of Contents

On July 7, 2016, after an approximately three-month trial in the United Kingdom, three men, all former low-level employees of Barclays Bank ("Barclays"), were sentenced for activities that the U.K. Serious Fraud Office ("SFO") alleged constitute "manipulation" of the London Interbank Offered Rate or "LIBOR," a global interest rate benchmark.[2] The terms of imprisonment range from 2 years, 9 months for Alex Pabon, who was employed for the shortest duration of the three men at Barclays, to 6 and 1/2 years for Jay Merchant, the most senior of the men during their employment at the bank. Pabon's and Merchant's sentences followed upon the Aug. 3, 2015 conviction of Tom Hayes, a former UBS and Citibank trader, who was sentenced to 14 years imprisonment, subsequently reduced to 11 years on appeal.[3] At the time of the conduct prosecuted, the British Bankers Association ("BBA") had oversight of the process of setting the global daily LIBOR rate, which was calculated based upon an average of submissions from 16 "Panel Banks," two of which were Barclays and UBS.

Several issues in the case raise the question whether the LIBOR trials constitute a manifest miscarriage of justice. Those issues include 1) the retroactive application of judge-made law to criminalize otherwise acceptable behavior, 2) the failure to investigate adequately, and 3) the refusal to disclose relevant evidence and other questionable prosecutorial tactics.

Judge Made Law Applied Retroactively

The LIBOR prosecutions generally relate to communications among derivatives traders, LIBOR setters, and other market participants allegedly made for the purpose of affecting a bank's daily LIBOR submission based on the bank's commercial interests. These communications were market practice for twenty years prior to the LIBOR prosecutions. The defendants were charged

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2 *R v. Stylianos Contogoulas, Jonathan Mathew, Jay Merchant, Peter Johnson, Alex Pabon and Ryan Reich*, case numbers T20147114, T20147116 and T20147239, in Southwark Crown Court.
3 *R. v. Hayes* [2015] EWCA Crim 1944. (Dec. 21, 2015).

with various counts of "Conspiracy to Defraud," an offence that the U.K. Law Commission has recommended should be abolished due to its vague and nebulous nature.[4]

On December 5, 2014, Justice Cooke of the Southwark Crown Court rejected legal arguments run by the Hayes defense that the activities in issue could not properly constitute a conspiracy to defraud and ruled that:

> (a) a Panel Bank has a duty to put forward its genuine assessment of the proper LIBOR rate when making a LIBOR submission, being the honest opinion of the Panel Bank of the rate at which that Panel Bank could borrow funds in the unsecured London interbank cash markets;
> (b) the fact that a Panel Bank can choose a submission from a range of valid, honest and correct submissions from within the market trading range (because a bank will likely have been offered cash in the interbank markets at a variety of rates on any given London trading morning and may well have *actually transacted* at a variety of different rates) does not answer the LIBOR question if the LIBOR rate submitted does not reflect the genuine assessment of the submitter; and
> (c) the non-binding LIBOR formulation and submission process, governed by the BBA, contains an implied requirement that a Panel Bank not take its own commercial interests into account when selecting a LIBOR submission from within that day's market trading range.[5]

In 2015, the U.K. Court of Appeal declined to hear the appeal on these rulings.[6] Certain of the legal rulings run contrary to the actual way in which the LIBOR process worked at the time, some proof of which was not disclosed to the Hayes defense but has come to light subsequently. In fact, that evidence demonstrates that, during the various indictment periods, the BBA was unconcerned as to whether or not a Panel Bank had taken its own commercial interests into account when making a LIBOR submission, provided that the LIBOR rates submitted were "*representative*." In plain English, this means that the BBA ran the LIBOR regime on the basis that, provided a Panel Bank responded to the LIBOR question with a rate at which the relevant Panel Bank *could* borrow, the relevant LIBOR submission was deemed to be acceptable. The presence of commercial considerations was unimportant, provided the bank could actually borrow at the rate put forward, it being possible to answer honestly as a matter of fact but simultaneously derive a commercial benefit.

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4 Fraud, Report on a reference under section 3(1)(e) of the Law Commissions Act 1965, presented July 2002
5 *R v. Hayes* [2014] (unreported).
6 *R. v. Hayes* [2015] EWCA Crim 46.

The aforementioned rulings were to be applied retroactively, with the trial judge and the court of appeal declaring that the standards required in the law handed down in 2014 and 2015 had always been so. This allowed the SFO to allege during the trials that the defendants' activities were unlawful at the time they were undertaken, despite the fact that the activities involved were not prohibited in any manner and were widely known, condoned, and encouraged by senior bank management and industry participants at the time. The flawed pre-trial Hayes rulings would serve as the basis for all LIBOR prosecutions moving forward.

Investigative Lapses

It can be argued that there were serious lapses in the SFO's investigation. The information collected by the Financial Conduct Authority ("FCA"), in wholly separate regulatory proceedings focused on the banks themselves, was used in large part as the underlying material for the criminal prosecutions conducted by the SFO. The scope of such regulatory investigations undoubtedly reflected a series of negotiations and compromises between the banks and the FCA. Clearly, the banks had little incentive to provide documentation implicating senior management or evidencing that the defendants' activities were known, condoned, and encouraged by the banks and the industry as a whole. Notably, in both cases, the SFO failed to investigate whether there were actual losses to counterparties, and if so, to what extent, and whether any such losses were caused by the defendants' activities; it failed to call any "wronged" counterparty to give evidence at the trials. Evidence set forth by the defense during the Barclays trial proved that counterparties such as hedge funds were aware of and did not object to the defendants' activities, further evidencing the widespread acceptability of the practices surrounding LIBOR setting." Furthermore, the SFO did not prove (or even attempt to prove) that the rates submitted were not the genuine assessment of the submitter.

Other Issues

The exclusion of evidence favorable to the defense was also an issue throughout the LIBOR trials. In the Barclays case, the SFO selected an indictment period that led to the exclusion of much of the evidence that would assist the defense, including evidence that senior management instructed the cash desk to adjust the Barclays LIBOR submissions downwards in order to address concerns about the bank's liquidity position, resulting in a commercial advantage to the bank (a practice that came to be known as "lowballing"). In the Hayes trial, UBS failed to supply to the FCA, and later to the SFO, 8,000,000 pieces of evidence relating specifically to LIBOR on the basis that the documents were located in Switzerland and were therefore covered by Swiss banking and secrecy law. UBS also failed to disclose evidence of specific and dedicated IT-setups utilized by the bank to ensure that UBS's LIBOR submissions were always commercially advantageous to the bank despite repeated requests by the Hayes defense team and a specific line of questioning regarding this by the trial judge.

In the Hayes trial, the trial judge went further than the Court of Appeal's endorsement of his previous rulings. The Hayes jury directions, which became the blueprint for all future jury directions in the LIBOR trials, instructed the jury that, as a *matter of law*, the mere fact of a conversation between a trader and submitter was contrary to the LIBOR definition because the submission was somehow "tainted." It was of no matter that the LIBOR submitter may have entirely ignored the trader's request for a high, low, or mid LIBOR submission drawn from within that day's market trading range, and it was of no matter that the LIBOR rates being requested and/or submitted were entirely accurate. The jury directions criminalized conversations regarding the submission of LIBOR rates that were arguably entirely legal.

Other claimed errors created undue prejudice against the defendants. For example, the Barclays judge ruled that a co-defendant's guilty plea, which was coerced under threat of extradition, was admissible and relevant in deciding the defendants' guilt or innocence. The Barclays court later instructed the jury that it could find guilt based upon a majority verdict after only a limited number of hours of unsuccessful deliberation on certain defendants. In the Hayes trial, the jury was not permitted to know that a senior UBS employee had been exonerated by the FCA on the basis that the rates requested were drawn from within the market trading range and were therefore correct, despite the relevant individual having engaged in identical behavior to Hayes and *with* Hayes. The FCA's notes in relation to this matter, disclosed after the commencement of the Hayes trial such that no further interlocutory appeal of the arguments regarding market trading ranges was possible, record that the SFO had advised the FCA that the SFO did not consider the material disclosable to the Hayes team, a decision that was questionable, at best. The SFO proceeded in the Hayes trial on the basis that market trading ranges did not exist, and the fact that the regulator disagreed with this was not permitted before the Hayes jury.

Disparate Treatment of the Same Conduct and the Status of Appeals

The disparate treatment of industry participants engaging in substantially similar or identical behavior must be emphasized in order to put these convictions into proper context. For example, the FCA has exonerated other market professionals for identical behavior and, in other instances found them merely "reckless" and declined to impose any fine. The U.S. Fed recently elected to impose only a civil fine and trading ban on certain individuals accused of foreign-exchange rate manipulation, even where those activities allegedly involved inter-bank communication in chat rooms where commercially sensitive information was provided to competitors, factors that were not present in the Barclays or Hayes cases. Even internationally, the conclusions as to the legality of LIBOR "manipulation" vary. Dutch bank Rabobank senior staff were subject to minimal fines by the Dutch regulatory entity and were allowed to remain in the industry, while certain other Rabobank individuals who undertook similar conduct were convicted and sentenced to terms of imprisonment by the US Department of Justice. Notably, Germany has declared that the behavior did not constitute a criminal offence in Germany at the relevant time.

At a broader level, the LIBOR cases raise significant issues about our criminal justice systems' ability to fairly address white collar crimes that may fall into a "gray area" of legal compliance. It is clear that the prosecutions were brought only after extreme media and political outrage against the banking industry resulting from the financial crisis. LIBOR "manipulation" fit perfectly into what any career-driven prosecutor could hope to pursue. Indeed, at the trials the SFO hammered home the point that LIBOR was tied to trillions of dollars in securities and loans (yet did not even attempt to prove that such "manipulation" resulted in any damages). Very low level traders were easy targets and singled out to quench the public's thirst for blood and to save more senior bankers and high-level bank practices from scrutiny. The cases also raise important questions regarding the use of sentencing to "make an example" out of defendants in certain industries not in favor with the public at the time of prosecution. Hayes' sentence, specifically, is far longer than what would be expected for a non-violent, white collar offense for which no real financial loss or damage was proven.

Hayes appealed his conviction and sentence to the U.K. Court of Appeals on December 1st and 2nd, 2015. On March 8, 2016, the Court of Appeal refused to certify his appeal to the UK Supreme Court. Attempts to apply for review by the Criminal Cases Review Commission are ongoing. Applications to appeal the Barclays convictions and/or sentences are currently pending.