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White Collar Roundup - November 2017

The DAG's Speeches on Corporate Prosecutions

Rod Rosenstein, the deputy attorney general (DAG) of the U.S. Department of Justice (DOJ) gave two speeches that hinted at the department's emerging vision regarding prosecution of corporate crime.

- In the October 6 keynote address on corporate enforcement policy at New York University's Program on Corporate Compliance and Enforcement, Rosenstein began by noting that the DOJ's past practice of "[m]anagement-by-memo is an inefficient and often ineffective method of enforcing government policies. Our policies should be readily accessible to the public we expect to follow them." Improving this access, Rosenstein said, is "one of the administrative goals" he hopes to achieve during his tenure at the DOJ. He then criticized the DOJ's habit of providing guidance on corporate liability through speeches and memos, lamenting that "it has become a hallmark of expertise in the white-collar arena to know the name of every former deputy attorney general who issued a memo about the prosecution of corporate fraud." In the future, he continued, "we should guide our employees through policies identified by section numbers in the manual or another reference source, instead of by memos named for former department officials."
- Turning to the substance of corporate crime, Rosenstein "generally agree[d] with the critique that motivated Deputy Attorney General Sally Q. Yates to issue a new policy. Federal prosecutors should be cautious about closing investigations in return for corporate payments, without pursuing individuals who broke the law." He then articulated the "common themes" of any changes to the current policies: (1) "any changes will reflect our resolve to hold individuals accountable for corporate wrongdoing"; (2) "they will affirm that the government should not use criminal authority unfairly to extract civil payments"; (3) they "will make the policy more clear and more concise"; and (4) "they will reflect input from stakeholders inside and outside" the DOJ.
- In the October 25 keynote address at the U.S. Chamber Institute for Legal Reform, he reemphasized those messages. Rosenstein said, "In order to promote efficiency and consistency in the Department of Justice, my office is working on a project to collect outstanding policy memoranda and incorporate them, where appropriate, into our operating manual. And we will keep it concise."
- As for corporate enforcement, he said, "We should never use the threat of federal enforcement unfairly to extract settlements. We should reward prompt reporting of wrongdoing. And we should ensure that our policies and practices focus on deterrence, which is the primary goal of law enforcement." To that end, Rosenstein announced, "We are establishing a Working Group on Corporate Enforcement and Accountability, which will offer recommendations on promoting individual accountability and corporate cooperation. We are also reviewing the mandate of the Financial Fraud Enforcement Task Force to evaluate whether it continues to meet current needs."

The DAG's Speech Part Deux: Cybersecurity

The DAG also gave a speech on cybersecurity at the Cambridge Cyber Summit in October. That speech focused on three issues: "(1) the scope of the cybersecurity threat that confronts our nation; (2) the challenges we face in countering the threat; and (3) the ways that law enforcement can help, before, during, and after a cyber incident." He noted that the threat is "significant and growing," with estimated costs increasing from approximately $3 trillion in 2015 to $6 trillion in 2021. The challenges include the use of "computer intrusions and attacks" by foreign governments and "the continued growth of dark markets that facilitate all manner of crime — from narcotics trafficking, to illegal firearms sales, identity theft, child exploitation and computer hacking." Insofar as law enforcement can help, he urged companies to report cyber incidents. He recognized

that "[w]hen deciding whether to notify law enforcement about a cyber incident or whether to cooperate fully in an investigation, organizations weigh the anticipated benefits of a proactive approach against legal, business, reputational, and other practical concerns." But he "emphasize[d] how important it is to report cyber incidents as quickly as possible" to allow law enforcement to help.

Arrival of the Connecticut Cyber Task Force

Deirdre M. Daly, then-U.S. attorney for the District of Connecticut, announced the formation of a Connecticut cyber task force among several law-enforcement agencies "to investigate complex crimes in cyberspace." The task force will be based at the offices of the FBI in New Haven and will include representatives from the FBI, Drug Enforcement Administration, U.S. Secret Service, U.S. Postal Inspection Service, Homeland Security Investigations, Internal Revenue Service – Criminal Investigation, Defense Criminal Investigative Service, Connecticut State Police and 11 police departments from across the state. FBI Special Agent in Charge Patricia M. Ferrick said, "The primary goal of the task force is to combine available federal, state and local law enforcement resources in Connecticut to address challenging and emerging cyber threats such as the use of the dark markets, crypto currencies such as bitcoin, and encrypted routing services, including TOR, to hide the advertising, sale and distribution of controlled substances and the sale of stolen personal identification, user credentials and financial information." The task force will focus on disrupting criminal organizations that use computer intrusions to defraud companies of their money and information and on activity on the dark web, such as drug distribution.

DreamHost Warrant Limited

As we reported here, a Superior Court judge in the District of Columbia granted the DOJ's request to obtain records from the website DisruptJ20.org which were purportedly related to violent protests at the inauguration. As noted here, the judge strictly limited the scope of the government's warrant, ruling "in a final order that the company could redact some of the identifying information about site visitors in order to protect their privacy and constitutional rights." The judge wrote, "While the government has the right to execute its warrant, it does not have the right to rummage through the information contained on DreamHost's website and discover the identity of, or access communications by, individuals not participating in alleged criminal activity, particularly those persons who were engaging in protected 1st Amendment activities." The government could appeal the ruling, but in the meantime, the order appears to limit the fruits of the warrant as the government conducts its investigation and to provide some protections to "innocent visitors" to the website.

First Circuit Affirms Conviction of Pump-and-Dump Lawyer

The U.S. Court of Appeals for the First Circuit in *United States v. Weed* shot down lawyer Richard Weed's attempts to reverse his securities-fraud conviction. Two former stockbrokers, Coleman Flaherty and Thomas Brazil, used public "shell" companies in so-called pump-and-dump schemes. They would find an entrepreneur with a privately held target company and offer to take it public through a "reverse merger" with the shell company. Weed completed the legal work to effectuate the merger. Flaherty and Brazil held debt in the post-merger company in the form of promissory notes, which could be converted into shares of stock. They would enlist stock promoters to inflate the company's value and then ask Weed to provide opinion letters allowing them to "convert their promissory notes into freely tradable stock, sell their overvalued shares to an unwitting public, and stop investing in the company, which would soon collapse." The opinion letters were crucial because they allowed Flaherty and Brazil to find a transfer agent to convert their notes into stock. The letters, written pursuant to Rule 144, opined that "[n]one of the persons who have elected to convert" the notes into stock "are affiliates of the [i]ssuer." Those opinions proved false, and Weed was convicted of participation in the scheme. In a Rule 29 motion, he argued that his opinion letters were correct because Section 3(a)(9) of the Securities Act of 1933 exempts from registration "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." The district court denied his motion, and he appealed. The First Circuit affirmed. It first noted that Weed's interpretation of Section 3(a)(9) was "contrary to the reading that the SEC has consistently employed for more than eighty years." It then rejected the argument, reasoning that "[e]ven assuming for the sake of argument that Weed is right about the meaning of Section 3(a)(9), that in itself would not entitle him to relief . . . because Weed was not charged with the sale of unregistered securities." Instead, he was charged with fraud because his Rule 144 opinion letters were false.

More Pumping, More Dumping and a $13 Million Disgorgement

The SEC obtained a final judgment ordering defendant Marcus A. Luna to pay over $13 million in disgorgement, "representing profits gained as a result of" alleged participation in a pump-and-dump scheme. As described in the complaint (summarized here), Luna is alleged to have run "boiler rooms of telemarketers to tout a pair of companies" that he and his coconspirator "secretly controlled." Salespeople in those boiler rooms "cold-called investors and urged them to purchase penny stocks they claimed would soar as high as $11 per share." They claimed the company "was going to be a leading nutraceutical company, when it actually had scant revenue and no real legitimate business prospects." The activities of the boiler rooms "artificially inflated" the company's value, allowing Luna and his co-conspirators to sell their shares at a profit. And once the "sales force stopped publicly touting [the] stock, the share price and volume subsequently plummeted." Luna failed to appear to contest the SEC's complaint, making the SEC's motion for default judgment an easy win for the Commission.

Trump's SEC Nominees Promise to Enforce Individual Accountability

President Donald Trump nominated Hester Peirce and Robert J. Jackson Jr. to fill the two open slots on the SEC. As reported here, both testified before the Senate Banking Committee, sharing the vision for the SEC they would pursue if confirmed as commissioners. Both Peirce and Jackson committed to support further action on executive accountability. As Peirce said, "I am worried that too often we are just seeing settlements using shareholder money to take the focus off the executives." It appears that both Peirce and Jackson are on their way to confirmation, suggesting the Commission might cant in the future toward more robust individual enforcement.

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