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White Collar Crime Report™

FRAUD

White Collar Crime and Securities Enforcement: 2014 in Review



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Results yielded in 2014 were mixed for the Department of Justice in the white collar arena. The government suffered a large setback in its crackdown on insider trading when the U.S. Court of Appeals for the Second Circuit overturned the convictions of two former hedge-fund managers in *United States v. Newman*.[1] The court's decision threatens several other convictions secured by the government over the last few years, and significantly raises the bar for the government going forward to prove insider trading against people who receive inside information.

The year also featured significant developments relating to the Foreign Corrupt Practices Act, bank fraud, and the government's pursuit of financial institutions suspected of having connections to overseas money laundering and tax evasion.

This article highlights some of 2014's key developments in white collar practice, along with cases to watch in 2015.

Right to Counsel

Although few white collar cases were decided by the U.S. Supreme Court in 2014, the court's decision in *Kaley v. United States*[2] may have a significant impact on the right to counsel and may encourage the government to seek more pretrial restraining orders covering potentially forfeitable property.

Defendants Kerri and Brian Kaley, accused of reselling stolen medical devices, sought a hearing to challenge the pretrial freezing of their assets pursuant to 21 U.S.C. § 853(e). Those assets included a $500,000 certificate of deposit that the Kaleys had acquired to pay their chosen counsel, who had advised them for two years prior to indictment. The Kaleys did not contest that their frozen assets were traceable to, or involved in,

[1] 09 WCR 837 (12/12/14).

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[2] 2014 BL 49923, 09 WCR 133 (U.S. 2014).

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the alleged criminal conduct. Instead, the Kaleys argued that they were entitled to a hearing to show that the underlying charges against them were baseless; in part, the Kaleys intended to rely on evidence presented by a co-defendant who had already been acquitted of any wrongdoing. Both the district court and the Eleventh Circuit concluded that the Kaleys were not entitled to such a hearing.

In February, the Supreme Court agreed and affirmed the lower courts' decisions in a ruling that vigorously defended the grand jury's prerogative to have the ''last word'' on the issue of whether probable cause exists.[3]

Writing for a 6-3 majority, Justice Elena Kagan explained that an asset freeze is permissible as long as there is probable cause to think that:

(1) the defendant committed an offense permitting forfeiture; and

(2) the property at issue has the requisite connection to the crime.

Although noting that lower courts generally permit a hearing to challenge the second requirement, Kagan concluded that criminal defendants are not constitutionally entitled to a hearing challenging the first—even where the frozen assets would otherwise be used to retain an attorney. Kagan reasoned that, once an indictment has issued, a grand jury has already found probable cause that a crime was committed and that any judicial second-guessing of that probable cause determination ''could not but undermine the criminal justice system's integrity—and especially the grand jury's integral, constitutionally prescribed role.''[4]

Chief Justice John G. Roberts Jr., joined by Justices Stephen G. Breyer and Sonia M. Sotomayor, penned a forceful dissent, arguing that the majority's opinion grants the government virtually unreviewable ''power to take away a defendant's chosen advocate.''[5]

Insider Trading

Once again, developments in insider trading dominated white collar criminal law in 2014.

The *Newman* Decision. The most significant development in insider trading law in 2014 was the Second Circuit's landmark *Newman* decision, which overturned the convictions of two former hedge fund managers and significantly raised the bar for proving insider trading by defining what benefit the tipper must receive in exchange for disclosing material, nonpublic information.[6]

The appeal arose out of the 2012 insider trading convictions of Level Global Investors LP co-founder Anthony Chiasson and ex-Diamondback Capital Management LLC portfolio manager Todd Newman after a six-week jury trial in front of Judge Richard J. Sullivan in the Southern District of New York.[7] Chiasson was found guilty after his fund made $50 million based on an advance earnings tip from a source inside Dell Inc. Newman was convicted for trading on the same inside information regarding Dell, along with inside information pertaining to Nvidia Corp. Chiasson was sentenced to 78 months in prison, and Newman was sentenced to 54 months.[8]

On appeal, Chiasson and Newman argued that there was no evidence that the corporate insiders provided inside information in exchange for a personal benefit, which is required to establish tipper liability under *Dirks v. SEC*, 463 U.S. 646 (1983). They also argued that even if the insider had received a personal benefit in exchange for the information, there was no evidence that they knew about any such benefit. Without such knowledge, they argued, they could not be complicit in the tipper's fraudulent breaches of fiduciary duty.

The Second Circuit agreed on both fronts. On the first point, the appeals court not only agreed that the government must prove that the tipper received a personal benefit in exchange for the insider information, but went a step further and decided that the evidence adduced at trial—even when viewed in the light most favorable to the government—was ''too thin'' to warrant even an inference on this point.[9] The appeals court ordered the district court to ''dismiss the indictment with prejudice,'' thus barring the government from retrying the case.[10]

In reaching this decision, the Second Circuit adopted a new, more demanding standard for the benefit a tipper must receive: ''an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.''[11]

Previously, the DOJ and Securities and Exchange Commission often argued that it was sufficient to establish a breach of fiduciary duty as long as the insider gained some sort of reputational benefit. Now, however, a friendship or close relationship alone will not meet the burden of proof to show that the insider benefited from releasing material, nonpublic information. Prosecutors will now need to meet all three of the new criteria, showing that an alleged benefit was objective, consequential and represents ''at least a potential'' monetary gain or gain of similar value. The question that courts will be grappling with over the next few years is what does ''objective, consequential'' mean.

On the appellants' second point, the court concluded that the trial court's instruction was flawed because it did not require the jurors to determine that the defendants knew that the tipper disclosed the material, nonpublic information for personal benefit in violation of his or her fiduciary duty.[12] This holding was less controversial, as there were several prior district court decisions in the Second Circuit and elsewhere articulating this requirement, which arises out of the fraud-based nature of insider trading liability.

The government has until Jan. 23 to seek en banc review of the *Newman* decision.

The Aftermath of *Newman*. In addition to dismissing the charges against Chiasson and Newman, the Second Circuit's opinion calls into question other recent prosecutions, including the 2013 conviction of Michael Steinberg, a former hedge fund manager for an affiliate of SAC Capital Advisors LP. Steinberg was also con-

[3] Id.
[4] Id.
[5] Id.
[6] *United States v. Newman*, 2014 BL 345948, 09 WCR 837, No. 13-1837-CR (2d Cir. Dec. 10, 2014).
[7] 07 WCR 981 (12/28/12).
[8] 08 WCR 337 (5/17/13).
[9] *Newman*at *21.
[10] Id. at *28.
[11] Id. at *22.
[12] Id. at *3-4.

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victed in front of Sullivan based on very similar jury instructions as those held invalid in *Newman*.[13]

The decision could also jeopardize the guilty pleas of other defendants in the *Newman* case, including former Whittier Trust Co. analyst Danny Kuo, who pleaded guilty before Newman and Chiasson went to trial.[14]

In addition, Judge Andrew L. Carter Jr., of the Southern District of New York, stated at a hearing in December that, based on *Newman*, he had serious doubts about whether there was a sufficient factual basis for guilty pleas entered by four defendants in an insider trading case arising from an alleged scheme to trade ahead of IBM Corp.'s 2009 acquisition of SPSS Inc.[15] Carter gave the government the opportunity to brief why the guilty pleas should still stand in the wake of the *Newman* decision, and he will decide the matter in early 2015.[16]

Given the significance of the *Newman* decision and the controversy around the court's ruling, look for further calls for Congress to pass a statute defining the crime of insider trading.[17]

It remains to be seen whether the SEC will be subject to the strict standards set forth by the Second Circuit in *Newman*, or whether the SEC can apply a lesser standard in civil cases when it comes to proving that the tipper received a personal benefit. In *Newman*, the Second Circuit stated repeatedly that it was seeking to clarify what was necessary to prove insider trading in the criminal context, and the court invoked several criminal law doctrines in reaching its decision. However, the court also cited extensively to *Dirks*, a civil case, in articulating its standard for insider trading liability.

Whether the SEC will be held to the demanding standards set forth in *Newman* is an issue that will be debated in 2015.

Other Criminal Insider Trading Cases

Newman was not the only criminal insider trading case in the news in 2014.

SAC Capital. The year also saw the government's long-running investigation of SAC Capital come to close. In February, Mathew Martoma, a portfolio manager at CR Intrinsic Investors LLC, a hedge fund advisory firm affiliated with SAC Capital, was found guilty in a case prosecutors called the largest insider trading scheme ever prosecuted.[18] Martoma was convicted of soliciting and using secret tips regarding clinical trials of a drug for Alzheimer's disease to trade Elan Corp. and Wyeth stock. Martoma received the tips directly from a neurology professor involved in the trials, and used the tips to make more than $275 million for the hedge fund. In September, Martoma was sentenced to nine years in prison, the second longest sentence handed out during the recent wave of insider trading convictions.[19] Martoma is unlikely to benefit from the Second Circuit's decision in *Newman*, as he was directly linked to the tipper and instrumental in cultivating the leak.

Then, in April, the court approved the government's plea agreement with SAC Capital.[20] In the milestone settlement, SAC Capital agreed to pay $1.8 billion to resolve criminal and civil proceedings. The settlement closed the chapter on the SAC Capital's role as a money manager—the firm has changed its name to Point72 Asset Management LP and has returned all investors' money—and ends the government's nearly 10-year long investigation of the firm. All told, the government secured the convictions of eight current or former employees of the firm in addition to the company's plea agreement.

Government Loses Insider Trading Trial. Marking the government's first trial loss during the recent crackdown on insider trading, Rengan Rajaratnam was acquitted by a jury in the Southern District of New York after fewer than three hours of deliberations.[21] Rajaratnam was accused of conspiring with his older brother, Raj, to commit insider trading in 2008 in connection with deals involving Advanced Micro Devices Inc. and Clearwire Corp. The government introduced wiretapped calls between the brothers discussing stock trades, but the jury apparently accepted Rengan's defense that he was acting merely at the behest of his brother and did not know he was doing anything illegal.

Douglas Whitman. It was not surprising that Douglas Whitman's petition for a writ of certiorari in his insider trading conviction was denied by the Supreme Court in November of 2014.[22] It was surprising, however, that Justice Antonin Scalia, joined by Justice Clarence Thomas, chided the Second Circuit for showing deference to the SEC's interpretation of Rule 10(b) when it affirmed Whitman's conviction.[23] The issue arises out of the SEC's adoption in 2000 of Rule 10b5-1, in which the SEC sought to clarify the law of insider trading interpreting Rule 10b-5. Scalia and Thomas took umbrage with the idea that a court should show deference to an agency's interpretation of a rule that contemplates both criminal and administrative enforcement, as Rule 10b-5 does. Scalia wrote that ''[l]egislatures, not executive officers, define crimes,'' and stated that he would be ''receptive'' to future certiorari petitions that placed the issue front and center. Expect this issue to be addressed directly in 2015.

Fraud

In June, in *Loughrin v. United States*,[24] the Supreme Court addressed the intent requirement under the federal bank fraud statute, specifically 18 U.S.C. § 1344(2), which provides, ''Whoever knowingly executes, or at-

[13] *United States v. Steinberg*, No. 1:12-cr-00121 (S.D.N.Y.). See 10 WCR 20 (Second Circuit grants stay of appeal while government decides how to respond to *Newman*).

[14] 07 WCR 318 (4/20/12).

[15] *United States v. Conradt*, No. 1:12-cr-00887 (S.D.N.Y.) (09 WCR 882).

[16] The government said in a brief filed Jan. 12 that the *Newman* decision is ''dramatically'' wrong. See 10 WCR 37

[17] James B. Stewart, *Delving into the Morass of Insider Trading*, N.Y. Times (Dec. 19 2014).

[18] *United States v. Martoma*, No. 1:12-cr-00973 (S.D.N.Y.) (09 WCR 106).

[19] 09 WCR 623 (9/19/14).

[20] *United States v. SAC Capital Advisors LP*, No. 1:13-cr-00541 (S.D.N.Y.) (09 WCR 242).

[21] *United States v. Rajaratnam*, No. 1:13-cr-00211 (S.D.N.Y.) (09 WCR 450).

[22] *Whitman v. United States*, No. 14-29 (cert. denied 11/10/14).

[23] 09 WCR 820 (11/28/14).

[24] 2014 BL 172972, 09 WCR 409, No. 13-316 (U.S. 2014).

tempts to execute, a scheme or artifice . . . to obtain any of the moneys, funds, . . . or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations or promises'' shall be fined or imprisoned up to 30 years.[25]

Defendant Kevin Loughrin was charged under the statute for the mundane crime of stealing checks from mailboxes, removing or altering the writing and then using the checks to purchase items from local Target stores, which items he immediately returned for cash. Loughrin argued for a jury instruction requiring the government to prove that he acted with the intent to defraud a financial institution. The district court denied his request, Loughrin was convicted and the Tenth Circuit affirmed the conviction.

Resolving a circuit split, the Supreme Court affirmed the Tenth Circuit in a fractured opinion but a unanimous judgment. In an opinion joined by seven other justices, Kagan wrote that the plain language of Section 1344(2) precluded Loughrin's argument because ''nothing in the clause additionally demands that a defendant have a specific intent to deceive a bank.''[26] Moreover, the court reasoned that Lougrhin's interpretation of Section 1344(2) would render it nearly duplicative of Section 1344(1), which criminalizes schemes and artifices ''to defraud a financial institution'' and thus plainly includes a requirement to prove intent to defraud a financial institution.

While the Supreme Court's reasoning on the plain language and structure of the statute was largely noncontroversial, there was greater disagreement as to what limits, if any, Section 1344(2) places on the prosecution of fraud cases traditionally left to state and local prosecutors. As Loughrin characterized the issue, without a requirement to prove an intent to defraud a financial institution, what limit is there to prevent the government from prosecuting every garden-variety fraud that happens to involve a check.

Kagan concluded that the statute's ''by means of'' language limits its scope to cases where the defendant's false statement or scheme ''is the mechanism naturally inducing a bank . . . to part with money in its control.''[27]

In a concurring opinion, Scalia, writing with Thomas, questioned the high court's conclusion that the ''by means of '' language in the statute provided the limit on the statute's scope that the court was looking for, arguing that the question of how to limit Section 1344(2)'s reach should be left for another day.

Foreign Corrupt Practices Act

The DOJ achieved a significant win in the FCPA realm this year in *United States v. Esquenazi*.[28] In that decision, the Eleventh Circuit became the first federal appellate court to interpret the phrase ''foreign instrumentality'' as used in the FCPA, ultimately adopting a broad, multi-factor test advocated by the government.

Joel Esquenazi and Carlos Rodriguez were convicted under the FCPA of bribing a Haitian telecommunications vendor in exchange for reduced rates. Esquenazi was sentenced to 15 years imprisonment, the longest sentence to date in an FCPA case, and Rodriguez was sentenced to seven years in prison.[29] Esquenazi and Rodriguez appealed, arguing, in part, that the ''foreign instrumentality'' jury instruction provided to the jury was erroneously broad. The defendants contended that ''instrumentality'' should be limited to entities that perform traditional, core government functions and that the Haitian telecommunications company at issue did not meet that standard.

The Eleventh Circuit disagreed, holding that an ''instrumentality'' under the FCPA is ''an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own.''[30] The appellate court laid out a list of nonexhaustive factors to be considered in determining ''control'' and ''function.'' Factors indicating government control include:

- the government's formal designation of the entity;
- the government's majority interest in the entity;
- the government's ability to hire and fire principals;
- the government's receipt of the entity's profits; and
- the length of time these indicia have existed.

Questions relevant to determining whether the entity performs a function the government treats as its own include whether:

- the entity has a monopoly on its function;
- the government subsidizes the entity's costs;
- the entity provides services to the public at large; and
- the public and government perceive the entity to be performing a governmental function.

The Supreme Court in October declined to revisit the Eleventh Circuit's decision, summarily denying a petition for writ of certiorari.[31]

Given *Esquenazi*'s rejection of a bright-line test to determine whether an entity is a foreign instrumentality, practitioners may worry that it will be difficult to make an ex ante determination regarding which entities and officials are covered by the FCPA. This issue is likely to receive continued attention in the future as other courts weigh in, either applying the *Esquenazi* factors or departing from its holding.

Intellectual Property

Computer Fraud and Abuse Act. In *United States v. Auernheimer*,[32] a closely-followed case in the Third Circuit, the court largely avoided questions about the substantive scope of the CFAA, instead overturning the defendant's CFAA conviction for lack of venue.

The defendant, Andrew Auernheimer, was tried and found guilty in New Jersey for writing a computer program that extracted e-mail addresses of Apple iPad users from AT&T's website. Auernheimer and his alleged

[25] Id.
[26] Id.
[27] Id.
[28] 752 F.3d 912, 09 WCR 342 (11th Cir. 2014).
[29] 06 WCR 927 (11/4/11).
[30] *Esquenazi* at 925.
[31] *Esquenazi v. United States*, No. 14-189 (cert. denied 10/6/14) (09 WCR 703)
[32] 748 F.3d 525, 09 WCR 256 (3d. Cir. 2014).

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co-conspirator were never in New Jersey while committing the accused acts, the servers they accessed were not in New Jersey and no disclosure of the e-mail addresses took place in New Jersey. The district court, however, held that venue was proper because Auernheimer had disclosed the e-mail addresses of about 4,500 New Jersey residents.

The Third Circuit reversed, holding that there were only two ''essential conduct elements'' in the charges under the CFAA: (1) accessing without authorization and (2) obtaining information.[33] Because New Jersey was not the site of either essential conduct element and because none of the charged overt acts took place in New Jersey, venue was improper. The *Auernheimer* decision sets forth a significant limit on the government's ability to select venue in the digital age.

Looking ahead to 2015, the Ninth Circuit will once again consider *United States v. Nosal*,[34] another closely-followed CFAA case. Nosal, a former Korn/Ferry International employee, was convicted in district court in 2013 on the basis of allegations that a current Korn/Ferry employee shared her database password with Nosal's competing executive search firm. On appeal, Nosal has argued that consensual password sharing is commonplace and not an offense under the CFAA.

Economic Espionage Act. The DOJ in 2014 continued to pursue criminal trade secret theft, especially thefts connected to China. In March, a federal jury convicted Walter Liew, his California-based company, and his business associate, Robert Maegerle, a former DuPont engineer, of crimes under the EEA.[35] Liew was convicted of selling DuPont trade secrets to companies owned or controlled by the Chinese government.[36] The trial in San Francisco was the first jury trial on economic espionage charges since the law's passage in 1996. Notably, the trial went forward without the participation of the indicted Chinese companies, upon which the government has been unable to successfully effectuate service.[37]

[33] Id. at 533.

[34] No. 14-10037 (9th Cir. 2014).

[35] *United States v. Liew*, No. 3:11-cr-00573 (N.D. Cal.).

[36] Liew was sentenced in July to 15 years in prison (09 WCR 489).

[37] *United States v. Pangang Grp. Co. Ltd.*, 879 F. Supp. 2d 1052, 1055 (N.D. Cal. 2012).

Money Laundering, Tax Evasion

In 2014, the federal government continued to pursue financial institutions for handling funds with a connection to sanctioned countries.

French bank BNP Paribas paid the largest penalty yet, $8.97 billion, for processing transactions involving Sudan, Iran and Cuba over the course of eight years.[38] The DOJ contended that BNP went to great lengths to conceal prohibited transactions, including by routing transactions through third-party financial institutions, and that it failed to cooperate when contacted by U.S. law enforcement.[39]

The government served up yet another headline-grabbing plea deal in May when Credit Suisse AG pleaded guilty to conspiracy to aid and assist Americans in the filing of false tax returns.[40] Credit Suisse agreed to pay $2.6 billion for conduct that the government alleged spanned decades, including the use of sham entities to hide undeclared accounts, the destruction of records sent to the U.S. for client review and the structuring of fund transfers to avoid reporting requirements.[41]

The news was not all good for the government in its efforts to prosecute tax evasion. In late October and early November, the DOJ suffered back-to-back losses in two jury trials of individual bank executives for tax violations.

Former UBS wealth-management executive Raoul Weil, tried in Fort Lauderdale, Fla., and retired Bank Mizrahi-Tefahot executive Shokrollah Baravarian, who went to trial in Los Angeles, were both found innocent of tax-related conspiracy charges after short deliberations by the jury in each case.[42]

[38] 09 WCR 449 (7/11/14).

[39] DOJ press release, *BNP Paribas Agrees to Plead Guilty and to Pay $8.9 Billion for Illegally Processing Financial Transactions for Countries Subject to U.S. Economic Sanctions* (June 30, 2014), available at http://www.justice.gov/opa/pr/bnp-paribas-agrees-plead-guilty-and-pay-89-billion-illegally-processing-financial.

[40] *United States v. Credit Suisse AG*, No. 1:14-cr-00188, Dkt. 13 (E.D. Va. May 19, 2014) (09 WCR 341).

[41] DOJ press release, *Credit Suisse Pleads Guilty to Conspiracy to Aid and Assist U.S. Taxpayers in Filing False Returns* (May 19, 2014), available at http://www.justice.gov/opa/pr/credit-suisse-pleads-guilty-conspiracy-aid-and-assist-us-taxpayers-filing-false-returns.

[42] Weil's acquittal; Baravarian's acquittal.