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White Collar Roundup - October 2014

Roadmap for the Future of Prosecuting Financial Fraud

In a speech at New York University School of Law, outgoing U.S. Attorney General Eric Holder outlined his agency's broad-based attack on financial fraud. After noting the recent successes against institutions and individuals, he stressed "the inherent value of bringing enforcement actions against individuals, as opposed to simply the companies that employ them." First, such prosecutions enhance accountability; second, they promote fairness; and third, they create powerful deterrence to future wrongdoing. He also outlined changes in the law to enable the Department of Justice to infiltrate ongoing fraudulent schemes instead of simply prosecuting them after the fact. First, he suggested lawmakers find ways to ensure that individuals at companies could not disclaim responsibility by "blur[ring] lines of authority." Second, he suggested lawmakers and prosecutors "think[] creatively" about incentives for "witness cooperation" and ways to "encourage whistleblowers at financial firms to come forward." Finally, he said, "we must ensure that the FBI has the necessary resources to conduct white-collar investigations; to foster expertise in specialties like forensic accounting; and to help us usher in a new era of aggressive enforcement that keeps pace with a rapidly changing industry." In sum, he noted, "No company, executive or employee is above reproach - no matter who they are, where they work or how much they make" and promised "to see that [criminals] are prosecuted to the fullest extent of the law."

Corporate Cooperation Hinges on Identifying Wrongdoers

Separately, Principal Deputy Assistant Attorney General for the Criminal Division Marshall Miller in a speech urged companies wanting to cooperate with government investigations to focus on identifying and building a case against the individual wrongdoers. He said that in meetings with the higher-ups in the Criminal Division where companies are looking to avoid prosecution, prosecutors will be focused on who was at fault. The prosecutors will want the "primary focus" of the meeting to be on "what evidence you uncovered as to culpable individuals, what steps you took to see if individual culpability crept up the corporate ladder, how tireless your efforts were to find the people responsible." In a choice turn of phrase, Miller (a former prosecutor in the Eastern District of New York) said, "At the risk of being a little too Brooklyn, I'm going to be blunt. If you want full cooperation credit, make your extensive efforts to secure evidence of individual culpability the first thing you talk about when you walk in the door to make your presentation. Make those efforts the last thing you talk about before you walk out." Finally, he recommended that firms "make securing evidence of individual culpability the focus of your investigative efforts so that you have a strong record on which to rely."

Government's Use of Agent as Summary Witness Backfires

Noting that the errors in the case "bordered on the structural," the U.S. Court of Appeals for the Second Circuit in *United States v. Groysman* vacated the defendant's conviction for health-care fraud and money laundering. In the case, the defendant was alleged to have been involved in a fraudulent scheme relating to the sale of durable medical equipment. At the trial, the government first called a Department of Homeland Security special agent, who in four days of testimony gave what "was the equivalent of an opening argument or summation by the prosecution...presented as evidence for the jury to consider." This witness gave hearsay testimony and provided inadmissible opinions. Further, he was allowed "without personal knowledge" to provide the foundation for certain government exhibits. By allowing the special agent to provide such broad and inadmissible testimony, "the jury was all but invited to fall asleep during the admissible but messy evidence of

wrongdoing," which included "garbled audio-video evidence and credibility-challenged testimony" from cooperators. The court found "serious impropriety" in the government's use of the special agent and vacated the conviction on plain-error review.

Seventh Circuit Frees Defendant After Oral Argument

After being convicted in June 2013 for conspiracy to commit bribery, James Barta was set free almost immediately after oral argument before the Seventh Circuit in *United States v. Barta*. At trial the government had conceded that he was not predisposed to commit the offense, which meant the government had to overcome the entrapment defense by showing it did not induce Barta to engage in the prohibited conduct. Unfortunately for the government, the agents had hounded Barta to participate in the bribery scheme. The panel also assailed the government for advancing a theory on appeal that was never presented to the jury. On the afternoon of the argument, the Seventh Circuit issued an order reversing the conviction and remanding with instructions to enter a judgment of acquittal, finding that the defendant "was entrapped as a matter of law." The court also ordered the government to immediately release the defendant from custody. A written opinion will be forthcoming.

Hobbs Act Conspiracy Easier to Prove

The Third Circuit in *United States v. Salahuddin* held that the government can obtain a conviction for Hobbs Act conspiracy to commit extortion without proving an overt act. In Salahuddin's case, the indictment had alleged an overt act, but the government had failed to prove one to the jury. In fact, the jury charge did not call for proof of an overt act. The Third Circuit joined the First, Second and Eleventh Circuits and held that "an overt act is not a required element of Hobbs Act conspiracy."

Even Ponzi Schemers Can Catch a Break

On appeal from one of the myriad Ponzi-scheme convictions of late, the Sixth Circuit in *United States v. Snelling* vacated the defendant's sentence because the court failed to "take into account the sums paid back to [the defendant's] Ponzi scheme's investors in the course of the fraud." In the case, Jasen Snelling was involved in a Ponzi scheme in which investors were asked to invest in two fictitious financial companies. These companies claimed to invest the money in overseas mutual funds but in fact used new investments to pay "returns" on earlier investors' capital. The district court sentenced Snelling based on a loss amount of approximately $9 million. On appeal, Snelling claimed the district court should have subtracted approximately $3.5 million to account for the money returned to investors over the life of the fraud. The Sixth Circuit turned to Application Note 3(F)(iv) to U.S.S.G. §2B1.1, which articulates how to calculate loss for Ponzi schemes. That note says, "loss shall not be reduced by the money or the value of property transferred to any individual investor in the scheme in excess of that investor's principal investment." The court held that "[t]he fact that the Application Notes limit deductions from loss figures to no more than the sums originally invested implies, quite strongly, that the loss figures are to be reduced in the first place." Because the district court had not done so, the Sixth Circuit vacated the sentence and remanded for resentencing.

For the Real NCIS, It's Not as Easy as It Is on TV

The Ninth Circuit in *United States v. Dreyer* reined in the Naval Criminal Investigative Service (NCIS) from investigating civilians. The Posse Comitatus Act (PCA) forbids military personnel from participating in civilian law enforcement activities. Despite this prohibition, an NCIS special agent had begun investigating online child pornography distribution in Washington state. In so doing, he came upon the illegal activity of Michael Dreyer, who had no current military affiliation, and turned the case over to the FBI to pursue. The FBI did so, and Dreyer was arrested and prosecuted for distributing child pornography based on the evidence uncovered by the NCIS. Dreyer moved to suppress the evidence, arguing that the NCIS had no lawful authority to investigate civilian crime. The district court denied the motion, and Dreyer was convicted at trial. He appealed the denial of the suppression motion, and the Ninth Circuit reversed. It held that NCIS had violated the PCA by focusing, not on military personnel, but on unknown child pornography traffickers, regardless of whether they had any military affiliation. The court rejected the government's argument that NCIS might have come upon military personnel involved in child pornography offenses during its investigation. It noted that theory would render the PCA meaningless. As the court explained, "To accept that position would mean that NCIS agents could, for example, routinely stop suspected drunk drivers in downtown Seattle on

the off-chance that a driver is a member of the military, and then turn over all information collected about civilians to the Seattle Police Department for prosecution."

Help for Future Conflict-minerals Disclosures

The inaugural round of conflict-minerals disclosures has been reviewed by the SEC, and Director of the SEC's Division of Corporation Finance Keith Higgins offered some observations, as reported here. First, issuers should be sure not to conflate their reasonable country-of-origin inquiry with their due-diligence requirements. Second, companies appear to be implying their products are conflict-free even though they have not labeled them as "conflict-free." As a result, there is a mismatch between the labeling and the reports. Third, even if firms cannot determine whether their minerals are conflict-free, they must disclose the smelter or refiner, if known, used to process them.