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White Collar Crime Report™

FRAUD

White Collar Crime and Securities Enforcement: 2013 in Review

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The Department of Justice's prosecution of white collar crime showed no signs of abating in 2013. Insider trading continued to dominate the headlines, but 2013 also featured significant developments in public corruption, the extraterritorial reach of the Sherman Act and federal securities laws, offenses under the Computer Fraud and Abuse Act and sentencing procedure. This article highlights some of 2013's key developments in white collar practice, along with cases to watch in 2014.

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Obstruction of Justice

The case against former San Francisco Giants star Barry Bonds reached the U.S. Court of Appeals for the Ninth Circuit in 2013 for the second time. A jury in San Francisco convicted Bonds of obstruction of justice based upon a statement he made before a grand jury. When asked whether a particular trainer had ever given Bonds anything that required a syringe, Bonds's response included a rambling statement regarding his upbringing as a celebrity child. The government argued that the statement, while not false, was intentionally evasive and constituted obstruction of justice. The Ninth Circuit agreed with the government and affirmed the conviction, stating, ''We can easily think of examples of responses that are true but nevertheless obstructive.''[1]

Bonds has filed a petition seeking rehearing en banc, arguing in part that by permitting an obstruction conviction in the face of truthful testimony—particularly testimony where the witness later clarified his answer to the question—the Ninth Circuit has greatly expanded the reach of the obstruction statute, permitting it to swallow the distinct crime of perjury and obviating the various requirements imposed by the U.S. Supreme Court on perjury convictions.

[1] *United States v. Bonds*, 730 F.3d 890, 895 (9th Cir. 2013).

The Ninth Circuit has yet to rule on the petition, but it has ordered the government to respond.

Fraud and Public Corruption

Another active area of criminal law in 2013 concerned fraud and corruption in the public sphere. Many of the developments in this area reflect the ongoing impact of the Supreme Court's decision in *Skilling v. United States*,[2] which limited the honest-services fraud statute to ''bribery and kickback schemes.'' In particular, a number of courts probed the difference between permissible campaign contributions and impermissible bribes or gratuities.

Honest-Services Fraud. One of the most high profile honest-services cases in 2013 involved ex-lobbyist Kevin Ring.[3] Ring was convicted of honest-services fraud and argued on appeal that the First Amendment's protection of the political process required that his conviction be overturned. Ring had been a member of Jack Abramoff's lobbying team, and his conviction was premised on his gift of sports tickets to a lawyer at the DOJ allegedly in exchange for expediting review of a visa application for an individual connected to Abramoff. Ring argued that the district court improperly permitted his conviction to stand even though the government had not proved the existence of an *explicit* quid pro quo agreement.

The District of Columbia Circuit rejected Ring's arguments, distinguishing between campaign contributions that are potentially subject to greater protection and the sports tickets at issue in Ring's case, holding that an implicit agreement is sufficient with regard to the latter. As Judge David S. Tatel explained, while ''providing information, commenting on proposed legislation, and other lobbying activities implicate First Amendment speech and petition rights . . . the First Amendment interest in giving hockey tickets to public officials is, at least compared to the interest in contributing to political campaigns, de minimis.''[4] The D.C. Circuit further rejected Ring's argument that the government must prove that the DOJ lawyer at issue in the case in fact entered into an agreement with Ring. Just as the federal bribery statute criminalizes the simple ''offer'' of a bribe, 18 U.S.C. § 201(b)(1), the court concluded that the same standard applies to honest-services fraud by bribery.

Federal Program Bribery. The First Circuit addressed another statute targeting public corruption in *United States v. Fernandez*[5] and in the process created a circuit split. The federal program bribery statute, 18 U.S.C. § 666, prohibits corruption with respect to state and local entities that receive federal funds. *Fernandez* concerned the question whether Section 666 criminalizes gratuities in addition to bribes. As explained by the Supreme Court, bribes and gratuities, although similar, are distinguished by their differing intent elements. ''Bribery requires intent 'to influence' an official act or 'to be influenced' in an official act, while illegal gratuity requires only that the gratuity be given or accepted 'for or because of' an official act.''[6] In other words, a bribe entails a quid pro quo, while a gratuity can be simply a reward offered for an act that has already been taken. After a lengthy analysis of the statutory text, legislative history and policy considerations, the First Circuit concluded that Section 666 encompassed only bribery, not gratuities. *Fernandez* is the first appellate opinion to explicitly hold that Section 666 does not extend to gratuities, though the Fourth and Third circuits have suggested they may reach the same conclusion. The Second, Seventh and Eighth circuits have reached the opposite conclusion, holding that Section 666 applies to gratuities in addition to bribes. Expect the Supreme Court and/or Congress to revisit this issue sometime in the near future.

Hobbs Acts. The Supreme Court addressed a different facet of public corruption in *Sekhar v. United States*.[7] Giridhar Sekhar was a managing partner of an investment company in which the New York State Comptroller was considering investing pension funds. The comptroller's general counsel recommended against the investment. Soon thereafter, the general counsel received a series of anonymous e-mails demanding that the negative recommendation be rescinded and threatening, if the general counsel refused, to disclose information about his extramarital affair.

The e-mails were traced to Sekhar, and he was charged with attempted extortion in violation of the Hobbs Act. Before the Supreme Court, Sekhar argued that the Hobbs Act applies only to threats issued to obtain *property* from another, and that the general counsel's recommendation of a particular investment is not ''property'' as contemplated by the statute. Justice Antonin Scalia, writing for a unanimous court, agreed. Scalia noted that the Hobbs Act defines ''extortion'' as ''the obtaining of property *from another*, with his consent, induced by wrongful use of actual or threatened force, violence, or fear, or under color of official right.''[8] According to Scalia, this definition, which aligns with the common law's understanding of extortion, requires both that the perpetrator gain possession of property, and that the victim part with it: ''The property extorted must . . . be *transferable*—that is, capable of passing from one person to another.''[9] Because a lawyer's recommendation of a particular investment is not obtainable property, a threat intended to coerce such a recommendation is not extortion under the Hobbs Act, Scalia reasoned.

Although *Sekhar*'s impact beyond cases brought under the Hobbs Act may be limited given that the opinion turns on the specific statutory language, the opinion reminds observers once again that Scalia's fidelity to statutory text, particularly when bolstered by common law history, can often redound to the benefit of criminal defendants.

Securities Fraud

Insider Trading. Insider trading continued to be among the most active areas of white collar prosecutions in 2013, and no investigation received more atten-

[2] 2010 BL 142337, 05 WCR 459 (U.S. 2010).
[3] *United States v. Ring*, 706 F.3d 460, 08 WCR 69 (D.C. Cir. 2013).
[4] Id. at 466.
[5] 722 F.3d 1, 08 WCR 475 (1st Cir. 2013).
[6] Id. at 19, quoting *United States v. Sun-Diamond Growers of California*, 526 U.S. 398, 404-05 (1999).
[7] 133 S. Ct. 2720, 08 WCR 431 (U.S. 2013).
[8] 18 U.S.C. § 1951(b)(2) (emphasis added).
[9] *Sekhar*, 133 S. Ct. at 2725 (emphasis added).

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tion than the DOJ's ongoing pursuit of SAC Capital Advisors LP, which has ensnared both the hedge fund itself and a growing number of former employees.

On July 25, SAC and three affiliated entities were indicted in the Southern District of New York on charges of wire fraud and securities fraud based on allegations of insider trading.[10] The charges against these entities—a rare federal criminal indictment of a major Wall Street entity—followed indictments of eight employees of SAC and its affiliates, with six pleading guilty. In November, SAC agreed to plead guilty and pay fines totaling $1.8 billion to settle civil and criminal charges, making it the first Wall Street firm in decades to plead guilty to criminal conduct.[11] SAC further agreed to end its investment adviser businesses.

Michael Steinberg, the first of the two individual defendants to plead not guilty, went to trial shortly after SAC's plea.[12] Steinberg was accused of receiving confidential information about earnings at technology companies Dell Inc. and Nvidia Corp. and making trades based upon that information, which resulted in total profits of $1.4 million. Steinberg's defense focused on the fact that he never received any confidential information directly from an insider but instead was accused of being a fourth-level recipient of such information. Steinberg's attorney argued that Steinberg never knew that the information he received was confidential, and the government's key witness acknowledged on the stand that he never explicitly told Steinberg that he had received inside information. After a five-week trial, the jury needed only two days to find Steinberg guilty of four counts of securities fraud and one count of conspiracy.[13]

A jury trial for the other defendant to challenge the charges, Matthew Martoma, began Jan. 7.[14] Unlike Steinberg, Martoma is accused of receiving confidential information directly from an insider, and his alleged net profits—$276 million—dwarf those at issue in Steinberg's case.[15] The alleged tipper in Martoma's case was a neurology professor who supposedly told Martoma that trials of certain drugs had gone poorly. Martoma's case has been a particular focus of commentary in light of allegations that SAC's founder and owner Steven A. Cohen, who has not been criminally charged, encouraged others to sell the same shares after speaking with Martoma. Practitioners will be watching the outcome in the Martoma case closely.

The SAC prosecutions highlight the legal question of whether the government must prove that the tippee in an insider trading case knew that the tipper stood to benefit personally from the disclosure of confidential information, an issue that has generated an intra-district split within the Southern District of New York,[16] and one that has been raised in a pending Second Circuit appeal. In *United States v. Newman*[17], the defendants are appealing their 2012 convictions. They contend that because they were unaware of any benefit that the insider stood to gain, they cannot be guilty of insider trading.[18] Although the government agrees that Supreme Court precedent requires it to prove that the insider did in fact stand to benefit, it argues that there is no reason to require proof that the tippee *knew* about the benefit to the tipper.

White collar specialists will be watching closely in 2014 to see how the Second Circuit resolves these issues.

Wiretaps. A separate issue that has arisen in a number of recent insider trading prosecutions concerns the government's aggressive use of wiretaps. The most well-known use of wiretap evidence in a white collar prosecution occurred in *United States v. Rajaratnam*, which involved Galleon Group principal Raj Rajaratnam. The Second Circuit in June affirmed Rajaratnam's conviction and approved of the use of wiretaps in that case.[19] Rajaratnam had argued that because the government's wiretap application did not provide a ''full and complete statement'' as required by the statute, the district court should have excluded all evidence obtained via the tap. The Second Circuit disagreed, holding that the district court was correct to analyze the application within the framework of *Franks v. Delaware*, 438 U.S. 154 (1978), which permits the district court to consider post hoc whether a complete application would have been granted, and also holding that the *Franks* analysis did not require suppression. The Second Circuit further rejected Rajaratnam's argument that the district court's jury instructions—which permitted the jury to convict if it concluded that the inside information ''was a factor, however small, in the defendant's decision to purchase or sell stock''—were improper.[20]

JPMorgan. One Wall Street bank that is likely grateful to see 2013 in the rearview mirror is JPMorgan Chase & Co. In September, two former JPMorgan traders, Javier Martin-Artajo and Julien Grout, were indicted for securities fraud in connection with the so-called $2 billion ''London Whale'' trading loss.[21] Both defendants are currently abroad and are resisting extradition. Notably, the JPMorgan trader behind the loss, Bruno Iksil, who earned the moniker the ''London Whale,'' has not been charged. JPMorgan itself was not indicted in connection with the loss.

In a separate matter, JPMorgan avoided indictment in connection with charges that it failed to warn officials about Bernie Madoff's fraud. Rather, JPMorgan entered into a deferred prosecution agreement, filed Jan. 7 in the Southern District of New York, and will pay $2.6 billion in penalties.[22]

Extraterritorial Application of Securities Laws. A final noteworthy securities case from 2013, also from the Second Circuit, limited the geographic reach of criminal securities laws. In *United States v. Vilar*[23], the court considered the impact of the Supreme Court's decision

[10] *United States v. SAC Capital Advisors LP*, No. 1:13-cr-00541 (S.D.N.Y.) (08 WCR 543).
[11] 08 WCR 779 (11/15/13).
[12] *United States v. Steinberg*, No. 1:12-cr-00121 (S.D.N.Y.).
[13] 08 WCR 865 (12/27/13).
[14] *United States v. Martoma*, No. 1:12-cr-00973 (S.D.N.Y.).
[15] 08 WCR 863 (12/27/13).
[16] 8 WCR 96 (2/8/13).
[17] No. 13-1837-cr (2d Cir. 2013)
[18] 09 WCR 16 (1/10/14).
[19] *United States v. Rajaratnam*, 719 F.3d 139, 08 WCR 432 (2d Cir. 2013).
[20] Id. at 143.
[21] 08 WCR 649 (9/20/13).
[22] 09 WCR 5 (1/10/14).
[23] 729 F.3d 62, 08 WCR 611 (2d Cir. 2013).

in *Morrison v. National Australia Bank Ltd.*, which held that, at least in the civil context, Section 10(b) and Rule 10b-5 do not apply to extraterritorial conduct. Over the government's objection, the Second Circuit concluded in *Vilar* that a ''statute either applies extraterritorially or it does not,''[24] and that a different application in the civil and criminal contexts is unsupportable. *Vilar* therefore expanded *Morrison*'s holding into the criminal context. But unfortunately for the *Vilar* defendants, the Second Circuit went on to conclude that there was sufficient domestic conduct in their cases to support their convictions.

Antitrust

2013 also saw the extraterritorial reach of federal antitrust law teed up for decision in the Ninth Circuit in a trio of price-fixing cases with potentially far-reaching implications. AU Optronics Corp. and two of its executives argue that their criminal antitrust convictions must be vacated because all the allegedly criminal behavior occurred overseas. The extraterritoriality argument is two-fold. First, the defendants argue that in light of *Morrison*, the Sherman Act cannot be presumed to have extraterritorial application. Second, they argue that even if the Sherman Act does have some extraterritorial application, the Ninth Circuit's opinion in *Metro Indus. Inc. v. Sammi Corp.*[25] dictates that such a case is subject to the rule of reason and cannot be considered a per se violation. Because the defendants were convicted on a per se theory, they argue that their convictions must be vacated. The Ninth Circuit's decision in the AU Optronics cases will be closely watched in 2014.

Intellectual Property Crimes

Criminal intellectual property cases were very much in the news again in 2013. The year began with the suicide in January of Internet activist Aaron Swartz, who was facing federal charges of wire fraud and violations of the Computer Fraud and Abuse Act (CFAA) for downloading millions of documents from the online database JSTOR through the Massachusetts Institute of Technology's computer network.[26] The government alleged that Swartz accessed protected computers belonging to JSTOR and MIT without authorization and that he did so by means designed to avoid efforts to prevent such copying and elude detection, including breaking into a utility closet at MIT and concealing a laptop plugged into MIT's network. Swartz's death sparked widespread criticism that the government had overreached in prosecuting him, particularly in light of the fact that JSTOR had declined to pursue an action against him, and calls to reform the CFAA.[27]

In another CFAA case that garnered widespread attention, David Nosal was convicted in April in the Northern District of California on the basis of allegations that, following his departure from the executive search firm Korn/Ferry International, he accessed a Korn/Ferry database in effort to set up a competing consulting firm. In 2012, the Ninth Circuit, sitting en banc, affirmed the dismissal of five CFAA counts that alleged that Nosal obtained information from the database from then-current Korn/Ferry employees. The court concluded that the phrase ''exceeds authorized access'' in the statute ''is limited to violations of restrictions on *access* to information, and not restrictions on its *use*.''[28]

On remand, the district court denied Nosal's motion to dismiss the remaining CFAA counts.[29] The court held that the remaining counts alleged that current employees had shared their database passwords with Nosal and thus sufficiently alleged violations of Korn/Ferry's restrictions on access to the database. The district court also rejected Nosal's argument that the CFAA requires proof that the defendant circumvented technological barriers to access a computer. Nosal was sentenced Jan. 8 to 1 year and 1 day in prison.

In 2014, practitioners will be watching another high-profile IP trial in the Northern District of California. Trial began Jan. 8 in the government's prosecution of Walter Liew, his wife and a business associate.[30] The government alleges that Liew stole DuPont Co. trade secrets and sold them to companies controlled by the Chinese government. Liew faces economic espionage, trade secret theft, tax evasion and evidence-tampering charges. Liew has denied the charges and claims that the trade secrets at issue were well-known and that there is no evidence that Liew intended to benefit the Chinese government or a government entity. The trial is expected to last two months.

Sentencing

2013 also saw the Supreme Court hand down two significant sentencing cases. *Alleyne v. United States*, 133 S. Ct 2151, (2013), resolved a long-standing controversy regarding the proof required to impose a mandatory minimum sentence. The controversy arose from two prior decisions: *Apprendi v. New Jersey*, 530 U.S. 466 (2000), and *Harris v. United States*, 536 U.S. 545 (2002). *Apprendi* held that any facts that increase a criminal defendant's maximum possible sentence are considered ''elements'' of the criminal offense that must be proved to a jury beyond a reasonable doubt. In *Harris*, the court decided that *Apprendi* did not apply to facts that would increase a defendant's mandatory minimum sentence and, therefore, a judge could constitutionally decide to apply a mandatory minimum sentence on the basis of facts not proved to a jury. After years of debate about how these decisions could be reconciled, the court overruled *Harris* in *Alleyne*. In a 5–4 decision, the court held that the defendant's seven-year mandatory minimum sentence was imposed in violation of his Sixth Amendment right to trial by jury because the question of brandishing a firearm (which added several years to Alleyne's sentence) was never submitted to the jury. The court held that *Apprendi* requires a jury to find all facts that fix the penalty range of a crime, including the mandatory minimum sentence.

In *Peugh v. United States*, 08 WCR 399, 133 S. Ct 2072 (2013), the court held that the Ex Post Facto Clause prohibits federal courts from sentencing a defendant on the basis of U.S. Sentencing Guidelines that

78 U.S.L.W. 1878, 130 S. Ct. 2869 (U.S. 2010).
[24] 729 F.3d at 74.
[25] 82 F.3d 839 (9th Cir. 1996).
[26] *United States v. Swartz*, 1:11-cr-10260 (D. Mass.).
[27] 08 WCR 459 (6/28/13).
[28] *United States v. Nosal*, 676 F.3d 854, 864, 07 WCR 311 (9th Cir. 2012).
[29] 08 WCR 182 (3/22/13).
[30] *United States v. Liew*, No. 3:11-cr-00573 (N.D. Cal.).

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were promulgated after he committed his crimes when the new version of the guidelines provides a higher sentencing range than the version in place at the time of the offense. In a jumbled 5-4 decision, the court held that, despite the advisory nature of the guidelines after *United States v. Booker*[31], a higher guidelines range still presents a ''significant risk'' of increasing the measure of punishment, thus violating the Constitution's Ex Post Facto Clause.

[31] 543 U.S. 220 (2005).