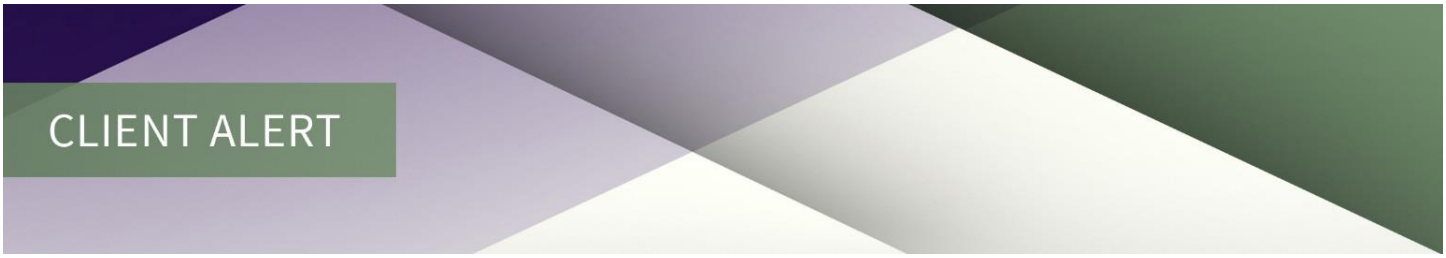

Two Former JPMorgan Precious Metals Traders Convicted in Spoofing Scheme

The DOJ Successfully Prosecutes Using Traditional Theories of Liability, but Fails to Secure a Conviction on a Rare RICO Theory

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On August 10, 2022, the Department of Justice ("DOJ" or the "Department") secured the conviction of the former head of JPMorgan Chase & Co.'s ("JPMorgan") precious metals desk, Michael Nowak, and his top gold trader, Gregg Smith, for wire fraud, attempted price manipulation, commodities fraud, and spoofing.[1] Both defendants were acquitted on charges of violations of the Racketeer Influenced and Corrupt Organizations Act ("RICO"). A third defendant, Jeffrey Ruffo, the former salesman on the desk, was acquitted on all charges. These prosecutions arose out of a joint DOJ, Securities and Exchange Commission ("SEC"), and Commodity Futures Trading Commission ("CFTC") investigation into JPMorgan for market manipulation, which resulted in a $920 million in criminal and civil penalties, disgorgement, and restitution against the bank. The bank's settlement[2] was one of the largest for market manipulation against a financial institution since the 2008 financial crisis.

1 *United States v. Smith*, no. 19-cr-669 (N.D. Ill.).

2 JPMorgan entered into a deferred prosecution agreement with the DOJ, and was subject to enforcement orders by both the SEC and the CFTC. Collectively, these orders served as the basis for JPMorgan's settlement.

Alleged Misconduct

The government alleged that Misters Nowak and Smith (as well as others on the trading desk) manipulated the futures market for gold precious metals contracts by placing thousands of orders for contracts with the intent to cancel those orders before execution over the course of eight years. Defendants profited off this scheme by placing genuine orders prior to these false orders and then either selling at the artificially inflated price or buying at an artificially deflated price. Defendants also concealed the size of their genuine orders through use of so-called "iceberg orders" that hid the overall size of the genuine order from other market participants. Although iceberg orders represent a permissible method to submit an order, the DOJ contended that the defendants used the iceberg order to minimize the impact of the genuine orders and maximize the intended effect of the false orders. In addition to the spoofing activity, the defendants also made false statements to both government regulators and the internal compliance function at JPMorgan, including through annual certifications required by the bank.

Unlike with the 2018 acquittal in *United States v. Flotron*,[3] the government was able to successfully utilize the testimony of two co-conspirators, who previously had pled guilty. These cooperating witnesses helped establish intent, an element the government struggled to establish in the *Flotron* prosecution. Additionally, unlike in the *Flotron* prosecution, where the government was limited to a theory of conspiracy requiring proof of coordination with other parties, the DOJ charged Nowak and Smith with substantive allegations related to the spoofing, allowing them to focus on each defendant's stand-alone conduct.

Takeaways

Among other things, this case demonstrates an aggressive approach by the DOJ towards market manipulation. The RICO charges were particularly striking because prosecutors normally charge violations of that statute in mafia- or gang-related prosecutions. The defeat is stark, in light of what appeared to be an emerging trend by the Department to use RICO in white-collar prosecutions.[4] Further, the Assistant Attorney General from the Criminal Division, at the time the charges were filed in *Smith*, noted that this scheme is "precisely the kind of conduct that the RICO statute is meant to punish."[5] This defeat has enormous ramifications, as RICO charges have simpler evidentiary requirements and more severe potential penalties than the more traditional statute under which the DOJ typically prosecutes market manipulation.[6]

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3 No. 17-cr-220 (D. Conn.).

4 *See United States v. Hwang*, No. 22-cr-240 (S.D.N.Y); *United States v. Becker*, No. 22-cr-231 (S.D.N.Y); *see also* Megan Davies and Chris Prentice, *U.S. Prosecutors Explore Racketeering Charges in Short-Seller Probe*, REUTERS, Feb. 22, 2022 (noting that the DOJ is considering the use of RICO charges in an investigation into short-selling practices by hedge funds and research firms).

5 *DOJ Charges Three Traders Under RICO in Alleged Spoofing Scheme*, JDSupra, Sept. 24, 2019.

6 Thomas Ryerson, *DOJ Brings Novel RICO Charges Against Alleged Spoofers*, White Collar Briefly, Oct. 4, 2019.

The acquittal of all three defendants on this count might cause DOJ to reevaluate its use in similar cases involving traditional allegations of market misconduct. The internal deception by the traders also highlights the inherent limitations of employee self-certification of compliance with company policies, reinforcing the need for independent trade surveillance to ensure compliance with key policies. Additionally, the DOJ continues its focus on individual prosecutions in connection with corporate criminal settlements, consistent with the Monaco "memo."[7] Companies should continue to identify bad actors during investigations in order to receive full cooperation credit.

Sentencing is expected to occur in 2023. We expect both defendants to appeal this verdict and will continue to monitor further developments in this case, as well as the DOJ's broader enforcement approach towards spoofing and other market conduct.

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[7] The Monaco "memo" references an October 2021 speech by Deputy Attorney General Lisa Monaco emphasizing companies must provide all non-privileged information regarding individuals within the company involved in or responsible for the misconduct relevant to the investigation. This was a reinstatement of the policy under the Obama Administration. For more information about the Monaco "memo," please refer to a contemporaneous article on the Willkie Compliance Concourse discussing the speech, https://complianceconcourse.willkie.com/articles/news-alerts-2021-11-november-20211102-doj-clarifies-certain-corporate-enforceme.