EXHIBIT 1

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

UNITED STATES OF AMERICA	)	
	)	
vs.	)	Case No. 1:18-cr-00048
	)	
EDWARD BASES and JOHN PACILIO,	)	Honorable John Z. Lee
	)	
Defendants.	)	

BRIEF OF *AMICI CURIAE*, BANK POLICY INSTITUTE, THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, AND SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION IN SUPPORT OF DEFENDANTS' MOTIONS TO DISMISS CHARGES FOR CONSPIRACY TO COMMIT WIRE FRAUD

Amici Curiae, Bank Policy Institute ("BPI"), the Chamber of Commerce of the United States of America ("Chamber"), and the Securities Industry and Financial Markets Association ("SIFMA"), by their counsel Morgan, Lewis & Bockius LLP, respectfully submit this brief *amici curiae* in support of the defendants' motions to dismiss the charges for conspiracy to commit wire fraud affecting a financial institution.[1]

Introduction

A. Interest of *Amici.*

BPI is a nonpartisan public policy, research, and advocacy group, representing the nation's leading banks and their customers. BPI's members include universal banks, regional banks, and the major foreign banks doing business in the United States. Collectively, BPI's members employ almost two million Americans, make nearly half of the nation's small business loans, and are an engine of financial innovation and economic growth.

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than three million businesses and professional organizations of every size and in every sector and geographic region of the country. An important function of the Chamber is to represent its members' interests in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus curiae* briefs in courts throughout the country on issues of concern to the business community.

SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of the industry's nearly one

[1] This brief addresses only the charge of conspiracy to violate the wire fraud statute. *Amici* take no position on the other charges in the indictment.

million employees, SIFMA advocates on legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. SIFMA serves as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency.

In this case, the government alleges that the defendants engaged in "spoofing" in the commodities futures market—*i.e.*, entering orders that the defendants intended to cancel before those orders were executed. In addition to charging one of the defendants, Pacilio, with spoofing, the government claims the orders were fraudulent statements that violated the wire fraud statute, charging both defendants with conspiracy to commit wire fraud affecting a financial institution in violation of 18 U.S.C. § 1849. The government's theory of wire fraud liability in this case is novel and expansive. It threatens to criminalize conduct that can be, and until recently has been, addressed under industry- and market-specific laws, rather than amorphous allegations of wire fraud, and threatens to extend criminal liability to legitimate commercial conduct. Under the government's theory, making a valid offer to trade on an open market would constitute wire fraud if the party hoped to withdraw the offer before acceptance. The government could charge individuals with this newly-articulated crime even in the absence of any misrepresentation to the market, and absent any fiduciary duty that would impose a duty to speak. *Amici* are concerned that this new wire fraud theory, if permitted in this case, could also be applied in broader commercial settings to any open offer capable of forming a binding contract upon acceptance.

The government's attempted expansion of wire fraud liability is especially troubling because spoofing is already a crime. *See* 7 U.S.C. § 6c(a)(5)(C) (the "Anti-Spoofing Statute"). The Anti-Spoofing Statute was designed to apply to a specific form of disruptive trading

conduct. Until the Anti-Spoofing Statute took effect in July 2011 as part of amendments to the Commodities Exchange Act ("CEA") in the Dodd-Frank Act, federal law did not expressly prohibit spoofing of commodity futures. The government's attempt to prosecute spoofing conduct under the wire fraud statute thus threatens to render superfluous a carefully considered statutory and regulatory scheme.

Expanding the already broad reach of the criminal wire fraud statute has potential consequences for *amici's* members that go well beyond the commodities markets. If the government's theory is ratified by the Court, any offer to enter into a transaction that makes only accurate factual representations and that would result in a binding contract if accepted, could violate the wire fraud statute if the party making the offer also intended, at the time of making the offer, that the offer would not be accepted. Such a sweeping application of the wire-fraud statute implicates legitimate, non-fraudulent commercial conduct. It would allow inquiry into the offering party's subjective intent in new and intrusive ways. Moreover, the government's theory of implied misrepresentation could also be deployed in the civil context, allowing a counterparty to a legitimate, but ultimately unsatisfying, transaction to bring otherwise-frivolous claims under the RICO statute (where the mail and wire fraud statutes are commonly pled as predicate acts to support the civil RICO claim), as well as other civil statutes and common law causes of action that require proof of a misrepresentation. Additionally, the use of the wire fraud statute to effectively criminalize conduct retroactively is fundamentally unfair and reduces business certainty and complicates compliance with a complex statutory and regulatory regime.

B. Background.

1. Federal regulation of commodities markets.

Futures trading is regulated by a comprehensive federal regime. Congress has enacted and periodically amended the CEA, which covers all trading on registered futures exchanges, including the trading at issue in this case. Futures trading is also regulated by exchanges themselves, which adopt and enforce additional rules.

The CEA specifically prohibits "spoofing" in commodity markets. 7 U.S.C. § 6c(a)(5)(C). As relevant here, the "Anti-Spoofing Statute" makes unlawful conduct that "is of the character of, or is commonly known to the trade as, 'spoofing' (bidding or offering with the intent to cancel the bid or offer before execution)." *Id.* The Anti-Spoofing Statute thus criminalizes a precise form of conduct, and associated subjective intent, in connection with submitting orders to a futures exchange. Until the Anti-Spoofing Statute took effect in July 2011 as part of amendments to the CEA in the Dodd-Frank Act, federal law did not expressly prohibit spoofing of commodity futures.

As this case demonstrates, the government has prosecuted individuals for violating the Anti-Spoofing Statute. This case is notable, however, because the indictment also charges spoofing conduct that pre-dated the effective date of the Anti-Spoofing Statute as conspiracy to commit wire fraud. *See* Indictment at 1-9

2. Trading in the electronic futures markets.

The charged conduct arises from offers to enter into commodity futures transactions on the COMEX, a federally-registered futures exchange. COMEX is an electronic marketplace in which all trading participants are anonymous. An order on the COMEX communicates to the exchange and the public four pieces of information: (i) the product to be traded; (ii) the price; (iii) whether the order is to buy (a "bid") or sell (an "offer"); and (iv) the number of futures

contracts to be bought or sold (or in the case of a Hidden Quantity Order ("Iceberg Order"), only a portion of the order is displayed to the marketplace, and when the displayed quantity has been filled, another portion of the order will then be displayed to the marketplace). If a bid and an offer match on price, the COMEX matches them automatically, resulting in a binding transaction (an executed trade). A trader may cancel an order at any time prior to the order being matched (executed). If the order is accepted before it is withdrawn, it cannot be cancelled and the executed trade is final.

An order entered into the market can be removed in either of two ways. It can be accepted by another trader, resulting in execution of a binding trade, or it can be cancelled by the trader who placed the order prior to acceptance. Market participants have complete control over the duration of an order prior to execution, as there is no exchange rule specifying a minimum time period that an order must be displayed before cancellation. Exchanges have developed recognized order types that allow market participants to choose how long to maintain an order in the market (*e.g.*, until it is filled in accordance with its terms, until the end of the trading session or day, or canceled if not filled immediately). Most trading in these markets is facilitated by computer algorithms at very high speeds, and the vast majority of orders are canceled by the traders who placed the orders before they are executed. Thus, the rules of the exchange and the practices of market participants support a system in which traders can only reasonably expect an offer to be available for acceptance for a brief moment in time.

Here, the government acknowledges that the orders the defendants made were valid offers to trade that could have been accepted at any time prior to cancellation, and if accepted would have resulted in a binding trade that would obligate the defendants to complete the transactions. Indictment ¶¶ 4, 12(a). The orders were subject to market risk—a fact that is

essential to the government's contention that the alleged wire fraud affected a financial institution. *Id.* ¶ 12(a) (alleging the defendants' conduct exposed the bank that employed them to "losses associated with the trading risk that the Fraudulent Orders would be executed"). This allegation is unsurprising, because after an order is entered into the COMEX marketplace and until its cancellation, there is nothing a trader can do to prevent a counterparty from executing against the order under the COMEX rules.

Even though it acknowledges the defendants' orders could be executed and were subject to market risk, the government claims that the executable offers to trade in the market constituted wire fraud because the traders allegedly entered the orders with an undisclosed intent to cancel the orders before they were executed. Indictment ¶ 4. The process of entering an order on the COMEX is fundamentally no different than the process of offering any other type of contract in commerce that is an open offer and capable of acceptance before being withdrawn. Offering to enter into a commercial contract without disclosing one's intent or motivation for making such offer should not open the offeror to potential exposure for wire fraud.

3. The indictment.

The defendants are charged with conspiracy to commit wire fraud affecting a financial institution and commodities fraud. *See* Indictment at 1-9. Defendant Pacilio is also charged with the crime of spoofing.

The indictment alleges that the defendants undertook a conspiracy to commit spoofing activity "beginning in or around 2007 and continuing through in or around at least 2013" by "plac[ing] one or more visible orders for precious metals futures contracts on one side of the market that, at the time they placed the orders, they intended to cancel before execution." Indictment ¶¶ 2, 4. The three specific instances of alleged wire fraud identified in the complaint

occurred between November 2010 and June 2011, before the Anti-Spoofing Statute took effect in July 2011. *See* Indictment ¶¶ 14-18. While acknowledging that these orders constituted valid offers to trade, the government nevertheless labels these orders "the Fraudulent Orders" and alleges that they were placed to "artificially move the prevailing [market] price in a manner that would increase the likelihood" that orders placed on the opposite side of the market—which the government labels "the Primary Orders"— "would be filled." *Id.* ¶¶ 9-10.

Argument

I. The Government's "Implied Misrepresentation" Theory Fails to State a Violation of the Wire Fraud Statute.

The government's theory conflates wire fraud and the crime of spoofing. But these are different offenses, and they have different elements. In particular, the Seventh Circuit long has held that the wire fraud statute requires proof of a material factual misrepresentation. *See, e.g.*, *United States v. Stephens*, 421 F.3d 503, 507 (7th Cir. 2005) (to establish a "scheme to defraud" under the mail and wire fraud statutes, the prosecution must prove "the making of a false statement or material misrepresentation") (quoting *Williams v. Aztar Ind. Gaming Corp*., 351 F.3d 294, 299 (7th Cir. 2003)); *United States v. Sloan*, 492 F.3d 884, 890 (7th Cir. 2007). Unlike the wire fraud statute, the Anti-Spoofing Statute criminalizes the preconceived and undisclosed intent to withdraw a live order before it is executed. 7 U.S.C. § 6c(a)(5)(C); *United States v. Coscia*, 866 F.3d 782, 796 (7th Cir. 2017).

The charge of conspiracy to commit wire fraud is inappropriate because the defendants' alleged conduct did not, as a matter of law, constitute wire fraud. This is because (1) the defendants made no false representations; (2) there is no precedent for finding an implied misrepresentation in the circumstances of open-market orders; and (3) any implied misrepresentations did not relate to an essential element of the transactions.

A. The indictment does not, and cannot, allege false representations.

COMEX rules permit traders to modify or cancel orders at any time prior to execution, but if another trader accepts an existing bid or offer, the exchange automatically executes a transaction and both parties are immediately bound to the trade. In other words, as long as an order remains on the market, the trader cannot control whether the order is executed or not. Thus, such orders are subject to execution and market risk for as long as they persist. *See, e.g.*, Indictment, § 12(a).

Orders subject to execution and market risk cannot constitute false statements. When an order is placed on COMEX, the only information conveyed to the market is the commodity to be traded, the price of the order, and the quantity available to trade at that price. No other information, such as the length of time the order will remain open, the identity of the trader, whether the trade is to open or close a position, the trader's reasoning for placing the order, or the amount of risk capital available to the trader or its risk tolerance, appears in the order book. (While this is all information that other traders presumably would like to know, it is not required to be disclosed under exchange rules.) Therefore, even if a trader harbors a subjective intent to cancel an order before it is matched, that subjective intent could not change any information made available to the market. The only "representation" that an order conveys is that the trader placing the order will transact at a certain price and quantity for so long as the order persists. That representation was just as true for the Fraudulent Orders alleged in the indictment as it was for any other order on COMEX.

B. The government's implied misrepresentation theory fails.

The indictment does not identify any misrepresentation made to the market. Instead, the government alleges that the defendants impliedly represented that they were "willing to trade" their orders but, in fact, they were not, because the defendants "intended to cancel" the orders. Indictment ¶ 11. The government cannot use its implied misrepresentation theory to satisfy the requirement that it identify a material misrepresentation supporting wire fraud.

First, the Government has not identified a single decision holding that bids and offers in an open market, like those in this case, carry an implied representation as to the trader's intent. Indeed, as the defendants emphasize, the government in its prosecution in *Coscia* expressly disclaimed that spoofing involves the making of a misrepresentation.

Second, courts repeatedly have rejected the argument that an open-market transaction represents any additional information beyond that contained in the order itself. For example, in *Sullivan & Long, Inc. v. Scattered Corp.*, 47 F.3d 857, 864-65 (7th Cir. 1995), the Seventh Circuit rejected a claim by a civil plaintiff that orders in the market contained implicit representations beyond the terms of the order. Instead, the court held that the defendant "made no representations, true or false, actual or implicit, concerning the number of shares that it would sell short." *See also United States v. Finnerty*, 533 F.3d 143, 149-150 (2d Cir. 2008) (rejecting claim that New York Stock Exchange trading specialist implicitly represented to the market that his trades complied with the NYSE's inter-positioning rules). In a case very similar to this one, the court in *United States v. Radley*, 659 F. Supp. 2d 803, 815 (S.D. Tex. 2009), *aff'd*, 632 F.3d 177 (5th Cir. 2011), considered whether a wire fraud indictment could rest on live bids that the defendants allegedly did not intend to execute. The court in *Radley* reached the same conclusion that this Court should reach, that the "indictment [did] not allege a single lie or misrepresentation." *Id.*

The government characterizes the alleged fraudulent conduct as "inject[ing] false and misleading information into the market" by not disclosing that the defendants "intended to cancel" the orders at the time they were placed. Indictment ¶¶ 5, 11. But the government's argument conflates two separate elements of the offense of wire fraud: a material misstatement and criminal intent. *See Stephens*, 421 F.3d at 508-09. Under the government's position, the exact same market order may constitute criminal fraud or may be just an ordinary offer based solely on the trader's intent, even though the order communicates the same information to the market regardless of that intent. The Court should reject the government's attempt to read out of the wire fraud statute the requirement that it prove a material misrepresentation.

C. Any "implied misrepresentations" did not relate to an essential element of the transactions.

Even if the defendants' offers carried "implied misrepresentations" regarding their intent to trade, they still would not violate the wire fraud statute. Not every misrepresentation or omission in a commercial context amounts to wire fraud. *See United States v. Weimert*, 819 F.3d 351, 357 (7th Cir. 2016) ("[Not] all or even most instances of non-disclosure that someone might find relevant come within the purview of the mail and wire fraud statutes.") (internal quotations omitted). To the contrary, courts distinguish between misrepresentations regarding an "essential element of the bargain"—which can support a wire fraud charge—and lesser misrepresentations. *United States v. Shellef*, 507 F.3d 82, 108 (2d Cir. 2007) (collecting cases); *Weimert*, 819 F.3d at 354, 356, 358 (noting that a party may not "misrepresent material facts about an asset during a negotiation," but misrepresentations regarding a party's "true goals, values, priorities, or reserve prices" are immaterial under the wire fraud statute).

The government's theory fails because neither a trader's intent to cancel the order in the future or the trader's undisclosed hope that the trade will not be executed relates to the nature of

the goods, assets, or rights the counterparty is obtaining in a futures trade. A party accepting an offer of twenty gold futures contracts at a price of $1,000 gets exactly what the order represents they will get. Because those essential facts are fully and truthfully disclosed in an open market order, any deception about a trader's intent cannot be material for purposes of wire fraud. A ruling to the contrary could pose significant harm to *amici*'s members engaged in legitimate commercial conduct. Allowing a party that got exactly what it bargained for to claim fraud based on an undisclosed factor that was not part of the offer poses a clear threat to reasonable expectations and certainty upon which commercial contracts depend.

II. The Government's Theory Poses Substantial Risks to *Amici's* Members.

A. The government's theory could criminalize legitimate commercial conduct.

The government's expansive theory of wire fraud liability in this case poses significant risk to *amici*'s members. If the government's theory that the defendants' unexpressed hopes or intentions constitute an implied misrepresentation to the market were accepted, a wide array of legitimate commercial activity would be at risk of being labeled criminal fraud. It is common, not rare, for a business in dealing with counterparties in the market, or with the public, not to disclose all of the facts motivating its conduct. So long as the business does not misrepresent any facts, this is of course not fraud.

Under the government's focus on the present intent motivating a transaction, however, conduct could be criminalized not based upon *what* a business represented to the public, but upon *why* the business acted—even if the business made no misrepresentations. Based on the government's wire fraud theory, such conduct could be charged as fraud even though (i) the business made only accurate statements to the market; and (ii) the business was willing to complete any transactions based on the terms the business offered, simply because the business

did not reveal all of the reasons it was acting. Such a rule effectively places upon parties to commercial transactions a duty to disclose not just truthful information about the terms on which they are willing to deal, but information sufficient to allow potential counterparties to assess the motivations and intentions underlying the party's conduct. If this theory were correct, almost any commercial conduct could be retroactively examined with an eye toward finding fraud based on the undisclosed plans or hopes of the parties to the transaction. For example, a bidder may attempt to test the market for a bankrupt entity's assets in advance of an auction for those assets by placing a so-called stalking horse bid. The purpose of such a bid is often to prevent lowball offers, rather than consummating a deal under the terms of the offer. Yet under the government's theory, the stalking horse bidder could be subject to wire fraud liability for failing to disclose its "hidden" intention of preventing a lowball bid.

The government's wire fraud theory not only risks criminalizing a wide swath of legitimate commercial conduct, it also could expose *amici*'s members to expanded civil liability. The wire and mail fraud statutes are commonly pleaded as predicate acts in civil RICO claims. *See* 18 U.S.C. § 1964(c). Under existing law, courts devote considerable efforts to policing the boundaries between criminal fraud under the RICO statute—which can lead to ruinous liability under RICO's treble damages provision, as well as the reputational risk associated with the accusation of criminal racketeering—and conduct that does not rise to the level of fraud. *See, e.g.*, *Carr v. Tillery*, 591 F.3d 909, 918 (7th Cir. 2010) ("civil RICO plaintiffs persist in trying to fit a square peg in [to] a round hole by squeezing garden-variety business disputes into civil RICO actions") (citation omitted). Under the government's theory, a disappointed participant in an unsatisfying negotiation could bring a treble-damages RICO claim based on a business's failure to disclose the "actual" intent underlying a legitimate transaction.

It bears repeating that any harm the government believes spoofing causes to commodities markets can be addressed by deploying the Anti-Spoofing Statute, a law that, unlike the wire fraud statute, was designed specifically to apply to spoofing conduct. The government can do so without distorting the meaning of the wire fraud statute, a mainstay of federal criminal law, under an "implied misrepresentation" theory that has never been accepted in the context of open market transactions and that risks expanded liability to *amici*'s members.

B. The government's theory would allow retroactive punishment for violation of yet-to be articulated rules of conduct.

As noted, the conspiracy to commit wire fraud charges here are largely based on conduct that pre-dates the Anti-Spoofing Statute. Congress made the decision specifically to criminalize spoofing as part of the Dodd-Frank Act. The indictment effectively makes this criminal prohibition retroactive by treating spoofing conduct as wire fraud, even though the two are not the same. This expansion of wire fraud liability also poses a threat to *amici*'s members. If the government's attempt is successful here, the generous 10-year statute of limitations for wire fraud affecting financial institutions and certain other offenses creates a risk that, as perceptions of permissible conduct evolve and new rules are enacted, the government will retroactively incorporate those rules into criminal prosecutions through its new theory of implied false representations. Conduct related to transactions completed a decade ago could be unearthed and subjected to this new, broader view of wire fraud. Such expanded, retroactive liability would undermine certainty and undercut the ability of *amici*'s members to comply with changing laws and rules.

Conclusion

For the foregoing reasons, *amici* respectfully support the defendants' motion to dismiss the charges for conspiracy to commit wire fraud affecting a financial institution.

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Respectfully submitted,

By: */s/ Kenneth M. Kliebard*

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CERTIFICATE OF SERVICE

I certify that a copy of the foregoing document was filed and served via the CM/ECF system on February 22, 2019, upon all counsel of record.

/s/ Kenneth M. Kliebard
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