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US Judge acquits FX Trader of front-running

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Summary

In an order published 4th March 2019 a Californian federal court acquitted Robert Bogucki (former head of Barclays Capital Inc.'s New York ("Barclays") foreign exchange trading operation) of all charges in a US criminal case alleging wire fraud. This case related to the alleged manipulation of foreign exchange options by Bogucki in advance of an exceptionally large trade by Hewlett-Packard Company ("HP") in 2011 through a method commonly referred to as "front-running". It is the latest in a number of cases in which the US government has sought to argue the existence of a fiduciary-like duty on a dealer in favour of its counterparty on the basis of assurances made by the dealer. In this instance the US Government was unsuccessful however other front-running cases have resulted in convictions, most notably in 2018 case United States v Johnson[1] in which ex-HSBC FX trader Mark Johnson was imprisoned for two years. The Bogucki decision further establishes the boundaries between legal and illegal trading practices in the context of FX front-running, pre-positioning, and pre-hedging, especially in light of the Johnson decision. The factual differences between this and the Johnson case provide useful guidance to the market on these issues. We can expect further guidance from the New York Federal Appellate court later this year when it is expected to issue judgment on the Johnson appeal.

Case background

HP bought £6 billion of cable options from Barclays in August 2011 giving it the option to exchange dollars for sterling to conclude its anticipated acquisition of a UK company. Shortly thereafter in September 2011, HP determined they did not need the options and discussed unwinding the options with Bogucki. The US Government alleged that,

1. Bogucki used this confidential information to engage in trading calculated to depress the value of HP's cable options and arguing that the confidential information created a fiduciary-like relationship between the parties which Bogucki had violated.
2. Bogucki had deprived HP of assets through material representations, amongst others that Bogucki would act in HP's best interests and that Barclays would not be in the market in the run up to the unwind.

The US Government argued HP lost millions of dollars from the value of the options due to Bogucki / Barclays front-running the tranched unwind of the cable options. The parties agreed that the charges of wire fraud affecting a financial institution requires the Government to prove five elements[2] There was no dispute regarding the last two elements so the key question

for the Court was the last two elements so the key question for the Court was the materiality of the statements made by Bogucki.

Impact of Confidential Information

The *Johnson* decision turned on the fact that the parties to an FX transaction had entered a variety of written agreements including a non-disclosure agreement and a request for proposal. No analogous documents were entered into in the *Bogucki* case. In fact, quite the opposite. The ISDA Master Agreement between HP and Barclays expressly stated that both HP and Barclays entered into *"each Transaction as principal (and not as agent or in another capacity, fiduciary or otherwise)"* and went on to include standard non-reliance language. Moreover Bogucki's primary contact at HP, the manager of HP's FX team ("HP's FX trader") gave testimony that he thought Bogucki was "posturing" and "bluffing" when making statements prior to the unwind (for example, statements that Barclays was "long a little bit of vega", saying that his guys were "not touching the market" and attributing the drop in volatility before the unwind to external forces rather than any action by Barclays) and HP's FX trader seemed to accept it which the Judge felt showed that the relationship was far from fiduciary. He concluded that no reasonable jury could conclude that Boguski had a duty of trust and confidence with HP, which allowed him to acquit on this limb.

language[3]. Moreover Bogucki's primary contact at HP, the manager of HP's FX team ("HP's FX trader") gave testimony that he thought Bogucki was "*posturing*" and "*bluffing*" when making statements prior to the unwind (for example, statements that Barclays was "*long a little bit of vega*", saying that his guys were "*not touching the market*" and attributing the drop in volatility before the unwind to external forces rather than any action by Barclays) and HP's FX trader seemed to accept it which the Judge felt showed that the relationship was far from fiduciary. He concluded that no reasonable jury could conclude that Boguski had a duty of trust and confidence with HP, which allowed him to acquit on this limb.

[1] United States v Johnson 2017 WL 5125770 (E.D.N.Y. Sept. 21, 2017).
[2] Elements of wire fraud - (1) the defendant must have knowingly participated in, devised, or intended to devise a scheme or plan to defraud, or a scheme or plan for obtaining money or property by means of false or fraudulent pretenses, representations, or promises or omitted facts; (2) the statements made or facts omitted as part of the scheme were material; (3) the defendant acted with the intent to defraud, that is, the intent to deceive or cheat; (4) the defendant used, or caused to be used, an interstate or foreign wire communication to carry out or attempt to carry out an essential part of the scheme; and (5) the scheme affected a financial institution
[3] "This agreement and each transaction have been entered into by each party in reliance only upon its judgment in order to accomplish legitimate business needs. Neither party holds itself out as advising, or any of its employees or agents as having any authority to advice, the other party as to whether or not it should enter into this agreement or any transaction. Neither party is receiving any compensation from the other party for providing advice in respect of this agreement or any transaction, nor will any such advice provided to such other party not form the primary basis for the investment decision of such other party."

Was there a Material Misrepresentation?

The Judge pointed to previous case law that materiality of allegedly false statements must be considered objectively and in context. This means that industry practice, the agreements between the parties and other information known to the parties at the time of the statements are relevant to assessing those statements materiality. Two crucial pieces of evidence the Judge considered to understand context in this case were: the ISDA Master Agreement terms and industry practice of "pre-positioning". The ISDA Master Agreement was clear that it was a principal to principal relationship. Evidence was also given that it is generally understood industry practice for banks to pre-position (i.e. change position prior to taking on an asset). Indeed, Barclays own Compliance manual distinguished between impermissible front-running and permissible bona fide hedges.

With this context in mind the Judge considered five pieces of evidence from the US Government which they argued satisfied the element of materiality. These included evidence of conversations, phone calls and presentations in which Bogucki was "posturing" or "bluffing". In testimony HP's FX trader admitted he was himself engaged in "bluffing" and "BS-ing" Barclays in the run up to the unwind. The Judge concluded that any half-truths by Bogucki were not material and also highlighted that HP's FX trader expected Barclays to be engaged in some trading and took no action to expressly limit what trading Barclays could take. Neither was there any expectation of full disclosure between the parties, as evidence by the HP's FX trader's own lies to Barclays, his disbelief as to portions of what Barclays was telling him, and the terms of the ISDA Master Agreement. Moreover, the Judge highlighted that all of the chat transcripts had a form of disclaimer that Barclays "*was a market participant acting in several capacities which may adversely affect any product's performance* ". Accordingly, he concluded that no reasonable jury could conclude beyond a reasonable doubt that it was objectively reasonable for HP to be influenced by any of Bogucki's statements. Accordingly, he also acquitted on this limb.

Practice Points to be considered

- Be clear on the trading relationship. Check that your trading documentation, such as your ISDA Master Agreement, presentations and other communications, reflect both party's understanding of the trading relationship. If you want an arms-length, principal to principal trading relationship make sure that your actions and agreements make this clear with appropriate representations, trading activity disclaimers and non-reliance language. However, be mindful that a general disclaimer is not a cure-all and any specific assurances given may not be negated by the disclaimer. Moreover sales practices should be monitored as it would seem highly inadvisable for traders to take comfort from this decision as a license to "bluff" or otherwise mislead clients no matter what the terms of your documentation.

- Careful consideration should be given in this situation before entering into any confidentiality agreements or other agreements that would limit the use of counterparty information in case it could be said to give rise to a duty for dealers which, if breached, could give rise to a claim of illegal frontrunning or similar. Consider

detailing the ways in which a dealer may use the client's information to trade ahead of the client trade so that both parties are clear on any duties that have arisen.

- Dealers acting on a principal to principal basis with their counterparties should be very careful about making any statements or commitments regarding "best execution" since such assurances could be argued to create a duty that goes beyond what would exist in a purely arms-length relationship.

- Given the tightening of regulations globally since these events parties would do well to consider the Judge's directions to Barclays in this case to enhance compliance policies and procedures to safeguard client confidential business information, maintain documentation related to such confidential information, and to address appropriate conduct in responding to potential conflicts of interest.

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