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Commentary

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Second Circuit Reverses Convictions In Municipal Bonds Cartel Case

Court's application of statute of limitations will likely guide future conspiracy prosecutions.

On December 9, 2013, the Second Circuit Court of Appeals issued a 2-1 opinion reversing the conviction of three defendants in *United States v. Grimm*,[1] a case involving alleged bid rigging in the market for municipal bond investment contracts. The court ruled that interest payments made by unnamed co-conspirators pursuant to allegedly rigged contracts did not constitute overt acts in furtherance of the conspiracy sufficient to bring the charges within the statute of limitations. *Grimm* clarifies the way that courts should apply statutes of limitation in conspiracy cases, and the Second Circuit's holding will likely have important ramifications for both general conspiracy and antitrust conspiracy prosecutions in the future.

Lower Court Proceedings

On July 27, 2010, a federal grand jury in the Southern District of New York returned a 12 count indictment against the three defendants. A superseding indictment filed on May 31, 2011 charged the defendants with six counts of conspiracy in violation of 18 U.S.C. § 371 and one count of wire fraud in violation of 18 U.S.C. § 1343.

The charged conspiracies focused on the market for municipal bonds derivatives. When municipalities receive the proceeds of tax-exempt bonds, they often invest the funds in guaranteed investment contracts (GICs) provided by certain financial institutions (GIC providers). The GIC provider, in exchange for borrowing the bonds proceeds, agrees to make periodic interest payments to the municipality, thereby providing the municipality with additional revenues. GICs have a fixed maturity date, but the municipal issuer can typically withdraw the principal and terminate the GIC whenever the funds become needed for the underlying capital project.

To prevent arbitrage, federal tax laws limit the return that municipal issuers can generate through GICs. Under US Treasury regulations, issuers use a closed, competitive bidding process which, if followed, establishes the GIC's fair market value for tax purposes. Municipalities hire third party brokers to solicit closed bids from at least three GIC providers; each provider offers an interest rate bid without knowing the rates of other bidders; and the winning bidder certifies in writing that it had no prior opportunity to review competing bids.

The *Grimm* defendants were employees of the same GIC provider. The superseding indictment charged that from August 1999 to November 2006, defendants conspired to rig the bids for GICs by paying kickbacks to GIC brokers. In turn, the brokers helped the defendants obtain favorable results in auctions by, among other things, providing information about competitors' submissions, keeping certain competitors off the bid list and asking other competitors to submit intentionally losing bids. As a result of

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this conduct, the indictment charged that defendants and their co-conspirators won GIC awards at artificially suppressed interest rates.

Importantly, all of the bid awards that were the subject of the charged conspiracy occurred more than six years prior to the return of the indictment. The defendants moved to dismiss the indictment on statute of limitations grounds. In response, the government took the position that, even though the bid awards occurred outside the applicable limitations period, interest payments by unindicted co-conspirator GIC providers took place within the limitations period and constituted overt acts in furtherance of the conspiracy. The district court denied the defendants' motion, ruling that the alleged conspiracies continued as long as interest payments were made on the underlying GICs. After a three-week jury trial in 2012, the jury returned guilty verdicts as to all three defendants.

Second Circuit: "Lengthy, Indefinite" Payments Are Not Overt Acts

The Second Circuit reversed the convictions and issued a 2-1 opinion ruling that the indictment was time-barred. The court began by citing prior cases recognizing that the "crucial question in determining whether the statute of limitations has run is the scope of the conspiratorial agreement, for it is that which determines both the duration of the conspiracy, and whether the act relied on as an overt act may properly be regarded as in furtherance of the conspiracy." According to the superseding indictment, the alleged purposes of the conspiracies were (1) to "deprive municipal issuers of money by causing them to award investment agreements and other municipal finance contracts at artificially determined or suppressed rates, and to deprive the municipal issuers of the property right to control their assets by causing them to make economic decisions based on false and misleading information"; and (2) to "defraud the United States . . . and the IRS by impeding . . . [the] collection of revenue due . . . from municipal issuers."

The court did not dispute that, in certain cases, the receipt of economic benefits can constitute overt acts in furtherance of the conspiracy. However, relying on the First Circuit opinion in *United States v. Doherty*,[2] the court limited that principle to cases in which the receipt of such benefits consists of "one action, or a handful of actions, taking place over a limited period of time, or where some evidence exists that the special dangers attendant to conspiracies . . . remain present until the payoff is received." In contrast, the court ruled that receipt of an economic benefit is not part of the conspiracy where receiving such benefit "merely consists of a lengthy, indefinite series of ordinary, typically noncriminal, unilateral actions . . . and there is no evidence that any concerted activity posing the special societal dangers of conspiracy is still taking place." Moreover, the court ruled that "overt acts have ended when the conspiracy has completed its influence on an otherwise legitimate course of common dealing that remains ongoing for a prolonged time, without measures of concealment, adjustment or any other corrupt intervention by any conspirator."

Perhaps most importantly, the court drew a clear distinction between acts "in furtherance" of a conspiracy and the "results" of a conspiracy. The court ruled that "when anticipated economic benefit continues, in a regular and ordinary course, well beyond the period 'when the unique threats to society posed by a conspiracy are present,' the advantageous interest payment is the <u>result</u> of a completed conspiracy, and is not in furtherance of one that is ongoing."

Applying these principles to the case at hand, the Second Circuit ruled that the GIC interest payments "fit that description in every particular" because they were ordinary commercial obligations under a common commercial arrangement, were noncriminal, were unilateral and were made over an indefinite period. The court ruled that "[p]ayments can be 'indefinite' either in the sense that they are of undetermined number or in the sense that they are prolonged beyond the near future." The GIC interest payments were both prolonged and undetermined in number, given the municipality's ability to terminate GIC contracts when the funds became needed. Therefore, the court ruled that the GIC payments were not "overt acts" in furtherance of the conspiracy and the indictment was time barred.

Dissenting Opinion

Dissenting from the majority opinion, Judge Kearse wrote that receipt of economic benefits should be considered an act in furtherance of a conspiracy where a purpose of the conspiracy is economic enrichment. In what she described as a "major flaw in the majority's opinion," Judge Kearse faulted the majority opinion for its failure to acknowledge that the alleged bid rigging enabled the institutional GIC providers — all unindicted co-conspirators — to pay interest to municipal issuers at artificially depressed rates, and that such acts are attributable to all other co-conspirators. Additionally, the indictment in *Grimm* included as a goal of the conspiracy "to defraud municipal issuers and to obtain money and property from municipal issuers by means of false and fraudulent pretences," and thus "the providers would realize economic gains each time they made an interest payment to the municipal entity at the lower rate."

In the dissent's view, the jury's finding that an objective of the conspiracies was to enable providers to make periodic interest payments at artificially suppressed rates, that the objective existed within the limitations period, and that the providers' payments were acts in furtherance of that objective was permissible. "Indeed, the payments were essential to the conspiracies' success: If the payments were not made, the providers would be in breach of the investment contracts and would cease to achieve their conspiratorial goals of economic gain through payments of interest below fair market rates." The dissent also disputed the majority's distinction between the conspiracy and its results, noting that the result of bid rigging was not the "payments;" rather, "the result is the artificially arrived-at interest rate that gives the providers an economic gain each time a payment is made."

Conclusion

Issues regarding statutes of limitation arise frequently in criminal conspiracy cases, particularly where a charged conspiracy involves long-term contracts or arrangements, or conduct that spans several years. *Grimm* likely will become a key legal touchstone, and indicates that courts may be skeptical of the government's reliance on mere payment as an "overt act" sufficient to evade a statute of limitations bar. Further, although the charges in *Grimm* arose under the general conspiracy statute, the rationale of the Second Circuit's ruling appears to apply equally to price-fixing and bid-rigging cases under the Sherman Act. Perhaps more importantly, *Grimm* draws a clear distinction between a conspiracy and its "results," holding that the latter may not be relied upon to satisfy the statute of limitations. This concept could limit the temporal scope of future charged conspiracies. Finally, *Grimm* could influence the ways in which prosecutors charge conspiracies, pushing prosecutors to place greater emphasis on conduct that forms the core of the conspiracy rather than tailing, non-criminal conduct more tangential to the allegedly unlawful agreement. *Grimm* may also lead prosecutors to include alternative charges in an attempt to trigger longer statutes of limitations. Indeed, after statute of limitations issues first arose in *Grimm*, the government superseded its indictment in another municipal bonds case, *U.S. v. Ghavami*, to add charges that the alleged conspiracies caused "actual loss" to financial institutions in an attempt to trigger the 10-year limitations period under 18 U.S.C. section 3293(2).

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[1] The district court case is Case No. 10-CR-654 (H.B.) (S.D.N.Y.).

[2] 867 F.2d 47 (1st Cir. 1989).