

CORPORATE CRIME

VOLUME ONE

CORPORATE CRIME:
AN INTRODUCTION TO
THE LAW AND ITS
ENFORCEMENT
VOLUME ONE

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Author's Note

This text was developed over the course of a decade or so of teaching from and editing self-created materials. It emerged from the ground up, out of one instructor's particular approach to preparing upper-level law students, most of whom head to jobs in "Biglaw" or the federal government, for entering the field of corporate enforcement and defense.

The course from which these materials emerged earns four credits and is designed to be demanding and cover many difficult topics. This book is meant to allow the author to use it to continue that particular approach, while providing a low-cost bound book for future students who take the course. Due to the confines of the self-publishing platform, this could be accomplished only by producing a two-volume text.

Those interested in using these materials in their own related courses, or to learn about aspects of the field, are welcome to draw from the materials in part and selectively. Each individual chapter is available for free in pdf at buelloncorporatecrime.com. That site will develop to include other materials, such as syllabus suggestions and sample exam problems.

Many thanks to the hundreds of students over the years who have tolerated these materials as they have been improved and refined, with their invaluable feedback. Special and deep gratitude to Lauren Smith and Sarah Lowe, for their essential roles in shepherding a loose pile of course materials into the first edition of the published text. Thanks to Jacob Kornhauser for assistance with the second edition and Jean Wilson-Stayton for assistance with the third and fourth editions.

Corporate crime is now one of the largest and most important fields in American law. Relative to its importance to practice and policy, it remains under-covered in law school curricula and in scholarship. It is hoped that this project, which will be updated frequently, will serve as a path to more mature and settled treatments of the subject that inevitably will follow. In the meantime, errata, comments, and suggestions are most welcome. Please send them to buell@law.duke.edu.

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INTRODUCTION

The materials that follow are designed to provide the upper-level law student or beginning attorney with an accessible but also challenging introduction to an exciting, rapidly growing, and still-young field: corporate crime.

What is this field? Corporate crime is crime committed within the context of business organizations, whether they are corporations or other forms of private legal entity, and whether they are operated for profit or for other purposes. This is, if you like, “organizational” crime—though the field is not concerned with “organized crime” and other illicit enterprises, or with crime committed within military structures or principally concerning the malfeasance of public officials. The crimes at issue are almost always “white collar,” though many white collar crimes are committed by individuals operating outside business organizations and thus are not corporate crimes. Corporate crime is, very roughly speaking, crime committed on the job in the private sector, and it can lead to the criminal prosecution of both individuals and organizations.

This field has grown enormously over the past two to three decades. It now represents a major pillar of practice among America’s largest and most profitable law firms. It draws the dedicated labors of thousands of government prosecutors, enforcement lawyers, and investigators. And it occupies a significant—though some would argue not significant enough—portion of the federal judicial docket. It overlaps and intersects closely with other major areas of practice, including civil government enforcement, private litigation, and advising on corporate compliance efforts.

The opportunity to join this very interesting and challenging field of practice is, at most, only half of what makes it so exciting for the new lawyer. For most people, the larger draw of corporate crime as a field of study are the economic, social, and political problems that give rise to crime in this context. At a seemingly accelerating pace over the past thirty years, Americans have been confronted with one after another challenging, infuriating, fascinating, and shocking problems emanating from the corporate sector.

These engrossing stories will unfold in rich detail in the pages that follow, told not as popular nonfiction (though there is plenty of good work on the subject in that genre), but directly from the legal materials these cases have left behind for study. At this moment, it is hard to argue for another field of law as so alluringly combining difficult and novel legal questions with hard and important problems of policy. (My scholarly biases in this regard should be obvious.)

These materials have been assembled with the following objectives in mind:

- The advanced law student, much less the new lawyer, must of course learn to read like a lawyer, not a student. Readings in the first year of law school appropriately focus on the case method and close deconstruction of relatively short texts to train in foundational legal reasoning. However, readings in an advanced subject like this should, to the extent possible, employ original legal

documents and lead the student to acquire the ability to distill important concepts and the most salient factual propositions from lengthier materials. That is what lawyers do every day.

- Most chapters begin with the texts of the most relevant statutes, rules, and constitutional provisions. These are provided at the outset of a topic, not as reference tools (there is no separate statutory supplement here) but as texts to be read carefully and understood. The skilled practicing lawyer always starts thinking about a problem by reading (or rereading) the potentially applicable statutory texts. Thus, these texts appear first in each chapter.
- Any entrant into the field of corporate crime must quickly learn not to be intimidated or deterred by the seeming complexity of transactions in large business organizations. Math expertise or prior knowledge of engineering, science, or other specialties are not necessary. All that is needed is a desire to understand, an instinct to “follow the money,” and the knowledge that the professionals who constructed the deals or products at issue in any given case were, at best, no more intellectually adept than any professional school student at a good university. (After all, no corporate crime you will read about did not end in failure!)

The lawyer who has dispensed with the fear factor about case complexity before entering corporate crime practice will have a leg up and a head start. The same goes for the new lawyer who already understands that, in practice, facts are more important than law, and that the master of the facts is both the most valuable counselor to the client and usually the winner of the case. Obviously, one cannot be taught the facts one will need to know in one’s practice. But one can most definitely learn how to be adept at the learning and practice of facts.

- This is a field of practice and social problems, not a field of doctrine. There is no more a body of black letter law of corporate crime than there is a body of law of the horse. To begin to understand the law applicable to corporate crime, one must learn something about many areas of doctrine that are often taught as stand-alone courses in law school: substantive white collar crime, corporate liability, regulatory enforcement, grand jury procedure, constitutional criminal procedure, evidence, attorney regulation, plea bargaining, sentencing, and others. The materials here have been assembled to pull these various areas of doctrine together, and to select from each of them enough to provide a basic introduction and understanding that will hopefully give a beginning foundation from which further learning and research in the field of corporate crime will be accomplished with greater ease.
- The problem method is the best way to learn law. (When we talk about “hypos” and use of the Socratic method in the classroom, I believe we are simply referring to the law’s version of the problem method.) Each section of the materials is followed by one or more problems that are designed for thinking

and discussion, in the classroom or elsewhere. Some problems pose important questions of social policy—such questions are present everywhere in the field of corporate crime and they must engage lawyers just as much as politicians, journalists, and citizens. Other problems provide brief factual scenarios to which one can apply the materials that have preceded the problems.

- These materials are divided roughly in half between “substance” and “procedure.” The first half or so of the materials are intended to introduce the concepts of crime definition and corporate liability that are essential to understand for any practicing lawyer assessing the question of whether criminal liability is in play for a client (whether, in the practice lingo, there is “exposure”). The object is not to cover all white collar crimes that potentially apply in the corporate setting—the number and variety of such offenses is vast and, frankly, nearly unmanageable. The intent is to cover in considerable depth the most commonly prosecuted offenses that convey the central concepts necessary to be able to distinguish a crime from what is “only a civil case.” By far the most important crime in this respect is fraud, on which these materials linger at length. That coverage might appear excessive at first blush. But years of practice, study, and teaching have convinced me that truly understanding fraud is the key to understanding the often elusive matter of white collar crime.

The procedural materials that make up the second half of the text deal with the numerous aspects of the American criminal justice and adjudication systems that can impact a corporation’s or an individual employee’s encounter with that system—features of those systems that are, for the most part, very different from those that have produced the now widely lamented “system” that processes “blue collar” crime in the United States.

Note that these materials assume basic familiarity with a few of the general concepts in American criminal law that are taught in first-year law school courses: elements of crimes, mens rea and actus reus, attempt, and accomplice and conspiracy liability. For the reader or student who has not yet had that background, a summary treatise or nutshell is recommended such as, for example, JOSHUA DRESSLER, *UNDERSTANDING CRIMINAL LAW* (8th ed. 2018).

Although the locution is too awkward, sometimes I think the field of corporate crime could be called “scandalology.” Law is not a belief system. It is an instrument for dealing with problems. There is now a legal field of corporate crime only because there has been a distinctive and growing social problem of misconduct within the modern corporate organization—a problem that bodies of law may have contributed to, by chartering modern corporations and markets in certain ways, but that criminal law and procedure certainly did not produce.

INTRODUCTION

The study of corporate crime thus should begin with seeing the contours of the relevant problem. Almost any large and salient example will do. And it makes sense to rotate introductory examples as new scandals, emerging from current business practices, inevitably emerge.

Whatever scandal one chooses to start with to develop the scope of the corporate crime problem, the relevant questions include at least the following seven points:

- First, how should we understand **the facts** of the misconduct? Who did what and why? And how can we simplify and summarize the story without distorting it? (As any trial lawyer knows, every case is a story.)
- What were the **economics** driving the conduct? (Follow the money!)
- What **institutions** were involved in the matter and how did the nature, dynamics, and culture of those institutions factor into what happened?
- What was the human **psychology** involved in the case and how might it explain things?
- What was the **regulatory context** in which the wrongdoing took place and how might the content of the law explain what happened and offer a locus for lessons and reform?
- What can we learn from the matter about the conduct of **lawyers** and the role of legal strategy?
- How do **politics** play into explaining what happened, how the legal system responded to the scandal, or both?

Read not only the materials that follow in this Introduction but every scandal or case in this field with the objective of developing answers to these seven questions.

UNITED STATES v. EBAY, INC., Deferred Prosecution Agreement, No. 24-CR-10003 (D. Mass. Jan. 11, 2024)

STATEMENT OF FACTS

The following Statement of Facts is incorporated by reference as part of the Deferred Prosecution Agreement (the “Agreement”) between the United States Attorney’s Office for the District of Massachusetts (the “U.S. Attorney’s Office”) and eBay Inc. (“eBay” or “the Company”). eBay hereby agrees and stipulates that the following information is true and accurate. eBay admits, accepts, and acknowledges that it is responsible for the acts of its officers, directors, employees, and agents as set forth below. Should the United States pursue the prosecution that is deferred by this Agreement, eBay (including its subsidiaries and majority-owned, operationally

controlled affiliates) agrees that it will neither contest the admissibility of, nor contradict, this Statement of Facts in any such proceeding. The following facts establish beyond a reasonable doubt the charges set forth in the criminal Information attached to this Agreement:

eBay

1. In 2019, eBay was a multinational ecommerce business that operated marketplaces that connected online sellers and their customers. eBay was headquartered in San Jose, California.

2. Executive 1 was eBay's Chief Executive Officer.

3. Executive 2, who joined eBay in February 2019, was the Company's Chief Communications Officer.

4. Executive 3 was eBay's Senior Vice President for Global Operations.

5. Jim Baugh ("Baugh") was eBay's Senior Director of Safety & Security—an eBay division responsible for, in general terms, the physical security and reputation of eBay's employees and facilities worldwide. Baugh reported to Executive 3.

6. David Harville ("Harville"), who reported to Baugh, was eBay's Director of Global Resiliency, a unit focused on ensuring that eBay could continue to operate after business disruptions, such as security threats, political unrest, or natural disasters.

7. Stephanie Popp ("Popp") was eBay's Senior Manager of Global Intelligence and served as Baugh's de facto chief of staff. Before May 2019, Popp managed eBay's Global Intelligence Center ("GIC"), an intelligence and analytics group within the GSR that supported eBay's security operations.

8. Stephanie Stockwell ("Stockwell") was an intelligence analyst in the GIC who became its manager in mid-2019, when eBay promoted Popp.

9. Veronica Zea ("Zea") was an eBay contractor who worked as an intelligence analyst in the GIC.

10. Brian Gilbert ("Gilbert") and Philip Cooke ("Cooke") were retired Santa Clara, California police captains. Each worked at eBay and had responsibilities for, among other things, safety and security at eBay facilities, executive protection, and special events security.

EcommerceBytes

11. Ina and David Steiner were a married couple living in Natick, Massachusetts. The Steiners co-founded EcommerceBytes, a website that since 1999 had reported on ecommerce companies, including eBay. Ina Steiner was the editor and reporter for EcommerceBytes; David Steiner served as its publisher.

Events Preceding the Harassment and Intimidation Campaign

12. By the spring of 2019, EcommerceBytes' reporting was a source of frustration at eBay. Executives 1, 2, and 3, Baugh, and others at eBay viewed Ina

Steiner's reporting adversarially and sometimes used coarse and aggressive language in messages and e-mails about her and EcommerceBytes.

13. On August 2, 2018, for example, Executives 2's predecessor as Chief Communications Officer wrote to Executive 3 that Executive 1 had "asked us to determine a more holistic strategy to counteract some of [Ina Steiner's] persistent flame throwing." In response, Executive 3 wrote, "We have to win hearts and minds to make it and Ina is more destructive with sellers than you guys give her credit for." Executive 3 then forwarded the email chain to Executive 1, asking to "talk to you a bit about how we get this place fighting and not whining. . . it's pervasive and destructive. I am ALL IN and we can do this—we just need more fight from people—including our leaders!"

14. On September 21, 2018, responding to a summary of positive media coverage about an eBay initiative, Executive 3 e-mailed, "We should clap back at Ina—this is a good thing and we should tell them that. . . I know comms doesn't want us to engage with them, but I want to."

15. On March 1, 2019, upon learning from a communications employee that "Ina has ignored our correction and has not acknowledged [an eBay communications employee's] email at all," Executive 2 responded: "Lame. I want to blow her site up."

16. On March 13, 2019, Executive 1 messaged Executive 2 about a "list of sites for sellers that didn't include Ina today. W[e s]hould find a way to promote it. It's a way to diminish her without saying it. I tweeted it out. Take a look." Executive 2 immediately messaged two eBay employees about the same list: "How can we promote it just to 'eff with her? Totally diminishing for her. I just had [Executive 1] tweet it out. Take a look."

17. On April 10, 2019, reacting to EcommerceBytes' coverage of Executive 1's compensation, Executive 2 messaged Executive 1, "we are going to crush this lady."

18. On April 20, 2019, discussing the *Wall Street Journal's* coverage of Executive 1, Executive 1 messaged Executive 2, "F[***] them. The journal is next on the list after i[n]a."

Fidomaster

19. By the spring of 2019, an anonymous internet user known variously as "Fidomaster", "Dan Davis", and "unsuckebay" (hereinafter "Fidomaster") had also become a source of frustration to Executive 1, Executive 2, Baugh, and others at eBay.

20. On February 22, 2019, for example, a communications employee asked Baugh and Popp to "dig up some intel" on Fidomaster, noting "He's been relentlessly trolling eBay and [Executive 1] on twitter. . . ." At Executive 2's direction, Baugh caused the GIC to prepare a report concerning Fidomaster. The March 2019 report concluded that Fidomaster was an "anonymous twitter user that posts negative content about eBay and its senior leadership." It also asserted that "Fidomaster" communicated with Ina Steiner about issues pertaining to eBay, noting "Steiner and eCommerceBytes are known for publishing negative content about eBay and its executives."

21. In approximately April or May 2019, Baugh met with GIC employees and told them the GIC would be writing an anonymous, handwritten, and threatening letter to Ina Steiner, to get her to stop publishing articles critical of eBay. The letter was never sent.

Walker's West

22. On or about May 21, 2019, EcommerceBytes published an article entitled, “Did You Know eBay Build a Lavish NYC Pub-Style Lounge?” The article reported that Executive 1 had commissioned the construction of a pub—Walker’s West—on eBay’s corporate campus, modelling it after a New York City bar. The article contained links to a contractor’s website, which featured pictures of the project and a description of the pub.

23. Baugh alerted Executive 3 to the article by email that night, with the subject “Fwd: Ina Steiner—Walker’s West.”

24. On May 22, 2019, at 9:10 a.m. (PDT), Executive 3 forwarded Baugh’s email to Executive 2 and an eBay facilities employee, asking, of the contractor, “Why in the world would they think it’s ok to do this and with this level of color???” eBay directed the contractor to take down its website. Executive 3, copying Executive 2 and Baugh, later emailed, “this is ridiculous and has caused serious problems.”

25. Within hours, Executive 2 contacted a public relations consultant about the Walker’s West article. Executive 2 wrote: “I’m just no longer accepting ‘ignore’ as a broader strategy and want to fight back. Look forward to talking ASAP to get your assessment of how to do that most [e]ffectively.”

26. Thereafter, eBay communications employees sent information to the consultant about the Steiners, including their buying-selling history on eBay and the perspectives of eBay employees who knew them.

27. On or about May 31, 2019, Executive 2 and Executive 3 exchanged messages regarding Ina Steiner and EcommerceBytes. In relevant part:

- a. Executive 2 described an EcommerceBytes article discussing Executive 1’s presentation to shareholders during eBay’s 2019 annual meeting as “[s]hockingly reasonable”;
- b. Executive 3 referred to Ina Steiner as a “cow”;
- c. Executive 2 responded, “Her day is coming. . .”
- d. Executive 3 stated, “I can’t wait. // Jim Baugh came to me with some thoughts and I told him to stand down and leave it alone.”
- e. Executive 2 responded, “You are being too kind. . .tell him to be my advisor on this issue // Some times you just need to make an example out of someone. Justice // We are too nice. She needs to be crushed”
- f. Executive 3 responded, “I told [Baugh] I would raise to you and you would let him know if you want him to proceed—but knew you were working on something and didn’t want to step into that.”
- g. Executive 2 responded with a “thumbs up” emoji.

28. On or about June 6, 2019, Baugh tasked the GIC with tracking all of Ina Steiner's and EcommerceBytes' articles and social media posts concerning eBay.

29. On or about June 7, 2019, beneath the letters "FYSA" [For Your Situational Awareness], Executive 2 forwarded to Baugh the emails about the Steiners that eBay had shared with the public relations consultant.

30. On or about June 7, 2019, at Baugh's direction, Gilbert (the retired police captain) traveled to the Boston area to surveil the Steiners.

31. On or about June 8, 2019, Baugh called the Steiners' home in the middle of the night and hung up without speaking to them.

32. On or about June 8, 2019, Gilbert went to the Steiners' home in Natick and scrawled the name "Fidomaster" on their fence.

33. On or about June 17, 2019, the consultant proposed steps to reduce the Steiners' and EcommerceBytes' impact on eBay. The consultant recommended that eBay either (1) create or promote company-friendly content that would drive EcommerceBytes' posts lower in search engine results; or (2) terminate the Steiners' eBay accounts for violations of the company's Terms of Use. Neither proposal was adopted.

34. On or about June 25, 2019, Executive 2 messaged two eBay communications employees about an EcommerceBytes article comparing eBay and another ecommerce company. After observing that he could not "complain about [Ina Steiner] pointing out fair bumps in our road", Executive 2 stated: "Love it when a secret, we can't speak it out loud plan comes together. . . <eye emoji>", and added, "We always reserve the right to go 0-60 and get crazy on her ass, but this is a huge adjustment the last month. Ever since the Walker's post. . . <smiley face emoji>".

The Harassment and Intimidation Campaign

35. On or about August 1, 2019, the New York Times reported that eBay had accused Amazon in a lawsuit of unlawfully poaching eBay sellers to Amazon's online marketplace.

36. That day, at approximately 1:46 p.m. (EDT), Ina Steiner posted an article on EcommerceBytes under the headline, "eBay RICO Lawsuit Meant to Curb Seller Exodus to Amazon?" She wrote: "[Executive 1] has been unable to stop a decline in market sales, but trying to dissuade sellers from turning to Amazon (and trying to get Amazon to stop recruiting sellers) may not be the best tactic."

37. At approximately 2:19 p.m. (EDT), Executive 1 texted Executive 2: "Ina is out with a hot piece on the litigation. If we are ever going to take her down..now [sic] is the time."

38. Executive 2 responded at approximately 2:36 p.m. (EDT): "On it."

39. As set forth below, a series of text messages followed between Executive 2 and Baugh, beginning with Executive 2 passing along Executive 1's suggestion that "we . . . take her down":

[Executive 2]	[Baugh]
Ina is out with a hot piece on the litigation	
If we are ever going to take her down ... now is the time.	
	I saw it.
Hatred is a sin. I am very sinful.	
	Let me ask you this. Do we need her entire site shut down?
	I'm not fucking around with her anymore.
Amen,.	
I want her DONE	
	< > said to burn her to the ground correct?
She is biased troll who needs to get BURNED DOWN	

40. Executive 2 and Baugh's August 1, 2019 conversation continued by text, with Baugh committing to put in motion a "plan B" and Executive 2 committing to "embrace managing any bad fall out."

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[Executive 2]	[Baugh]
She is biased troll who needs to get BURNED DOWN	
	Copy that
	I have a plan B
	I will put it in motion
	Will take 2 weeks
I'll embrace managing any bad fall out. We need to STOP her.	

41. Baugh continued, stating falsely that Fidomaster—whom he referred to as the “unsuck idiot”—was David Steiner “or [an]other close associate” of Ina Steiner’s:

Regarding the unsuck idiot, I have further reason to believe he is either her husband or other close associate. I’ve been communicating with him every day. I told him I have an incriminating video that he needs to see. He bit on it hook line and sinker.
I want to leave it at a hotel concierge for him. If I can get him to pick it up, his ass is mine.

42. Baugh concluded the August 1 exchange with Executive 2 as follows:

Confidential obviously
Rest assured, I will handle Ina

43. On or about August 6, 2019, an eBay seller contacted Executive 1 to complain about @unsuckebay, one of the Twitter accounts controlled by Fidomaster. The seller’s complaint led Executive 2, Executive 1, Baugh, and eBay’s general counsel to communicate about eBay’s unsuccessful efforts to have the Twitter account shut down.¹

44. Executive 2’s email concluded: “I am utterly vexed by this! This twitter account [Fidomaster] dominates our social narrative with his CONSTANT obsession with trolling us. It’s more than annoying, it’s very damaging.”

¹ Baugh messaged privately to Executive 1 that Baugh was using an alias Twitter account in an attempt to trick Fidomaster into identifying himself. Baugh stated, “Sorry I have not found him yet, but when I do, it will be fixed”.

45. The email noted that Fidomaster “and the eCom[m]ercebytes gal”—a reference to Ina Steiner—were “infatuated with eBay” and “seemingly dedicated their lives to erroneously trashing us as a way to build their own brand—or even build a business.” It continued, “This issue gives me ulcers, harms employee moral, and tricles into everything about our brand. I genuinely believe these people are acting out of malice and ANYTHING we can do to solve it should be explored. Somewhere, at some point, someone chose to let this slide. It has grown to a point that is absolutely unacceptable. It’s the ‘blind eye toward graffiti that turns into mayhem’ syndrome and I’m sick about it. Whatever. It. Takes.”

46. On or about August 7, 2019, at 4:59 p.m. (PDT), Baugh asked Executive 2 by message, “If I can neutralize Ina’s website in two weeks or less, does that work for you?” Within minutes, Executive 2 responded: “I want to see ashes. As long as it takes. Whatever it takes.”

47. After receiving Executive 2’s text messages and emails about the Steiners, EcommerceBytes, and Fidomaster, Baugh shared them with, among others, Harville, Gilbert, Cooke, Popp, Stockwell, and Zea.

48. Beginning on or about August 5, 2019, and continuing through at least September 6, 2019, Baugh, Harville, Gilbert, Cooke, Popp, Stockwell, and Zea (together “the Individual Defendants”) worked together to harass and intimidate the Steiners, and to place them under surveillance with the intent to harass and intimidate them, through repeated and hostile Twitter messages, deliveries of unwanted—and in some instances disturbing—items to the Steiners’ home, and travel to Massachusetts to conduct physical surveillance. The Individual Defendants’ conduct caused, attempted to cause, and would reasonably have been expected to cause substantial emotional distress to the Steiners.

49. The purposes of the harassment campaign were, among other things, to distract the Steiners from publishing EcommerceBytes, to alter the website’s coverage of eBay, and to gather information that the Individual Defendants could use to discredit the Steiners and EcommerceBytes.

50. The Individual Defendants took steps to conceal their harassment campaign from eBay investigators and state and federal authorities, by, among other things, using non-eBay electronic communications platforms, billing expenses related to the campaign to an outside contractor, monitoring law enforcement communications, forging records, lying to investigators, and destroying evidence.

51. Among the manner and means by which Individual Defendants carried out the harassment campaign were the following:

- a. Creating Twitter accounts in false names that featured ominous profile photos.
- b. Using these Twitter accounts to sending threatening private direct messages (“DMs”) to Ina Steiner about her, David Steiner, and EcommerceBytes.
- c. Publicly posting the Steiners’ home address on Twitter, while suggesting in threatening messages that eBay sellers who were angry about EcommerceBytes’ coverage were going to visit the Steiners’ home.

- d. Ordering unwanted and scary items and services to the Steiners' home, and ordering items intended to embarrass the Steiners to their neighbors' addresses.
- e. Posting online advertisements for fictitious events at the Steiners' home, including sexual encounters, to encourage strangers to visit them there.
- f. Traveling to Natick to install a GPS device on the Steiners' car, and to surveil the Steiners in their home and in their community.
- g. Monitoring law enforcement communications to avoid detection.
- h. Establishing false cover stories for the surveillance trip, including that the coconspirators were investigating the Steiners for threatening Executive 1.
- i. Continuing surveillance, even after the Steiners had detected it, with the purpose of intimidating them.
- j. Disguising their roles in the conspiracy by harassing and intimidating the Steiners using prepaid cell phones and laptops, VPN services, overseas email accounts, and prepaid debit cards purchased with cash.
- k. Offering the Steiners assistance with the very harassment they were committing, to earn the Steiners' good will ("the White Knight Strategy").
- l. Making false and misleading statements to NPD personnel who were investigating the threatening communications, harassing deliveries, and surveillance of the Steiners.
- m. Communicating by WhatsApp regarding how to harass the Steiners and how to respond to the NPD investigation.
- n. Creating a "dossier" of their own threats to the Steiners, which they planned to show to the NPD as proof that Zea and Harville were in Massachusetts investigating the harassment of the Steiners (purportedly by third parties).
- o. Exchanging ideas about how best to thwart the NPD investigation, including creating false suspects, continuing the harassing deliveries, fabricating cover stories, and intervening with any San Jose area police that the NPD contacted to further its investigation.
- p. Lying to eBay investigators who were responding to NPD requests for eBay's assistance.
- q. Exchanging ideas about how best to thwart eBay's internal investigation.
- r. Deleting the contents of computers, cell phones, and social media accounts that evidenced the harassment and intimidation campaign and the defendants' and their coconspirators' efforts to obstruct the NPD investigation.

Actions in Furtherance of the Harassment and Intimidation Campaign

52. From on or about August 5, 2019 through at least September 6, 2019, the Individual Defendants took the following steps, among others, as part of the harassment and intimidation campaign:

- a. On or about August 6, 2019, Baugh, Gilbert, Cooke, and Popp met at eBay headquarters to plan the White Knight Strategy.
- b. On or about August 6, 2019, Baugh, Popp, Stockwell, Zea, and other members of the GIC met at eBay headquarters to plan the delivery to the Steiners' home of unwanted and disturbing items to distract the Steiners from publishing the Newsletter.
- c. On or about August 6, 2019, Stockwell purchased a laptop computer at a Best Buy store in San Jose, California for use in the harassment and intimidation campaign.
- d. On or about August 6, 2019, Popp created a Twitter account in the name of “@Tui_Elei” that used a picture of a skeleton mask as a profile picture.
- e. On or about August 7, 2019, Popp sent the following DMs from the @Tui_Elei Twitter account to Ina Steiner’s Twitter account:
 - i. “[Ina]... whats your problem w/ ebay? You know thats how we pay rent...”
 - ii. “HELLO!!!!!!”
- f. On or about August 8, 2019, Zea and a GIC analyst purchased prepaid debit cards with cash at a Santa Clara, California supermarket for use in ordering harassing deliveries to be sent to Ina and David Steiner.
- g. On or about August 9, 2019, Popp sent the following DMs from the @Tui_Elei Twitter account to Ina Steiner's Twitter account:
 - i. “WTF... whats it goin to take for u to answer me??”
 - ii. “I guess im goin to have to get ur attention another way bitch...”
 - iii. “U dont have the balls to talk to me?? Stop hiding behind ur computer screen u fuckin cunt!!!”
- h. On or about August 9, 2019, Stockwell used an anonymous email account to order live spiders and fly larvae for delivery to the Steiners’ home.
 - i. On or about August 9, 2019, one or more of the Individual Defendants ordered a subscription for pornographic magazines in the name of David Steiner to be sent to the Steiners’ neighbors.
 - j. On or about August 9, 2019, one or more of the Individual Defendants attempted to order a pig fetus for delivery to the Steiners’ home.
 - k. On or about August 10, 2019, one or more of the Individual Defendants ordered a Halloween Pig Mask for delivery to the Steiners’ home.

- l. On or about August 10, 2019, Popp sent the following DM from the @Tui_Elei Twitter account to Ina Steiner's Twitter account:
 - i. "DO I HAVE UR ATTENTION NOW???"
- m. On or about August 10, 2019, Popp sent the following DMs from the @Tui_Elei Twitter account to Ina Steiner's Twitter account:
 - i. "Ur fat fuck pussy husband [David Steiner's first name] needs to put u in line cunt"
 - ii. "after he takes the plugs out of his asshole... fuckin pussies!!!"
- n. On or about August 11, 2019, Baugh directed Harville to travel with him to Boston for an "op" targeting Ina Steiner and her website (*i.e.*, EcommerceBytes).
 - o. On or about August 11, 2019, Baugh sent Harville the following text message: "I won't send the bosses texts, but I've been ordered to find and destroy." Harville replied, "Copy. Totally black[.] I'm deleting this now."
 - p. On or about August 12, 2019, Baugh sent Popp, Stockwell, Zea, and other GIC analysts the following WhatsApp message: "Starting now through Tuesday night double our effort on everything. Spam, house deliveries, etc. I don't want anything delivered on Thursday, so the cut off should be Wednesday night—wake them up with a limo driver or something and then everything goes cold Thursday morning.... Take down all Craigslist posts late Wednesday night. Stop spam late Wednesday night etc."
 - q. On or about August 12, 2019, one or more of the Individual Defendants sent a book titled "Grief Diaries: Surviving Loss of a Spouse" to the Steiners' home.
 - r. On or about August 12, 2019, Popp used the @Tui_Elei Twitter account to post publicly to Ina Steiner's Twitter account: "Ina... wats ur problem with ebay??..."
 - s. On or about August 12, 2019, Popp used the @Tui_Elei Twitter account to post publicly to Ina Steiner's Twitter account: "many familys including mine make money 2 pay 4 food cloths and rent by selling on ebay... UR stupid idiot comments r pushin buyers away from ebay and hurtin familys!! STOP IT NOW!!!"
 - t. On or about August 13, 2019, one or more of the Individual Defendants used a prepaid debit card to order a funeral wreath for delivery to the Steiners' home.
 - u. On or about August 14, 2019, one or more of the Individual Defendants ordered live cockroaches for delivery to the Steiners' home.
 - v. On or about August 14, 2019, Popp used the @Tui_Elei Twitter account to post a public message to Ina Steiner's Twitter account: "[First name of Ina Steiner] wen u hurt our bizness u hurt ourfamilys... Ppl will do ANYTHING 2 protect family!!!!"

w. On or about August 14, 2019, Baugh, Harville, Zea, Gilbert, and Popp met to discuss a trip to Natick, Massachusetts to install a GPS tracking device on the Steiners' car and to surveil the Steiners. At the meeting, Baugh instructed Zea to stop harassing deliveries that would interfere with the surveillance operation.

x. On or about August 14, 2019, Zea attempted to register herself and Harville for a software development conference in Boston as false cover for the surveillance trip.

y. On or about August 15, 2019, Harville used his eBay-issued phone to visit a website that could be used to monitor the "Natick Police and Fire Live Audio Feed."

z. On or about August 15, 2019, Baugh, Harville, and Zea flew from California to Boston, Massachusetts.

aa. On or about August 15, 2019, Stockwell sent a text message to Harville providing the license plate numbers for the Steiners' cars.

bb. On or about August 15, 2019, Baugh, Harville, and Zea drove to the Steiners' home in Natick and attempted unsuccessfully to install a GPS tracking device on the Steiners' car, which was locked in the Steiners' garage.

cc. On or about August 15, 2019, Baugh, Harville, Popp, and Zea dialed in to a conference line to communicate during the surveillance operation and to monitor the NPD dispatch.

dd. On or about August 15, 2019, Baugh directed Stockwell by WhatsApp message to prepare an eBay "Person of Interest" report ("POI Report") that listed the Steiners as eBay's top POIs. Baugh wrote, "In the narrative I need you to write that they have made direct threats to ebay, [eBay's CEO], and our employees (make it up)."

ee. On or about August 16, 2019, Harville purchased tools at a Boston hardware store for the purpose of breaking into the Steiners' locked garage.

ff. On or about August 16, 2019, Baugh, Harville, and Zea returned to Natick in a rented Dodge Caravan to surveil the Steiners and drove past their home repeatedly.

gg. On or about August 16, 2019, Harville dialed in to the surveillance team's conference line.

hh. On or about August 16, 2019, Baugh, Harville, and Zea followed David Steiner as he drove around Natick.

ii. On or about August 16, 2019, believing that David Steiner had spotted the surveillance, Baugh returned the Dodge Caravan to the rental car agency.

jj. On or about August 16, 2019, after the failed surveillance, Baugh directed that harassing deliveries to the Steiners resume [sic].

kk. On or about August 17, 2019, at 3:08 a.m. (EDT), Stockwell researched Boston- area 24-hour drain repair services on the internet for

the purpose of sending a repairman to the Steiners' home in the middle of the night

ll. On or about August 17, 2019, one or more of the Individual Defendants ordered pizza to be delivered to the Steiners' home at 4:30 a.m., for payment upon delivery.

mm. On or about August 17, 2019, Harville returned to California, and Popp traveled to Boston to replace him on the surveillance team.

nn. On or about August 18, 2019, Popp replied to a public tweet on Ina Steiner's Twitter account using the @Tui_Elei account and stated: "Dis ur address???" The message was followed by information about Ina Steiner, accurately stating her name, age, address, and telephone number.

oo. On or about August 18, 2019, Popp sent the following DM from the @Tui_Elei Twitter account to Ina Steiner's Twitter account: "U get my gifts cunt!!?"

pp. On or about August 18, 2019, one or more of the Individual Defendants posted an advertisement on Craigslist claiming to be a married couple seeking a sexual partner or partners, and providing the Steiners' home address.

qq. On or about August 18, 2019, Baugh, Popp, and Zea followed David Steiner as he drove in Natick.

rr. On or about August 20, 2019, Baugh sent a text message to Popp, Gilbert, and Cooke that the Individual Defendants had "burned" two surveillance cars and that either the Steiners or the NPD were "seeing ghosts right now."

ss. On or about August 20, 2019, Baugh forwarded to Gilbert the POI Report falsely indicating that the Steiners were security threats to eBay. In a WhatsApp message to Gilbert, Cooke, and Popp, Baugh stated: "Just sent poi doc with [the Steiners] included. I had GIC send this to me last week in case we got stopped..that [sic] way would at least have something to show to PD"

tt. On or about August 20, 2019, after Twitter suspended the @Tui_Elei account for posting the Steiners' home address, Popp created a new Twitter account, @Elei_Tui, for use in harassing the Steiners.

uu. On or about August 20, 2019, Popp also created two other Twitter accounts, including one that used the name of a prominent eBay seller.

vv. On or about August 21, 2019, Zea and Baugh made false statements to an NPD detective who came to the surveillance team's hotel to investigate Zea and Harville's connection to the cyberstalking campaign.

ww. On or about August 21, 2019, at approximately 9:36 a.m. (EDT), Baugh sent the following text message to Popp, Gilbert, and Cooke: "Natick detective is in lobby looking for [Zea]. I've taken her

away from hotel headed to airport... Detective called her cell. I answered just now as her husband and played dumb.”

xx. On or about August 21, 2019, at approximately 9:39 a.m. (EDT), Gilbert proposed to Baugh, Cooke, and Popp bringing “dossiers” on the Steiners to the NPD: “Definitely want to make them look crazy.”

yy. On or about August 21, 2019, between approximately 10:30 a.m. and 12:00 p.m. (EDT), Popp sent more threatening tweets to and about Ina Steiner and the Newsletter (“the Concerning Tweets”). Popp used the three Twitter accounts that she had created the night before to have a public “conversation” on Twitter, asking over one account what Ina Steiner’s address was, and responding from the other “guest I hav to pay Ina a visit.”

zz. On or about August 21, 2019, minutes after writing the Concerning Tweets, Popp forwarded images of the Concerning Tweets to Baugh and Gilbert, writing falsely that Ina Steiner was “really bringing out some angry Twitter users”

aaa. On or about August 21, 2019, at approximately 12:34 p.m. (EDT), Baugh forwarded the Concerning Tweets to Harville

bbb. On or about August 21, 2019, at approximately 2:30 p.m. (EDT), executing the White Knight Strategy, Gilbert called the Steiners, identified himself as an eBay employee, and offered eBay’s assistance.

ccc. After the call, Gilbert messaged Baugh, Popp, and Cooke that the Steiners were “totally rattled and immediately referred [Gilbert] to Natick PD”.

ddd. Thereafter, still on August 21, 2019, Gilbert spoke, text messaged, and emailed with an NPD detective who was handling the investigation into the harassment of the Steiners. Gilbert falsely claimed not to know Zea or Harville and falsely stated that he had to travel to Toronto and New York but would instead attempt to come to Boston to meet with the NPD.

eee. On or about August 21, 2019, after learning that the NPD was investigating the use of a prepaid debit card to purchase pizzas for delivery to the Steiners, Baugh and Popp directed Stockwell to prepare a list of eBay “Persons of Interest” in the San Francisco Bay Area that could be used (as part of Gilbert’s “dossier”) to deflect attention from Zea.

fff. On or about August 21, 2019, Stockwell created the document that Baugh requested—“Bay Area POIs_August 2019.docx”—and emailed it to Popp and Baugh, who forwarded it to Gilbert for use in the NPD meeting.

ggg. On or about August 22, 2019, Gilbert and another eBay employee met with three NPD officers at the NPD. During the meeting, Gilbert falsely stated that:

- i. Zea and Harville had come to Boston to attend a conference;
- ii. Popp was Zea’s supervisor; and

iii. Popp had assigned Zea to a Person of Interest investigation regarding the Steiners, and that Zea had driven to Natick “on her own.”

hhh. On or about August 22, 2019, after the NPD meeting, Popp used one of the new Twitter accounts to post “[Newsletter] 20 yrs of lies n distroy familys... dunt b proud of dat u wurthless BITCH!!! i wil distroy ur family n bizness 2... C how u like it...\n\n@Elei_Tui wen r we goin 2 visit her in natik???”

iii. On or about August 23, 2019, Harville falsely told eBay investigators that he had traveled to Boston to attend a conference, he had not been in Natick, and he had not had any interaction with the Steiners or the NPD.

jjj. On or about August 23, 2019, Baugh falsely told eBay investigators his team was not responsible for harassing messages or deliveries and that his team had been in Natick to investigate threats to the Steiners.

kkk. On August 23, 2019, at 5:15 p.m. (PDT), Baugh messaged Executive 2 as follows:

Hi [Executive 2]—this is Jim Baugh’s personal cell. My team ran an Op on our friend in Boston. Nothing illegal occurred and we were actually intending to team up with her and get her on our side in a positive manner. However, small town police got a couple of rental car plates and tracked it back to my people and the hotel the were staying at. They sent a note to ebay investigations GAP team who then passed it to legal and they are conducting an internal investigation on us. We are cooperating, but I know they realize something is off. We will continue to cooperate, but not sure how much longer we can keep this up. If there is any way to get some top cover that would be great. If not, I just wanted you to have a heads up because they are aware that multiple members of the ELT are not a fan of that website to include [] and his wife. Again, no crime was committed and local police don't have a case. I don’t want our legal team to give them one. Let me know if you want to discuss this weekend.

lll. On or about August 26, 2019, Harville falsely told eBay investigators that he didn’t know whether Zea had gone to Natick and that he had not worked on a matter involving the Steiners.

mmm. On or after August 26, 2019, Baugh, Harville, Popp, Zea, Gilbert, and others deleted and attempted to delete data from their mobile phones that evidenced the conspiracy, including WhatsApp messages.

nnn. On or about August 27, 2019, Harville falsely told eBay investigators that he had attended a conference in Boston with Zea.

ooo. On or about August 28, 2019, Baugh falsely told eBay investigators that his team was not responsible for the deliveries or harassing communications.

ppp. On or about August 30, 2019, Baugh directed an eBay employee to retrieve computers from the GIC and to bring them to his house.

qqq. On or about August 30, 2019, after receiving an email from an eBay investigator directing him to preserve relevant information and to turn in his eBay-issued cell phone, Harville messaged Baugh, Gilbert, and Popp, “Want me to wipe it.”

rrr. On or about August 30, 2019, Harville turned in his eBay-issued cell phone from which significant data related to his trip to Natick had been deleted.

sss. On or about September 6, 2019, Popp posted five new Tweets to one of the Twitter accounts that the Individual Defendants had used to harass the Steiners, to suggest that those responsible for harassing the Steiners were still at large.

Executive 2’s Receipt of Information Regarding the Harrassment and Intimidation Campaign

53. On or about August 20, 2019, an NPD detective emailed eBay to request assistance with the NPD’s investigation into the harassment of the Steiners.

54. On or about August 21, 2019, at approximately 2:49 p.m. (PDT), an eBay communications employee forwarded to Executive 2, who was traveling overseas, an email containing the NPD request, underneath an “exploding head” emoji.

55. At approximately 3:05 p.m. (PDT), Executive 2 responded, “Please do not do anything until I can check a few things ... I don’t want us to engage. Who specifically did the local police contact first at eBay.”

56. On or about August 22, 2019, eBay’s General Counsel emailed Executive 2, Executive 3, and another eBay executive, informing them that the Steiners had contacted the NPD about being harassed, and that eBay would be beginning an internal investigation immediately (“the GC Email”). The GC Email enclosed a copy of a second NPD request to eBay for assistance in the investigation that identified Harville and Zea’s possible involvement in the harassment.

57. On or about August 23, 2019, at approximately 5:15 p.m. (PDT), Baugh messaged Executive 2 as follows:

Hi [Executive 2]—this is Jim Baugh’s personal cell. My team ran an Op on our friend in Boston. Nothing illegal occurred and we were actually intending to team up with her and get her on our side in a positive manner. However, small town police got a couple of rental car plates and tracked it back to my people and the hotel the were staying at. They sent a note to ebay investigations GAP

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team who then passed it to legal and they are conducting an internal investigation on us. We are cooperating, but I know they realize something is off. We will continue to cooperate, but not sure how much longer we can keep this up. If there is any way to get some top cover that would be great. If not, I just wanted you to have a heads up because they are aware that multiple members of the BLT are not a fan of that website to include [] and his wife. Again, no crime was committed and local police don't have a case. I don't want our legal team to give them one. Let me know if you want to discuss this weekend.

58. On or about August 23, 2019, at approximately 5:24 p.m. (PDT), Executive 2 and Baugh spoke by phone for approximately 10 minutes.

59. On or about August 27, 2019 and August 28, 2019, eBay investigators interviewed Executive 2 regarding the harassment and intimidation of the Steiners.

60. On or about August 30, 2019, eBay investigators obtained forensic copies of Executive 2's eBay-issued and personal cell phones.

61. Executive 2's cell phones did not contain the message from Baugh described in paragraph 57 above or the other August 2019 messages between Baugh and Executive 2 regarding Ina Steiner and EcommerceBytes, indicating that those messages had, at some point, been deleted.

TERMS OF DEFERRED PROSECUTION AGREEMENT

Defendant eBay Inc. (the "Company"), pursuant to authority granted by the Company's Board of Directors reflected in Attachment B, and the United States Attorney's Office for the District of Massachusetts ("the U.S. Attorney's Office"), enter into this Deferred Prosecution Agreement (the "Agreement").

Criminal Information and Acceptance of Responsibility

1. The Company acknowledges and agrees that the U.S. Attorney's Office will file the attached six-count criminal Information in the United States District Court for the District of Massachusetts charging the Company with (i) two counts of interstate travel with the intent to harass and intimidate, in violation of Title 18, United States Code, Section 2261A(1)(B); (ii) two counts of using electronic communications services to harass and intimidate, in violation of Title 18, United States Code, Section 2261A(2)(B); (iii) one count of witness tampering, in violation of Title 18, United States Code, Section 1512(b)(3); and (iv) one count of altering documents with the intent to impede, obstruct, and influence the investigation of a matter within the jurisdiction of the Federal Bureau of Investigation, in violation of Title 18, United States Code, Section 1519 ("the Information"). In so doing, the Company: (a) knowingly waives any right it may have to indictment on these charges, as well as all rights to a speedy trial pursuant to the Sixth Amendment to the United States Constitution, Title 18, United States Code, Section 3161, and Federal Rule of Criminal Procedure 48(b); (b) agrees to venue of the case in the District of Massachusetts and knowingly waives any objection with respect to venue to any charges by the United States arising out of the conduct described in the Statement of Facts attached hereto as Attachment A; (c) knowingly waives any applicable statute of limitations and any legal or procedural defects in the Information; and (d) consents to the filing of the Information, as provided under the terms of this Agreement, in the United States District Court for the District of

Massachusetts. The U.S. Attorney's Office agrees to defer prosecution of the Company pursuant to the terms and conditions described below

2. The Company admits, accepts, and acknowledges that it is responsible under United States law for the acts of its officers, directors, employees, and agents as charged in the Information, and as set forth in the attached Statement of Facts, and that the allegations described in the Information and the facts described in the attached Statement of Facts are true and accurate. The Company agrees that, effective as of the date the Company signs this Agreement, in any prosecution that is deferred by this Agreement, it will not dispute the Statement of Facts set forth in this Agreement, and, in any such prosecution, the Statement of Facts shall be admissible as: (a) substantive evidence offered by the government in its case-in-chief and rebuttal case; (b) impeachment evidence offered by the government on cross-examination; and (c) evidence at any sentencing hearing or other hearing. In addition, in connection therewith, the Company agrees not to assert any claim under the United States Constitution, Rule 410 of the Federal Rules of Evidence, Rule 11(f) of the Federal Rules of Criminal Procedure, Section 1B1.1(a) of the United States Sentencing Guidelines, or any other federal rule that the Statement of Facts should be suppressed, excluded, or is otherwise inadmissible as evidence in any form. The Company further agrees, as described in Paragraph 24 below, that it shall not, through present or future attorneys, officers, directors, employees, agents, or any other person authorized to speak for the Company make any public statement, in litigation or otherwise, contradicting the acceptance of responsibility by the Company set forth above or the facts described in the attached Statement of Facts.

Term of the Agreement

3. This Agreement is effective for a period beginning on the date on which the Information is filed and ending three years from the later of the date on which the Information is filed or the date on which the independent compliance monitor (the "Monitor") is retained by the Company, as described in Paragraphs 11 to 14 below (the "Term"). The Company agrees, however, that, in the event the U.S. Attorney's Office determines, in its sole discretion, that the Company has knowingly violated any provision of this Agreement or has failed to completely perform or fulfill each of the Company's obligations under this Agreement, an extension or extensions of the Term may be imposed by the U.S. Attorney's Office, in its sole discretion, for up to a total additional time period of one year, without prejudice to the U.S. Attorney's Office's right to proceed as provided in Paragraphs 17 to 21 below. Any extension of the Agreement extends all terms of this Agreement, including the terms of the monitorship or compliance reporting obligations described in Attachment D, for an equivalent period.

Relevant Considerations

4. The U.S. Attorney's Office enters into this Agreement based on the individual facts and circumstances presented by this case and the Company, including:
- a. the nature, seriousness, and pervasiveness of the offense conduct, as described in the Statement of Facts, including the involvement of senior company employees in a harassment and intimidation campaign targeting journalists with whose reporting individuals in corporate management took issue;

- b. the impact of the offense conduct on the victims and their expressed views regarding this Agreement, see Justice Manual. 9-28.1400 and the Attorney General Guidelines for Victim and Witness Assistance;
- c. the Company received full credit for its cooperation with the U.S. Attorney's Office's investigation, including: proactively disclosing certain evidence of which the United States was previously unaware; providing information obtained through its internal investigation, which allowed the government to preserve and obtain evidence as part of its own independent investigation; making detailed factual presentations to the U.S. Attorney's Office; voluntarily facilitating interviews of employees; and collecting and producing voluminous relevant documents to the U.S. Attorney's Office;
- d. the Company engaged in extensive remedial measures, including:
 - (i) commencing remedial measures based on internal investigations of the misconduct prior to the commencement of the U.S. Attorney's Office investigation; (ii) strengthening its corporate governance by appointing numerous new individuals to senior management and Board of Directors positions; (iii) strengthening its compliance organization by hiring or appointing additional compliance personnel, including the appointment of a Chief Ethics Officer, who reports directly to the Company's General Counsel and the Chair of the Audit Committee of the Board of Directors; (iv) updating its code of conduct, policies, procedures, and internal controls relating to, among other things, safety and security, ethical leadership, the use of company-issued communications resources, management of commercial agents and other third parties, and expense reimbursement; (v) enhancing its internal reporting, investigations and risk assessment processes; (vi) overhauling its compliance training and communications; and (vii) disciplining certain employees involved in the relevant conduct, including terminating Executive 2, the Company's former Chief Communications Officer;
- e. the Company permitted its then-Chief Executive Officer to resign following the offense conduct described in the Statement of Facts, and, in doing so, stated only that "a number of considerations" led the then-CEO and the Company to mutually agree "that a new CEO is best for the Company". The Company did not publicly reprimand the CEO for his actions with respect to the conduct described in the Statement of Facts—including his statements concerning the victims—or for the corporate culture that he oversaw that permitted the offense conduct to occur. Instead, it lauded him in its public announcement of his departure as "a tireless advocate for driving improvement in the business" and paid him contractual severance benefits of more than \$40 million;
- f. the Company has enhanced and has committed to continuing to enhance its compliance program and internal controls, including ensuring that its compliance program satisfies the minimum elements set forth in Attachment C to this Agreement (Corporate Compliance Program) but, despite its extensive remedial measures described above, the Company to date has not fully implemented or tested its enhanced compliance program, and thus the imposition of an independent compliance monitor for a term of

three years, as described more fully below and in Attachment D, is necessary to prevent the recurrence of misconduct;

g. the Company has been the subject of alleged violations of civil law or regulations of the Environmental Protection Agency and the Drug Enforcement Administration, but has no prior criminal history;

h. the unavailability or inadequacy of civil or regulatory enforcement actions;

i. potential collateral consequences, including whether there is disproportionate harm to shareholders, employees, and others not proven personally culpable; and

j. the Company has agreed to continue to cooperate with the U.S. Attorney's Office in any ongoing investigation as described in Paragraph 5 below.

Accordingly, after considering (a) through (j) above, the U.S. Attorney's Office believes that the appropriate resolution in this case is a Deferred Prosecution Agreement with the Company; a criminal monetary penalty in the amount of \$3,000,000, the maximum applicable fine permitted by statute upon the Company's conviction of the six counts charged in the Information; and the imposition of a three-year independent compliance monitor.

Future Cooperation and Disclosure Requirements

5. The U.S. Attorney's Office has conducted an extensive investigation of the conduct described in this Agreement and the attached Statement of Facts since September 2019 that has resulted in felony criminal convictions of six Company employees and a Company contractor, and sentences of imprisonment of between 12 and 57 months for four of those defendants. The Company has cooperated fully with the U.S. Attorney's Office in this investigation to date. The Company shall continue to cooperate fully as requested by the U.S. Attorney's Office in any and all matters relating to the conduct described in this Agreement and the attached Statement of Facts and other conduct under investigation by the U.S. Attorney's Office at any time during the Term, until the later of the date upon which all investigations and prosecutions arising out of such conduct are concluded, or the end of the Term. At the request of the U.S. Attorney's Office, the Company shall also cooperate fully with other domestic or foreign law enforcement and regulatory authorities and agencies in any investigation of the Company or any of its subsidiaries or affiliates, or any of its present or former officers, directors, employees, agents, and consultants, or any other party, in any and all matters relating to the conduct described in this Agreement and the attached Statement of Facts and other conduct under investigation by the U.S. Attorney's Office at any time during the Term. The Company's cooperation pursuant to this Paragraph is subject to applicable law and regulations as well as valid claims of attorney-client privilege or attorney work product doctrine; however, the Company must provide to the U.S. Attorney's Office a log of any information or cooperation that is not provided based on an assertion of law, regulation, or privilege, and the Company bears the burden of establishing the validity of any such assertion. The Company agrees, in any and all matters related to the conduct described in this Agreement and the attached Statement of Facts and other conduct under investigation by the

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U.S. Attorney's Office, that its cooperation pursuant to this Paragraph shall include, but not be limited to, the following:

- a. The Company shall timely and truthfully disclose all factual information with respect to its activities, those of its subsidiaries and affiliates, and those of its present and former directors, officers, employees, agents, and consultants, including any evidence or allegations and internal or external investigations, about which the Company has any knowledge or about which the U.S. Attorney's Office may inquire. This obligation of truthful disclosure includes, but is not limited to, the obligation of the Company to provide to the U.S. Attorney's Office, upon request, any document, record, or other tangible evidence about which the U.S. Attorney's Office may inquire of the Company.
 - b. Upon request of the U.S. Attorney's Office, the Company shall designate knowledgeable employees, agents, or attorneys to provide to the U.S. Attorney's Office the information and materials described in Paragraph 5(a) above on behalf of the Company. It is further understood that the Company must at all times provide complete, truthful, and accurate information.
 - c. The Company shall use its best efforts to make available for interviews or testimony, as requested by the U.S. Attorney's Office, present or former officers, directors, employees, agents, and consultants of the Company. This obligation includes, but is not limited to, sworn testimony before a federal grand jury or in federal trials, as well as interviews with domestic or foreign law enforcement and regulatory authorities. Cooperation under this Paragraph shall include identification of witnesses who, to the knowledge of the Company, may have material information regarding the matters under investigation.
 - d. With respect to any information, testimony, documents, records, or other tangible evidence provided to the U.S. Attorney's Office pursuant to this Agreement, the Company consents to any and all disclosures, subject to applicable laws and regulations, to other governmental authorities, including United States authorities and those of a foreign government, of such materials as the U.S. Attorney's Office, in its sole discretion, shall deem appropriate.
6. In addition to the obligations in Paragraph 5, during the Term, should the Company learn of any evidence or allegation of conduct that may constitute a violation of the criminal laws of the United States by the Company, its officers, directors, employees or agents had the conduct occurred within the jurisdiction of the United States, the Company shall promptly report such evidence or allegation to the U.S. Attorney's Office.

Payment of Monetary Penalty

7. The Company agrees to pay a total monetary penalty in the amount of \$3,000,000 (the "Total Criminal Penalty"). This is the maximum applicable fine permitted by statute upon the Company's conviction of the six counts charged in the Information. The Company and the U.S. Attorney's Office agree that the Company

will pay the United States Treasury \$3,000,000, equal to the Total Criminal Penalty, within ten business days of the execution of this Agreement. Nothing in this Agreement shall be deemed an agreement by the U.S. Attorney's Office that the Total Criminal Penalty is the maximum penalty that may be imposed in any future prosecution, and the U.S. Attorney's Office is not precluded from arguing in any future prosecution that the Court should impose a higher fine, although the U.S. Attorney's Office agrees that under those circumstances, it will recommend to the Court that any amount paid under this Agreement should be offset against any fine the Court imposes as part of a future judgment. The Company acknowledges that no tax deduction may be sought in connection with the payment of any part of the Total Criminal Penalty. The Company will not use the Total Criminal Penalty to offset any potential civil liability to the victims, and it will not accept directly or indirectly reimbursement or indemnification from any source with regard to the penalty that the Company pays pursuant to this Agreement or any other agreement entered into with an enforcement authority or regulator concerning the facts set forth in the Statement of Facts.

Conditional Release from Liability

8. Subject to Paragraphs 17 to 21, the U.S. Attorney's Office agrees, except as provided in this Agreement, that it will not bring any criminal or civil case against the Company or any of its direct or indirect affiliates, subsidiaries or joint ventures relating to any of the conduct described in the attached Statement of Facts or the criminal Information filed pursuant to this Agreement. The U.S. Attorney's Office, however, may use any information related to the conduct described in the attached Statement of Facts against the Company: (a) in a prosecution for perjury or obstruction of justice; (b) in a prosecution for making a false statement; (c) in a prosecution or other proceeding relating to any crime of violence; or (d) in a prosecution or other proceeding relating to a violation of any provision of Title 26 of the United States Code.

a. This Agreement does not provide any protection against prosecution of any future conduct by the Company.

b. In addition, this Agreement does not provide any protection against prosecution of any individuals, regardless of their affiliation with the Company.

Corporate Compliance Program

9. The Company represents that it has implemented and will continue to implement a compliance and ethics program designed to prevent and detect violations of federal criminal laws throughout its operations, including those of its affiliates, subsidiaries, agents, and joint ventures, including, but not limited to, the minimum elements set forth in Attachment C.

10. In order to address any deficiencies in its internal controls, policies, and procedures, the Company represents that it has undertaken, and will continue to undertake in the future, in a manner consistent with all of its obligations under this Agreement, a review of its existing internal controls, policies, and procedures regarding compliance with federal criminal laws. Where necessary and appropriate, the Company agrees to modify its existing compliance program, including internal controls, compliance policies, and procedures in order to ensure that it maintains: (a) an effective system of internal accounting controls designed to ensure the

INTRODUCTION

making and keeping of fair and accurate books, records, and accounts; and (b) a rigorous compliance program that incorporates relevant internal accounting controls, as well as policies and procedures designed to effectively detect and deter violations of federal criminal laws. The compliance program, including the internal accounting controls system will include, but not be limited to, the minimum elements set forth in Attachment C. In assessing the Company's compliance program, the U.S. Attorney's Office, in its sole discretion, may consider the Monitor's certification decision.

Independent Compliance Monitor

11. Promptly after the U.S. Attorney's Office's selection pursuant to Paragraph 13 below, the Company agrees to retain a Monitor for the term specified in Paragraph 14. The Monitor's duties and authority, and the obligations of the Company with respect to the Monitor and the U.S. Attorney's Office, are set forth in Attachment D, which is incorporated by reference into this Agreement. Within ten (10) business days after the date of execution of this Agreement, the Company shall submit a written proposal identifying three monitor candidates, and, at a minimum, provide the following:

- a. a description of each candidate's qualifications and credentials in support of the evaluative considerations and factors listed below;
- b. a written certification by the Company that it will not employ or be affiliated with the monitor for a period of not less than two years from the date of the termination of the monitorship;
- c. a written certification by each of the candidates that the candidate is not a current or recent (i.e., within the prior two years) employee, agent, or representative of the Company and holds no interest in, and has no relationship with, the Company, its subsidiaries, affiliates or related entities, or its employees, officers, or directors;
- d. a written certification by each of the candidates that the candidate has notified any clients that the candidate represents in a matter involving the U.S. Attorney's Office (or any other Department of Justice component), and that the candidate has either obtained a waiver from those clients or has withdrawn as counsel in the other matter(s); and
- e. a statement identifying the monitor candidate that is the Company's first, second, and third choice to serve as the Monitor.

12. The monitor candidates or their team members shall have, at a minimum, the following qualifications:

- a. a demonstrated expertise with respect to the federal criminal laws, including experience counseling on criminal matters;
- b. experience designing and/or reviewing corporate compliance policies, procedures, and internal controls;
- c. the ability to access and deploy resources as necessary to discharge the Monitor's duties as described in the Agreement; and

d. sufficient independence from the Company to ensure effective and impartial performance of the Monitor's duties as described in the Agreement.

13. The U.S. Attorney's Office retains the right, in its sole discretion, to choose the Monitor from among the candidates proposed by the Company. Monitor selections shall be made in keeping with the Department's commitment to diversity and inclusion. If the U.S. Attorney's Office determines, in its sole discretion, that any or all of the three candidates lack the requisite qualifications, it shall notify the Company and request that the Company propose another candidate or candidates within twenty (20) business days. This process shall continue until a Monitor acceptable to both parties is chosen. The U.S. Attorney's Office and the Company will use their best efforts to complete the selection process within sixty (60) calendar days of the execution of this Agreement. The U.S. Attorney's Office retains the right to determine that the Monitor should be removed if, in the U.S. Attorney's Office's sole discretion, the Monitor fails to conduct the monitorship effectively, fails to comply with this Agreement, or no longer meets the qualifications outlined in Paragraph 12 above. If the Monitor resigns, is removed, or is otherwise unable to fulfill the Monitor's obligations as set out herein and in Attachment D, the Company shall within twenty (20) business days recommend a pool of three qualified monitor candidates from which the U.S. Attorney's Office will choose a replacement, following the process outlined above.

14. The Monitor's term shall be three years from the date on which the Monitor is retained by the Company, subject to extension as described in Paragraph 3. The Monitor's powers, duties, and responsibilities, as well as additional circumstances that may support an extension of the Monitor's term, are set forth in Attachment D. The Company agrees that it will not employ or be affiliated with the Monitor or the Monitor's firm for a period of not less than two years from the date on which the Monitor's term expires. Nor will the Company discuss with the Monitor or the Monitor's firm the possibility of further employment or affiliation during the Monitor's term. Upon agreement by the parties, this prohibition will not apply to other monitorship responsibilities that the Monitor or the Monitor's firm may undertake in connection with related resolutions with foreign or other domestic authorities.

Deferred Prosecution

15. In consideration of the undertakings agreed to by the Company herein, the U.S. Attorney's Office agrees that any prosecution of the Company for the conduct set forth in the attached Statement of Facts be and hereby is deferred for the Term. To the extent there is conduct disclosed by the Company that is not set forth in the attached Statement of Facts, such conduct will not be exempt from further prosecution and is not within the scope of this Agreement.

16. The U.S. Attorney's Office further agrees that if the Company fully complies with all of its obligations under this Agreement, the U.S. Attorney's Office will not continue the criminal prosecution against the Company described in Paragraph 1 and, at the conclusion of the Term, this Agreement shall expire. Within six months after the Agreement's expiration, the U.S. Attorney's Office shall seek dismissal with prejudice of the criminal Information filed against the Company described in Paragraph 1, and agrees not to file charges in the future against the Company based on the conduct described in this Agreement and the attached Statement of Facts. If, however, the U.S. Attorney's Office determines during this six-month period that the Company breached the Agreement during the Term, as described in Paragraph

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17, the U.S. Attorney's Office's ability to extend the Term, as described in Paragraph 3, or to pursue other remedies, including those described in Paragraphs 19 to 20, remains in full effect.

Breach of the Agreement

17. If, during the Term, the Company (a) commits any felony under U.S. federal law; (b) deliberately provides in connection with this Agreement false, incomplete, or misleading information, including in connection with its disclosure of information about individual culpability; (c) fails to cooperate as set forth in Paragraphs 5 and 6 of this Agreement; (d) fails to implement a compliance program as set forth in Paragraphs 9 and 10 of this Agreement and Attachment C; (e) commits any acts that, had they occurred within the jurisdictional reach of the United States, would be violations of federal criminal law; or (f) otherwise fails to completely perform or fulfill each of the Company's obligations under the Agreement, regardless of whether the U.S. Attorney's Office becomes aware of such a breach after the Term is complete, the Company shall thereafter be subject to prosecution for any federal criminal violation of which the U.S. Attorney's Office has knowledge, including, but not limited to, the charges in the Information described in Paragraph 1, which may be pursued by the U.S. Attorney's Office in the U.S. District Court for the District of Massachusetts or any other appropriate venue. Determination of whether the Company has breached the Agreement and whether to pursue prosecution of the Company shall be in the U.S. Attorney's Office's sole discretion. Any such prosecution may be premised on information provided by the Company or its personnel. Any such prosecution relating to the conduct described in the attached Statement of Facts or relating to conduct known to the U.S. Attorney's Office prior to the date on which this Agreement was signed that is not time-barred by the applicable statute of limitations on the date of the signing of this Agreement may be commenced against the Company, notwithstanding the expiration of the statute of limitations, between the signing of this Agreement and the expiration of the Term plus one year. Thus, by signing this Agreement, the Company agrees that the statute of limitations with respect to any such prosecution that is not time-barred on the date of the signing of this Agreement shall be tolled for the Term plus one year. In addition, the Company agrees that the statute of limitations as to any violation of federal law that occurs during the Term will be tolled from the date upon which the violation occurs until the earlier of the date upon which the U.S. Attorney's Office is made aware of the violation or the duration of the Term plus five years, and that this period shall be excluded from any calculation of time for purposes of the application of the statute of limitations.

18. In the event the U.S. Attorney's Office determines that the Company has breached this Agreement, the U.S. Attorney's Office agrees to provide the Company with written notice of such breach prior to instituting any prosecution resulting from such breach. Within thirty days of receipt of such notice, the Company shall have the opportunity to respond to the U.S. Attorney's Office in writing to explain the nature and circumstances of such breach, as well as the actions the Company has taken to address and remediate the situation, which explanation the U.S. Attorney's Office shall consider in determining whether to pursue prosecution of the Company.

19. In the event that the U.S. Attorney's Office determines that the Company has breached this Agreement: (a) all statements made by or on behalf of the

Company to the U.S. Attorney's Office or to the Court, including the attached Statement of Facts, and any testimony given by or on behalf of the Company before a grand jury, a court, or any tribunal, or at any legislative hearings, whether prior or subsequent to this Agreement, and any leads derived from such statements or testimony, shall be admissible in evidence in any and all criminal proceedings brought by the U.S. Attorney's Office against the Company; and (b) the Company shall not assert any claim under the United States Constitution, Rule 11(f) of the Federal Rules of Criminal Procedure, Rule 410 of the Federal Rules of Evidence, or any other federal rule that any such statements or testimony made by or on behalf of the Company prior or subsequent to this Agreement, or any leads derived therefrom, should be suppressed or are otherwise inadmissible. The decision whether conduct or statements of any current director, officer or employee, or any person acting on behalf of, or at the direction of, the Company, will be imputed to the Company for the purpose of determining whether the Company has violated any provision of this Agreement shall be in the sole discretion of the U.S. Attorney's Office.

The Company acknowledges that the U.S. Attorney's Office has made no representations, assurances, or promises concerning what sentence may be imposed by the Court if the Company breaches this Agreement and this matter proceeds to judgment. The Company further acknowledges that any such sentence is solely within the discretion of the Court and that nothing in this Agreement binds or restricts the Court in the exercise of such discretion. . . .

Problem 0-1

With regard to this matter involving eBay, return to the questions at the outset of this Introduction and consider the extent to which you can develop answers from the materials you read here:

How should we understand **the facts** of the misconduct? Who did what and why? And how can we simplify and summarize the story without distorting it? (As any trial lawyer knows, every case is a story.)

What were the **economics** driving the conduct? (Follow the money!)

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What **institutions** were involved in the matter and how did the nature, dynamics, and culture of those institutions factor into what happened?

What was the human **psychology** involved in the case and how might it explain things?

What was the **regulatory context** in which the wrongdoing took place and how might the content of the law explain what happened and offer a locus for lessons and reform?

What can we learn from the matter about the conduct of **lawyers** and the role of legal strategy? In this connection, what do you make of the terms of the corporate settlement?

How do **politics** play into explaining what happened, how the legal system responded to the scandal, or both?

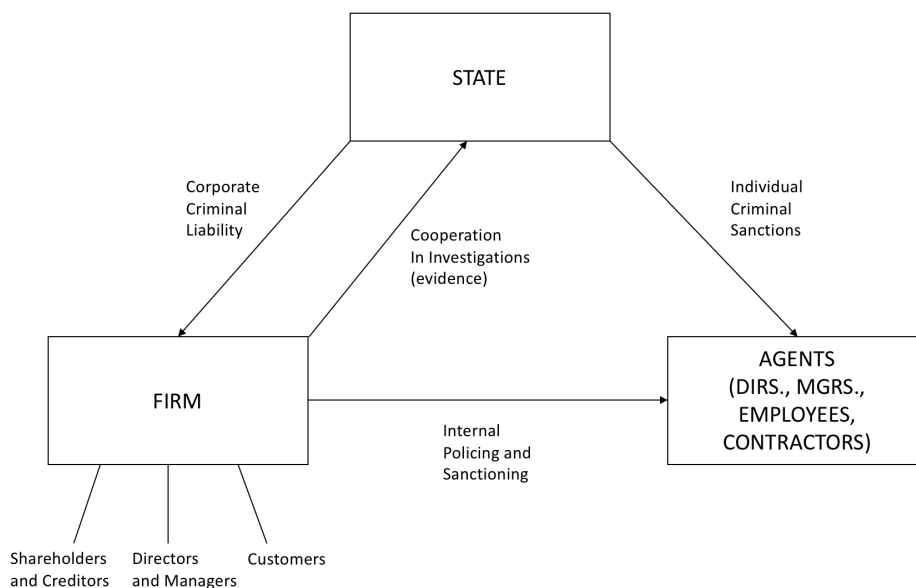
1. CRIMINAL LIABILITY OF BUSINESS FIRMS

A. Introduction

The central difference between corporate crime and what the rest of the American criminal justice system addresses is, of course, the corporation. Thus, an introduction to this field begins with understanding (1) the nature of the firm and (2) the rules and practices for imposing criminal liability on firms. (A basic course in Business Associations is essential for any prospective lawyer in this field.)

Ordinary criminal law and procedure are concerned with the relationship between the individual and the state. The presence of the firm introduces a third actor. This creates a triangle of relationships that must be considered in analyzing any problem of substantive law or procedure in this field. The firm is an especially interesting addition—to the analysis of criminal law and justice because it can function like the individual—as the subject of criminal sanctions and threat of liability—and also function like the state—as an institutional mechanism for generating deterrence and investigating crime.

The relationship looks like this:



The state uses the instrument of corporate criminal liability to induce the firm to do two things: (1) cooperate in criminal investigations, meaning to provide the state with evidence of individual crimes; and (2) monitor and police its own employees and other agents to prevent the commission of crime in the first instance.

Because the firm itself does not have the capacity to reason, in reality this pressure is exerted on the persons who control the firm, primarily the board of directors, senior managers, major investors, and counter-parties in the markets in which the firm operates. To the extent that the potential imposition of criminal liability on the firm raises the

specter of undesirable costs for such persons, they will be induced to take action to forestall, or reduce the impact of, such liability, typically through cooperation with the state.

The state also uses its control over criminal liability to deter crime in the ordinary manner, by threatening persons in the corporate sector with individual criminal punishment. Notice, therefore, how the theory of corporate criminal enforcement anticipates pressure on the individual from two directions: from the state, with its power to levy legal sanctions, *and* from the firm, with its power and incentive to levy private sanctions in order to avoid legal sanctions on the firm.

A helpful organizing principle is the distinction between *de jure* corporate criminal liability and *de facto* corporate criminal liability.² *De jure*, the law of corporate criminal liability in the United States is broad and relatively absolute. Doctrine gives business firms little basis to resist the imposition of criminal liability if an employee has committed a crime in the course of her job. *De facto*, the contemporary practice of corporate criminal liability involves bargaining away (or bargaining down) that severe form of liability in exchange for helping the government overcome the special problem it faces in policing corporate crime: the difficulty of detecting and proving crimes that are committed within the complex and opaque setting of the large modern business firm.

The reality of the American approach to corporate crime enforcement is that it is overwhelmingly concerned with the instrumental project of crime reduction, primarily through mechanisms of deterrence. While some argue that the ancient and persistent idea of retribution in criminal punishment also explains corporate criminal liability, there is cause for skepticism of that claim, at least with respect to arguments for retribution that do not turn out, in the end, to rest on instrumentalist claims about how pursuing corporate retribution is an avenue for reducing corporate crime.³ Because retributive theory plays a small role in the current practice of corporate criminal law, this text will address these arguments only briefly.⁴

The focus throughout this text will be primarily on *criminal* liability, both corporate and individual.⁵ But it is important to understand that most cases of serious corporate

² Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence* in RESEARCH HANDBOOK ON THE ECONOMICS OF CRIMINAL LAW (A. Harel & K. Hylton eds. 2012).

³ See Samuel W. Buell, *Retiring Corporate Retribution*, 83 LAW & CONTEMP. PROBS. 25 (2020).

⁴ For those interested in the idea of retribution for corporations, a continuing theoretical debate in the academic literature is easily accessible.

⁵ An essential institutional point, that often confuses even practicing lawyers not immersed in this field, is that *only* prosecutors can bring criminal charges in the United States. This means that in the federal system only the Department of Justice and its subdivisions can charge corporations and individuals with crimes and seek the sanction of imprisonment. Other government enforcement agencies, such as the Securities and Exchange Commission (SEC), have no legal authority over criminal violations—even though parallel statutes often allow civil proceedings to be brought for the same or similar conduct and such enforcers sometimes say (incorrectly) that they have chosen to “prosecute” a case.

wrongdoing lead to the potential for four types of liability, all of which must be considered by the practitioner in this field:

- (1) Criminal sanctions against the firm.
- (2) Criminal sanctions against individuals.
- (3) Civil sanctions against the firm, through private lawsuits and/or regulatory proceedings.
- (4) Civil sanctions against the individual, through private lawsuits and/or regulatory proceedings.

The remainder of this chapter is organized as follows. First, this introductory part consists of a recent book chapter that frames corporate crime as a theoretical and public policy problem and summarizes the state of the discussion about corporate criminal liability in the United States legal system. Part B will cover the law that constitutes the *de jure* regime of corporate criminal liability. Part C will cover the *de facto* system of corporate criminal enforcement as it presently exists. Finally, Part D will discuss the role of the judiciary, if any, in the current *de facto* regime.

CORPORATE CRIMINAL LIABILITY

Samuel W. Buell

in EDWARD ELGAR RESEARCH HANDBOOK ON CORPORATE LIABILITY (M. Petrin and C. Witting eds. 2023)⁶

The most common question associated with corporate criminal liability in the academic literature is why the doctrine should exist. From the standpoint of criminal law theory, some question the conceptual soundness of applying the concepts of blame and punishment to inanimate legal persons. However, one can turn this framing around, observing that criminal liability's standard burdens of justification arise from the painful and liberty-depriving characteristics of punishment, which corporations cannot experience.

From the standpoint of corporate law theory, some question the potential wastefulness ("overdeterrence") in criminal liability's potential to spill over into harming employees, investors, counterparties, and others who neither participated in wrongdoing nor can directly control whether others within the corporation do—especially in instances of substantial reputational sanction or industrial delicensing or debarment. However, this framing also can be inverted, by pointing out that the argument's concession to criminal liability's unique potency highlights the very reason legal systems might view criminal liability as a necessary supplement to civil liability in encouraging managers of firms to

⁶ © Samuel W. Buell 2023.

control agent misconduct. Such misconduct, after all, can be highly profitable to both firms and individual agents.

While such consequentialist and deontological debates have proceeded without pause over decades and produced a voluminous literature, the United States and, more recently, many other legal systems have eagerly embraced criminal liability for corporations. Alongside increased scale, complexity, and globalization of the activities of multinational firms has come greater and justified worry about the costs of corporate crime. Salient corporate scandals seem to pile up like the faulty automobiles, crashed airplanes, spilled oil, laundered assets, and depleted pension funds left in their wake. A common response of governments has been to use criminal liability, and especially the threat of its imposition, as a lever in strategies meant to compel the massive private industrial sector to get its house in order. The law of corporate criminal liability can no longer be meaningfully understood without comprehending the institutional and political particulars of its enforcement. . . .

Theoretical discussion of criminal liability for corporations generally starts from the standpoint of criminal law, specifically what has become known as punishment theory. Because corporate *liability* . . . is itself not controversial in some form, the question becomes why law should impose liability on corporations through criminal process. This question logically points, at least initially, to the tools of criminal law theory.

Criminal sanctions are generally justified on two familiar lines of argument: deontological (roughly Kantian) theories that see punishment, given necessary conditions, as morally mandated, usually on grounds of retributive desert; and consequentialist (roughly Benthamite) theories that see punishment, when justified according to cost-benefit analysis, as necessary to the project of reducing crime, usually through the mechanism of deterrence. . . .

The most common objection to justifying criminal punishment of corporations on grounds of moral imperative is probably that corporations are inanimate (indeed, somewhat ethereal) objects in the world, not people or even living creatures, and thus cannot be themselves moral agents bearing responsibility and deserving retribution for wrongs committed by humans working within them. In the often-cited phrase of the Baron Lord Thurlow, a corporation has “no soul to damn, no body to kick.”. . .

Corporations, especially large ones, are institutions, not objects. Their legal existence may be limited to paper filings and statutes. But their presence in the world is far larger and more complex. They comprise the collective actions of groups of humans engaged in directed and often highly impactful industrial projects. As Bishop said in an early foundational criminal law treatise, “If . . . the invisible, intangible essence or air which we term a corporation can level mountains, fill up valleys, lay down iron tracks, and run railroad cars on them, it can intend to do it, and can act therein as well viciously as virtuously.” Social practice certainly reflects Bishop’s view. The modern world would be unintelligible without the common language of responsibility ascription that applies to corporations, especially when harm, disaster, or failure strikes. When we say that a

company spilled oil, harmed consumers, deceived markets, corrupted a government, or the like, we mean more than that some number of people did those things. We mean that their *group* enterprise went wrong, as a result of how they arranged themselves and pursued their common project. . . .

The trouble with corporate retribution is not that it cannot be deserved. It is that it cannot be carried out. Because a corporation, apart from its constituents, has no affective capacity to experience punishment as a grave setback to its interests (again, it can be a setback, but it cannot be a felt or experienced one), seeking to punish a corporation on retributive grounds is fruitless. Retribution may be deserved but it cannot be carried out. . . .

It thus should not be surprising that, even as some authors continue to explore the problem of corporate retribution, the literature on corporate criminal liability is overwhelmingly, and increasingly, in the consequentialist tradition. Here, corporate criminal liability finds much theoretical support. The basic instrumental case in favor of corporate criminal liability sees the firm as an additional actor, beyond the state and the individual, that can be exploited in the project of reducing criminal violations. If sanctions are directed at firms for the crimes of their agents, then firms, in their nicely rational cost-managing way, will be encouraged to invest in efforts to prevent crime on the job and to punish it when it occurs in order to deter others within the firm. Firms have exceptional “policing” capacities in their ability to monitor their employees and see within themselves. They also have “sanctions” (and rewards) they can impose on their employees in the form of assignments, promotion, compensation, and hiring or termination. All this corporate activity roughly combines now into an entire field of practice and study, called compliance.

The powers of the firm, properly directed, complement the powers of the state. Consider a corporate employee deciding whether to engage in activity that is a possible or known legal violation. There may be strong incentives and rewards available from pursuing such activities if they do not result in sanctions. With the state and the firm allied in the project of sanctioning wrongdoing, such an employee must consider: (1) the extent of official legal sanctions likely to be imposed if such an activity is caught; (2) the negative consequences to the employee’s career within the firm, and elsewhere in the market, if the activity is caught; and (3) critical to any analysis of deterrence, the enhanced *probability* of being caught that comes from the state’s surveillance capabilities coupling with the firm deploying its own surveillance capabilities, in hopes of avoiding or reducing the imposition of criminal sanctions on the firm itself should the employee’s crime be revealed. . . .

Now consider complications to this model, and how a consequentialist case for corporate criminal liability would respond. The most basic complication is one that the U.S. Sentencing Commission and the U.S. Department of Justice recognized quickly when they began designing guidelines for the sentencing decisions and prosecutorial discretion involved in criminal enforcement against corporations. If firms are not rewarded for

internal policing and sanctioning efforts (compliance) through reduced penalties, then they often will choose to forego such efforts and hope that legal violations will not be caught. What is the benefit in discovering and disclosing employee crimes if doing so only guarantees full prosecution of the firm? If it is to yield deterrence benefits, corporate criminal liability should be structured to include both sticks and carrots.

A further complication is agency costs. Managers may not fear imposition of criminal liability on the corporation if the costs of such liability do not flow through to managers sufficiently to outweigh the benefits managers may enjoy from tolerating legal risk-taking by underlings, foregoing distracting focus on compliance, or even engaging in criminal violations themselves. Corporate criminal liability itself, of course, cannot directly address the problem of agency costs in corporate governance. However, managers have substantial reasons to seek to avoid prosecution of the firm. Highest management has a legal duty under corporate law to do so. Criminal scandals are failures that can tarnish the reputations of corporate managers, potentially lead to termination, and affect their self-esteem and prospects. While it is frequently observed that fear of individual criminal liability is a more powerful reason for managers to steer firms away from criminal wrongdoing, core principles of legality and criminal punishment, at least at present, do not allow for the imposition of criminal liability for failures of supervision except in some very narrow circumstances involving misdemeanor liability. Even when senior managers personally engage in acts that are clearly defined as crimes, prosecutors may struggle to obtain indictments and convictions given the steep burden of proof for criminal liability and the tendency of the activities of supervisors to be less enmeshed in corporate documents and the testimony of employees.

A final complication to the consequentialist case for corporate criminal liability is that civil regulatory mechanisms, in most legal systems, allow for the imposition of financial and other penalties on corporations. A corporation can be fined, suspended or disbarred from sectors or lines of business, and even placed under court supervision and monitoring with mandated reforms, without having to resort to criminal prosecution. Some therefore argue that criminal liability for corporations is unnecessary or, worse, wasteful in at least some cases because of the capacity of criminal indictment and conviction to severely damage a corporation's ability to do business, causing losses to investors, employees, and counterparties who did not engage in wrongdoing and are not logical targets for deterrent incentives.

The response to this argument embraces, rather than disfavors, the reputational effects of corporate criminal prosecutions. Civil enforcement and liability cannot convey the seriousness and fault involved in a corporation's production of crime. Criminal prosecution—because it arises from, after all, the commission of defined *crime*, because it must satisfy the highest burden of proof, and because it has higher salience to observers than civil proceedings—carries a unique messaging effect that no other legal mechanism can produce. Corporate managers will especially seek to avoid the threatened or actual imposition of criminal sanctions on their firms and thus the presence of prosecutorial institutions in corporate affairs supplies a powerful incentive to devote resources to

compliance. A criminal prosecution of a firm that carries strong reputational effects may result in individual reputational damage to managers, and even employees, and may cause persons within a firm and in similar firms to reflect on the group failure represented by a criminal scandal and devote energies to avoiding such disasters in the future. Importantly, in many legal systems including that of the United States, regulatory regimes treat criminal convictions, beyond civil regulatory violations, as more likely to trigger debarment or exclusion of firms from industries or lines of business. In some industries and under some regulatory schemes, such provisions have the potential to operate in conjunction with criminal conviction as essentially a corporate death penalty. . . .

The simplest rule for corporate criminal liability is the one that applies in the United States under federal law, which governs most corporate prosecutions: *respondeat superior*. Under this doctrine, a corporation will be criminally liable for any criminal violation committed by any agent of the corporation while acting within the scope of employment and at least in part with the intention to benefit the company (thus excluding, for example, employee theft from the employer as a basis for employer liability). This very old doctrine of agency law was allowed to travel from tort law into the criminal law by an early twentieth century decision of the United States Supreme Court dealing with enforcement of the first antitrust laws.

The *respondeat superior* rule has two primary advantages. The first is its simplicity. All issues of act and mental state involved in determining whether a crime has been committed are dealt with in the traditional manner of criminal law, through the conduct of an individual. Corporate liability is then analyzed separately, through the application of agency principles, only after a crime has been proven. Regulated actors, prosecutors, judges, and juries all can see clearly when criminal liability will and should apply, if crimes are defined clearly (which is not always true, of course). The second advantage to the rule is its potency. Because it does not consider the conduct of the corporation itself in relation to the crime, firms cannot insincerely escape imposition of criminal liability by, for example, simply telling their employees not to break the law, adopting merely facial compliance programs, or purposely turning a blind eye to crimes committed by lower-level employees.

The greatest problem with the *respondeat superior* rule is that it is badly overinclusive. If the primary purpose of corporate criminal liability is to encourage firms to invest in efforts to prevent crime by their employees, then holding them liable for any crime by any employee in any branch and at any level of the firm may cause firms to forego such investment on the view that sanctions will be imposed in any event. Moreover, if the special potency of criminal liability for corporations comes from the communication of institutional fault, and the resulting reputational effects on the firm, then imposing criminal liability for employee crimes that do not represent instances of genuine institutional wrongdoing clouds and weakens the expressive potential of such legal processes.

The first of these problems has caused some to advocate for rules of corporate criminal liability that would insulate firms from sanctions if they can be shown to have engaged in sufficient compliance efforts prior to a given instance of employee crime. The second problem has led some approaches to maintain that a corporation should be held criminally liable only if a crime has been committed by one or more members of higher-level management, or only if it has been committed by a large number of employees across the organization.

Unfortunately, these more limited approaches are so badly underinclusive that they would make corporate criminal liability ineffective. If firms can avoid liability whenever managers cannot be proven to have engaged in criminal acts themselves, the law ends up providing corporate management with a perverse incentive not only to forego affirmative compliance efforts but also to actively insulate itself from knowledge of the conduct of employees, or even to affirmatively incentivize employees to take excessive legal risks through compensation systems and then to ignore the consequences. In addition, large and damaging cases of corporate criminality sometimes involve acts by lower-level employees that are correctly attributed to corporate systems and to decisions and conduct of corporate managers that are causal of crime, even though not themselves criminal. Disallowing corporate liability in such cases fails to communicate the truth of institutional responsibility.

A rule that required that lower-level employee crime be pervasive or widespread for the firm to be held liable falters for similar reasons. Under such a rule, management might be encouraged to push legal risk-taking onto a small number of individuals or a single node in the firm that could still do enormous damage as a result of intentionally designed corporate systems. Some recent cases of serious corporate crime, particularly in the financial sector, have involved one or a handful of persons who engaged in activities such as large-scale trading fraud or massive bribery as a result of being able to control assets and decision authority that higher management intentionally delegated to them. Depending on causal explanations that usually emerge fully only following investigation, a corporation can sometimes be seriously at fault for even a single mid-level employee's crime.

It thus has proven difficult to design doctrines of corporate criminal liability that resolve the tension between under- and overinclusion in relation to the target phenomenon of institutional fault. There is a literature in which various scholars have proposed concepts and tests that would pose the question of institutional responsibility directly, such as by examining whether employee crime resulted from the “ethos” of the corporation, whether the wrongdoing stemmed from the corporation's character, or whether the corporate organization can be said to have been “constructively” at fault.

These efforts have not yet successfully brought their arguments at the level of theory fully to ground in doctrinal realities. Any workable rule of corporate criminal liability must give legal actors—prosecutors, judges, and juries—the ability to argue about and determine the intersection of rule and fact. American criminal adjudication, at the

charging and liability stage, fundamentally proceeds through the proof of elements of criminal offenses. It is hard to see how legal actors can be expected to proceed fairly and rigorously with their duties when working with vague concepts such as ethos, character, or even adequacy of compliance efforts. Again, this difficulty arises from the great complexity of the large industrial organization and the intangible nature of corporate culture, which is real and causal but cannot be described, at least with present tools, in the terms of either the basic models of corporate governance or the traditional act and mental state elements of criminal offenses.

This survey of the doctrinal problem explains why American law and practice, as well as those of some other legal systems, have developed procedures for examining questions of organizational responsibility outside of the liability phase of criminal adjudication. Under American law, *respondeat superior* remains the *de jure* rule of liability but its severe effects are often slackened at the charging or sentencing phases of the criminal process. In the structure of the American criminal process, decisions are controlled at these stages by actors (the prosecutor at the charging stage and the judge at the sentencing stage) who are afforded discretion to engage in broader inquiries that account for a diverse totality of relevant circumstances. . . .

Without having been subject to any legal mandates, federal prosecutors in the United States have developed elaborate guidelines and practices under which corporations can earn leniency under the overbroad *respondeat superior* rule according to a variety of factors that relate to (1) the deterrent purposes of corporate criminal liability and (2) the question of whether fault for the crime is correctly attributed to the corporation. On the first score, enforcers heavily emphasize the extent to which a corporation has invested efforts in lowering the probability of employee crime *ex ante* and in making prosecution of employees more likely *ex post* (thus lowering the probability that others will choose to violate in the future). Effective compliance systems, self-reporting to the government of violations not yet known to officials, and full cooperation in providing prosecutors with access to testimonial and documentary proof are continually stressed as the most effective paths to leniency when it comes to sanctions at the corporate level. . . .

Leniency, when justified, is provided through several aspects of settlements of corporate prosecutions. Prosecutors may reduce monetary sanctions below what could have been legally imposed in the form of fines. They may forego requiring firms to be subject to onerous and intrusive outside monitoring mechanisms designed to ensure that they follow through on post-crime commitment to reforms, such as improved compliance programs. Most importantly for firms, prosecutors may choose forms of settlement that are less damaging to firms because they are less likely to result in a firm being prevented from doing future business in various regulated areas. Prosecutors may work with civil regulatory counterparts to agree to forego punitive debarment and delicensing measures. More commonly, prosecutors will permit firms to settle outside the traditional criminal settlement context in order to slacken the potential collateral consequences of a criminal conviction.

In the United States, criminal settlements for individuals usually take the form of guilty pleas with plea agreements (a form of contract) in which prosecutors agree to forego some charges or recommend lesser punishments. In the corporate context, because of the collateral consequences that can apply when a going business concern has been convicted of a serious crime, and because of the seriousness with which a formal conviction can be seen by constituents, counterparties, and other observers, a guilty plea is seen as a punitive resolution. Prosecutors thus frequently offer corporations settlements in the form of deferred and nonprosecution agreements (DPAs and NPAs) as less punitive settlements. The form of agreement under a DPA or an NPA is largely the same. It consists of a contract between the government and the company in which sanctions are imposed and obligations are undertaken, with at least theoretically severe consequences for the company, at the discretion of the prosecutor, should the company fall short on its commitments. With a DPA, a charge is also filed before a judge and agreed to be kept pending, with no further proceedings, until the company is determined to have completed its commitments, at which time the charge is dismissed. An NPA is more like a pre-suit settlement in a civil matter, in that no charge is filed and no court's jurisdiction is invoked. It is perhaps believed that a DPA, with its pending charge on file, represents a more threatening sword over the neck of a company, although under an NPA the government has the right to file charges immediately if it determines that a company has breached the agreement. . . .

This enforcement system has abundant critics. A strain of argument based in populist impulses, or in skepticism of prosecutors' motivations, has painted the contemporary American enforcement practice as affording undue leniency to corporations that violate the law. By allowing corporations to settle frequently without convictions (under DPAs and NPAs), routinely reducing monetary penalties to reward cooperation to a degree that makes criminal fines a priceable "cost of doing business," often arranging for regulatory forbearance on suspension and debarment, and almost never taking a large corporation all the way through indictment and trial, the government under-deters corporate crime and expresses public toleration of corporate criminality. It is sometimes contended that this pattern has emerged through distasteful "revolving door" capture dynamics, whereby American prosecutors handling corporate crime tend to negotiate forgivingly and amenably with their corporate counterparts, who now practice in a highly lucrative professional compliance and defense industry into which most American prosecutors will move following a period of public service. Some add the criticism that programmatic leniency in the corporate prosecution area—a system based in a philosophy of carrots before sticks—is especially distasteful and expressively problematic in the American criminal justice system, which treats street offenders notoriously harshly and with ingrained racially discriminatory effects.

Business interests, not surprisingly, tend to see the enforcement landscape from an entirely different perspective. To them, the Justice Department's program is not one of negotiated settlements but one of dictated corporate behavior. Because *respondeat superior* doctrine affords companies virtually no viable argument to defeat liability any time an employee commits a crime, because even the best compliance programs cannot

prevent all crime, and because criminal convictions threaten to disable firms from continuing to do business in the short or even long term, management must do what the government says, whether doing so is best for the firm's stakeholders or not. Full cooperation, they would say, is not an option but an obligation, when measured from the standpoint of business risks. Especially because some business crimes, including regulatory offenses, are defined vaguely and very broadly, this means that corporations must cooperate, settle, and admit wrongdoing even when they may believe they have meritorious defenses, or at least mitigating arguments, and that prosecutors are mistaken or overreaching. This line of argument is not without force, particularly when it comes to considering how prosecutors might best be supervised and regulated. But it strains credulity to think that large corporations, with the superb legal representation they typically enjoy, do not have ample opportunity to argue their points with prosecutors on questions such as the gravity of the wrongdoing or the fair level and kind of punishment. . . .

In sum, enforcement procedures have, over time, sought to accommodate the choice of an overbroad rule of corporate criminal liability, rather than an underinclusive one, with the necessity of rewarding corporations with leniency in order to encourage their partnership with the state in the project of reducing corporate crime. Most common business crimes are not observable outside the enforcement process and present empirical tools cannot effectively measure their prevalence. It thus cannot yet be meaningfully assessed whether an entirely different model, such as one in which prosecutors routinely prosecuted corporations to the fullest extent of on-the-books penalties and did not shy away from putting firms out of business, would result in more effective deterrence of corporate crime at justifiable cost. . . .

B. *De Jure* Corporate Criminal Liability

1. Statutes

There is no general statute on corporate criminal liability in the United State Code, even though people commonly talk about criminal liability of corporations as if it were a matter of blanket federal law. This statute is the closest thing to a general statute on the subject. Do you see how this statute is relevant? What important questions about the federal law of corporate criminal liability does it leave unanswered?

1 U.S.C. § 1 – Words denoting number, gender, and so forth (“The Dictionary Act”)

In determining the meaning of any Act of Congress, unless the context indicates otherwise—. . .the words “person” and “whoever” include corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals; . . .

2. Respondeat Superior Liability

“Respondeat superior” liability is an ancient legal principle by which the master is held liable for his servant’s violation of the law. Imported from the law of torts into corporate criminal law, respondeat superior liability can have the effect of imposing almost strict liability on corporate employers. I say “almost” because the imposition of liability is not entirely automatic. There are some qualifications of the doctrine, though, as we will see, how much limiting work these qualifications do is subject to skepticism.

The following case is the seminal one on criminal liability of firms in federal court based on respondeat superior principles. This case was brought under the Elkins Act, which, *inter alia*, prohibited shippers and railroad companies from engaging in the anticompetitive behavior of paying and accepting rebates off of the shipping rates set by federal regulation. It should not be surprising that the law of corporate criminal liability that prevails today originated in the era when American lawmakers and courts first embarked on comprehensive programs of legal control of the large corporation. Pay close attention to the holding and rationale(s). What did the Supreme Court really say here? Why might this case have become so routinely cited as establishing our modern *de jure* system of corporate criminal liability?

NEW YORK CENT. & HUDSON RIVER R.R. CO. V. UNITED STATES, 212 U.S. 481 (1909)

MR. JUSTICE DAY delivered the opinion of the court:

This is a writ of error to the circuit court of the United States for the southern district of New York, sued out by the New York Central & Hudson River Railroad Company, plaintiff in error. In the circuit court the railroad company and Fred L. Pomeroy, its assistant traffic manager, were convicted for the payment of rebates to the American Sugar Refining Company and others, upon shipments of sugar from the city of New York to the city of Detroit, Michigan. The indictment was upon seven counts and was returned against the company, its general traffic manager, and its assistant traffic manager. The first count, covering the offering of a rebate, was withdrawn from the jury by the district attorney, and it is unnecessary to consider it. The second count charges the making and publishing of a through tariff rate upon sugar by certain railroad companies, including the plaintiff in error, fixing the rate at 23 cents per 100 pounds from New York city to Detroit, and charges the railroad company’s general traffic manager and assistant traffic manager with entering into an unlawful agreement and arrangement with the shippers, the American Sugar Refining Company of New York and the American Sugar Refining Company of New Jersey, and the consignees of the sugar, W. H. Edgar & Son, of Detroit, whereby it was agreed that, for sugar shipped over the line, the full tariff rate being paid thereon, the railroad company should give a rebate of 5 cents for each 100 pounds. This count charges that during the months of April and May, 1904, shipments were made under this agreement, and the regular tariff rates paid thereon. On July 14 of that year a claim for a rebate in the sum of \$1,524.99 was presented by the agents of the shipper and consignees, and paid on the 31st day of August

to Lowell M. Palmer, agent of the sugar company, for the benefit of the shippers and consignees. In each of the counts, except the sixth, the lawful rate is charged to have been 23 cents per 100 pounds. During the month of June, 1904, the same was reduced to 21 cents per 100 pounds, and the rebate agreed to and paid being 3 cents per 100 pounds. The second count covers the shipments of April and May, 1904; the third count the shipments for July and August, 1904; the fourth for September, 1904; the fifth for October, 1904; the sixth for June, 1904, and the seventh for April and May, 1904. In each of these counts there is an allegation of the payment of the published rate, the presentation of the claim for the rebate, and the statement of a specific sum allowed and paid on account thereof.

Upon the trial there was a conviction upon all of the six counts, two to seven inclusive. The assistant traffic manager was sentenced to pay a fine of \$1,000 upon each of the counts; the present plaintiff in error to pay a fine of \$18,000 on each count, making a fine of \$108,000 in all.

The facts are practically undisputed. They are mainly established by stipulation, or by letters passing between the traffic managers and the agent of the sugar refining companies. It was shown that the established, filed, and published rate between New York and Detroit was 23 cents per 100 pounds on sugar, except during the month of June, 1904, when it was 21 cents per 100 pounds.

The sugar refining companies were engaged in selling and shipping their products in Brooklyn and Jersey City, and W. H. Edgar & Son were engaged in business in Detroit, Michigan, where they were dealers in sugar. By letters between Palmer, in charge of the traffic of the sugar refining companies and of procuring rates for the shipment of sugar, and the general and assistant traffic managers of the railroad company, it was agreed that Edgar & Son should receive a rate of 18 cents per 100 pounds from New York to Detroit. It is unnecessary to quote from these letters, from which it is abundantly established that this concession was given to Edgar & Son to prevent them from resorting to transportation by the water route between New York and Detroit, thereby depriving the roads interested of the business, and to assist Edgar & Son in meeting the severe competition with other shippers and dealers. The shipments were made accordingly and claims of rebate made on the basis of a reduction of 5 cents a hundred pounds from the published rates. These claims were sent to the assistant freight traffic manager of the railroad company by Palmer, the agent of the sugar companies, and then sent to one Wilson, the general manager of the New York Central and Fast Freight Lines at Buffalo, New York. Wilson returned to the assistant traffic manager of the railroad company a cashier's draft for the amount of the claim. This draft was then sent to the agent of the sugar companies, and his receipt taken. It was stipulated that these drafts were ultimately paid from the funds of the railroad company.

Numerous objections and exceptions were taken at every stage of the trial to the validity of the indictment and the proceedings thereunder. The principal attack in this court is

upon the constitutional validity of certain features of the Elkins act. 32 Stat. at L. 847, chap. 708, U. S. Comp. Stat. Supp. 1907. That act, among other things, provides:

(1) That anything done or omitted to be done by a corporation common carrier subject to the act to regulate commerce, and the acts amendatory thereof, which, if done or omitted to be done by any director or officer thereof, or any receiver, trustee, lessee, agent, or person acting for or employed by such corporation, would constitute a misdemeanor under said acts, or under this act, shall also be held to be a misdemeanor committed by such corporation; and, upon conviction thereof, it shall be subject to like penalties as are prescribed in said acts, or by this act, with reference to such persons, except as such penalties are herein changed. . . .

“In construing and enforcing the provisions of this section, the act, omission, or failure of any officer, agent, or other person acting for or employed by any common carrier, acting within the scope of his employment, shall, in every case, be also deemed to be the act, omission, or failure of such carrier, as well as that of the person.”

It is contended that these provisions of the law are unconstitutional because Congress has no authority to impute to a corporation the commission of criminal offenses, or to subject a corporation to a criminal prosecution by reason of the things charged. The argument is that to thus punish the corporation is in reality to punish the innocent stockholders, and to deprive them of their property without opportunity to be heard, consequently without due process of law. And it is further contended that these provisions of the statute deprive the corporation of the presumption of innocence,—a presumption which is part of due process in criminal prosecutions. It is urged that, as there is no authority shown by the board of directors or the stockholders for the criminal acts of the agents of the company, in contracting for and giving rebates, they could not be lawfully charged against the corporation. As no action of the board of directors could legally authorize a crime, and as, indeed, the stockholders could not do so, the arguments come to this: that, owing to the nature and character of its organization and the extent of its power and authority, a corporation cannot commit a crime of the nature charged in this case.

Some of the earlier writers on common law held the law to be that a corporation could not commit a crime. It is said to have been held by Lord Chief Justice Holt (Anonymous, 12 Mod. 559) that “a corporation is not indictable, although the particular members of it are.” In Blackstone’s Commentaries, chapter 18, § 12, we find it stated: ‘A corporation cannot commit treason, or felony, or other crime in its corporate capacity, though its members may, in their distinct individual capacities.’ The modern authority, universally, so far as we know, is the other way. In considering the subject, Bishop’s New Criminal Law, § 417, devotes a chapter to the capacity of corporations to commit crime, and states the law to be: ‘Since a corporation acts by its officers and agents, their purposes, motives, and intent are just as much those of the corporation as are the things done. If, for

example, the invisible, intangible essence or air which we term a corporation can level mountains, fill up valleys, lay down iron tracks, and run railroad cars on them, it can intend to do it, and can act therein as well viciously as virtuously.' Without citing the state cases holding the same view, we may note *Telegram Newspaper Co. v. Com.*, in which it was held that a corporation was subject to punishment for criminal contempt; and the court, speaking by Mr. Chief Justice Field, said: 'We think that a corporation may be liable criminally for certain offenses of which a specific intent may be a necessary element. There is no more difficulty in imputing to a corporation a specific intent in criminal proceedings than in civil. A corporation cannot be arrested and imprisoned in either civil or criminal proceedings, but its property may be taken either as compensation for a private wrong or as punishment for a public wrong.' It is held in England that corporations may be criminally prosecuted for acts of misfeasance as well as nonfeasance. *R. v. Great North of England R. Co.*.

It is now well established that, in actions for tort, the corporation may be held responsible for damages for the acts of its agent within the scope of his employment. *Lake Shore & M. S. R. Co. v. Prentice*.

And this is the rule when the act is done by the agent in the course of his employment, although done wantonly or recklessly or against the express orders of the principal. In such cases the liability is not imputed because the principal actually participates in the malice or fraud, but because the act is done for the benefit of the principal, while the agent is acting within the scope of his employment in the business of the principal, and justice requires that the latter shall be held responsible for damages to the individual who has suffered by such conduct. *Lothrop v. Adams*.

A corporation is held responsible for acts not within the agent's corporate powers strictly construed, but which the agent has assumed to perform for the corporation when employing the corporate powers actually authorized, and in such cases there need be no written authority under seal or vote of the corporation in order to constitute the agency or to authorize the act. *Washington Gaslight Co. v. Lansden*.

In this case we are to consider the criminal responsibility of a corporation for an act done while an authorized agent of the company is exercising the authority conferred upon him. It was admitted by the defendant at the trial that, at the time mentioned in the indictment, the general freight traffic manager and the assistant freight traffic manager were authorized to establish rates at which freight should be carried over the line of the New York Central & Hudson River Company, and were authorized to unite with other companies in the establishing, filing, and publishing of through rates, including the through rate or rates between New York and Detroit referred to in the indictment. Thus, the subject-matter of making and fixing rates was within the scope of the authority and employment of the agents of the company, whose acts in this connection are sought to be charged upon the company. Thus clothed with authority, the agents were bound to respect the regulation of interstate commerce enacted by Congress, requiring the filing and publication of rates and punishing departures therefrom. Applying the principle

governing civil liability, we go only a step farther in holding that the act of the agent, while exercising the authority delegated to him to make rates for transportation, may be controlled, in the interest of public policy, by imputing his act to his employer and imposing penalties upon the corporation for which he is acting in the premises.

It is true that there are some crimes which, in their nature, cannot be committed by corporations. But there is a large class of offenses, of which rebating under the Federal statutes is one, wherein the crime consists in purposely doing the things prohibited by statute. In that class of crimes we see no good reason why corporations may not be held responsible for and charged with the knowledge and purposes of their agents, acting within the authority conferred upon them. 2 Morawetz, Priv. Corp. § 733; Green's Brice, Ultra Vires, 366. If it were not so, many offenses might go unpunished and acts be committed in violation of law where, as in the present case, the statute requires all persons, corporate or private, to refrain from certain practices, forbidden in the interest of public policy.

It is a part of the public history of the times that statutes against rebates could not be effectually enforced so long as individuals only were subject to punishment for violation of the law, when the giving of rebates or concessions inured to the benefit of the corporations of which the individuals were but the instruments. This situation, developed in more than one report of the Interstate Commerce Commission, was no doubt influential in bringing about the enactment of the Elkins law, making corporations criminally liable.

This statute does not embrace things impossible to be done by a corporation; its objects are to prevent favoritism, and to secure equal rights to all in interstate transportation, and one legal rate, to be published and posted and accessible to all alike. *New York, N. H. & H. R. Co. v. Interstate Commerce Commission; Armour Packing Co. v. United States.*

We see no valid objection in law, and every reason in public policy, why the corporation, which profits by the transaction, and can only act through its agents and officers, shall be held punishable by fine because of the knowledge and intent of its agents to whom it has entrusted authority to act in the subject-matter of making and fixing rates of transportation, and whose knowledge and purposes may well be attributed to the corporation for which the agents act. While the law should have regard to the rights of all, and to those of corporations no less than to those of individuals, it cannot shut its eyes to the fact that the great majority of business transactions in modern times are conducted through these bodies, and particularly that interstate commerce is almost entirely in their hands, and to give them immunity from all punishment because of the old and exploded doctrine that a corporation cannot commit a crime would virtually take away the only means of effectually controlling the subject-matter and correcting the abuses aimed at.

There can be no question of the power of Congress to regulate interstate commerce, to prevent favoritism, and to secure equal rights to all engaged in interstate trade. It would be a distinct step backward to hold that Congress cannot control those who are

conducting this interstate commerce by holding them responsible for the intent and purposes of the agents to whom they have delegated the power to act in the premises.

It is contended that the Elkins law is unconstitutional, in that it applies to individual carriers as well as those of a corporate character, and attributes the act of the agent to all common carriers, thereby making the crime of one person that of another, thus depriving the latter of due process of law and of the presumption of innocence which the law raises in his favor. This contention rests upon the last paragraph of § 1 of the Elkins act, which is as follows:

‘In construing and enforcing the provisions of this section, the act, omission, or failure of any officer, agent, or other person acting for or employed by any common carrier, acting within the scope of his employment shall, in every case, be also deemed to be the act, omission, or failure of such carrier as well as that of the person.’

We think the answer to this proposition is obvious; the plaintiff in error is a corporation, and the provision as to its responsibility for acts of its agents is specifically stated in the first paragraph of the section. There is no individual in this case complaining of the unconstitutionality of the act, if objectionable on that ground, and the case does not come within that class of cases in which unconstitutional provisions are so interblended with valid ones that the whole act must fall, notwithstanding its constitutionality is challenged by one who might be legally brought within its provisions. *Employers’ Liability Cases* (*Howard v. Illinois C. R. Co.*). It may be doubted whether there are any individual carriers engaged in interstate commerce, and every act is to be construed so as to maintain its constitutionality if possible. There can be no question that Congress would have applied these provisions to corporation carriers, whether individuals were included or not. In this view the act is valid as to corporations. *Berea College v. Kentucky*. . . .

Notice that in *New York Central*, the Court did not actually hold that corporate respondeat superior liability is applicable to all federal crimes. Rather, the Court observed that corporate respondeat superior liability was contained in the Elkins Act and held that such statutory liability was not unconstitutional. However, federal courts have frequently cited *New York Central* as support for a broad rule of respondeat superior liability in cases of corporate crime.

Problem 1-1
(a) What argument do you find most persuasive in support of, or in opposition to, the law imposing criminal liability on corporations and other legal entities?
(b) If writing on a clean slate, what doctrinal rule would you propose for determining when a corporation is liable for a crime committed by one or more of its employees?

New Developments in UK Law. Contrast the doctrine of respondeat superior with the United Kingdom's approach to corporate criminal liability. Except under specific laws such as the UK Bribery Act (discussed in Chapter 5), UK law long based the criminal responsibility of corporations on the "Identification Principle," which held a company liable based only on the criminal conduct of those persons who embody the corporate entity's "directing mind and will." The identification principle rendered successful prosecution of a corporate entity difficult in many serious cases. Two new developments have modified this approach, though without adopting the breadth of liability that U.S. law imposes.

Liability for Senior Manager Conduct. First, Section 196 of the Economic Crime and Corporate Transparency Act of 2023 broadens the category of persons whose criminal conduct can lead to liability of the corporation, providing, in relevant part:

(1) If a **senior manager** of a body corporate or partnership ("the organisation") acting **within the actual or apparent scope of their authority** commits a relevant offence after this section comes into force, the organisation is also guilty of the offence. . . .

(2) "Relevant offence" means an act which constitutes— (a) an offence listed in Schedule 12 ("a listed offence"), (b) an attempt or conspiracy to commit a listed offence, (c) an offence—(i) under Part 2 of the Serious Crime Act 2007 (England and Wales and Northern Ireland: encouraging or assisting crime) in relation to a listed offence, or (ii) under the law of Scotland of inciting the commission of a listed offence, or (d) aiding, abetting, counselling or procuring the commission of a listed offence. . . .

(4) In this section—. . . "**senior manager**", in relation to a body corporate or partnership, means an individual who **plays a significant role** in—(a) the **making of decisions** about how the whole or a substantial part of the activities of the body corporate or (as the case may be) partnership are to be managed or organised, or (b) the **actual managing or organising of the whole or a substantial part** of those activities.

Failure to Prevent Fraud. Second, with section 199 of the Economic Crime and Corporate Transparency Act of 2023 the UK has enacted a "Failure to Prevent Fraud" offense, which imposes corporate liability for failure to prevent employee fraud. In essence, this statute couples a form of respondeat superior liability for fraud with a defense for compliance efforts in relation to fraud. Section 199 provides, in relevant part:

(1) A relevant body which is a large organisation (see sections 201 and 202) is guilty of an offence if, in a financial year of the body ("the year of the fraud offence"), a person who is associated with the body ("the associate") commits a fraud offence intending to benefit (whether directly or indirectly)—(a) the relevant body, or (b)

any person to whom, or to whose subsidiary undertaking, the associate provides services on behalf of the relevant body.

(2) A relevant body is also guilty of an offence under subsection (1) if—(a) an employee of the relevant body commits a fraud offence intending to benefit (whether directly or indirectly) the relevant body, (b) the fraud offence is committed in a financial year of a parent undertaking of which the relevant body is a subsidiary undertaking (“the year of the fraud offence”), and (c) the parent undertaking is a relevant body which is a large organisation.

(3) But the relevant body is not guilty of an offence under subsection (1)(b) if the body itself was, or was intended to be, a victim of the fraud offence.

(4) It is a defence for the relevant body to prove that, at the time the fraud offence was committed—(a) the body had in place such prevention procedures as it was reasonable in all the circumstances to expect the body to have in place, or (b) it was not reasonable in all the circumstances to expect the body to have any prevention procedures in place.

(5) In subsection (4) “prevention procedures” means procedures designed to prevent persons associated with the body from committing fraud offences. . . .

(7) For the purposes of this section a person is associated with a relevant body if—
(a) the person is an employee, agent or subsidiary undertaking of the relevant body, or
(b) the person otherwise performs services for or on behalf of the body.

3. The “Intent to Benefit the Firm” Element

On the terms of *respondeat superior* doctrine, not all agent crimes will trigger corporate criminal liability: the agent must have acted not only within the scope of employment but also, at least in part, “with intent to benefit the firm.” How, if at all, does this element of corporate criminal liability limit application of the doctrine? Read the following case and then try to imagine a case of crime by an employee that would *not* satisfy this element of corporate criminal liability. (It should be noted, of course, that the law governing federal campaign contributions was more restrictive at the time of this prosecution than it is at present.)

UNITED STATES v. SUN-DIAMOND GROWERS OF CALIFORNIA, 138 F.3d 961 (D.C. Cir. 1998)

STEPHEN F. WILLIAMS, Circuit Judge:

Sun-Diamond is a large agricultural cooperative owned by individual member cooperatives including Diamond Walnut Growers, Sun-Maid Growers of California, Sunsweet Growers, Valley Fig Growers, and Hazelnut Growers of Oregon. It came within the sights of an independent counsel, Donald C. Smaltz, who was responsible for investigating allegations of unlawful activity by former Secretary of Agriculture Mike

Espy. The independent counsel charged Sun-Diamond with making illegal gifts to Espy, committing wire fraud, and making illegal campaign contributions.

Linking Sun-Diamond and Espy was the figure of Richard Douglas. As Sun-Diamond's vice president for corporate affairs, Douglas was responsible for (among other things) representing the interests of the corporation and its member cooperatives in Washington. Given Sun-Diamond's business, the Department of Agriculture ("USDA") was naturally part of his bailiwick. According to performance evaluations signed by Sun-Diamond's president, Douglas was a diligent and able representative. He once described his approach to lobbying by paraphrasing Lord Palmerston: "We have no permanent friends or permanent enemies, only a permanent interest in Sun-Diamond Growers of California." Permanent friends aside, he had a long-time friend in Mike Espy—the two had gone to college together at Howard University and had stayed close in the years since.

The crimes charged to Sun-Diamond grow out of two largely independent stories. One involves illegal gratuities given to Espy while he was Secretary of Agriculture, the other wire fraud and illegal contributions to the congressional campaign of the Secretary's brother, Henry Espy. We save the recitation of facts for the discussion of the distinct legal issues raised by each story. . . .

Sun-Diamond was found guilty on Counts III and IV of committing wire fraud in violation of 18 U.S.C. §§ 1343 & 1346, and on Counts V through IX of violating the Federal Election Campaign Act, 2 U.S.C. §§ 441b(a) & 441f ("FECA"). Both sets of convictions flow from a scheme of Richard Douglas and James H. Lake to help repay the debts of the failed congressional campaign of Mike Espy's brother Henry. The following facts about the scheme come from the testimony of Lake, who was granted immunity by prosecutors in exchange for his cooperation.

Lake was one of the founding partners of a Washington based firm, Robinson Lake Sawyer & Miller ("RLSM"), which handled communications and public relations matters for Sun-Diamond. Sun-Diamond retained RLSM for a fee of \$20,000 a month; Douglas oversaw Sun-Diamond's dealings with RLSM and maintained his own office there. RLSM was a wholly-owned subsidiary of Bozell Worldwide, Inc. ("Bozell").

After Mike Espy became Secretary of Agriculture, Henry Espy unsuccessfully pursued election to his brother's vacant seat in Congress, building up a sizable campaign debt in the process. In February 1994 Douglas left a telephone message at Lake's office—a crucial act for jurisdiction over one of the wire fraud counts. When Lake contacted Douglas, he learned that Secretary Espy had asked Douglas for help in retiring his brother's campaign debt. Lake immediately offered to donate \$1,000, the maximum permissible individual contribution. Douglas replied that he had to raise at least \$5,000 fast, and that he needed Lake's help. He then proposed a way around the campaign finance restrictions. If Lake would get five RLSM employees (including Lake himself) to write a check for \$1,000 each, Douglas would find a way for Sun-Diamond to reimburse them all. Lake knew the scheme was illegal—corporations are forbidden to

make contributions “in connection with any election” for Congress, 2 U.S.C. § 441b(a), and no one may make a campaign contribution in the name of another person, 2 U.S.C. § 441f—but agreed to participate anyway. Lake testified that no one else at RLSM or Bozell knew about the plan.

Lake wrote a \$1,000 check in his own name and then approached the four RLSM employees identified by Douglas. Three of them agreed to pay up. (A fourth—presumably suspicious about the notion of a reimbursable campaign contribution—declined.) Lake then passed the checks worth \$4,000 to Douglas, who deposited them in a “Henry Espy for Congress” account he had opened.

As the vehicle for reimbursement, Douglas settled on the Joint Center Dinner, an annual benefit for which RLSM and Lake had in the past routinely bought tickets on Sun-Diamond’s behalf. Lake’s staff prepared an internal RLSM document authorizing reimbursement to Lake for his supposed purchase of tickets to the dinner in the amount of \$5,000 (even though he had raised only \$4,000 for Henry Espy). The same document became part of the monthly invoice sent to Sun-Diamond, billing the client \$5,000 for the fictitious dinner attendance on top of its \$20,000 monthly retainer and other expenses. Lake received a \$5,000 reimbursement check from Bozell, which he cashed and used to pay back the three other individual contributors (apparently pocketing the extra \$1,000 for himself). Douglas, as part of his normal duties at Sun-Diamond, approved the payment to RLSM, which eventually went through. The net result: a \$5,000 expenditure by Sun-Diamond, \$4,000 of which went into Henry Espy’s campaign coffers and \$1,000 into James H. Lake’s pocket. The independent counsel charged that the scheme worked a fraud on Bozell and RLSM, depriving the former (albeit temporarily) of \$5,000, and depriving the latter of the “honest services” of its agent Lake under 18 U.S.C. § 1346. The jury convicted, evidently convinced that at least one such deprivation occurred. The jury also found Sun-Diamond guilty of making illegal campaign contributions in violation of FECA, 2 U.S.C. §§ 441b(a) & 441f.

As a threshold matter, Sun-Diamond raises a challenge which it says goes equally to the wire fraud and FECA counts. Richard Douglas’s campaign contribution scheme cannot be attributed to it, Sun-Diamond argues, because Douglas was not acting with an intent to benefit the corporation. It is true, as the district court instructed the jury in this case, that an agent’s acts will not be imputed to the principal in a criminal case unless the agent acts with the intent to benefit the principal. Here, Sun-Diamond says, Douglas’s scheme was designed to—and did in fact—*defraud* his employer, not benefit it. In this circumstance, it strenuously argues, there can be no imputation: “[T]o establish precedent holding a principal *criminally* liable for the acts of an agent who defrauds and deceives the principal while pursuing matters within his self-interest merely because the agent’s conduct *may* provide some incidental benefit to the principal serves to punish innocent principals with no countervailing policy justifications.”

This argument has considerable intuitive appeal—Sun-Diamond does look more like a victim than a perpetrator, at least on the fraud charges. The facts in the record,

however—that Douglas hid the illegal contribution scheme from others at the company and used company funds to accomplish it—do not preclude a valid finding that he undertook the scheme to benefit Sun-Diamond. Part of Douglas’s job was to cultivate his, and Sun-Diamond’s, relationship with Secretary Espy. By responding to the Secretary’s request to help his brother, Douglas may have been acting out of pure friendship, but the jury was entitled to conclude that he was acting instead, or also, with an intent (however befuddled) to further the interests of his employer. The scheme came at some cost to Sun-Diamond but it also promised some benefit. *See, e.g., United States v. Automated Medical Laboratories, Inc.*, (agent’s conduct which is actually or potentially detrimental to corporation may nonetheless be imputed to corporation in criminal case if motivated at least in part by intent to benefit it); *cf. Local 1814, International Longshoremen’s Association*, (“[T]he acts of an agent motivated partly by self-interest—even where self-interest is the predominant motive—lie within the scope of employment so long as the agent is actuated by the principal’s business purposes ‘to any appreciable extent.’”) (quoting *Restatement (Second) of Agency* § 236 & comment b (1957)). Where there is adequate evidence for imputation (as here), the only thing that keeps deceived corporations from being indicted for the acts of their employee-deceivers is not some fixed rule of law or logic but simply the sound exercise of prosecutorial discretion.

And the answer to Sun-Diamond’s claim of the absence of any “countervailing policy justification” is simply the justification usually offered in support of holding corporate principals liable for the illegal acts of their agents: to increase incentives for corporations to monitor and prevent illegal employee conduct. One might well question this justification—and scholars have. Moreover, the justification may be at its weakest in cases like this one, where the offending employee breaches a duty of honesty to the very corporation whose goals he aims to advance. In any event, Sun-Diamond’s argument here, whatever its merit as an issue of policy, has no real grounding in the relevant statutes. And Sun-Diamond does not invoke the Constitution, which in any event would require either an overruling of the Supreme Court’s rejection of a due process attack on corporate liability, *New York Cent. & Hudson River R.R. Co. v. United States*, or the development of some new theory.

Sun-Diamond also raises a narrower objection concerning imputation, one which goes only to the fraud counts. To the extent Douglas’s conduct is to be imputed to his employer, argues Sun-Diamond, then so must Lake’s be imputed to his employers (RLSM and Bozell). Both men occupied high-level management positions in their respective firms, and both men’s firms sought to establish and maintain good relations with Secretary Espy. If Douglas’s knowledge can be imputed to Sun-Diamond to hold it responsible for Douglas’s acts, then Lake’s must be imputed to his employers, RLSM and Bozell, and they cannot be victims.

Even assuming the evidence showed the balance of private and corporate purpose in Douglas’s and Lake’s motivation to be identical, Sun-Diamond’s argument rests on a faulty assumption—that the imputation rules must be the same on both the perpetrator

and victim sides. They need not be, and indeed are not. Imputation is a legal fiction designed to assist in the allocation of liability, not a literal description of the state of a principal's knowledge. The law imputes the wrongdoer's conduct to the corporation in order to encourage monitoring, but it is not at all clear that imputation on the other side of the equation would be useful in eliciting additional caution on the part of would-be fraud victims. A rule that makes victim wariness a condition of criminally punishing the perpetrator—unlike, say, a rule of contributory negligence in tort—might not inspire much extra precaution in potential victims. However much they may benefit from the criminalization of fraud generally, potential victims (who have many incentives to avoid being gulled, independent of the criminal law) seem unlikely to step up their precautions just to increase the *ex ante* chances that their deceivers will face criminal sanctions—or so Congress could reasonably conclude. Thus, when an individual is swindled, the offender does not escape mail or wire fraud liability just because the victim was unwary, or even “gullible.” Indeed, Congress's adoption of 18 U.S.C. § 1346, specifying that the term “scheme or artifice to defraud,” as used in various federal criminal fraud statutes, should include schemes to deprive a principal “of the intangible right of honest services,” is hard to square with an imputation rule on the victim side as broad as the one governing corporate criminal responsibility. . . .

4. Corporate Compliance Policies

Under federal law, it is no defense to corporate criminal liability that the corporation had a policy against criminal conduct by its employees, or even that it had a particularly good or effective such policy. The following case illustrates the rule. Is this well-considered law? *Should* something like this be a defense? (Notice that this case, like *New York Central*, involves anti-competitive behavior, and that this court also takes up the question of whether the statute defining the crime includes corporate liability.)

UNITED STATES v. HILTON HOTELS CORP., 467 F.2d 1000 (9th Cir. 1972)

BROWNING, Circuit Judge:

This is an appeal from a conviction under an indictment charging a violation of section 1 of the Sherman Act, 15 U.S.C. § 1.

Operators of hotels, restaurants, hotel and restaurant supply companies, and other businesses in Portland, Oregon, organized an association to attract conventions to their city. To finance the association, members were asked to make contributions in predetermined amounts. Companies selling supplies to hotels were asked to contribute an amount equal to one per cent of their sales to hotel members. To aid collections, hotel members, including appellant, agreed to give preferential treatment to suppliers who paid their assessments, and to curtail purchases from those who did not.

The jury was instructed that such an agreement by the hotel members, if proven, would be a *per se* violation of the Sherman Act. Appellant argues that this was error.

We need not explore the outer limits of the doctrine that joint refusals to deal constitute per se violations of the Act, for the conduct involved here was of the kind long held to be forbidden without more. “Throughout the history of the Sherman Act, the courts have had little difficulty in finding unreasonable restraints of trade in agreements among competitors, at any level of distribution, designed to coerce those subject to a boycott to accede to the action or inaction desired by the group or to exclude them from competition.” Barber, *Refusals to Deal under the Federal Anti-trust Laws*, 103 U. Pa. L. Rev. (1955).

Appellant argues that in cases in which the per se rule has been applied to refusals to deal, the defendants intended “to destroy a competitor or a line of competition,” while the purpose of the defendants in the present case “was solely to bring convention dollars into Portland.” But the necessary and direct consequence of defendants’ scheme was to deprive uncooperative suppliers of the opportunity to sell to defendant hotels in free and open competition with other suppliers, and to deprive defendant hotels of the opportunity to buy supplies from such suppliers in accordance with the individual judgment of each hotel, at prices and on terms and conditions of sale determined by free competition. Defendants therefore “intended” to impose these restraints upon competition in the only sense relevant here. The ultimate objective defendants sought to achieve is immaterial. . . .

This is not a case in which joint activity having a primary purpose and direct effect of accomplishing a legitimate business objective is also alleged to have had an incidental and indirect adverse effect upon the business of some competitors. The primary purpose and direct effect of defendants’ agreement was to bring the combined economic power of the hotels to bear upon those suppliers who failed to pay. The exclusion of uncooperative suppliers from the portion of the market represented by the supply requirements of the defendant hotels was the object of the agreement, not merely its incidental consequence. . . .

Appellant’s president testified that it would be contrary to the policy of the corporation for the manager of one of its hotels to condition purchases upon payment of a contribution to a local association by the supplier. The manager of appellant’s Portland hotel and his assistant testified that it was the hotel’s policy to purchase supplies solely on the basis of price, quality, and service. They also testified that on two occasions they told the hotel’s purchasing agent that he was to take no part in the boycott. The purchasing agent confirmed the receipt of these instructions, but admitted that, despite them, he had threatened a supplier with loss of the hotel’s business unless the supplier paid the association assessment. He testified that he violated his instructions because of anger and personal pique toward the individual representing the supplier.

Based upon this testimony, appellant requested certain instructions bearing upon the criminal liability of a corporation for the unauthorized acts of its agents. These requests were rejected by the trial court. The court instructed the jury that a corporation is liable for the acts and statements of its agents “within the scope of their employment,” defined

to mean “in the corporation’s behalf in performance of the agent’s general line of work,” including “not only that which has been authorized by the corporation, but also that which outsiders could reasonably assume the agent would have authority to do.” The court added:

“A corporation is responsible for acts and statements of its agents, done or made within the scope of their employment, even though their conduct may be contrary to their actual instructions or contrary to the corporation’s stated policies.”

Appellant objects only to the court’s concluding statement.

Congress may constitutionally impose criminal liability upon a business entity for acts or omissions of its agents within the scope of their employment. Such liability may attach without proof that the conduct was within the agent’s actual authority, and even though it may have been contrary to express instructions.

The intention to impose such liability is sometimes express, *New York Central & Hudson R. R. Co. v. United States*, but it may also be implied. The text of the Sherman Act does not expressly resolve the issue. For the reasons that follow, however, we think the construction of the Act that best achieves its purpose is that a corporation is liable for acts of its agents within the scope of their authority even when done against company orders.

It is obvious from the Sherman Act’s language and subject matter that the Act is primarily concerned with the activities of business entities. The statute is directed against “restraint upon commercial competition in the marketing of goods or services.” *Apex Hosiery Co. v. Leader*. In 1890, as now, the most significant commercial activity was conducted by corporate enterprises. See *New York Central & Hudson R. R. Co. v. United States*; *Regan v. Kroger Grocery & Baking Co.*

Despite the fact that “the doctrine of corporate criminal responsibility for the acts of the officers was not well established in 1890”, *United States v. Wise*, the Act expressly applies to corporate entities. 15 U.S.C. § 7. The preoccupation of Congress with corporate liability was only emphasized by the adoption in 1914 of section 14 of the Clayton Act to reaffirm and emphasize that such liability was not exclusive, and that corporate agents also were subject to punishment if they authorized, ordered, or participated in the acts constituting the violation.

Criminal liability for the acts of agents is more readily imposed under a statute directed at the prohibited act itself, one that does not make specific intent an element of the offense. The Sherman Act is aimed at consequences. Specific intent is not an element of any offense under the Act except attempt to monopolize under section 2, and conscious wrongdoing is not an element of that offense. The Sherman Act is violated if “a restraint of trade or monopoly results as the consequence of a defendant’s conduct or business arrangements.” *United States v. Griffith*.

The breadth and critical character of the public interests protected by the Sherman Act, and the gravity of the threat to those interests that led to the enactment of the statute, support a construction holding business organizations accountable, as a general rule, for violations of the Act by their employees in the course of their businesses. In enacting the Sherman Act, “Congress was passing drastic legislation to remedy a threatening danger to the public welfare. . . .” *United Mine Workers v. Coronado Coal Co.* The statute “was designed to be a comprehensive charter of economic liberty aimed at preserving free and unfettered competition as the rule of trade. It rests on the premise that the unrestrained interaction of competitive forces will yield the best allocation of our economic resources, the lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic political and social institutions.” *Northern Pacific Ry. v. United States.*

With such important public interests at stake, it is reasonable to assume that Congress intended to impose liability upon business entities for the acts of those to whom they choose to delegate the conduct of their affairs, thus stimulating a maximum effort by owners and managers to assure adherence by such agents to the requirements of the Act.

Legal commentators have argued forcefully that it is inappropriate and ineffective to impose criminal liability upon a corporation, as distinguished from the human agents who actually perform the unlawful acts (*see* Francis, *Criminal Responsibility of the Corporation*; Canfield, *Corporate Responsibility for Crime*), particularly if the acts of the agents are unauthorized. *See* Mueller, *Mens Rea and the Corporation*. But it is the legislative judgment that controls, and “the great mass of legislation calling for corporate criminal liability suggests a widespread belief on the part of legislators that such liability is necessary to effectuate regulatory policy.” ALI Model Penal Code, Comment on § 2.07, Tentative Draft No. 4, (1956). Moreover, the strenuous efforts of corporate defendants to avoid conviction, particularly under the Sherman Act, strongly suggests that Congress is justified in its judgment that exposure of the corporate entity to potential conviction may provide a substantial spur to corporate action to prevent violations by employees.

Because of the nature of Sherman Act offenses and the context in which they normally occur, the factors that militate against allowing a corporation to disown the criminal acts of its agents apply with special force to Sherman Act violations. . . .

Thus the general policy statements of appellant’s president were no defense. Nor was it enough that appellant’s manager told the purchasing agent that he was not to participate in the boycott. The purchasing agent was authorized to buy all of appellant’s supplies. Purchases were made on the basis of specifications, but the purchasing agent exercised complete authority as to source. He was in a unique position to add the corporation’s buying power to the force of the boycott. Appellant could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks. . . .

Problem 1-2

Should the law of corporate criminal liability incorporate an affirmative defense that would bar liability if the defendant firm had an effective legal compliance program? If so, what should be the specific scope and contours of that affirmative defense? In other words, how would you draft the jury instructions for such a defense? Should the law go farther by requiring the prosecutor to prove the absence of such an effective program as an element of corporate criminal liability?

5. Corporate Mens Rea

Mental state is the keystone in most forms of criminal liability. So how should mens rea analysis work when the defendant is a firm and therefore has no brain? The general answer under current law is that respondeat superior liability means there is no need to inquire into “corporate mens rea.” Provided other requirements are satisfied, if the firm is liable so long as an employee is liable, then the only question about mental state is whether the employee had whatever mens rea, if any, is required for the applicable offense.

But notice how the court in the following case deals with the issue of corporate mens rea. Does the court’s analysis make sense? This case is much discussed but also controversial. There is debate about how far this concept of “collective mens rea” goes, or even whether other courts could be expected to follow the concept, which has not been sufficiently tested in the federal courts. Think about how the court’s analysis might work, or not, with other kinds of criminal statutes.

The legal framework applicable in this case is federal money laundering laws. Part of that regime requires individuals and banks to file a form with the IRS for any cash transaction of \$10,000 or more—the purpose being to make it easier for the government to identify and further investigate potentially suspicious transactions that might involve criminal proceeds. To make this rule more effective, federal law also prohibits “structuring” of cash transactions, that is, converting one large transaction into a series of smaller ones to avoid filing of the required report.

UNITED STATES v. BANK OF NEW ENGLAND, NA, 821 F.2d 844 (1st Cir. 1987)

BOWNES, Circuit Judge:

The Bank of New England appeals a jury verdict convicting it of thirty-one violations of the Currency Transaction Reporting Act (the Act). 31 U.S.C. §§ 5311-22 (1982). Department of Treasury regulations promulgated under the Act require banks to file Currency Transaction Reports (CTRs) within fifteen days of customer currency transactions exceeding \$10,000. 31 C.F.R. § 103.22 (1986). The Act imposes felony liability when a bank willfully fails to file such reports “as part of a pattern of illegal activity involving transactions of more than \$100,000 in a twelve-month period. . . .” 31 U.S.C. § 5322(b). . . .

The Bank was found guilty of having failed to file CTRs on cash withdrawals made by James McDonough. It is undisputed that on thirty-one separate occasions between May 1983 and July 1984, McDonough withdrew from the Prudential Branch of the Bank more than \$10,000 in cash by using multiple checks—each one individually under \$10,000—presented simultaneously to a single bank teller. . . .

Criminal liability under 31 U.S.C. § 5322 only attaches when a financial institution “willfully” violates the CTR filing requirement. A finding of willfulness under the Reporting Act must be supported by “proof of the defendant’s knowledge of the reporting requirements and his specific intent to commit the crime.” Willfulness can rarely be proven by direct evidence, since it is a state of mind; it is usually established by drawing reasonable inferences from the available facts.

The Bank contends that the trial court’s instructions on knowledge and specific intent effectively relieved the government of its responsibility to prove that the Bank acted willfully. The trial judge began her instructions on this element by outlining generally the concepts of knowledge and willfulness:

Knowingly simply means voluntarily and intentionally. It’s designed to exclude a failure that is done by mistake or accident, or for some other innocent reason. Willfully means voluntarily, intentionally, and with a specific intent to disregard, to disobey the law, with a bad purpose to violate the law.

The trial judge properly instructed the jury that it could infer knowledge if a defendant consciously avoided learning about the reporting requirements. The court then focused on the kind of proof that would establish the Bank’s knowledge of its filing obligations. The judge instructed that the knowledge of individual employees acting within the scope of their employment is imputed to the Bank. She told the jury that “if any employee knew that multiple checks would require the filing of reports, the bank knew it, provided the employee knew it within the scope of his employment, . . .”

The trial judge then focused on the issue of “collective knowledge”:

In addition, however, you have to look at the bank as an institution. As such, its knowledge is the sum of the knowledge of all of the employees. That is, the bank’s knowledge is the totality of what all of the employees know within the scope of their employment. So, if Employee A knows one facet of the currency reporting requirement, B knows another facet of it, and C a third facet of it, the bank knows them all. So if you find that an employee within the scope of his employment knew that CTRs had to be filed, even if multiple checks are used, the bank is deemed to know it. The bank is also deemed to know it if each of several employees knew a part of that requirement and the sum of what the separate employees knew amounted to knowledge that such a requirement existed.

After discussing the two modes of establishing knowledge—via either knowledge of one of its individual employees or the aggregate knowledge of all its employees—he trial judge turned to the issue of specific intent:

There is a similar double business with respect to the concept of willfulness with respect to the bank. In deciding whether the bank acted willfully, again you have to look first at the conduct of all employees and officers, and, second, at what the bank did or did not do as an institution. The bank is deemed to have acted willfully if one of its employees in the scope of his employment acted willfully. So, if you find that an employee willfully failed to do what was necessary to file these reports, then that is deemed to be the act of the bank, and the bank is deemed to have willfully failed to file. . . .

Alternatively, the bank as an institution has certain responsibilities; as an organization, it has certain responsibilities. And you will have to determine whether the bank as an organization consciously avoided learning about and observing CTR requirements. The Government to prove the bank guilty on this theory, has to show that its failure to file was the result of some flagrant organizational indifference. In this connection, you should look at the evidence as to the bank's effort, if any, to inform its employees of the law; its effort to check on their compliance; its response to various bits of information that it got in August and September of '84 and February of '85; its policies, and how it carried out its stated policies. . . .

If you find that the Government has proven with respect to any transaction either that an employee within the scope of his employment willfully failed to file a required report or that the bank was flagrantly indifferent to its obligations, then you may find that the bank has willfully failed to file the required reports.

The Bank contends that the trial court's instructions regarding knowledge were defective because they eliminated the requirement that it be proven that the Bank violated a known legal duty. It avers that the knowledge instruction invited the jury to convict the Bank for negligently maintaining a poor communications network that prevented the consolidation of the information held by its various employees. The Bank argues that it is error to find that a corporation possesses a particular item of knowledge if one part of the corporation has half the information making up the item, and another part of the entity has the other half.

A collective knowledge instruction is entirely appropriate in the context of corporate criminal liability. *Riss & Company v. United States*; *Inland Freight Lines v. United States*; *Camacho v. Bowling*; *United States v. T.I.M.E.-D.C., Inc.*; *United States v. Sawyer Transport, Inc.* The acts of a corporation are, after all, simply the acts of all of its employees operating within the scope of their employment. The law on corporate

criminal liability reflects this. *See, e.g., United States v. Cincotta; United States v. Richmond.* Similarly, the knowledge obtained by corporate employees acting within the scope of their employment is imputed to the corporation. *Steere Tank Lines, Inc. v. United States.* Corporations compartmentalize knowledge, subdividing the elements of specific duties and operations into smaller components. The aggregate of those components constitutes the corporation's knowledge of a particular operation. It is irrelevant whether employees administering one component of an operation know the specific activities of employees administering another aspect of the operation:

[A] corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual who then would have comprehended its full import. Rather the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for their failure to act accordingly.

United States v. T.I.M.E.-D.C., Inc. Since the Bank had the compartmentalized structure common to all large corporations, the court's collective knowledge instruction was not only proper but necessary.

Nor do we find any defects in the trial court's instructions on specific intent. The court told the jury that the concept of willfulness entails a voluntary, intentional, and bad purpose to disobey the law. Her instructions on this element, when viewed as a whole, directed the jury not to convict for accidental, mistaken or inadvertent acts or omissions. It is urged that the court erroneously charged that willfulness could be found via flagrant indifference by the Bank toward its reporting obligations. With respect to federal regulatory statutes, the Supreme Court has endorsed defining willfulness, in both civil and criminal contexts, as "a disregard for the governing statute and an indifference to its requirements." *Trans World Airlines, Inc. v. Thurston.* Accordingly, we find no error in the court's instruction on willfulness.

The Bank asserts that the evidence did not suffice to show that it had willfully failed to comply with the Act's reporting requirements. We review the evidence in the light most favorable to the government. *United States v. Medina.*

As already discussed, the language of the Treasury regulations itself gave notice that cash withdrawals over \$10,000 were reportable, regardless of the number of checks used. Primary responsibility for CTR compliance in the Bank's branch offices was assigned to head tellers and branch managers. Head tellers Orlandella and Murphy, who knew of the nature of McDonough's transactions, also knew of the CTR filing obligations imposed by the Bank. The jury heard testimony from former bank teller Simona Wong, who stated that she knew McDonough's transactions were reportable, and that the source of her knowledge was head teller Murphy.

Even if some Bank personnel mistakenly regarded McDonough as engaging in multiple transactions, there was convincing evidence that the Bank knew that his withdrawals

were reportable. An internal memo sent in May 1983 by project coordinator Jayne Brady to all branch managers and head tellers stated that “[r]eportable transactions are expanded to include multiple transactions which aggregate more than \$10,000 in any *one day*.’ This includes deposits or withdrawals by a customer to or from more than one account.” The Prudential Branch Manual instructed that if Bank personnel know that a customer has engaged in multiple transactions totalling \$10,000 or more, then such transactions should be regarded as a single transaction. In addition, since 1980, the instructions on the back of CTR forms have directed that reports be filed on multiple transactions which aggregate to over \$10,000. Finally, a Bank auditor discussed with Orlandella and Murphy, the Bank’s obligation to report a customer’s multiple transactions in a single day which amount to more than \$10,000. We do not suggest that these evidentiary items in themselves legally bound the Bank to report McDonough’s transactions; it is the language of the regulations that impose such a duty. This evidence, however, proved that the Bank had ample knowledge that transactions like McDonough’s came within the purview of the Act.

Regarding the Bank’s specific intent to violate the reporting obligation, Simona Wong testified that head teller Patricia Murphy knew that McDonough’s transactions were reportable, but, on one occasion, deliberately chose not to file a CTR on him because he was “a good customer.” In addition, the jury heard testimony that bank employees regarded McDonough’s transactions as unusual, speculated that he was a bookie, and suspected that he was structuring his transactions to avoid the Act’s reporting requirements. An internal Bank memo, written after an investigation of the McDonough transactions, concluded that a “person managing the branch would have to have known that something strange was going on.” Given the suspicions aroused by McDonough’s banking practices and the abundance of information indicating that his transactions were reportable, the jury could have concluded that the failure by Bank personnel to, at least, inquire about the reportability of McDonough’s transactions constituted flagrant indifference to the obligations imposed by the Act.

We hold that the evidence was sufficient for a finding of willfulness. . . .

A More Recent Example

On September 9, 2010, a natural gas line in San Bruno, California owned by the PG&E corporation exploded, causing a fire in which eight people died and fifty-eight were injured. Federal prosecutors charged the corporation with violations of the federal Pipeline Safety Act (PSA). PG&E chose to contest the case at trial and a jury convicted the company on numerous counts.

In explaining corporate criminal liability in the case, the judge told the jurors that to convict on the PSA charges they needed to find, beyond a reasonable doubt, that a PG&E employee acting within the scope of employment and in part to benefit the company violated the PSA. When explaining the PSA to the jury, the judge said that a criminal

violation of the statute occurs only when a defendant acts “willfully.” The judge then stated to the jury that corporate “willfulness” exists when an employee acts willfully on behalf of the corporation and that “a corporation is considered . . . to have acquired the collective knowledge of its employees. The corporation’s ‘knowledge’ is therefore the totality of what the employees know within the scope of their employment.”

Was there any problem in the trial court’s instruction? (Unfortunately for interested observers, PG&E and the government settled the matter after trial and no appellate decision resulted from the prosecution.)

C. *De Facto* Corporate Criminal Liability

Now we shift to examining *de facto* corporate criminal liability. All lawyers practicing in this field know that the imposition, and degree, of any criminal sanctions imposed on a business firm in a case of employee crime—should the case, as is common, result in settlement—will depend heavily on a number of factors that prosecutors will weigh. These factors thus guide negotiation between defense lawyers and the government over corporate criminal liability and, well before that stage, the advising of corporations on how to best position themselves to obtain leniency should they face an enforcement problem.

To introduce these discretionary factors, three items follow: (1) excerpts from the longstanding provisions of the Justice Manual, setting out DOJ policy on prosecution of corporations, together with recent policy updates issued by the Biden Administration DOJ; (2) the SEC’s “Seaboard Report,” which is the most explicit statement from the SEC on its policy regarding enforcement against firms; and (3) two recent judicial decisions on the question of whether courts have any role in the current *de facto* enforcement process.

Notice the things the DOJ and SEC consider relevant to firm liability that are not found anywhere in American *de jure* doctrine. What is the policy motivation behind each of these factors? These documents are not law or otherwise enforceable in court. So why do the DOJ and SEC have them?

U.S. DEPARTMENT OF JUSTICE, JUSTICE MANUAL (Excerpts)

9-28.010. Foundational Principles of Corporate Prosecution

The prosecution of corporate crime is a high priority for the Department of Justice. By investigating allegations of wrongdoing and bringing charges where appropriate for criminal misconduct, the Department promotes critical public interests. These interests include, among other things: (1) protecting the integrity of our economic and capital markets by enforcing the rule of law; (2) protecting consumers, investors, and business entities against competitors who gain unfair advantage by violating the law; (3) preventing violations of environmental laws; and (4) discouraging business practices that would permit or promote unlawful conduct at the expense of the public interest.

One of the most effective ways to combat corporate misconduct is by holding accountable all individuals who engage in wrongdoing. Such accountability deters future illegal activity, incentivizes changes in corporate behavior, ensures that the proper parties are held responsible for their actions, and promotes the public's confidence in our justice system.

Prosecutors should focus on wrongdoing by individuals from the very beginning of any investigation of corporate misconduct. By focusing on building cases against individual wrongdoers, we accomplish multiple goals. First, we increase our ability to identify the full extent of corporate misconduct. Because a corporation only acts through individuals, investigating the conduct of individuals is the most efficient and effective way to determine the facts and the extent of any corporate misconduct. Second, a focus on individuals increases the likelihood that those with knowledge of the corporate misconduct will be identified and provide information about the individuals involved, at any level of an organization. Third, we maximize the likelihood that the final resolution will include charges against culpable individuals and not just the corporation.

9-28.100. Duties of Federal Prosecutors and Duties of Corporate Leaders

Corporate directors and officers owe a fiduciary duty to a corporation's shareholders (the corporation's true owners) and they owe duties of honest dealing to the investing public and consumers in connection with the corporation's regulatory filings and public statements. A prosecutor's duty to enforce the law requires the investigation and prosecution of criminal wrongdoing if it is discovered. In carrying out this mission with the diligence and resolve necessary to vindicate the important public interests discussed above, prosecutors should be mindful of the common cause we share with responsible corporate leaders who seek to promote trust and confidence. Prosecutors should also be mindful that confidence in the Department is affected both by the results we achieve and by the real and perceived ways in which we achieve them. Thus, the manner in which we do our job as prosecutors—including the professionalism and civility we demonstrate, our willingness to secure the facts in a manner that encourages corporate compliance and self-regulation, and also our appreciation that corporate prosecutions can harm blameless investors, employees, and others—affects public perception of our mission. Federal prosecutors must maintain public confidence in the way in which we exercise our charging discretion. This endeavor requires the thoughtful analysis of all facts and circumstances presented in a given case.

9-28.200. General Considerations of Corporate Liability

A. General Principle: Corporations should not be treated leniently because of their artificial nature nor should they be subject to harsher treatment. Vigorous enforcement of the criminal laws against corporate wrongdoers, where appropriate, results in great benefits for law enforcement and the public, particularly in the area of white collar crime. Indicting corporations for wrongdoing enables the government to be a force for positive change of corporate culture, and a force to prevent, discover, and punish serious crimes.

B. Comment: In all cases involving corporate wrongdoing, prosecutors should consider the factors discussed in these guidelines. In doing so, prosecutors should be aware of the public benefits that can flow from indicting a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when one is indicted for criminal misconduct that is pervasive throughout a particular industry, and thus an indictment can provide a unique opportunity for deterrence on a broad scale. In addition, a corporate indictment may result in specific deterrence by changing the culture of the indicted corporation and the behavior of its employees. Finally, certain crimes that carry with them a substantial risk of great public harm—*e.g.*, environmental crimes or sweeping financial frauds—may be committed by a business entity, and there may therefore be a substantial federal interest in indicting a corporation under such circumstances.

In certain instances, it may be appropriate to resolve a corporate criminal case by means other than indictment. Non-prosecution and deferred prosecution agreements, for example, occupy an important middle ground between declining prosecution and obtaining the conviction of a corporation. These agreements are discussed further in JM 9-28.1100 (Collateral Consequences). Likewise, civil and regulatory alternatives may be appropriate in certain cases, as discussed in JM 9-28.1200 (Civil or Regulatory Alternatives). When considering whether to enter into a non-prosecution or deferred prosecution agreement with the defendant, prosecutors should consider the interests of any victims and be aware that any fines collected under such agreements will *not* be deposited into the Crime Victims Fund, but will rather go to the General Fund of the Treasury. *See* JM 9-28.1400.

Prosecutors have substantial latitude in determining when, whom, how, and even whether to prosecute for violations of federal criminal law. In exercising that discretion, prosecutors should consider the following statements of principles that summarize the considerations they should weigh and the practices they should follow in discharging their prosecutorial responsibilities. Prosecutors should ensure that the general purposes of the criminal law—appropriate punishment for the defendant, deterrence of further criminal conduct by the defendant, deterrence of criminal conduct by others, protection of the public from dangerous and fraudulent conduct, rehabilitation, and restitution for victims—are adequately met, taking into account the special nature of the corporate “person.”

9-28.210. Focus on Individual Wrongdoers

A. General Principle: Prosecution of a corporation is not a substitute for the prosecution of criminally culpable individuals within or without the corporation. Because a corporation can act only through individuals, imposition of individual criminal liability may provide the strongest deterrent against future corporate wrongdoing. Provable individual criminal culpability should be pursued, particularly if it relates to high-level corporate officers, even in the face of an offer of a corporate guilty plea or some other disposition of the charges against the corporation, including a deferred prosecution or non-

prosecution agreement, or a civil resolution. In other words, regardless of the ultimate corporate disposition, a separate evaluation must be made with respect to potentially liable individuals.

Absent extraordinary circumstances or approved departmental policy such as the Antitrust Division's Corporate Leniency Policy, no corporate resolution should provide protection from criminal liability for any individuals. The United States generally should not release individuals from criminal liability based on corporate settlement releases. Any such release of individuals from criminal liability due to extraordinary circumstances must be personally approved in writing by the relevant Assistant Attorney General or United States Attorney.

B. Comment: It is important early in the corporate investigation to identify the responsible individuals and determine the nature and extent of their misconduct. Prosecutors should not allow delays in the corporate investigation to undermine the Department's ability to pursue potentially culpable individuals. Every effort should be made to resolve a corporate matter within the statutorily allotted time, and tolling agreements should be the rare exception. In situations where it is anticipated that a tolling agreement is unavoidable, all efforts should be made either to prosecute culpable individuals before the limitations period expires or to preserve the ability to charge individuals by tolling the limitations period by agreement or court order.

If an investigation of individual misconduct has not concluded by the time authorization is sought to resolve the case against the corporation, the prosecution authorization memorandum should include a discussion of the potentially liable individuals, a description of the current status of the investigation regarding their conduct and the investigative work that remains to be done, and, when warranted, an investigative plan to bring the matter to resolution prior to the end of any statute of limitations period. If a decision is made at the conclusion of the investigation to pursue charges or some other resolution with the corporation but not to bring criminal charges or civil claims against culpable individuals, the reasons for that determination must be memorialized and approved by the United States Attorney or Assistant Attorney General whose office handled the investigation, or their designees.

Under the doctrine of *respondeat superior*, a corporation may be held criminally liable for the illegal acts of its directors, officers, employees, and agents. To hold a corporation liable for these actions, the government must establish that the corporate agent's actions (i) were within the scope of his duties and (ii) were intended, at least in part, to benefit the corporation. In all cases involving wrongdoing by corporate agents, prosecutors should not limit their focus solely to individuals or the corporation, but should consider both as potential targets.

Agents may act for mixed reasons—both for self-aggrandizement (direct and indirect) and for the benefit of the corporation, and a corporation may be held liable as long as one motivation of its agent is to benefit the corporation. *See United States v. Potter*

(stating that the test to determine whether an agent is acting within the scope of employment is “whether the agent is performing acts of the kind which he is authorized to perform, and those acts are motivated, at least in part, by an intent to benefit the corporation.”). In *United States v. Automated Medical Laboratories, Inc.*, for example, the Fourth Circuit affirmed a corporation’s conviction for the actions of a subsidiary’s employee despite the corporation’s claim that the employee was acting for his own benefit, namely his “ambitious nature and his desire to ascend the corporate ladder.” The court stated, “Partucci was clearly acting in part to benefit AML since his advancement within the corporation depended on AML’s well-being and its lack of difficulties with the FDA.” . . .

Moreover, the corporation need not even necessarily profit from its agent’s actions for it to be held liable. In *Automated Medical Laboratories*, the Fourth Circuit stated:

[B]enefit is not a “touchstone of criminal corporate liability; benefit at best is an evidential, not an operative, fact.” Thus, whether the agent’s actions ultimately redounded to the benefit of the corporation is less significant than whether the agent acted with the intent to benefit the corporation. The basic purpose of requiring that an agent have acted with the intent to benefit the corporation, however, is to insulate the corporation from criminal liability for actions of its agents which may be *inimical* to the interests of the corporation or which may have been undertaken solely to advance the interests of that agent or of a party other than the corporation.

(quoting *Old Monastery Co. v. United States*).

9-28.300. Factors to be Considered

A. General Principle: Generally, prosecutors apply the same factors in determining whether to charge a corporation as they do with respect to individuals. See JM 9-27.220 et seq. Thus, the prosecutor must weigh all of the factors normally considered in the sound exercise of prosecutorial judgment: the sufficiency of the evidence; the likelihood of success at trial; the probable deterrent, rehabilitative, and other consequences of conviction; and the adequacy of noncriminal approaches. However, due to the nature of the corporate “person,” some additional factors are present. In conducting an investigation, determining whether to bring charges, and negotiating plea or other agreements, prosecutors should consider the following factors in reaching a decision as to the proper treatment of a corporate target:

1. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime (see JM 9-28.400);

2. the pervasiveness of wrongdoing within the corporation, including the complicity in, or the condoning of, the wrongdoing by corporate management (*see* JM 9-28.500);
3. the corporation's history of similar misconduct, including prior criminal, civil, and regulatory enforcement actions against it (*see* JM 9-28.600);
4. the corporation's willingness to cooperate, including as to potential wrongdoing by its agents (*see* JM 9-28.700);
5. the adequacy and effectiveness of the corporation's compliance program at the time of the offense, as well as at the time of a charging decision (*see* JM 9-28.800);
6. the corporation's timely and voluntary disclosure of wrongdoing (*see* JM 9-28.900);
7. the corporation's remedial actions, including, but not limited to, any efforts to implement an adequate and effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, or to pay restitution (*see* JM 9-28.1000);
8. collateral consequences, including whether there is disproportionate harm to shareholders, pension holders, employees, and others not proven personally culpable, as well as impact on the public arising from the prosecution (*see* JM 9-28.1100);
9. the adequacy of remedies such as civil or regulatory enforcement actions, including remedies resulting from the corporation's cooperation with relevant government agencies (*see* JM 9-28.1200);
10. the adequacy of the prosecution of individuals responsible for the corporation's malfeasance (*see* JM 9-28.1300); and
11. the interests of any victims (*see* JM 9-28.1400).

B. Comment: The factors listed in this section are intended to be illustrative of those that should be evaluated and are not an exhaustive list of potentially relevant considerations. Some of these factors may not apply to specific cases, and in some cases one factor may override all others. For example, the nature and seriousness of the offense may be such as to warrant prosecution regardless of the other factors. In most cases, however, no single factor will be dispositive. In addition, national law enforcement policies in various enforcement areas may require that more or less weight be given to certain of these factors than to others. Of course, prosecutors must exercise their thoughtful and pragmatic judgment in applying and balancing these factors, so as to achieve a fair and just outcome and promote respect for the law.

9-28.700. The Value of Cooperation

Cooperation is a mitigating factor, by which a corporation—just like any other subject of a criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution. Of course, the decision not to cooperate by a corporation (or individual) is not itself evidence of misconduct, at least where the lack of cooperation does not involve criminal misconduct or demonstrate consciousness of guilt (*e.g.*,

suborning perjury or false statements, or refusing to comply with lawful discovery requests). Thus, failure to cooperate, in and of itself, does not support or require the filing of charges with respect to a corporation any more than with respect to an individual.

A. General Principle: In order for a company to receive any consideration for cooperation under this section, the company must identify all individuals substantially involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all relevant facts relating to that misconduct. If a company seeking cooperation credit declines to learn of such facts or to provide the Department with complete factual information about the individuals substantially involved in or responsible for the misconduct, its cooperation will not be considered a mitigating factor under this section. Nor, if a company is prosecuted, will the Department support a cooperation-related reduction at sentencing.

If the company is unable to identify all relevant individuals or provide complete factual information despite its good faith efforts to cooperate fully, the organization may still be eligible for cooperation credit. For example, there may be circumstances where, despite its best efforts to conduct a thorough investigation, a company genuinely cannot get access to certain evidence or is legally prohibited from disclosing it to the government. Under such circumstances, the company seeking cooperation will bear the burden of explaining the restrictions it is facing to the prosecutor.

To be clear, a company is not required to waive its attorney-client privilege or attorney work product protection to be eligible to receive cooperation credit. The extent of the cooperation credit earned will depend on all the various factors that have traditionally applied in making this assessment (*e.g.*, the timeliness of the cooperation, the diligence, thoroughness and speed of the internal investigation, and the proactive nature of the cooperation).

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor may encounter several obstacles resulting from the nature of the corporation itself. It may be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying potentially relevant actors and locating relevant evidence, among other things, and in doing so expeditiously.

This dynamic—*i.e.*, the difficulty of determining what happened, where the evidence is, and which individuals took or promoted putatively illegal corporate actions—can have negative consequences for both the government and the corporation that is the subject or target of a government investigation. More specifically, because of corporate

attribution principles concerning actions of corporate officers and employees, uncertainty about who authorized or directed apparent corporate misconduct can inure to the detriment of a corporation. For example, it may not matter under the law which of several possible executives or leaders in a chain of command approved or authorized criminal conduct; however, that information if known might bear on the propriety of a particular disposition short of indictment of the corporation. It may not be in the interest of a corporation or the government for a charging decision to be made in the absence of such information, which might occur if, for example, a statute of limitations were relevant and authorization by any one of the officials were enough to justify a charge under the law.

For these reasons and more, cooperation can be a favorable course for both the government and the corporation. Cooperation benefits the government by allowing prosecutors and federal agents, for example, to avoid protracted delays, which compromise their ability to quickly uncover and address the full extent of widespread corporate crimes. With cooperation by the corporation, the government may be able to reduce tangible losses, limit damage to reputation, and preserve assets for restitution. At the same time, cooperation may benefit the corporation—and ultimately shareholders, employees, and other often blameless victims—by enabling the government to focus its investigative resources in a manner that may expedite the investigation and that may be less likely to disrupt the corporation’s legitimate business operations. In addition, cooperation may benefit the corporation by presenting it with the opportunity to earn credit for its efforts. . . .

9-28.720. Cooperation: Disclosing the Relevant Facts

Eligibility for cooperation credit is not predicated upon the waiver of attorney-client privilege or work product protection. Instead, the sort of cooperation that is most valuable to resolving allegations of misconduct by a corporation and its officers, directors, employees, or agents is disclosure of the relevant *facts* concerning such misconduct. In this regard, the analysis parallels that for a non-corporate defendant, where cooperation typically requires disclosure of relevant factual knowledge and not of discussions between an individual and his attorneys.

Thus, when the government investigates potential corporate wrongdoing, it seeks the relevant facts. For example, how and when did the alleged misconduct occur? Who promoted or approved it? Who was responsible for committing it? In this respect, the investigation of a corporation differs little from the investigation of an individual. In both cases, the government needs to know the facts to achieve a just and fair outcome. The party under investigation may choose to cooperate by disclosing the facts, and the government may give credit for the party’s disclosures. If a corporation wishes to receive credit for such cooperation, which then can be considered with all other cooperative efforts and circumstances in evaluating how fairly to proceed, then the corporation, like any person, must disclose the relevant facts of which it has knowledge. . . .

9-28.800. Corporate Compliance Programs

A. General Principle: Compliance programs are established by corporate management to prevent and detect misconduct and to ensure that corporate activities are conducted in accordance with applicable criminal and civil laws, regulations, and rules. The Department encourages such corporate self-policing, including voluntary disclosures to the government of any problems that a corporation discovers on its own. However, the existence of a compliance program is not sufficient, in and of itself, to justify not charging a corporation for criminal misconduct undertaken by its officers, directors, employees, or agents. In addition, the nature of some crimes may be such that national law enforcement policies mandate prosecutions of corporations notwithstanding the existence of a compliance program.

B. Comment: The existence of a corporate compliance program, even one that specifically prohibited the very conduct in question, does not absolve the corporation from criminal liability under the doctrine of *respondeat superior*. See *United States v. Basic Constr. Co.* (“[A] corporation may be held criminally responsible for antitrust violations committed by its employees if they were acting within the scope of their authority, or apparent authority, and for the benefit of the corporation, even if ... such acts were against corporate policy or express instructions.”). As explained in *United States v. Potter*, a corporation cannot “avoid liability by adopting abstract rules” that forbid its agents from engaging in illegal acts, because “[e]ven a specific directive to an agent or employee or honest efforts to police such rules do not automatically free the company for the wrongful acts of agents.” See also *United States v. Hilton Hotels Corp.* (noting that a corporation “could not gain exculpation by issuing general instructions without undertaking to enforce those instructions by means commensurate with the obvious risks”); *United States v. Beusch* (“[A] corporation may be liable for acts of its employees done contrary to express instructions and policies, but . . . the existence of such instructions and policies may be considered in determining whether the employee in fact acted to benefit the corporation.”).

While the Department recognizes that no compliance program can ever prevent all criminal activity by a corporation’s employees, the critical factors in evaluating any program are whether the program is adequately designed for maximum effectiveness in preventing and detecting wrongdoing by employees and whether corporate management is enforcing the program or is tacitly encouraging or pressuring employees to engage in misconduct to achieve business objectives. The Department has no formulaic requirements regarding corporate compliance programs. The fundamental questions any prosecutor should ask are: Is the corporation’s compliance program well designed? Is the program being applied earnestly and in good faith? Does the corporation’s compliance program work? In answering these questions, the prosecutor should consider the comprehensiveness of the compliance program; the extent and pervasiveness of the criminal misconduct; the number and level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any remedial actions taken by the corporation, including, for example, disciplinary action against past violators

uncovered by the prior compliance program, and revisions to corporate compliance programs in light of lessons learned. Prosecutors should also consider the promptness of any disclosure of wrongdoing to the government. In evaluating compliance programs, prosecutors may consider whether the corporation has established corporate governance mechanisms that can effectively detect and prevent misconduct. For example, do the corporation's directors exercise independent review over proposed corporate actions rather than unquestioningly ratifying officers' recommendations; are internal audit functions conducted at a level sufficient to ensure their independence and accuracy; and have the directors established an information and reporting system in the organization reasonably designed to provide management and directors with timely and accurate information sufficient to allow them to reach an informed decision regarding the organization's compliance with the law.

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed, implemented, reviewed, and revised, as appropriate, in an effective manner. In addition, prosecutors should determine whether the corporation has provided for a staff sufficient to audit, document, analyze, and utilize the results of the corporation's compliance efforts. Prosecutors also should determine whether the corporation's employees are adequately informed about the compliance program and are convinced of the corporation's commitment to it. This will enable the prosecutor to make an informed decision as to whether the corporation has adopted and implemented a truly effective compliance program that, when consistent with other federal law enforcement policies, may result in a decision to charge only the corporation's employees and agents or to mitigate charges or sanctions against the corporation. . . .

9-47.120. Criminal Division Corporate Enforcement and Voluntary Self-disclosure Policy

This policy—previously known as the FCPA Corporate Enforcement Policy—applies to all FCPA cases nationwide *and all other corporate criminal matters handled by the Criminal Division*.

In the years since the creation of the FCPA Corporate Enforcement Policy, the Criminal Division has observed that transparency concerning benefits that a company may obtain as a result of voluntary self-disclosure of misconduct can create important incentives for corporate behavior. The Criminal Division handles unique and complex corporate matters involving conduct that spans many jurisdictions, including, but not limited to, FCPA cases. Accordingly, the Criminal Division is issuing this revised Policy, effective on a prospective basis as of January 2023, which provides, *inter alia*, that when a company has voluntarily self-disclosed misconduct to the Criminal Division, fully cooperated, and timely and appropriately remediated, all in accordance with the standards set forth below, there will be a presumption that the company will receive a declination absent aggravating circumstances involving the seriousness of the offense or the nature of the offender.

To qualify for a declination under this Policy, a company is required to pay all disgorgement, forfeiture, and/or restitution resulting from the misconduct at issue

1. Consideration of Aggravating Circumstances and Credit for Voluntary Self-Disclosure, Full Cooperation, and Timely and Appropriate Remediation in Criminal Division Corporate Matters

Aggravating circumstances that may warrant a criminal resolution include, but are not limited to: involvement by executive management of the company in the misconduct; a significant profit to the company from the misconduct; egregiousness or pervasiveness of the misconduct within the company; or criminal recidivism.

Although a company will not qualify for a *presumption* of a declination if aggravating circumstances are present, prosecutors may nonetheless determine that a declination is an appropriate outcome if the company demonstrates to the Criminal Division that it has met all of the following factors:

- The voluntary self-disclosure was made immediately upon the company becoming aware of the allegation of misconduct;
- At the time of the misconduct and disclosure, the company had an effective compliance program and system of internal accounting controls, which enabled the identification of the misconduct and led to the company's voluntary self-disclosure; and
- The company provided extraordinary cooperation with the Department's investigation and undertook extraordinary remediation that exceeds the respective factors listed herein.

If a criminal resolution is warranted for a company that has voluntarily self-disclosed, fully cooperated, and timely and appropriately remediated, the Criminal Division:

- will accord, or recommend to a sentencing court, at least 50% and up to a 75% reduction off of the low end of the U.S. Sentencing Guidelines (U.S.S.G.) fine range, except in the case of a criminal recidivist, in which case a reduction of at least 50% and up to 75% will generally not be from the low end of the U.S.S.G. fine range, and prosecutors will have discretion to determine the starting point for the reduction based on the particular facts and circumstances of the case;
- in assessing the appropriate form of the resolution, will generally not require a corporate guilty plea—including for criminal recidivists—absent the presence of particularly egregious or multiple aggravating circumstances, such as those described above, excluding recidivism (*i.e.*, involvement by executive management of the company in the misconduct; a significant profit to the company from the misconduct; and egregiousness or pervasiveness of the misconduct within the company); and

- generally will not require appointment of a monitor if a company has, at the time of resolution, demonstrated that it has implemented and tested an effective compliance program and remediated the root cause of the misconduct.

In matters that resolve through a form of criminal disposition (including convictions, guilty pleas, deferred prosecution agreements, or non-prosecution agreements), the Department will generally require the company to pay a criminal penalty/fine as well as, where applicable, disgorgement, forfeiture, and/or restitution. . . .

2. Limited Credit for Full Cooperation and Timely and Appropriate Remediation in Criminal Division Corporate Matters Without Voluntary Self-Disclosure

If a company did not voluntarily self-disclose its misconduct to the Criminal Division in accordance with the standards set forth above, but later fully cooperated and timely and appropriately remediated in accordance with the standards set forth above and below, the company will receive, or the Criminal Division will recommend to a sentencing court, up to a 50% reduction off of the low end of the U.S.S.G. fine range, except in the case of a criminal recidivist, in which case the reduction of up to 50% will generally not be from the low end of the U.S.S.G. fine range. Prosecutors will have discretion to determine the specific percentage reduction and starting point in the range based on the particular facts and circumstances of the case. . . .

3. Definitions

a. *Voluntary Self-Disclosure*

In evaluating self-disclosure, the Criminal Division will make a careful assessment of the circumstances of the disclosure, including the extent to which the disclosure permitted the Criminal Division to preserve and obtain evidence as part of its investigation. The Criminal Division encourages self-disclosure of potential wrongdoing at the earliest possible time, even when a company has not yet completed an internal investigation, if it chooses to conduct one. The Criminal Division will require the following items for a company to receive credit for voluntary self-disclosure of wrongdoing (beyond the credit available under the U.S.S.G.):

- The voluntary disclosure must be to the Criminal Division;
- The company had no preexisting obligation to disclose the misconduct;
- The voluntary disclosure qualifies under U.S.S.G. § 8C2.5(g)(1) as occurring “prior to an imminent threat of disclosure or government investigation”;
- The company discloses the conduct to the Criminal Division within a reasonably prompt time after becoming aware of the misconduct, with the burden being on the company to demonstrate timeliness; and

- The company discloses all relevant, non-privileged facts known to it, including all relevant facts and evidence about all individuals involved in or responsible for the misconduct at issue, including individuals inside and outside of the company regardless of their position, status, or seniority.

b. *Full Cooperation*

In addition to the provisions contained in the Principles of Federal Prosecution of Business Organizations to satisfy the threshold for any cooperation credit, *see* JM 9-28.000, the following actions will be required for a company to receive credit for full cooperation for purposes of this Policy (beyond the credit available under the U.S.S.G.):

- Timely disclosure of all non-privileged facts relevant to the wrongdoing at issue, including:
 - 1) facts gathered during a company's independent internal investigation, if the company chooses to conduct one;
 - 2) attribution of facts to specific sources where such attribution does not violate the attorney-client privilege, rather than a general narrative of the facts;
 - 3) timely updates on a company's internal investigation, if the company chooses to conduct one, including but not limited to rolling disclosures of information;
 - 4) identification of all individuals involved in or responsible for the misconduct at issue, regardless of their position, status, or seniority, including the company's officers, employees, customers, competitors, or agents and third-parties, and all non-privileged information relating to the misconduct and involvement by those individuals;
- Proactive cooperation, rather than reactive; that is, the company must timely disclose all facts that are relevant to the investigation, even when not specifically asked to do so, and, where the company is or should be aware of opportunities for the Criminal Division to obtain relevant evidence not in the company's possession and not otherwise known to the Criminal Division, it must identify those opportunities to the Criminal Division;
- Timely voluntary preservation, collection, and disclosure of relevant documents and information relating to their provenance, including (a) disclosure of overseas documents, the locations in which such documents were found, their custodians, and individuals who authored and/or located the documents; (b) facilitation of third-party production of documents; and (c) where requested, provision of translations of relevant documents in foreign languages. . .
- De-confliction of witness interviews and other investigative steps that a company intends to take as part of its internal investigation to prevent the company's

investigation from conflicting or interfering with the Criminal Division's investigation; and

- Subject to the individuals' Fifth Amendment rights, making company officers and employees who possess relevant information available for interviews by the Criminal Division, including, where appropriate and possible, officers, employees, and agents located overseas as well as former officers and employees, and, where possible, the facilitation of interviews of third-parties. . . .

In recent decades, each new administration has announced revisions to and interpretations of the Justice Manual provisions on corporate prosecutions to emphasize varying policies and strategies. The following memorandum excerpts, issued by Deputy Attorney General Lisa Monaco, are the clearest and most detailed statement to date by the Biden Administration about how it will approach corporate enforcement and settlement.

MEMORANDUM FOR THE ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION

**U.S. Department of Justice
Office of the Deputy Attorney General**

September 15, 2022

By combating corporate crime, the Department of Justice protects the public, strengthens our markets, discourages unlawful business practices, and upholds the rule of law. Strong corporate criminal enforcement also assures the public that there are not two sets of rules in this country—one for corporations and executives, and another for the rest of America. Corporate criminal enforcement will therefore always be a core priority for the Department. . . .

I. Guidance on Individual Accountability

The Department's first priority in corporate criminal matters is to hold accountable the individuals who commit and profit from corporate crime. Such accountability deters future illegal activity, incentivizes changes in individual and corporate behavior, ensures that the proper parties are held responsible for their actions, and promotes the public's confidence in our justice system. . . .

To be eligible for any cooperation credit, corporations must disclose to the Department all relevant, non-privileged facts about individual misconduct. The mere disclosure of records, however, is not enough. If disclosures come too long after the misconduct in question, they reduce the likelihood that the government may be able to adequately investigate the matter in time to seek appropriate criminal charges against individuals. The expiration of statutes of limitations, the dissipation of corroborating evidence, and other factors can inhibit individual accountability when the disclosure of facts about individual misconduct is delayed.

In particular, it is imperative that Department prosecutors gain access to all relevant, non-privileged facts about individual misconduct swiftly and without delay. Therefore, to receive full cooperation credit, corporations must produce on a timely basis all relevant, non-privileged facts and evidence about individual misconduct such that prosecutors have the opportunity to effectively investigate and seek criminal charges against culpable individuals. Companies that identify significant facts but delay their disclosure will place in jeopardy their eligibility for cooperation credit. Companies seeking cooperation credit ultimately bear the burden of ensuring that documents are produced in a timely manner to prosecutors.

Likewise, production of evidence to the government that is most relevant for assessing individual culpability should be prioritized. Such priority evidence includes information and communications associated with relevant individuals during the period of misconduct. Department prosecutors will frequently identify the priority evidence they are seeking from a cooperating corporation, but in the absence of specific requests from prosecutors, cooperating corporations should understand that information pertaining to individual misconduct will be most significant.

Going forward, in connection with every corporate resolution, Department prosecutors must specifically assess whether the corporation provided cooperation in a timely fashion. Prosecutors will consider, for example, whether a company promptly notified prosecutors of particularly relevant information once it was discovered, or if the company instead delayed disclosure in a manner that inhibited the government's investigation. Where prosecutors identify undue or intentional delay in the production of information or documents—particularly with respect to documents that impact the government's ability to assess individual culpability—cooperation credit will be reduced or eliminated.

Finally, prosecutors must strive to complete investigations into individuals—and seek any warranted individual criminal charges—prior to or simultaneously with the entry of a resolution against the corporation. If prosecutors seek to resolve a corporate case prior to completing an investigation into responsible individuals, the prosecution or corporate resolution authorization memorandum must be accompanied by a memorandum that includes a discussion of all potentially culpable individuals, a description of the current status of the investigation regarding their conduct and the investigative work that remains to be done, and an investigative plan to bring the matter to resolution prior to the end of any statute of limitations period. . . .

Foreign Prosecutions of Individuals Responsible for Corporate Crime

The prosecution by foreign counterparts of individuals responsible for cross-border corporate crime plays an increasingly important role in holding individuals accountable and deterring future criminal conduct. Cooperation with foreign law enforcement

partners—both in terms of evidence-sharing and capacity-building—has become a significant part of the Department’s overall efforts to fight corporate crime. At the same time, the Department must continue to pursue forcefully its own individual prosecutions, as U.S. federal prosecution serves as a particularly significant instrument for accountability and deterrence.

At times, Department criminal investigations take place in parallel to criminal investigations by foreign jurisdictions into the same or related conduct. In such situations, the Department may learn that a foreign jurisdiction intends to bring criminal charges against an individual whom the Department is also investigating. The Principles of Federal Prosecution recognize that effective prosecution in another jurisdiction may be grounds to forego federal prosecution. Going forward, before declining to commence a prosecution in the United States on that basis, prosecutors must make a case-specific determination as to whether there is a significant likelihood that the individual will be subject to effective prosecution in the other jurisdiction. To determine whether an individual is subject to effective prosecution in another jurisdiction, prosecutors should consider, *inter alia*: (1) the strength of the other jurisdiction’s interest in the prosecution; (2) the other jurisdiction’s ability and willingness to prosecute effectively; and (3) the probable sentence and/or other consequences if the individual is convicted in the other jurisdiction.

When appropriate, Department prosecutors may wait to initiate a federal prosecution in order to better understand the scope and effectiveness of a prosecution in another jurisdiction. However, prosecutors should not delay commencing federal prosecution to the extent that delay could prevent the government from pursuing certain charges (*e.g.*, on statute of limitations grounds), reduce the chance of arresting the individual, or otherwise undermine the strength of the federal case.

Similarly, prosecutors should not be deterred from pursuing appropriate charges just because an individual liable for corporate crime is located outside the United States.

II. Guidance on Corporate Accountability

A. Evaluating a Corporation’s History of Misconduct

[I]n determining how best to resolve an investigation of corporate criminal activity, prosecutors should, among other factors, consider the corporation’s record of past misconduct, including prior criminal, civil, and regulatory resolutions, both domestically and internationally. Consideration of a company’s historical misconduct harmonizes the way the Department treats corporate and individual criminal histories, and ensures that prosecutors give due weight to an important factor in evaluating the proper form of resolution.

Not all instances of prior misconduct, however, are equally relevant or probative. To that end, prosecutors should consider the form of prior resolution and the associated sanctions or penalties, as well as the elapsed time between the instant misconduct, the

prior resolution, and the conduct underlying the prior resolution. In general, prosecutors weighing these factors should assign the greatest significance to recent U.S. criminal resolutions, and to prior misconduct involving the same personnel or management. Dated conduct addressed by prior criminal resolutions entered into more than ten years before the conduct currently under investigation, and civil or regulatory resolutions that were finalized more than five years before the conduct currently under investigation, should generally be accorded less weight as such conduct may be generally less reflective of the corporation's current compliance culture, program, and risk tolerance. However, depending on the facts of the particular case, even if it falls outside these time periods, repeated misconduct may be indicative of a corporation that operates without an appropriate compliance culture or institutional safeguards. . . .

B. Voluntary Self-Disclosure by Corporations

I am directing each Department of Justice component that prosecutes corporate crime to review its policies on corporate voluntary self-disclosure, and if the component lacks a formal, written policy to incentivize such self-disclosure, it must draft and publicly share such a policy. Any such policy should set forth the component's expectations of what constitutes a voluntary self-disclosure, including with regard to the timing of the disclosure, the need for the disclosure to be accompanied by timely preservation, collection, and production of relevant documents and/or information, and a description of the types of information and facts that should be provided as part of the disclosure process. The policies should also lay out the benefits that corporations can expect to receive if they meet the standards for voluntary self-disclosure under that component's policy. . . .

C. Evaluation of Cooperation by Corporations

. . . Companies seeking credit for cooperation must timely preserve, collect, and disclose relevant documents located both within the United States and overseas. In some cases, data privacy laws, blocking statutes, or other restrictions imposed by foreign law may complicate the method of production of documents located overseas. In such cases, the cooperating corporation bears the burden of establishing the existence of any restriction on production and of identifying reasonable alternatives to provide the requested facts and evidence, and is expected to work diligently to identify all available legal bases to preserve, collect, and produce such documents, data, and other evidence expeditiously.

Department prosecutors should provide credit to corporations that find ways to navigate such issues of foreign law and produce such records. Conversely, where a corporation actively seeks to capitalize on data privacy laws and similar statutes to shield misconduct inappropriately from detection and investigation by U.S. law enforcement, an adverse inference as to the corporation's cooperation may be applicable if such a corporation subsequently fails to produce foreign evidence.

D. Evaluation of a Corporation's Compliance Program

Although an effective compliance program and ethical corporate culture do not constitute a defense to prosecution of corporate misconduct, they can have a direct and significant impact on the terms of a corporation's potential resolution with the Department. Prosecutors should evaluate a corporation's compliance program as a factor in determining the appropriate terms for a corporate resolution, including whether an independent compliance monitor is warranted. Prosecutors should assess the adequacy and effectiveness of the corporation's compliance program at two points in time: (1) the time of the offense; and (2) the time of a charging decision. The same criteria should be used in each instance.

Prosecutors should evaluate the corporation's commitment to fostering a strong culture of compliance at all levels of the corporation—not just within its compliance department. For example, as part of this evaluation, prosecutors should consider how the corporation has incentivized or sanctioned employee, executive, and director behavior, including through compensation plans, as part of its efforts to create a culture of compliance.

There are many factors that prosecutors should consider when evaluating a corporate compliance program. The Criminal Division has developed resources to assist prosecutors in assessing the effectiveness of a corporation's compliance program. *See* Criminal Division, Evaluation of Corporate Compliance Programs (updated June 2020). Additional guidance has been provided by other Department components as to specialized areas of corporate compliance. *See, e.g.,* Antitrust Division, Evaluation of Corporate Compliance Programs in Criminal Antitrust Investigations (July 2019). Prosecutors should consider, among other factors, whether the corporation's compliance program is well designed, adequately resourced, empowered to function effectively, and working in practice. Prior guidance has identified numerous considerations for this evaluation, including, *inter alia*, how corporations measure and identify compliance risk; how they monitor payment and vendor systems for suspicious transactions; how they make disciplinary decisions within the human resources process; and how senior leaders have, through their words and actions, encouraged or discouraged compliance.

In addition to those factors, this Memorandum identifies additional metrics relevant to prosecutors' evaluation of a corporation's compliance program and culture.

1. Compensation Structures that Promote Compliance

Corporations can help to deter criminal activity if they reward compliant behavior and penalize individuals who engage in misconduct. Compensation systems that clearly and effectively impose financial penalties for misconduct can incentivize compliant conduct, deter risky behavior, and instill a corporate culture in which employees follow the law and avoid legal "gray areas." When conducting this evaluation, prosecutors should consider how the corporation has incentivized

employee behavior as part of its efforts to create a culture of ethics and compliance within its organization.

Corporations can best deter misconduct if they make clear that all individuals who engage in or contribute to criminal misconduct will be held personally accountable. In assessing a compliance program, prosecutors should consider whether the corporation's compensation agreements, arrangements, and packages (the "compensation systems") incorporate elements—such as compensation clawback provisions—that enable penalties to be levied against current or former employees, executives, or directors whose direct or supervisory actions or omissions contributed to criminal conduct. Since misconduct is often discovered after it has occurred, prosecutors should examine whether compensation systems are crafted in a way that allows for retroactive discipline, including through the use of clawback measures, partial escrowing of compensation, or equivalent arrangements.

Similarly, corporations can promote an ethical corporate culture by rewarding those executives and employees who promote compliance within the organization. Prosecutors should therefore also consider whether a corporation's compensation systems provide affirmative incentives for compliance-promoting behavior. Affirmative incentives include, for example, the use of compliance metrics and benchmarks in compensation calculations and the use of performance reviews that measure and reward compliance-promoting behavior, both as to the employee and any subordinates whom they supervise. When effectively implemented, such provisions incentivize executives and employees to engage in and promote compliant behavior and emphasize the corporation's commitment to its compliance programs and its culture.

Prosecutors should look to what has happened in practice at a corporation—not just what is written down. As part of their evaluation of a corporation's compliance program, prosecutors should review a corporation's policies and practices regarding compensation and determine whether they are followed in practice. If a corporation has included clawback provisions in its compensation agreements, prosecutors should consider whether, following the corporation's discovery of misconduct, a corporation has, to the extent possible, taken affirmative steps to execute on such agreements and clawback compensation previously paid to current or former executives whose actions or omissions resulted in, or contributed to, the criminal conduct at issue.

Finally, prosecutors should consider whether a corporation uses or has used non-disclosure or non-disparagement provisions in compensation agreements, severance agreements, or other financial arrangements so as to inhibit the public disclosure of criminal misconduct by the corporation or its employees. . . .

2. Use of Personal Devices and Third-Party Applications

The ubiquity of personal smartphones, tablets, laptops, and other devices poses significant corporate compliance risks, particularly as to the ability of companies to

monitor the use of such devices for misconduct and to recover relevant data from them during a subsequent investigation. The rise in use of third-party messaging platforms, including the use of ephemeral and encrypted messaging applications, poses a similar challenge.

Many companies require all work to be conducted on corporate devices; others permit the use of personal devices but limit their use for business purposes to authorized applications and platforms that preserve data and communications for compliance review. How companies address the use of personal devices and third-party messaging platforms can impact a prosecutor's evaluation of the effectiveness of a corporation's compliance program, as well as the assessment of a corporation's cooperation during a criminal investigation.

As part of evaluating a corporation's policies and mechanisms for identifying, reporting, investigating, and remediating potential violations of law, prosecutors should consider whether the corporation has implemented effective policies and procedures governing the use of personal devices and third-party messaging platforms to ensure that business-related electronic data and communications are preserved. To assist prosecutors in this evaluation, I have asked the Criminal Division to further study best corporate practices regarding use of personal devices and third-party messaging platforms and incorporate the product of that effort into the next edition of its Evaluation of Corporate Compliance Programs, so that the Department can address these issues thoughtfully and consistently.

As a general rule, all corporations with robust compliance programs should have effective policies governing the use of personal devices and third-party messaging platforms for corporate communications, should provide clear training to employees about such policies, and should enforce such policies when violations are identified. Prosecutors should also consider whether a corporation seeking cooperation credit in connection with an investigation has instituted policies to ensure that it will be able to collect and provide to the government all non-privileged responsive documents relevant to the investigation, including work-related communications (*e.g.*, texts, e-messages, or chats), and data contained on phones, tablets, or other devices that are used by its employees for business purposes. . . .

A longstanding debate in the field of criminal and civil enforcement against corporations concerns whether legal rules threatening to impose financial penalties on miscreant corporations sufficiently incentivize managers and employees, who may not own shares in the employing entity, to comply with the law. Some have argued that law and enforcement should do more to target the compensation systems that transfer value from corporations to individual employees and managers. It is argued that individuals will be more strongly motivated by corporate actions that affect their own compensation, not just the corporation's overall profits and losses. Recently the Justice Department announced the following "pilot" program designed to link enforcement against corporations with individual compensation paid to managers and employees.

U.S. DEPT. OF JUSTICE, CRIMINAL DIVISION: PILOT PROGRAM REGARDING COMPENSATION INCENTIVES AND CLAWBACKS (March 3, 2023)

The Department of Justice (Department) is committed to tackling corporate crime and will continue to investigate and prosecute companies (and responsible individuals) who engage in such misconduct. But the Department's ultimate goal is to prevent corporate crime before it occurs. Through its policies and enforcement actions, the Department strives to deter criminal conduct, incentivize the development and implementation of effective compliance programs, and promote ethical corporate cultures. . . .

Throughout this process, one consideration has been how policies may seek to potentially shift the burden of corporate financial penalties away from shareholders—who in many cases do not have a role in misconduct—onto those more directly responsible. . . .

Accordingly, the Division is conducting a Compensation Incentives and Clawbacks Pilot Program (Program). As set forth below, the Program provides that, when entering into criminal resolutions, companies will be required to implement compliance-related criteria in their compensation and bonus system and to report to the Division about such implementation during the term of such resolutions. The Program also directs Division prosecutors to consider possible fine reductions where companies seek to recoup compensation from culpable employees and others who both (a) had supervisory authority over the employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct. . . .

During the Program, every corporate resolution entered into by the Division shall include a requirement that the resolving company implement criteria related to compliance in its compensation and bonus system. The company must also report to the Division annually during the term of the resolution about its implementation of such criteria. These criteria may include, but are not limited to: (1) a prohibition on bonuses for employees who do not satisfy compliance performance requirements; (2) disciplinary measures for employees who violate applicable law and others who both (a) had supervisory authority over the employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct; and (3) incentives for employees who demonstrate full commitment to compliance processes. Division prosecutors will use their discretion in fashioning the appropriate requirements based on the particular facts and circumstances of the case, including, but not limited to, applicable foreign and domestic law. In making this determination, prosecutors will be mindful of, and afford due consideration to, how the company has structured its existing compensation program.

Where a criminal resolution is warranted, if a company fully cooperates and timely and appropriately remediates and demonstrates it has implemented a program to recoup compensation from employees who engaged in wrongdoing in connection with the conduct under investigation, or others who both (a) had supervisory authority over the

employee(s) or business area engaged in the misconduct and (b) knew of, or were willfully blind to, the misconduct, and has in good faith initiated the process to recoup such compensation before the time of resolution, an additional fine reduction may be warranted. Specifically, in such circumstances, Division prosecutors shall accord, in addition to any other reduction available under applicable policy, a reduction of the fine in the amount of 100% of any such compensation that is recouped during the period of the resolution. Any fine reduction afforded under the Program does not affect any applicable restitution, forfeiture, disgorgement, or other agreed-upon payment by the company.

To accommodate the process required to recoup such compensation, at the time of resolution, the company will be required to pay the full amount of the otherwise applicable fine (Original Fine) less 100% of the amount of compensation the company is attempting to claw back (Possible Clawback Reduction). At the conclusion of the resolution term, if the company has not recouped the full amount of compensation it sought to claw back, the company will be required to pay the Possible Clawback Reduction minus 100% of the compensation actually recovered.

If a company's good faith attempt to recoup any such compensation is unsuccessful, Division prosecutors may in their discretion accord a reduction of up to 25% of the amount of compensation the company attempted to clawback such that the company must at the conclusion of the resolution term make an additional fine payment of the Possible Clawback Reduction less the determined reduction percentage of the compensation sought. Such reductions may be warranted where, for instance, a company incurred significant litigation costs for shareholders or can demonstrate that it is highly likely that it will successfully recoup the compensation shortly after the end of the resolution term.

Next, consider the SEC's primary statement on the subject of civil enforcement against corporations in the securities industry and compare what the SEC says to DOJ's policy.

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Release No. 44969 / October 23, 2001

ACCOUNTING AND AUDITING ENFORCEMENT

Release No. 1470 / October 23, 2001

Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation to Agency Enforcement Decisions ("The Seaboard Report")

Today, we commence and settle a cease-and-desist proceeding against Gisela de Leon-Meredith, former controller of a public company's subsidiary. Our order finds that Meredith caused the parent company's books and records to be inaccurate and its periodic reports misstated, and then covered up those facts.

We are not taking action against the parent company, given the nature of the conduct and the company's responses. Within a week of learning about the apparent misconduct, the company's internal auditors had conducted a preliminary review and had advised company management who, in turn, advised the Board's audit committee, that Meredith had caused the company's books and records to be inaccurate and its financial reports to be misstated. The full Board was advised and authorized the company to hire an outside law firm to conduct a thorough inquiry. Four days later, Meredith was dismissed, as were two other employees who, in the company's view, had inadequately supervised Meredith; a day later, the company disclosed publicly and to us that its financial statements would be restated. The price of the company's shares did not decline after the announcement or after the restatement was published. The company pledged and gave complete cooperation to our staff. It provided the staff with all information relevant to the underlying violations. Among other things, the company produced the details of its internal investigation, including notes and transcripts of interviews of Meredith and others; and it did not invoke the attorney-client privilege, work product protection or other privileges or protections with respect to any facts uncovered in the investigation.

The company also strengthened its financial reporting processes to address Meredith's conduct— developing a detailed closing process for the subsidiary's accounting personnel, consolidating subsidiary accounting functions under a parent company CPA, hiring three new CPAs for the accounting department responsible for preparing the subsidiary's financial statements, redesigning the subsidiary's minimum annual audit requirements, and requiring the parent company's controller to interview and approve all senior accounting personnel in its subsidiaries' reporting processes.

Our willingness to credit such behavior in deciding whether and how to take enforcement action benefits investors as well as our enforcement program. When businesses seek out, self-report and rectify illegal conduct, and otherwise cooperate with Commission staff, large expenditures of government and shareholder resources can be avoided and investors can benefit more promptly. In setting forth the criteria listed below, we think a few caveats are in order:

First, the paramount issue in every enforcement judgment is, and must be, what best protects investors. There is no single, or constant, answer to that question. Self-policing, self-reporting, remediation and cooperation with law enforcement authorities, among other things, are unquestionably important in promoting investors' best interests. But, so too are vigorous enforcement and the imposition of appropriate sanctions where the law has been violated. Indeed, there may be circumstances where conduct is so egregious, and harm so great, that no amount of cooperation or other mitigating conduct can justify

a decision not to bring any enforcement action at all. In the end, no set of criteria can, or should, be strictly applied in every situation to which they may be applicable.

Second, we are not adopting any rule or making any commitment or promise about any specific case; nor are we in any way limiting our broad discretion to evaluate every case individually, on its own particular facts and circumstances. Conversely, we are not conferring any “rights” on any person or entity. We seek only to convey an understanding of the factors that may influence our decisions.

Third, we do not limit ourselves to the criteria we discuss below. By definition, enforcement judgments are just that—judgments. Our failure to mention a specific criterion in one context does not preclude us from relying on that criterion in another. Further, the fact that a company has satisfied all the criteria we list below will not foreclose us from bringing enforcement proceedings that we believe are necessary or appropriate, for the benefit of investors.

In brief form, we set forth below some of the criteria we will consider in determining whether, and how much, to credit self-policing, self-reporting, remediation and cooperation—from the extraordinary step of taking no enforcement action to bringing reduced charges, seeking lighter sanctions, or including mitigating language in documents we use to announce and resolve enforcement actions.

1. What is the nature of the misconduct involved? Did it result from inadvertence, honest mistake, simple negligence, reckless or deliberate indifference to indicia of wrongful conduct, willful misconduct or unadorned venality? Were the company’s auditors misled?
2. How did the misconduct arise? Is it the result of pressure placed on employees to achieve specific results, or a tone of lawlessness set by those in control of the company? What compliance procedures were in place to prevent the misconduct now uncovered? Why did those procedures fail to stop or inhibit the wrongful conduct?
3. Where in the organization did the misconduct occur? How high up in the chain of command was knowledge of, or participation in, the misconduct? Did senior personnel participate in, or turn a blind eye toward, obvious indicia of misconduct? How systemic was the behavior? Is it symptomatic of the way the entity does business, or was it isolated?
4. How long did the misconduct last? Was it a one-quarter, or one-time, event, or did it last several years? In the case of a public company, did the misconduct occur before the company went public? Did it facilitate the company’s ability to go public?

5. How much harm has the misconduct inflicted upon investors and other corporate constituencies? Did the share price of the company's stock drop significantly upon its discovery and disclosure?
6. How was the misconduct detected and who uncovered it?
7. How long after discovery of the misconduct did it take to implement an effective response?
8. What steps did the company take upon learning of the misconduct? Did the company immediately stop the misconduct? Are persons responsible for any misconduct still with the company? If so, are they still in the same positions? Did the company promptly, completely and effectively disclose the existence of the misconduct to the public, to regulators and to self-regulators? Did the company cooperate completely with appropriate regulatory and law enforcement bodies? Did the company identify what additional related misconduct is likely to have occurred? Did the company take steps to identify the extent of damage to investors and other corporate constituencies? Did the company appropriately recompense those adversely affected by the conduct?
9. What processes did the company follow to resolve many of these issues and ferret out necessary information? Were the Audit Committee and the Board of Directors fully informed? If so, when?
10. Did the company commit to learn the truth, fully and expeditiously? Did it do a thorough review of the nature, extent, origins and consequences of the conduct and related behavior? Did management, the Board or committees consisting solely of outside directors oversee the review? Did company employees or outside persons perform the review? If outside persons, had they done other work for the company? Where the review was conducted by outside counsel, had management previously engaged such counsel? Were scope limitations placed on the review? If so, what were they?
11. Did the company promptly make available to our staff the results of its review and provide sufficient documentation reflecting its response to the situation? Did the company identify possible violative conduct and evidence with sufficient precision to facilitate prompt enforcement actions against those who violated the law? Did the company produce a thorough and probing written report detailing the findings of its review? Did the company voluntarily disclose information our staff did not directly request and otherwise might not have uncovered? Did the company ask its employees to cooperate with our staff and make all reasonable efforts to secure such cooperation?
12. What assurances are there that the conduct is unlikely to recur? Did the company adopt and ensure enforcement of new and more effective internal controls and procedures designed to prevent a recurrence of the misconduct? Did the company

provide our staff with sufficient information for it to evaluate the company's measures to correct the situation and ensure that the conduct does not recur?

13. Is the company the same company in which the misconduct occurred, or has it changed through a merger or bankruptcy reorganization?

We hope that this Report of Investigation and Commission Statement will further encourage self-policing efforts and will promote more self-reporting, remediation and cooperation with the Commission staff. We welcome the constructive input of all interested persons. We urge those who have contributions to make to direct them to our Division of Enforcement. The public can be confident that all such communications will be fairly evaluated not only by our staff, but also by us. We continue to reassess our enforcement approaches with the aim of maximizing the benefits of our program to investors and the marketplace.⁷

The CFTC and Foreign Examples

The focus in this text is, of course, on criminal enforcement. The relationship between criminal and civil enforcement is very important to understand. Given the vast size and complexity of civil enforcement mechanisms in U.S. law, there is space here to proceed only by example. The SEC enforcement example is featured throughout this text because it is the one that most commonly overlaps with criminal enforcement. To see an example of how the DOJ's approach to *de facto* corporate liability has spread even beyond the SEC, consider the statements of factors controlling credit for cooperation issued by the Division of Enforcement of the Commodities Futures Trading Commission, available at:

- (1) <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisorycompanies011917.pdf> (enforcement advisory for companies).
- (2) <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrenforcementactions/documents/legalpleading/enfadvisoryselfreporting0917.pdf> (updated advisory on full credit for self-reporting and cooperation).
- (3) <https://www.cftc.gov/PressRoom/PressReleases/8235-20> (guidance on evaluating corporate compliance programs).

The CFTC's statements echo many of the factors stressed in the DOJ guidelines. Some of the same factors are also being stressed by the United Kingdom and EU nations, as they begin to adopt procedures for settling enforcement actions with companies. *See*

⁷ In addition to the Seaboard Report with regard to corporations, the SEC has issued a policy statement regarding credit individuals may receive as a result of their cooperation in SEC enforcement investigations and actions, available at: <https://www.sec.gov/rules/policy/2010/34-61340.pdf>.

Organization for Economic Cooperation and Development (OECD), Resolving Foreign Bribery Cases with Non-Trial Resolutions (2019), available at:

<https://www.oecd.org/daf/anti-bribery/Resolving-foreign-bribery-cases-with-non-trial-resolutions.pdf>.

For recent UK enforcement policy statements that mirror many of the factors expressed by DOJ, SEC, and CFTC policy, see the sections on corporate cooperation, deferred prosecution agreements, and evaluating corporate compliance programs in the Operational Handbook of the Serious Fraud Office, available here:

<https://www.sfo.gov.uk/publications/guidance-policy-and-protocols/sfo-operational-handbook>.

D. The Role of the Judiciary

Courts, of course, have a role in the criminal sanctioning of a corporation when a case goes to trial and conviction, or results in a guilty plea, and thus proceeds to sentencing. (Sentencing of corporations is addressed in Chapter 18.) Is there also a role for the courts in *de facto* corporate criminal liability? That is, in the process whereby the DOJ and other government agencies pursue policies designed to encourage business firms to behave in certain ways in order to obtain favorable settlements with lower sanctions? Some have argued that judicial supervision of the process would be helpful and even might be essential. Perhaps the primary difficulty is this: On what legal theory could courts police the process of settlement? The following two cases take up that question.

UNITED STATES v. FOKKER SERVICES B.V., 818 F.3d 733 (D.C. Cir. 2016)

SRINIVASAN, Circuit Judge:

The Constitution allocates primacy in criminal charging decisions to the Executive Branch. The Executive's charging authority embraces decisions about whether to initiate charges, whom to prosecute, which charges to bring, and whether to dismiss charges once brought. It has long been settled that the Judiciary generally lacks authority to second-guess those Executive determinations, much less to impose its own charging preferences. The courts instead take the prosecution's charging decisions largely as a given, and assume a more active role in administering adjudication of a defendant's guilt and determining the appropriate sentence.

In certain situations, rather than choose between the opposing poles of pursuing a criminal conviction or forgoing any criminal charges altogether, the Executive may conclude that the public interest warrants the intermediate option of a deferred prosecution agreement (DPA). Under a DPA, the government formally initiates prosecution but agrees to dismiss all charges if the defendant abides by negotiated conditions over a prescribed period of time. Adherence to the conditions enables the defendant to demonstrate compliance with the law. If the defendant fails to satisfy the

conditions, the government can then pursue the charges based on facts admitted in the agreement.

This case arises from the interplay between the operation of a DPA and the running of time limitations under the Speedy Trial Act. Because a DPA involves the formal initiation of criminal charges, the agreement triggers the Speedy Trial Act's time limits for the commencement of a criminal trial. In order to enable the government to assess the defendant's satisfaction of the DPA's conditions over the time period of the agreement—with an eye towards potential dismissal of the charges—the Speedy Trial Act specifically allows for a court to suspend the running of the time within which to commence a trial for any period during which the government defers prosecution under a DPA.

In this case, appellant Fokker Services voluntarily disclosed its potential violation of federal sanctions and export control laws. After extensive negotiations, the company and the government entered into an 18-month DPA, during which Fokker would continue cooperation with federal authorities and implementation of a substantial compliance program. In accordance with the DPA, the government filed criminal charges against the company, together with a joint motion to suspend the running of time under the Speedy Trial Act pending assessment of the company's adherence to the agreement's conditions. The district court denied the motion because, in the court's view, the prosecution had been too lenient in agreeing to, and structuring, the DPA. Among other objections, the court disagreed with prosecutors' decision to forgo bringing any criminal charges against individual company officers.

We vacate the district court's denial of the joint motion to exclude time under the Speedy Trial Act. We hold that the Act confers no authority in a court to withhold exclusion of time pursuant to a DPA based on concerns that the government should bring different charges or should charge different defendants. Congress, in providing for courts to approve the exclusion of time pursuant to a DPA, acted against the backdrop of long-settled understandings about the independence of the Executive with regard to charging decisions. Nothing in the statute's terms or structure suggests any intention to subvert those constitutionally rooted principles so as to enable the Judiciary to second-guess the Executive's exercise of discretion over the initiation and dismissal of criminal charges. . . .

The Speedy Trial Act establishes time limits for the completion of various stages of a criminal prosecution. *See* 18 U.S.C. §§ 3161–3174. For instance, the Act requires the commencement of trial within seventy days of the filing of an information or indictment by the government. § 3161(c)(1). The Act also excludes various pretrial periods from the running of that seventy-day time clock. Of particular relevance, the Act excludes “[a]ny period of delay during which prosecution is deferred by the attorney for the Government pursuant to written agreement with the defendant, with the approval of the court, for the purpose of allowing the defendant to demonstrate his good conduct.” § 3161(h)(2).

That exemption exists to enable prosecutors to resolve cases through DPAs. DPAs, along with their out-of-court analogues, non-prosecution agreements (NPAs), afford a middle-ground option to the prosecution when, for example, it believes that a criminal conviction may be difficult to obtain or may result in unwanted collateral consequences for a defendant or third parties, but also believes that the defendant should not evade accountability altogether. Both DPAs and NPAs generally include an admitted statement of facts, require adherence to “conditions designed . . . to promote compliance with applicable law and to prevent recidivism,” and remain in effect for a period of one to three years. U.S. Attorney’s Manual § 9–28.1000 (2015). During that period, if the defendant fails to abide by the terms of the agreement, the government can prosecute based on the admitted facts. While prosecutors at one time seldom relied on NPAs and DPAs, their use has grown significantly in recent years.

DPAs differ from NPAs primarily with regard to the filing of criminal charges. With an NPA, “formal charges are not filed and the agreement is maintained by the parties rather than being filed with a court.” Craig S. Morford, *Selection and Use of Monitors in Deferred Prosecution Agreements and Non-Prosecution Agreements with Corporations*, (Mar. 7, 2008). A DPA, by contrast, “is typically predicated upon the filing of a formal charging document by the government.”

For that reason, a DPA’s viability depends on the specific exclusion of time for such agreements set forth in the Speedy Trial Act, 18 U.S.C. § 3161(h)(2). The filing of an information or indictment would ordinarily trigger the Act’s seventy-day clock within which trial must commence. *See* § 3161(c)(1). But in the case of a DPA, if the defendant were to fulfill the agreement’s conditions, the prosecution would move to dismiss all charges with prejudice at the end of the specified time period, ordinarily one to three years. Without the statutory exclusion of time for DPAs provided in § 3161(h)(2), the government would relinquish its ability to prosecute based on the conceded facts if the defendant were to violate the agreement after seventy days. That would largely eliminate the leverage that engenders the defendant’s compliance with a DPA’s conditions. The statutory exclusion of time for DPAs therefore is essential to the agreements’ effective operation. . . .

In light of Fokker’s cooperation, remediation efforts, and other mitigating factors, federal agencies negotiated a global settlement with the company. The settlement included, as an integral component, an 18-month DPA. During the DPA’s 18-month period, Fokker was to: continue full cooperation with the government, implement its new compliance policy, and pay fines and penalties totaling \$21 million (a sum equaling the gross revenues gained by the company from the illicit transactions). Fokker also accepted responsibility for the acts described in the stipulated factual statement accompanying the DPA.

On June 5, 2014, pursuant to the agreement, the government filed with the district court a one-count information against Fokker, together with the DPA. The information charged Fokker with conspiracy to violate the International Emergency Economic

Powers Act. *See* 18 U.S.C. § 371; 50 U.S.C. § 1705. The same day, the government and Fokker filed a joint motion for the exclusion of time under the Speedy Trial Act, in order to “allow [the company] to demonstrate its good conduct and implement certain remedial measures.”

The district court then held a series of status conferences, during which it repeatedly emphasized its concerns about the absence of any criminal prosecution of individual company officers. The court requested several additional written submissions from the government. The government was asked to explain why the interests of justice supported the court’s approval of the deal embodied by the DPA, and also to address whether Fokker’s initial disclosures to the government had in fact been voluntary. In response, the government described why the “proposed resolution with Fokker Services is fair and is an appropriate exercise of the government’s discretion,” and affirmed the absence of any indication “that Fokker Services was motivated to make its disclosures out of fear about a nonexistent U.S. government investigation.” The district court later expressed that it might still reject the DPA because it was “too good a deal for the defendant.”

On February 5, 2015, the district court denied the joint motion for the exclusion of time. In explaining the reasons for its decision, the court criticized the government for failing to prosecute any “individuals . . . for their conduct.” According to the court, approval of an agreement in which the defendant had been “prosecuted so anemically for engaging in such egregious conduct for such a sustained period of time and for the benefit of one of our country’s worst enemies” would “promote disrespect for the law.” The court further noted that certain employees had been permitted to remain with the company; that the DPA contained no requirement for an independent monitor; and that the amount of the fine failed to exceed the revenues Fokker gained from the illegal transactions. Based on those considerations, the court rejected the DPA as an “[in]appropriate exercise of prosecutorial discretion.”

The district court’s order marks the first time any federal court has denied a joint request by the parties to exclude time pursuant to a DPA. Both parties filed a timely notice of appeal. Because both parties seek to overturn the district court’s denial of their joint motion to exclude time, we appointed an amicus curiae to present arguments defending the district court’s action. . . .

By rejecting the DPA based primarily on concerns about the prosecution’s charging choices, the district court exceeded its authority under the Speedy Trial Act. The Act excludes any period of time “during which prosecution is deferred by the attorney for the Government pursuant to written agreement with the defendant, with the approval of the court, for the purpose of allowing the defendant to demonstrate his good conduct.” 18 U.S.C. § 3161(h)(2). While the exclusion of time is subject to “the approval of the court,” there is no ground for reading that provision to confer free-ranging authority in district courts to scrutinize the prosecution’s discretionary charging decisions. Rather, we read the statute against the background of settled constitutional understandings under which authority over criminal charging decisions resides fundamentally with the

Executive, without the involvement of—and without oversight power in—the Judiciary. So understood, the statute’s “approval of the court” requirement did not empower the district court to disapprove the DPA based on the court’s view that the prosecution had been too lenient.

The Executive’s primacy in criminal charging decisions is long settled. That authority stems from the Constitution’s delegation of “take Care” duties, U.S. Const. art. II, § 3, and the pardon power, § 2, to the Executive Branch. Decisions to initiate charges, or to dismiss charges once brought, “lie[] at the core of the Executive’s duty to see to the faithful execution of the laws.” *Cnty. for Creative Non-Violence v. Pierce*. The Supreme Court thus has repeatedly emphasized that “[w]hether to prosecute and what charge to file or bring before a grand jury are decisions that generally rest in the prosecutor’s discretion.” *United States v. Batchelder*.

Correspondingly, “judicial authority is . . . at its most limited” when reviewing the Executive’s exercise of discretion over charging determinations. *Pierce*; see *ICC v. Bhd. of Locomotive Eng’rs*. The decision whether to prosecute turns on factors such as “the strength of the case, the prosecution’s general deterrence value, the [g]overnment’s enforcement priorities, and the case’s relationship to the [g]overnment’s overall enforcement plan.” *Wayte v. United States*. The Executive routinely undertakes those assessments and is well equipped to do so. By contrast, the Judiciary, as the Supreme Court has explained, generally is not “competent to undertake” that sort of inquiry. Indeed, “[f]ew subjects are less adapted to judicial review than the exercise by the Executive of his discretion in deciding when and whether to institute criminal proceedings, or what precise charge shall be made, or whether to dismiss a proceeding once brought.” *Newman v. United States*. “Judicial supervision in this area” would also “entail[] systemic costs.” *Wayte*. It could “chill law enforcement,” cause delay, and “impair the performance of a core executive constitutional function.” *Armstrong*. As a result, “the presumption of regularity” applies to “prosecutorial decisions and, in the absence of clear evidence to the contrary, courts presume that [prosecutors] have properly discharged their official duties.” . . .

Judged by those principles, the district court in this case erred in denying the parties’ motion for exclusion of time under § 3161(h)(2). There is no indication that the parties entered into the DPA to evade speedy trial limits rather than to enable Fokker to demonstrate its good conduct and compliance with law. Rather, the district court denied the exclusion of time based on its view that the prosecution should have brought different charges or sought different remedies. In doing so, the court exceeded its authority under § 3161(h)(2).

From the first status conference concerning the DPA, the district court repeatedly criticized the government for failing to bring charges against individual company officers. Noting its belief that illegal conduct had been “orchestrated at the highest levels of the company,” and unpersuaded by the government’s efforts to ground its charging decisions in traditional prosecutorial considerations such as the strength of the evidence

and the value of pursuing of different charges, the district court questioned why no individuals would be held separately accountable. The court also faulted the government for “not requiring Fokker Services to pay as its fine a penny more than the \$21 million in revenue it collected from its illegal transactions.” In addition, the court thought the prosecution should have required an independent monitor as part of the DPA’s terms. The district court denied the motion for the exclusion of time for those reasons.

Even if the district court’s criticisms of the prosecution’s exercise of charging authority were entirely meritorious—an issue we have no occasion to address—the court should not have “assume[d] the role of Attorney General,” *Microsoft*. Rather, the court should have confined its inquiry to examining whether the DPA served the purpose of allowing Fokker to demonstrate its good conduct, as contemplated by § 3161(h)(2). There is no reason to question the DPA’s bona fides in that regard, and the district court made no suggestion otherwise. And insofar as a court has authority to reject a DPA if it contains illegal or unethical provisions, the district court again made no such suggestion here. The court instead denied the exclusion of time under § 3161(h)(2) based on a belief that the prosecution had been unduly lenient in its charging decisions and in the conditions agreed to in the DPA. The court significantly overstepped its authority in doing so. . . .

UNITED STATES v. HSBC BANK USA, N.A., 863 F.3d 125 (2d Cir. 2017)

KATZMANN, Chief Judge:

We are called upon in this case to address the role of a district court in monitoring the implementation of a deferred prosecution agreement. In December 2012, plaintiff-appellant the United States entered into a five-year deferred prosecution agreement (the “DPA”) with defendants-appellants HSBC Holdings plc and HSBC Bank, USA, N.A. (collectively, “HSBC”), deferring prosecution of charges under the Bank Secrecy Act, the International Emergency Economic Powers Act, and the Trading with the Enemy Act. The still-pending agreement provides that if HSBC complies with its extensive obligations under the DPA, the government will seek the dismissal of those charges at the conclusion of the DPA’s term. If, on the other hand, HSBC breaches the DPA, the government may seek to convict HSBC on the deferred charges. To inform that determination, the DPA provides for the appointment of an independent monitor charged with preparing periodic reports on HSBC’s ongoing compliance with anti-money laundering laws and with the DPA itself.

When the government and HSBC jointly moved for a speedy trial waiver, the district court (Gleeson, J.) invoked its supervisory power both to review and “approve” the DPA on its merits and to condition its approval on the court’s monitoring of the DPA’s implementation. In the exercise of that asserted authority, the district court subsequently ordered the government to file a confidential report prepared by the independent monitor regarding HSBC’s compliance with the DPA (the “Monitor’s Report”). In November 2015, appellee Hubert Dean Moore, Jr., a member of the public, moved to unseal the Monitor’s Report. The district court granted the motion, subject to redactions, finding

that the Monitor's Report was a "judicial document" to which the public enjoyed a qualified First Amendment right of access. The government and HSBC appeal the district court's unsealing and redaction orders, arguing that the district court ran afoul of separation of powers principles in involving itself in the implementation of the DPA.

We agree. By *sua sponte* invoking its supervisory power at the outset of this case to oversee the government's entry into and implementation of the DPA, the district court impermissibly encroached on the Executive's constitutional mandate to "take Care that the Laws be faithfully executed." U.S. Const. art. II, § 3. In the absence of evidence to the contrary, the Department of Justice is entitled to a presumption of regularity—that is, a presumption that it is lawfully discharging its duties. Though that presumption can of course be rebutted in such a way that warrants judicial intervention, it cannot be preemptively discarded based on the mere theoretical possibility of misconduct. Absent unusual circumstances not present here, a district court's role vis-à-vis a DPA is limited to arraigning the defendant, granting a speedy trial waiver if the DPA does not represent an improper attempt to circumvent the speedy trial clock, and adjudicating motions or disputes as they arise. Because the Monitor's Report is not now relevant to the performance of the judicial function, it is not a "judicial document" and the district court erred in ordering it unsealed. Accordingly, we reverse. . . .

The threshold merits question in this case is whether the Monitor's Report is a judicial document, as only judicial documents are subject to a presumptive right of public access, whether on common law or First Amendment grounds. Though we review the "ultimate decision to seal or unseal for abuse of discretion," we review the determination that the Monitor's Report is a judicial document *de novo*. In this Circuit, to qualify as a "judicial document" subject to a presumptive right of public access, "the item filed must be relevant to the performance of the judicial function and useful in the judicial process." *United States v. Amodeo* ("Amodeo I"). . . .

The district court ordered the filing of the Monitor's Report for its review in the exercise of its stated supervisory power to monitor the implementation of the DPA and to condition its approval of the DPA on such monitoring. If the district court's conception of its supervisory power in this context were correct, the Monitor's Report would quite obviously "be relevant to the performance of the judicial function and useful in the judicial process." *Amodeo I*. Thus, even though the appellants did not attempt to appeal the district court's Approval Order announcing its supervisory power over the DPA, whether the district court was correct to assert such a power is squarely at issue on this appeal. We hold that the district court erred in *sua sponte* invoking its supervisory power to monitor the implementation of the DPA in the absence of a showing of impropriety. . . .

The district court justified its concededly "novel" exercise of supervisory power in this context by observing that "it is easy to imagine circumstances in which a deferred prosecution agreement, or the implementation of such an agreement, so transgresses the

bounds of lawfulness or propriety as to warrant judicial intervention to protect the integrity of the Court.” We agree that it is not difficult to *imagine* such circumstances. But the problem with this reasoning is that it runs headlong into the presumption of regularity that federal courts are obliged to ascribe to prosecutorial conduct and decisionmaking. That presumption is rooted in the principles that undergird our constitutional structure. In particular, “because the United States Attorneys are charged with taking care that the laws are faithfully executed, there is a ‘presumption of regularity support[ing] their prosecutorial decisions and, in the absence of clear evidence to the contrary, courts presume that they have properly discharged their official duties.’” *United States v. Sanchez* (quoting *United States v. Armstrong*). In resting its exercise of supervisory authority on hypothesized scenarios of egregious misconduct, the district court turned this presumption on its head. . . .

To be sure, in its history, this nation has not been free of executive misconduct and abuse of power. And if misconduct in the implementation of a DPA came to a district court’s attention (for example, through a whistleblower filing a letter with the court), the district court might very well be justified in invoking its supervisory power *sua sponte* to monitor the implementation of the DPA or to take other appropriate action. The point is not that the court can or should disregard governmental misconduct, but rather that a federal court has no roving commission to monitor prosecutors’ out-of-court activities just in case prosecutors might be engaging in misconduct. *See Fokker Servs. B.V.*, (“[A]lthough charges remain pending on the court’s docket under a DPA, the court plays no role in monitoring the defendant’s compliance with the DPA’s conditions.”); *In re U.S.*, (“[A] judicial effort to supervise [a prosecutor’s] process of reaching a decision intrudes impermissibly into the activities of the Executive Branch of government.”). . .

Problem 1-3

You are a prosecutor. Should you pursue prosecution of the organization, or just individuals, or neither, in the following cases? Explain your reasoning, as well as what more you would want to know before making your decision. (A quick internet glance at some of the events in these cases might help prime your intuitions.) You should consider the DOJ policies excerpted above but need not view them as your exclusive criteria.

(a) The Exxon Corporation for the 1989 Exxon Valdez oil spill in Prince William Sound, Alaska, which was caused by an intoxicated ship captain.

(b) The BP Corporation for the 2010 oil spill in the Gulf of Mexico and the deaths of its workers which were caused by the explosion of the Deepwater Horizon rig.

(c) The Catholic Archdiocese of Boston for sexual abuse of children by members of the clergy who were allowed to continue employment after the Archdiocese had information of possible abuse by those persons. (The film *Spotlight* is a must-see if you haven't.)

2. FRAUD

To one who marveled what should be the reason that acts
and statutes are continually made at every Parliament
without intermission, and without end, a wise man made a
good and short answer, both which are well composed in
verse. ‘If you ask why there are so many laws, the answer
is that fraud ever increases on this earth.’ – Lord Coke,
Twyne’s Case, 76 Eng. Rep. 809 (K.B.) (1601)

Crimes of deception give rise to most of the investigations pursued, and offenses charged, in the field of corporate crime. Fraud is thus the most important legal concept to understand to develop a firm grasp of the “substantive criminal law” that applies in corporate crime practice. Fraud’s conceptual structure, and often its doctrinal particulars, lie at the core of business crimes in sectors ranging from securities dealing to health care services to consumer product manufacturing.

Fraud is both intuitive—rooted in the basic concept of deception—and endlessly complex—turning heavily on contextual particulars. The truth in the modern world is that deceptive statements and conduct are sometimes expected and permissible—think about used car sales, many kinds of negotiations, poker, or campaign promises—and sometimes forbidden—consider doctors and lawyers talking to patients and clients, securities brokers dealing with customers, and corporate executives speaking to shareholders.

Conceptually, fraud is a general problem with common features. Doctrinally, it varies somewhat with statutory particulars. This chapter will move from the concept to the doctrine, introducing fraud primarily through the broad, flexible, and frequently deployed federal mail and wire fraud statutes. The objective of this chapter is that students leave it with the ability to read the facts of the next scandal about deception in a business setting and form an opinion about whether the conduct amounted to criminal fraud.

The chapter is organized as follows: Part A introduces the concept of fraud through three examples. Part B deals briefly with (1) the jurisdictional component of the federal mail and wire fraud statutes and (2) the essential element of “materiality” in the crime of fraud. Part C introduces some potential limiting principles on the reach of the mail and wire fraud statutes. Part D explores the question of what kinds of interests might count as “property” in a mail or wire fraud prosecution. Part E covers the law of “honest services” mail and wire fraud—a concept that broadened the potential reach of these statutes, but that the Supreme Court then curtailed.

A. The Concept of Fraud

Before taking up the particulars of statutes and doctrine, it will help to develop an idea of the basic concept of fraud. What is fraud, and what isn’t? Consider the three examples

that follow. What do these examples tell us about what is involved in the social concept of fraud, both generally and particularly in financial markets? To work towards answering this question, pay at least as much attention to the facts in these examples as what is said about the law.

Note that the first case is a *civil lawsuit*, not a criminal prosecution. The court's discussion of fraud is nonetheless useful. To generalize, civil fraud claims differ from the crime of fraud mostly on two dimensions: (1) *mens rea* (more is required for criminal liability, of course), and (2) burden of proof (a preponderance of the evidence versus beyond a reasonable doubt). Additionally, civil fraud plaintiffs must prove damages because they seek to recover money. Prosecutors do not have to prove damages and, as elsewhere in criminal law, attempt and conspiracy are available theories even when a fraud does not come to fruition or succeed.

GOMEZ-JIMENEZ v. NEW YORK LAW SCHOOL, 103 A.D.3d 13 (N.Y. Sup. Ct. App. Div. 2012)

ACOSTA, J.

This appeal involves the propriety of the disclosures of postgraduate employment and salary data by defendant New York Law School to prospective students during the period August 11, 2005 to the present. Plaintiffs allege that the disclosures caused them to enroll in school to obtain, at a very high price, a law degree that proved less valuable in the marketplace than they were led to expect. We hold that defendant's disclosures, though unquestionably incomplete, were not false or misleading. We thus affirm the dismissal of the complaint.

Plaintiffs are graduates of the law school who attended the school between 2004 and 2011. They assert, individually and on behalf of all others similarly situated, a claim for deceptive acts and practices in violation of General Business Law § 349 and claims for common-law fraud and negligent misrepresentation. These claims are based on allegations that the employment and salary information published by defendant during the relevant time period concealed, or failed to disclose, that the employment data included temporary and part-time positions and that the reported mean salaries were calculated based on the salary information submitted by a deliberately small, specifically selected, subset of graduates. In addition, plaintiffs allege that defendant enhanced its numbers by, among other things, hiring unemployed graduates as short-term research assistants so that they could be classified as employed. Plaintiffs assert that defendant engaged in this fraud to increase its class size and use the high tuition demanded of its students to lavish perks and exorbitant salaries on its administration and large faculty. The complaint seeks damages and equitable relief, including the refund and reimbursement of plaintiffs' tuition.

Defendant moved to dismiss the complaint pursuant to CPLR 3211(a)(1) and (7), arguing, among other things, that its employment reports were not materially misleading because they (1) complied with the then applicable disclosure rules of the American Bar Association (ABA); (2) made no representation or implication that they included only full-time, permanent employment that required or preferred a law degree; and (3) explicitly revealed that the reported salary ranges were based on a small sample of graduates. . . .

To state a cause of action for fraudulent misrepresentation, “a plaintiff must allege a misrepresentation or a material omission of fact which was false and known to be false by defendant, made for the purpose of inducing the other party to rely upon it, justifiable reliance of the other party on the misrepresentation or material omission, and injury” (*Mandarin Trading Ltd. v Wildenstein*). “A cause of action for fraudulent concealment requires, in addition to the four foregoing elements, an allegation that the defendant had a duty to disclose material information and that it failed to do so” (*P.T. Bank Cent. Asia, N.Y. Branch v ABN AMRO Bank N.V.*). “In addition, in any action based upon fraud, the circumstances constituting the wrong shall be stated in detail.” *Id.* (citing CPLR 3016 [b]). To state a cause of action for negligent misrepresentation, in turn, the plaintiff must allege “(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff; (2) that the information was incorrect; and (3) reasonable reliance on the information” (*Mandarin Trading*).

Plaintiffs argue that they stated causes of action for common law fraud and negligent misrepresentation based on their allegations that defendant knowingly published misrepresentations about its graduates’ employment rates and salaries, and fraudulently concealed the fact that the employment rates included temporary, part-time, voluntary or non-JD-required/preferred employment. However, . . . the employment and salary data disclosed by defendant was not actually false (even if it was incomplete). Thus, the fraud claim fails insofar as it is based on fraudulent misrepresentations (*see Pappas v Harrow Stores*; *see also MacDonald v Thomas M. Cooley Law Sch.*, [dismissing a lawsuit against a law school on the grounds that plaintiff’s “subjective misunderstanding of information that is not objectively false or misleading cannot mean that (defendant) has committed the tort of (fraud)”]). Furthermore, because plaintiffs have not alleged any special relationship or fiduciary obligation requiring a duty of full and complete disclosure from defendant to its prospective students, we dismiss plaintiff’s claim to the extent that it is based on fraudulent and negligent misrepresentation.

We are not unsympathetic to plaintiffs’ concerns. We recognize that students may be susceptible to misrepresentations by law schools. As such, “[t]his Court does not necessarily agree [with Supreme Court] that [all] college graduates are particularly sophisticated in making career or business decisions” (*MacDonald*). As a result, prospective students can make decisions to yoke themselves and their spouses and/or their children to a crushing burden of student loan debt, sometimes because the schools have made less than complete representations giving the impression that a full-time job is easily obtainable, when, in fact, it is not.

Given this reality, it is important to remember that the practice of law is a noble profession that takes pride in its high ethical standards. Indeed, in order to join and continue to enjoy the privilege of being an active member of the legal profession, every prospective and active member of the profession is called upon to demonstrate candor and honesty in their practice. This requirement is not a trivial one. For the profession to continue to ensure that its members remain candid and honest public servants, all segments of the profession must work in concert to instill the importance of those values. “In the last analysis, the law is what the lawyers are. And the law and lawyers are what the law schools make them.” Defendant and its peers owe prospective students more than just barebones compliance with their legal obligations. Defendant and its peers are educational not-for-profit institutions. They should be dedicated to advancing the public welfare. In that vein, defendant and its peers have at least an ethical obligation of absolute candor to their prospective students.

Accordingly, the order of the Supreme Court, New York County (Melvin L. Schweitzer, J.), entered March 21, 2012, which granted defendant New York Law School’s motion to dismiss the complaint, should be affirmed, without costs.

The next case further explores the question of what makes a particular business practice fraudulent or not. The case also includes a very useful explanation of futures trading which is, in its essence, similar to many of the securities derivative trading activities you will read about throughout these materials. The explanation here introduces the concepts involved in derivatives trading.

UNITED STATES v. DIAL, 757 F.2d 163 (7th Cir. 1985)

POSNER, Circuit Judge:

Donald Dial and Horace Salmon were found guilty by a jury of mail and wire fraud (18 U.S.C. §§ 1341 and 1343) in connection with the trading of silver futures on the Chicago Board of Trade. Dial was sentenced to 18 months in prison to be followed by 5 years on probation, and was fined \$16,000. Salmon was sentenced to 5 years on probation with 30 days of this period to be spent in work release (meaning that he will work during the day but sleep in jail), and was fined \$15,000 and ordered to do 500 hours of community service.

The main argument of the appeals is that the conduct in which the defendants engaged was not fraudulent. To understand this argument you must know something about commodity futures. . . . A futures contract is a contract for the sale of a commodity at a future date; but unlike a forward contract, which it otherwise resembles, a futures contract rarely results in actual delivery of the commodity. Suppose that today, a day in March, the price of silver for delivery in June is \$4 an ounce, but you think the price will go up to \$5 by the time June rolls around. You would then buy June silver at \$4. The person on the other side of the contract, the seller, presumably thinks differently—that the price in June will be \$4 or lower. You are “long” on the contract; you expect the

price to rise. He is “short”; he expects it to fall. As the months go by, the price of June silver will change as more and more information becomes available on the likely demand and supply of silver in June. Suppose in May the price hits \$5 and you want to take your profit. All you have to do is sell the contract for \$5; you don’t have to worry about ending up with a pile of silver to dispose of. Nor need the person who sold you the silver for \$4, and who probably never had any silver, have to worry about getting some and delivering it in June to the person to whom you sold your contract. All he has to do in order to take his loss and get out of the market is buy (at \$5) the same amount of June silver that he had agreed to sell; the two contracts cancel, and he is out of the market.

What we have described is speculation but not, as the defendants contend, gambling. Commodity futures trading serves a social function other than to gratify the taste for taking risks—two other social functions in fact. It increases the amount of information that the actual consumers of the commodity (mainly, in the case of silver, manufacturers of film, electronics, and jewelry) have about future price trends, by creating incentives for investors and their advisers to study and forecast demand and supply conditions in the commodity. And it enables the risk-averse to hedge against future uncertainties. Suppose a jewelry manufacturer knows that it will need a certain amount of silver in June and is worried that the price might be very high by then. By buying June silver futures at \$4 it can place a ceiling on what the silver will cost it (sellers can hedge similarly, by selling futures). Suppose that by June the price has risen to \$5. When the manufacturer buys silver then, it will have to pay \$5; but by selling its futures contract (to someone who had gone short on June silver) just before delivery is due, for \$5, which is to say at a profit of \$1, the manufacturer ends up paying a net of only \$4 for the silver. The manufacturer could have hedged by means of a forward instead of a futures contract, that is, by signing a contract with a silver company for delivery in June at \$4. But then it would have to locate and negotiate with a particular seller in advance, rather than wait till June when it will actually want the silver and buy then at the current price (\$5). Since futures contracts are standard contracts—for example, the Chicago Board of Trade’s silver futures contract in the period relevant to this case was a contract for 5,000 troy ounces of silver of a specified grade and quality—there is no negotiation over terms; and since the transaction is guaranteed by the clearing members of the exchange, see *Bernstein v. Lind-Waldock & Co.*, the buyer does not have to worry about whom he is dealing with.

Traders on a commodity futures exchange will, however, want some assurance that there are no people in the market who have preferential access to information. If there are known to be such people, the other traders will tend to leave the exchange for other exchanges that do not have such people—and several commodity exchanges besides the Board of Trade offer trading in silver futures contracts. If trading is “rigged” on all commodity futures exchanges, there will be less commodity futures trading, period, and the social benefits of such trading, outlined above, will be reduced. The greatest danger of preferential access comes from the brokers, who often trade on their own account as well as for their customers. Brokers have more information than any of their customers because they know all their customers’ orders. Suppose a customer directs his broker to

buy a large number of silver futures contracts. The broker knows that when he puts this order in for execution the price will rise, and he can make it rise further if he waits to execute the order until he can combine it with other buy orders from his customers into a “block” order that will be perceived in the market as a big surge in silver demand. If, hoping to profit from this knowledge, the broker buys silver futures on his own account just before putting in the block order and then sells at the higher price that the block order generates, he will hurt his customers. His purchase (if substantial) will have caused the market price to rise just before the block order went in, and thus the price that his customers pay will be higher than otherwise; and his sale will cause the price to fall, and thus reduce the value of his customers’ contracts. So if “trading ahead”—as the practice of a broker’s putting in his own orders for execution ahead of his customers’ orders is called—became widespread, customers would realize that the market was rigged against them. And trading ahead serves no social function at all. The broker obtains a profit from information that he has not invested in producing but that comes to him automatically in his capacity as a broker. It is like a lawyer’s discovering that his client is about to make a takeover bid for another company and rushing out and buying some of that company’s stock before the bid is made public.

Against this background we consider the facts as the jury could reasonably have found them in the government’s favor. Dial, an experienced silver trader, was the manager of a branch office of the Clayton Brokerage Company. Salmon was the company’s president. In 1978 Dial was looking for a very large investor to make a multi-million dollar purchase of silver futures through Clayton Brokerage. In preparation for the appearance of such an investor Salmon arranged for Dial to control a trading account at Clayton Brokerage in the name of Multi-Projects (Cayman), Ltd., a Cayman Islands corporation. An “equity raiser” named Kirst located on Dial’s behalf the putative grand investor in the person of Nasrullah Khan, who said he represented a group of investors organized as the International Monetary Corporation (IMC). While negotiations between Khan and Dial’s son were proceeding, Dial began buying silver futures for the Multi-Projects account. But he put up no cash or cash equivalent for these purchases. To understand the significance of this omission, recall that a futures contract commits each of the contracting parties to buy or sell the underlying commodity at a date in the future at whatever the market price then is. Since the brokerage house (here, Clayton Brokerage) is responsible for the undertakings in its customers’ futures contracts, it wants to be sure that each customer has the financial wherewithal to make good on his obligation under his futures contract should the price move in the opposite direction from his expectations. To this end, the brokerage house requires each of its customers to put up “margin”—cash or a cash equivalent such as a Treasury bill—as a guarantee of solvency. The required margin is a (small) percentage of the contract price and fluctuates as the price fluctuates.

Brokerage houses naturally keep very close tabs on their margin accounts, insisting that as the price of the futures contracts bought on margin fluctuates the buyer increase his margin (if necessary—it will be necessary for the long if the market price of the futures contract falls, and for the short if the price rises) so that the brokerage house will always

have a cushion under its guarantee of its customers' transactions. Therefore when Dial bought silver futures for the Multi-Projects account without putting up any cash or cash equivalent—bought a lot of silver futures, 200 in all, worth \$5 million—Clayton Brokerage Company's computer department notified its margin department that margin calls amounting to \$100,000 should be issued to Multi-Projects, and they were. But Salmon instructed the director of the computer department to delete the Multi-Projects account from its computer programs and as a result the margin calls (which were never met) stopped.

On the weekend of November 10, 1978, at a time when Dial's personal trading account was in a perilous position (he had put up \$1 million in Treasury bills against margin calls and all but \$6,000 had been debited to meet them), negotiations with Khan were successfully concluded and Kirst was dispatched to London to pick up IMC's check for \$25 million. On the same weekend Dial engaged in intensive solicitation of his regular customers to create a block order for silver futures to put in for execution on Monday, November 13. Kirst as directed deposited IMC's check—drawn on the Oxford International Bank in the Turks and Caicos Islands, and not certified—on Monday morning in Clayton Brokerage Company's account in a Chicago bank. Between 8:43 a.m. and 12:15 p.m. Salmon transmitted to the floor of the Board of Trade an order to buy 12 February (1979) silver futures contracts, and Dial transmitted orders on behalf of Multi-Projects, himself, his son, and Kirst and other associates, including two secretaries, for a total of 262 February futures. During this period the price of February silver fluctuated between \$5.83 and \$5.86 an ounce. At 12:40 p.m. Dial put in the block order, which was to buy 583 February futures, at higher prices—between \$5.88 and \$5.90. At 12:59 (two minutes after having bought 2,000 December futures for IMC), Dial bought 1,192 February futures for IMC at \$5.92. Later that afternoon Salmon sold 10 of his 12 February futures at \$5.91, seven cents more than he had bought them for that morning. The price kept on rising as the afternoon wore on, until it reached its limit—a 20 cent rise from the opening price. (Exchanges impose daily limits on price fluctuations; no trading is allowed at prices outside of the limits.)

At some point during the day, Dial and Salmon learned that Khan's check had not been certified. Yet Dial, authorized by Salmon, continued in the following days to buy silver futures heavily for IMC's account, even as it became increasingly likely from communications with the Oxford Bank that the check would never clear. On November 28 Dial decided the price of silver was now too high. He placed an order to sell 200 February silver futures contracts for the Multi-Projects account at \$6.13. He had again assembled a block order (also to sell) from his customers, which he placed ten minutes after the Multi-Projects order and which was executed at lower prices than all but eight of the Multi-Projects contracts. The IMC check never did clear, and eventually the account was liquidated—at a profit. However, we were told at argument that in subsequent silver trading Dial was wiped out.

The surge of buy orders on November 13 caught the attention of Board of Trade officials and the Commodity Futures Trading Commission. Only 1,587 February silver futures

contracts had been traded on the most recent trading day, November 10; 4,756 were traded on November 13. The closing price for February silver futures on the Board of Trade on November 13 had been 13 cents higher than the closing price on the New York Commodity Exchange, where a similar futures contract is traded—an unusual discrepancy between such close substitutes. The Board and the Commission began an investigation of Clayton Brokerage Company's trading of the IMC account. Dial and Salmon lied (under oath) a number of times in the course of this investigation—Dial saying for example that he had not learned that IMC's check was not certified until the week of November 28 (and later admitting that he had known this on November 13), Salmon for example denying his interest in Multi-Projects.

The question for decision is whether the conduct we have described amounts to a fraud; if so, the defendants are guilty of federal wire and mail fraud, as there is no dispute that the telephone and the mails were used extensively. Although stiff federal criminal penalties for commodity dealers who defraud or attempt to defraud their customers were added to the Commodity Futures Trading Act on October 1, 1978, see 7 U.S.C. §§ 6b(A), 13(b), about six weeks before the defendants' scheme fructified in the trading on November 13, 1978, the defendants were not charged under these sections (they were, however, charged with and acquitted of filing a false report under another section), perhaps because the ambiguous wording of section 6b, on which see 1 Bromberg & Lowenfels, *Securities Fraud & Commodities Fraud* § 4.6(452) (1984), makes it an uncertain vehicle for a criminal prosecution.

The defendants do not argue that the Commodity Futures Trading Act supersedes the federal mail or wire fraud statutes, and are wise not to make the argument. See e.g., *United States v. Brien*. But they emphasize that none of the defendants' customers, or the defendants' employer, Clayton Brokerage Company, lost money as a result of their acts and that there is no statute, regulations, or Board of Trade rule that specifically forbids insider trading in commodity futures (as in securities), or block trading, or trading ahead (other than by floor brokers—the brokers who actually execute the trades on the floor of the exchange—which the defendants were not). Rule 150(b) of the Board of Trade, forbidding “trad[ing] systematically against the orders or position of his customers,” may implicitly forbid trading ahead by any broker; but the only specific rule the defendants violated was the Board of Trade's Rule 210, which requires that accounts be margined. Neither the Multi-Projects account nor the IMC account was margined—the latter not only because IMC's check was no good but because margin must be in cash or a cash equivalent, such as a certified check.

But we think there was a scheme to defraud in a rather classic sense, which is obscured only because commodity futures trading is an arcane business—though not to these defendants. Fraud in the common law sense of deceit is committed by deliberately misleading another by words, by acts, or, in some instances—notably where there is a fiduciary relationship, which creates a duty to disclose all material facts—by silence. See Prosser and Keeton on the Law of Torts §§ 105–06 (5th ed. 1984). Liability is narrower for nondisclosure than for active misrepresentation, since the former

sometimes serves a social purpose; for example, someone who bought land from another thinking that it had oil under it would not be required to disclose the fact to the owner, because society wants to encourage people to find out the true value of things, and it does this by allowing them to profit from their knowledge. But if someone asks you to break a \$10 bill, and you give him two \$1 bills instead of two \$5's because you know he cannot read and won't know the difference, that is fraud. Even more clearly is it fraud to fail to "level" with one to whom one owes fiduciary duties. The essence of a fiduciary relationship is that the fiduciary agrees to act as his principal's alter ego rather than to assume the standard arm's length stance of traders in a market. Hence the principal is not armed with the usual wariness that one has in dealing with strangers; he trusts the fiduciary to deal with him as frankly as he would deal with himself—he has bought candor.

As a broker, and therefore, the defendants concede (as they must, *see, e.g., Marchese v. Shearson Hayden Stone, Inc.*), a fiduciary of his customers, Dial, when he solicited his customers to participate in block orders, implicitly represented to them that he would try to get the best possible price. He could have gotten a better price by putting their orders in ahead of the orders he placed for his own accounts and those of his friends. In trading ahead of his customers without telling them what he was doing, he was misleading them for his own profit, and conduct of this type has long been considered fraudulent. *See SEC v. Capital Gains Research Bureau, Inc.* . . .

It is true that the Board of Trade has no express rule against trading ahead of a customer (other than by a floor broker) and that there is no other specific prohibition (relevant to this case) of insider trading on commodity futures exchanges. But it is apparent that such a practice, when done without disclosure to the customer, is both contrary to a broker's fiduciary obligations and harmful to commodity futures trading, because it means that a person wanting to engage in such trading can trade only through an agent who has a conflict of interest.

The federal mail and wire fraud statutes have often been used to plug loopholes in statutes prohibiting specific frauds, a pertinent example being the application of the mail fraud statute to insider trading in securities before the promulgation of the SEC's Rule 10b-5. Although some scholars question the appropriateness of prohibiting insider trading by corporate officers, pointing out for example that (at least if short selling by insiders is prohibited) it gives officers a greater incentive to take risks that may benefit the shareholders, we would be surprised to find anyone saying a good word for insider trading by a broker; the only information he exploits is his knowledge of his customers' intentions.

The fraud was not only Dial's, but Salmon's, who was Dial's boss, knew what was going on, furthered the scheme by arranging for Dial to use the Multi-Projects account, and profited personally from the fraud along with Dial (indeed, more directly than Dial, who did not sell silver on his own account, as Salmon did, on November 13). Dial and Salmon not only defrauded their own customers; they also defrauded the people from whom they

bought silver futures contracts, and their employer, the Clayton Brokerage Company, by trading, without margin, the Multi-Projects and IMC accounts. Trading without margin gives a misleading signal, because a signal not backed by any cash. If you had no assets at all, and could buy futures contracts at will (say \$25 million worth), you could have a powerful influence on futures prices. Yet you might be totally irresponsible and incompetent in forecasting such prices, and might therefore reduce the accuracy of the market as a device for forecasting price; for you would lack the stimulus to sober reflection that comes from having to put one's money where one's mouth is. Trading without margin also shifts risk from the trader to the broker, in this case from Dial and Salmon to their employer, the Clayton Brokerage Company, which would have had to make good any losses on the Multi-Projects and IMC accounts. This risk was not disclosed to Clayton Brokerage any more than trading ahead was disclosed to the defendants' customers or the lack of cash backing for the enormous buying by Multi-Projects and IMC was disclosed to those who sold futures contracts to the defendants and their associates. Far from disclosing what they were doing, Dial and Salmon actively concealed it by using an account with an uninformative name (Multi-Projects) and by Salmon's ordering the deletion of the Multi-Projects account from Clayton Brokerage Company's computer records. The defendants' failure to disclose to their employer what was going on was the breach of the defendants' fiduciary duty as employees. Although they owed no similar duty to people on the other side of their silver futures transactions, their trading an unmargined account was an active misrepresentation and hence actionable even without a breach of fiduciary duty.

It is true that no one "lost money," because silver prices were rising for reasons other than the defendants' unmargined trading. If that trading had been the only thing jacking up the price, the price would have collapsed when the IMC account was liquidated—and it did not; between November 1978 and February 1980, the average monthly price of silver rose to \$38.27 per ounce. But the analysis is incomplete. The defendants' customers did lose money—the additional profit they would have made if the defendants had placed their customers' orders ahead of rather than behind their own orders. And Clayton was subjected to the risk of having to make good what might have been \$25 million in trading losses in the IMC account. The risk did not materialize, but just as it is embezzlement if an employee takes money from his employer and replaces it before it is missed, so it is fraud to impose an enormous risk of loss on one's employer through deliberate misrepresentation even if the risk does not materialize. Finally, the defendants confused the market by signaling the presence of big buyers who had not in fact put up any money (IMC and Multi-Projects); and to undermine the confidence on which successful futures trading depends is to harm the exchanges, and the society at large. The evidence that the defendants' misrepresentations were deliberate was overwhelming, beginning with the establishment of an offshore trading operation in an uninformative name; continuing with the timing of the defendants' purchases for their own and their friends' accounts ahead of the block order and the IMC orders, all carefully orchestrated over the preceding weekend; culminating in the defendants' repeated lies to the investigating authorities; and including the violation of the margin requirements

(Rule 210 of the Board of Trade) and the concealment of the defendants' interests in the Multi-Projects account. It is inessential whether the defendants also violated Rule 150(b).

Concern has been expressed with the possible abuse of the mail and wire fraud statutes to punish criminally any departure from the highest ethical standards. When the broad language of the statutes ("Whoever, having devised or intending to devise any scheme or artifice to defraud. . ."), which punishes the scheme to defraud rather than the completed fraud itself, is read by the light of the broad concept of fraud that has evolved in civil cases and the precept that the mail and wire fraud statutes are not confined to common law fraud, concern naturally arises that the criminal law will be used to hold businessmen to the maximum, rather than minimum, standards of ethical behavior. It is not allayed by such popular formulations of the test for mail or wire fraud as the Fifth Circuit's in *Gregory v. United States*, which continues to be repeated with approval, *see, e.g., United States v. Bohonus*: fraud is whatever is not a "reflection of moral uprightness, of fundamental honesty, fair play and right dealing in the general and business life of members of society." Courts have been more concerned with making sure that no fraud escapes punishment than with drawing a bright line between fraudulent, and merely sharp, business practices, even though the universality of telephone service has brought virtually the whole commercial world within the reach of the wire-fraud statute. But we need not explore the outer bounds of mail and wire fraud in this case. The defendants' elaborate efforts at concealment provide powerful evidence of their own consciousness of wrongdoing, making it unnecessary for us to decide whether the same conduct, done without active efforts at concealment, would have been criminal.

UNITED STATES v. FINNERTY, 533 F.3d 143 (2d Cir. 2008)

DENNIS JACOBS, Chief Judge:

In this securities fraud case, the government appeals from a judgment of acquittal entered by the district judge following a jury's guilty verdict. Defendant–Appellee David Finnerty was a specialist at the New York Stock Exchange ("NYSE") who engaged in the practice of "interpositioning"—the arbitrage of the gap between customers' orders to buy and sell stock—to the benefit of his firm's account and (via compensation) himself. The sole issue on appeal is whether the government proved that Finnerty's conduct was deceptive.

This case is one of several arising from an investigation into the practices of specialists on the NYSE trading floor. The NYSE operates as an auction market with specialists fielding competing bids and offers for stock in the 2,800 listed companies. We recently described the role of the specialist firms as follows:

Each security listed for trading on the NYSE is assigned to a particular [specialist] Firm. To execute purchases and sales of a particular security, buyers and sellers must present their bids to buy and offers to

sell to the specific Specialist Firm assigned to that security. The primary method of trading on the Exchange occurs through the NYSE's Super Designated Order Turnaround System, which transmits orders to buy and sell to the Specialist Firm electronically. The orders appear on a special electronic workstation often referred to as the "display book." Each Specialist Firm has a computerized "display book" at its trading post that permits the Firm to execute orders for the market.

In addition to executing trades for NYSE customers, specialists trade for the "proprietary" or "principal" account of their own firm.

In 2002, the NYSE opened an investigation into improper trading by specialists. The investigation focused on two practices: "interpositioning" and "trading ahead." A specialist engages in interpositioning when he "prevent[s] the normal agency trade between matching public orders and instead interpose[s]" himself "between the matching orders in order to generate profits" for the principal account-in other words, when the specialist acts as an arbitrager by taking a profit on the spread between the bid price and the ask price of customers' orders. A specialist trades ahead when he trades for his own "account before undertaking trades for public investors." These practices implicate two NYSE rules.

NYSE Rule 104 allows for a proprietary trade when it is "reasonably necessary to permit [a] specialist to maintain a fair and orderly market," and otherwise prohibits "such dealings." NYSE Rule 92(a) prohibits a proprietary trade when the specialist "has knowledge of any particular unexecuted customer's order to buy (sell) such security which could be executed at the same price."

In 2006, Finnerty was charged with three counts of securities fraud. The superseding indictment alleged that while he was employed by Fleet Specialists, Inc. between 1999 and 2003, Finnerty "caused approximately 26,300 instances of interpositioning, resulting in illegal profits to his dealer account of approximately \$4,500,000, and approximately 15,000 instances of trading ahead, resulting in approximately \$5,000,000 in customer harm." The indictment charged that Finnerty thus engaged in a fraudulent and deceptive course of conduct, in violation of 15 U.S.C. §§ 78j(b) and 78ff and 17 C.F.R. § 240.10b-5. . . .

At trial, the government narrowed its case. It did not undertake to prove trading ahead; it focused exclusively on interpositioning. It did not try to prove that Finnerty owed a fiduciary duty to public customers. . . .

The government called three former NYSE clerks, who testified that Finnerty directed them to execute interpositioning trades for the principal account ahead of (and to the detriment of) existing public orders. One of the clerks, Philip Finale, testified that just before he was scheduled to testify before the NYSE investigation, Finnerty pulled him aside and whispered: "don't say anything to incriminate [me], because it's going to incriminate [you] also."

The government displayed graphics showing the sequence of keystrokes that compose an interpositioning trade. An NYSE managing director testified about the computer codes used to generate “exception reports,” which identify instances of interpositioning and trading ahead. Several summary charts of that data showed 26,283 instances of interpositioning trades under Finnerty’s watch. In 95% of those instances, Fleet’s principal account profited—yielding a total of \$4.5 million.

Joseph DiPrisco, who served as Fleet’s CFO during the relevant period, testified that individual “profitability” was one factor that determined a specialist’s bonus. Fleet generally paid a specialist 15 to 20% of his profits.

Finally, the government introduced into evidence Finnerty’s testimony before the NYSE, in which Finnerty admitted that he and his clerks could trade for the principal account only when necessary to maintain a fair and orderly market, and only when the public customers subsequently received the same or a better price than the principal account received.

Finnerty called Dr. Patrick Conroy, who testified that Finnerty’s 26,283 alleged acts of interpositioning represented only .94% of the total trades executed by Finnerty during the relevant time period. . . .

Section 10(b) of the 1934 Act prohibits the use of any “manipulative or deceptive device or contrivance” in connection with the purchase or sale of securities. “The language of § 10(b) gives no indication that Congress meant to prohibit any conduct not involving manipulation or deception.” *Santa Fe Indus. Inc. v. Green*. The government has abandoned on appeal any claim of market manipulation. So the question is, what did Finnerty say or do that was deceptive?

The government admits that Finnerty made no misstatement. The government told the jury that the “real issue” in the case was “whether David Finnerty directed” the interpositioning trades and whether he did it “intentionally and with the intent to defraud.” This was, in essence, a theory of non-verbal deceptive conduct.

“Conduct itself can be deceptive,” and so liability under § 10(b) or Rule 10b–5 does not require “a specific oral or written statement.” *Stoneridge Inv. Partners, LLC v. Scientific–Atlanta*. Broad as the concept of “deception” may be, it irreducibly entails some act that gives the victim a false impression. “Theft not accomplished by deception (e.g., physically taking and carrying away another’s property) is not fraud absent a fiduciary duty.” *In re Refco Capital Markets, Ltd. Brokerage Customer Sec. Litig.*

The government has identified no way in which Finnerty communicated anything to his customers, let alone anything false. Rather, viewing the evidence in the light most favorable to the government, the government undertook to prove no more than garden variety conversion. As the government put it during summation, “David Finnerty stole from his public customers tens of times a day, sometimes over a hundred times in one day . . .” The government later analogized Finnerty’s conduct to a bank teller who

takes in hundreds of deposits a day and he gives out hundreds of withdrawals, and just once, once every day takes he takes one of those deposits, instead of putting it in the till, he puts it in his pocket. He committed a crime probably less than 1 percent of the time in that example, but does that make it right to steal? Of course it doesn't.

Like a thieving bank teller, the government argued, Finnerty had the motive and the means to profit from interpositioning. But there is no evidence that Finnerty conveyed an impression that was misleading, whether or not it could have a bearing on a victim's investment decision in connection with a security. We need not decide whether some form of communication by the defendant is always required to prove deception (although that is the template of virtually every case). To impose securities fraud liability here, absent proof that Finnerty conveyed a misleading impression to customers, would pose "a risk that the federal power would be used to invite litigation beyond the immediate sphere of securities litigation and in areas already governed by functioning and effective state-law guarantees." *Stoneridge*. . . .

The evidence shows (in the words of the government's brief) that "Finnerty, while holding himself out as a specialist obligated to follow NYSE rules and refrain from interpositioning, interpositioned on a massive scale under the guise of maintaining a fair and orderly market." Accordingly, the government argues, a reasonable jury could find that at least some customers were aware of the NYSE rules, would have expected Finnerty to comply with the rules, and were therefore deceived when Finnerty violated them. The government relies on the following chain of premises and inferences: (1) brokerage houses are "members" of the NYSE; (2) as members, brokerage houses know about (and are subject to) the NYSE rules against interpositioning; (3) brokerage houses were customers of Finnerty; so (4) Finnerty's violation of the NYSE rules deceived the brokerage houses. In essence, the government seeks to impose criminal liability based on a background assumption of compliance with NYSE rules. . . .

Some customers may have understood that the NYSE rules prohibit specialists from interpositioning, and that the rules amount to an assurance (by somebody) that interpositioning will not occur. As a consequence, some customers may have expected that Finnerty would not engage in the practice. But unless their understanding was based on a statement or conduct by Finnerty, he did not commit a primary violation of § 10(b)—the only offense with which he was charged. . . .

Taking a slightly different tack, the government argues that Finnerty's scheme was "self-evidently deceptive" because he had "two critical advantages" over his customers: he could see all pending orders to buy and sell a particular stock, and he determined the price ultimately paid.

It may be that Finnerty unfairly profited from superior information. But "not every instance of financial unfairness constitutes fraudulent activity under § 10(b)." *Chiarella v. United States*. And characterizing Finnerty's conduct as "self-evidently deceptive" is conclusory; there must be some proof of manipulation or a false statement, breach of a

duty to disclose, or deceptive communicative conduct. “Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud.” .

The government points to evidence showing Finnerty’s consciousness of guilt: (1) Finnerty testified before the NYSE that he traded ahead of customers only when the public received the same or a better price than his principal account did (testimony that was countered by the government’s demonstrative chart, which showed that the customer was disadvantaged 95% of the time); (2) clerk Philip Finale testified that Finnerty pressured him to lie about being instructed to execute interpositioning trades; and (3) shortly after Finnerty learned about the NYSE investigation, his rate of interpositioning declined almost to zero.

Viewed in the light most favorable to the government, this evidence shows that Finnerty knew he had violated an NYSE rule, and tried to cover it up. But violation of an NYSE rule does not establish securities fraud in the civil context, let alone in a criminal prosecution. Finnerty may have known that interpositioning was wrong within the context of his employment, and that it put him at risk professionally; but an awareness of peril, a guilty conscience or an impulse to cover one’s tracks does not bespeak criminally fraudulent conduct within the context of the securities laws. . . .

Problem 2-1	
(a)	What is Judge Posner’s point in the final sentence of his opinion in <i>Dial</i> ? How does the point relate to his theory of when nondisclosure of facts may constitute fraud?
(b)	Was <i>Dial</i> correctly decided? <i>Finnerty</i> ? Can the two opinions be reconciled or is this a sort of circuit split (though, technically, one case involved the wire fraud statute and the other the securities fraud statutes)?

Problem 2-2

Should the following be called fraud? Explain.

- (a) An antique dealer is invited to tea at the house of an elderly woman who attends his church. In the living room, he spots a desk he knows is worth a great deal of money. He says, “I just adore that cute little desk.” She says, “I wish I could get it out of here. I keep banging into it.” He offers her \$100 for the desk, which she accepts. He sells the desk later that day to a professional auctioneer for \$10,000.
- (b) A parent with young children tells a spouse that she needs to go back to the office for a few hours and cannot help with the kids that evening. On the way, she stops at a bar and stays for a couple of hours, enjoying beers and a basketball game.
- (c) Accounting rules say that companies should maintain “reserve” accounts for large expected liabilities, such as litigation costs. As reported in its disclosures to its shareholders, PharmCo establishes a \$500 million reserve account, representing its “best estimate” of how much it will cost to litigate a wave of products liability lawsuits relating to a drug that caused unanticipated side effects. Six months later, PharmCo reduces the reserve account to \$200 million because it needs an additional \$300 million in earnings in order to reach its earnings-per-share goal for the quarter. The week before, outside counsel had told the PharmCo General Counsel that “the litigation is going somewhat better than we expected.”

As a final entrée into the concepts underlying criminal fraud, the following case is about the meaning of cheating and dishonesty in English law, not the law of fraud itself. But this English court’s discussion of cheating in gambling provides much insight into the problem of how to determine whether deception in a particular context is wrongful. The case involved a contract dispute turning on a criminal law definition. The unusual factual setting is both vivid and illustrative. (The opinion, while heavily edited here, is still long—British judges sometimes appear to believe they are paid by the page.)

IVEY v. GENTING CASINOS (UK) LTD, [2017] UKSC 67 (UK Supreme Court 2017)

LORD HUGHES:

This case, in which a professional gambler sues a casino for winnings at Punto Banco Baccarat, raises questions about (1) the meaning of the concept of cheating at gambling, (2) the relevance to it of dishonesty, and (3) the proper test for dishonesty if such is an essential element of cheating.

Over two days in August 2012 Mr. Ivey, the claimant in this case, deployed a highly specialist technique called edge-sorting which had the effect of greatly improving his

chances of winning. He had the help of another professional gambler, Cheung Yin Sun ("Ms. Sun"). First they set up the conditions which enabled him to win. Then, later that evening and the following day, over the course of some hours, he won approximately £7.7m. The casino declined to pay, taking the view that what he had done amounted to cheating. His case is that it was not cheating, but deployment of a perfectly legitimate advantage. . . .

Punto Banco is a variant of Baccarat. It is not normally, to any extent, a game of skill. Six or eight decks or, in English nomenclature, packs of 52 cards are dealt from a shoe, face down by a croupier. Because the cards are delivered one by one from the shoe, she has only to extract them; no deviation is permitted in their sequence. She places them face down in two positions on the table in front of her, marked "player", the "Punto" in the name, and "Banker", "Banco". Those descriptions label the positions marked on the table; there need be no person as "player" and ordinarily there is not. She slides the cards from the shoe, face down, one card to player, one to banker; a second to player and a second to banker. . . .

The basic object of the game is to achieve, on one of the two positions, a combination of two or three cards which, when added together, is nearer to 9 in total than the combination on the other position. Aces to 9 count at face value, 10 to King inclusive count as nothing. Any pair or trio of cards adding up to more than 10 requires 10 to be deducted before arriving at the counting total. Thus 4 plus 5 equals 9, but 6 plus 5 (which equals 11) counts as only 1.

Punters (of whom there need only be one) play the house. They bet before any card is dealt and can bet on either the player or banker position. The cards are revealed by the croupier after a full hand (or "coup"), usually of four cards, two to each position, has been dealt. . . . The different odds mean that the casino, or house, enjoys a small advantage, taken over all the play. That is standard and well known to all; casinos publish the percentage "house edge" which they operate. In Punto Banco at Crockfords it was 1.24% if player wins and 1.06% if banker wins.

A pack of 52 playing cards is manufactured so as to present a uniform appearance on the back and a unique appearance on the face. . . . In casino games in which the orientation of the back of the card may matter, cards are used which are in principle indistinguishable whichever way round they are when presented in a shoe. . . .

"Edge-sorting" becomes possible when the manufacturing process causes tiny differences to appear on the edges of the cards so that, for example, the edge of one long side is marginally different from the edge of the other. Some cards printed by Angel Co Ltd for the Genting Group (which owns Crockfords) have this characteristic, apparently within the narrow tolerances specified for manufacture. The pattern is not precisely symmetrical on the back of the cards. The machine which cuts the card leaves very slightly more of the pattern, a white circle broken by two curved lines, visible on one long edge than on the other. The difference is sub-millimetric, but the pattern is, to that very limited extent, closer to one long edge of the card than it is to the other. Before a

card is dealt from a shoe, it sits face down at the bottom of the shoe, displaying one of its two long edges. It is possible for a sharp-eyed person sitting close to the shoe to see which long edge it is.

Being able thus to see which long edge is displayed is by itself of no help to the gambler. All the cards have the same tiny difference between their right and left long edges, so knowing which edge is displayed tells the gambler nothing about the value of the next card in the shoe. The information becomes significant only if things can be so arranged that the cards which the gambler is most interested in are all presented with long edge type A facing the table, whilst all the less interesting cards present long edge type B. Then the gambler knows which kind of card is next out of the shoe.

In Punto Banco cards with a face value of 7, 8 and 9 are high value cards. If one such card is dealt to player or to banker, it will give that position a better chance of winning than the other. Thus a punter who knows that when the first card dealt (always to the “player” position) is a 7, 8 or 9, he will know that it is more likely than not that player will win. If he knows that the card is not a 7, 8 or 9, he will know that it is more likely than not that banker will win. Such knowledge, it is agreed, will give the punter a long-term edge of about 6.5% over the house if played perfectly accurately.

What is therefore necessary for edge-sorting to work is for the cards in the shoe to be sorted so that all the 7s, 8s and 9s display edge type A, whilst the rest display edge type B. That means rotating the high value cards so that they display edge type A. If the punter were to touch the cards, the invariable practice at most casinos, including at Crockfords, would be that those cards would not be used again. The only person who touches the cards is the croupier. So what had to happen was to get the cards sorted (i.e. differentially rotated) by type A and type B by the croupier and then to get them re-used in the next shoe, now distinctively sorted.

For edge-sorting to work at Crockfords it is therefore essential that the croupier is persuaded to rotate the relevant cards without her realising why she is being asked to do so. Casinos routinely play on quirky and superstitious behaviour by punters. It is in the casino’s interests that punters should believe, erroneously, that a lucky charm or practice will improve their chance of winning and so modify or defeat the house edge. Consequently a wide variety of requests by punters, particularly those willing to wager large sums on games which they must, if they play long enough, lose in the long run, are accommodated by casinos without demur or surprise.

All of the games of Punto Banco played by the claimant and Ms. Sun on 20 and 21 August 2012 were captured on CCTV, mostly with contemporaneous audio recording as well. The moment at which they persuaded the croupier, Kathy Yau, to rotate the cards was at 9 pm on 20 August. The video shows it and the words spoken have been transcribed. Before then, the claimant and Ms. Sun had played part of four shoes, the first two plain backed, and the second two Angel cards but with no asymmetry on the back.

The claimant is a high stakes gambler. He began, by his standards, modestly: bets placed on those four shoes ranged from £4,000 to £75,000 per coup. He was losing. At 8.56 pm he requested a new shoe of cards. A new shoe was produced. The cards were blue Angel cards with the rounded pattern described on the back. At 8.57 the claimant asked Jeremy Hillier, the senior croupier overseeing the game: “If I win, can I say I want the same cards again?” to which Mr. Hillier replied he could, “because [he was] not bending them”. The claimant had in fact avoided touching the cards from either the first or second shoe onwards.

The croupier, Kathy Yau, then put the cards face down in blocks on the table to make the cut, as is conventional. She cut the cards so as to exclude about one deck from play. The claimant asked about the cut: “Why so big?” Ms. Sun said: “They don’t cut the seven cards”, a reference to the traditional cut of 7 cards from the end. Ms. Yau asked if he wanted her to cut 7 cards, to which he replied “yes”, he wanted to play 90 hands, slightly more than the maximum likely to be possible with an eight-deck shoe with a seven-card cut. She complied, after checking with the supervisor on duty in the room. That had the effect of maximising the number of coups which would be possible with those packs, and of exposing the maximum number of cards to the sorting (rotation) process.

Ms. Yau then dealt the first coup. After the bet was made, and all the cards then dealt, the next stage was for the croupier to turn the cards face up to reveal whether Player or Banker had won. Ms. Sun then asked Ms. Yau in Cantonese to do it, in other words to turn the cards over so that the face showed, slowly. Ms. Yau said “yes.” Ms. Sun then asked her again in Cantonese to turn the cards in a particular and differential way as they were being exposed and before they were put on the pile of used cards. “If I say it is good, you turn it this way, good, yes? Um, no good.” (A slightly different sounding um). Ms. Yau did not immediately understand what was required. She asked, “so you want me to leave it?” To which Ms. Sun replied, “change, yeah, yeah, change luck.” Ms. Yau: “what do you mean?” Ms. Sun gestured how to turn it. “Turn it this way.” Ms. Yau: “what, just open it? Yeah.” Ms. Sun: “um,” signifying good in Cantonese.

The claimant then chipped in, “yeah, change the luck, that’s good. Anything to change the luck, it is okay with me.” Ms. Sun reiterated her request in Cantonese, “If I say it is not good, you turn it this way. If it is good, turn it this way, okay?” To which Ms. Yau said “okay.” When she turned over the cards of the second coup, Ms. Sun said of four of them, “good,” and of one, “not good,” in Cantonese. Ms. Yau did as requested. What she was being asked to do, and did, was to turn the cards which Ms. Sun called as “good” end to end, and the “not good” cards side to side. In consequence, the long edge of the “not good” card was oriented in a different way from the long edge of the “good” cards. The judge found that she had been “wholly ignorant” of the significance of what she was doing, card by card, at the call of Ms. Sun.

This procedure was followed for each of the next 79 coups dealt from this shoe. The maximum amount staked by the claimant on the coups towards the end of the shoe

reached £100,000. Self-evidently, at no time during the play of this shoe did he derive any advantage from the rotation of the cards requested by Ms. Sun because that rotation occurred at the end, not at the beginning, of each coup. This was all preparation.

At 10.03 pm, when the shoe was exhausted, the claimant said that he had won with that deck (i.e. shoe), and that he would keep it. The senior croupier, who had brought in a new collection of cards, was told by the claimant he did not want them, as he “had won £40,000 with that deck”; that was agreed to. The original cards were reused. The defendant has not been able to calculate retrospectively whether that assertion of winnings to that point was true.

Before the shoe was reused it had to be reshuffled. The claimant had earlier asked Ms. Yau’s predecessor as croupier for a shuffling machine to shuffle the cards. The cards were reshuffled by a machine. For a punter using the edge-sorting technique this ensured that the shuffle would be effected without rotating any of the cards unless the croupier did so before they were put into the machine. Ms. Yau did not do so. Manual shuffling would have carried a much higher risk of re-rotation as it was done.

Play with the reshuffled shoe recommenced at 10.12 pm and continued until Ms. Yau went for a half hour break at 10.31 pm. The claimant did not play during her break but resumed when she returned until 3.57 am on 21 August. Ms. Yau was the croupier throughout. The claimant’s stake increased to £95,000 and then to £149,000 per coup. He won approximately £2m.

The accuracy of his bets on player increased sharply. In the first two shoes in which Angel cards were used, those without an asymmetric pattern on the back, he placed respectively 11 bets and then 1 bet on player and a 7, 8 or 9 only occurred once in that 12 times. On the shoe in which the edge-sorting was done in the manner described, he placed 23 bets on player of which eight were 7s, 8s or 9s. On the succeeding shoes, those at least that were completed on that night, shoes four to eight, the record was as follows. Shoe four, 23 accurate bets out of 27; shoe five, 22 accurate bets out of 25; shoe six, 20 accurate bets out of 26; shoe 7, 23 accurate bets out of 30; shoe 8, 17 accurate bets out of 19. A similar but slightly less pronounced pattern occurred on the following day.

At the end of play on the early morning of the 21st the claimant asked if he could keep the same shoe, which he referred to as a deck, if he returned on the following day. He was told he could. Ms. Yau returned to duty at 2 pm on 21 August. The claimant resumed play with the same cards at 3 pm and played until 6.41 pm. His average stake was never less than £149,000. For the last three shoes it was £150,000, the maximum that he was allowed to bet each time. In the middle of play of the last shoe, the senior croupier told the claimant that the shoe would be replaced when it was exhausted. When it was, the claimant and Ms Sun left. By then he had won just over £7.7m.

Crockfords’ practice after a large win such as this is to conduct an ex post facto investigation to work out how it occurred. After quite lengthy review of the CCTV

footage and examination of the cards, the investigators succeeded in spotting what had been done. Nobody at Crockfords had heard of edge-sorting before.

Nine days after the play, on 30 August, the claimant spoke to Mr. Pearce, Managing Director of the London casinos of Genting UK, who told him that Crockfords would not be paying his winnings because the game had been compromised. The claimant said he had not touched the cards, but did not state that which at the trial he freely admitted, that he had used edge-sorting. Arrangements were made to refund his deposited stake, £1m, on 31 August. . . .

Section 42 [of the Gambling Act 2005] is in the following terms: (1) A person commits an offence if he - (a) cheats at gambling, or (b) does anything for the purpose of enabling or assisting another person to cheat at gambling. (2) For the purposes of subsection (1) it is immaterial whether a person who cheats- (a) improves his chances of winning anything, or (b) wins anything. . . .

It has been common ground throughout this litigation that the (now in principle enforceable) contract for betting into which these parties entered is subject to an implied term that neither of them will cheat. . . .

The section leaves open what is and what is not cheating, as is inevitable given the extraordinary range of activities to which the concept may apply. Plainly, what is cheating in one form of game may be legitimate competition in another. . . .

To the extent that defrauding someone may take the form of depriving him of something which is his, or to which he might otherwise be entitled, it is plain, and wholly unsurprising, that a criminal offence of defrauding must contain in addition an element which demonstrates that the means adopted are illegitimate and wrong. Otherwise much perfectly proper business competition would be at risk of being labelled fraud, since such competition frequently involves strategies to divert business from A to B. Hence it is entirely unsurprising that conspiracy to defraud was held to require in addition the proof of dishonest means. Dishonesty, in this context, supplies the essential element of illegitimacy and wrongfulness. . . .

Although the great majority of cheating will involve something which the ordinary person (or juror) would describe as dishonest, this is not invariably so. When, as it often will, the cheating involves deception of the other party, it will usually be easy to describe what was done as dishonest. . . . The runner who trips up one of his opponents is unquestionably cheating, but it is doubtful that such misbehaviour would ordinarily attract the epithet “dishonest.”. . .

Conversely, there may be situations in which there is deception of the other player but what is done does not amount to cheating. The so-called “three card trick,” much practised upon travellers on Victorian and Edwardian trains especially to and from racecourses, commonly involved a deception of the target traveller by a group of associates pretending to be unconnected to one another. The idea was to lure the target

into playing the game. But once he was ensnared, the game was often played genuinely; the target lost not because of any cheating but because the shuffler of the cards had sufficient speed of hand to deceive the eye. No doubt other exponents of the three card trick had less genuine methods, such as a fourth (concealed) card, which would indeed be cheating. Sometimes the game admits of a level of legitimate deception. The unorthodox lead or discard at bridge is designed to give the opponent a misleading impression of one's hand, but it is part of the game and not cheating. Pretending to be stupid at the poker table, so that one's opponent does not take one seriously, and takes risks which he otherwise might not, may or may not be another example.

These far from sophisticated examples demonstrate the inevitable truth that there will be room for debate at the fringes as to what does and does not constitute cheating. To label an activity "advantage play," as Mr. Ivey and others did, is of no help at all. It asks, rather than answers, the question whether it is legitimate or cheating. It would be very unwise to attempt a definition of cheating. No doubt its essentials normally involve a deliberate (and not an accidental) act designed to gain an advantage in the play which is objectively improper, given the nature, parameters and rules (formal or informal) of the game under examination. The question in the present case, however, does not depend on the near impossible task of formulating a definition of cheating, but on whether cheating necessarily requires dishonesty as one of its legal elements. . . .

The judge's conclusion, that Mr. Ivey's actions amounted to cheating, is unassailable. It is an essential element of Punto Banco that the game is one of pure chance, with cards delivered entirely at random and unknowable by the punters or the house. What Mr. Ivey did was to stage a carefully planned and executed sting. The key factor was the arranging of the several packs of cards in the shoe, differentially sorted so that this particular punter did know whether the next card was a high value or low value one. If he had surreptitiously gained access to the shoe and re-arranged the cards physically himself, no one would begin to doubt that he was cheating. He accomplished exactly the same result through the unwitting but directed actions of the croupier, tricking her into thinking that what she did was irrelevant. As soon as the decision to change the cards was announced, thus restoring the game to the matter of chance which it is supposed to be, he first covered his tracks by asking for cards to be rotated at random, and then abandoned play.

It may be that it would not be cheating if a player spotted that some cards had a detectably different back from others, and took advantage of that observation, but Mr. Ivey did much more than observe; he took positive steps to fix the deck. That, in a game which depends on random delivery of unknown cards, is inevitably cheating.

Although the judge did not think it necessary to make a finding on the topic, and it is unnecessary to the resolution of this appeal, it would also seem that the facts which he found amounted in any event to a deception of the croupier. Certainly, the judge found that pretending to be superstitious did not *by itself* cross the line from legitimate play to cheating, comparing it to the skilled poker player who pretends to be a fool. He also

found, contrary to one of Crockfords' submissions, that what occurred did not amount to such deception as altogether to negate the existence of any contract for the game. But that was not a finding that there was no deception at all, and on the facts found there clearly was deception of the croupier into doing something which appeared innocuous or irrelevant, but was in fact highly significant and enabled Mr. Ivey to win when he should not have done. . . .

A significant refinement to the test for dishonesty was introduced by *R v Ghosh* [1982] QB 1053. Since then, in criminal cases, the judge has been required to direct the jury, if the point arises, to apply a two-stage test. Firstly, it must ask whether in its judgment the conduct complained of was dishonest by the lay objective standards of ordinary reasonable and honest people. If the answer is no, that disposes of the case in favour of the defendant. But if the answer is yes, it must ask, secondly, whether the defendant must have realised that ordinary honest people would so regard his behaviour, and he is to be convicted only if the answer to that second question is yes. . . .

The principal objection to the second leg of the *Ghosh* test is that the less the defendant's standards conform to what society in general expects, the less likely he is to be held criminally responsible for his behaviour. It is true that *Ghosh* attempted to reconcile what it regarded as the dichotomy between a "subjective" and an "objective" approach by a mixed test. The court addressed the present objection in this way, at p 1064:

"There remains the objection that to adopt a subjective test is to abandon all standards but that of the accused himself, and to bring about a state of affairs in which 'Robin Hood would be no robber': *R v Greenstein*. This objection misunderstands the nature of the subjective test. It is no defence for a man to say 'I knew that what I was doing is generally regarded as dishonest; but I do not regard it as dishonest myself. Therefore I am not guilty'. What he is however entitled to say is 'I did not know that anybody would regard what I was doing as dishonest'. He may not be believed; just as he may not be believed if he sets up 'a claim of right' under section 2(1) of the Theft Act 1968, or asserts that he believed in the truth of a misrepresentation under section 15 of the Act of 1968. But if he is believed, or raises a real doubt about the matter, the jury cannot be sure that he was dishonest."

And a little later the court added that upon the test which it was setting:

"In most cases, where the actions are obviously dishonest by ordinary standards, there will be no doubt about it. It will be obvious that the defendant himself knew that he was acting dishonestly. It is dishonest for a defendant to act in a way which he knows ordinary people consider to be dishonest, even if he asserts or genuinely believes that he is morally justified in acting as he did. For example, Robin Hood or those ardent anti-vivisectionists who remove animals from vivisection laboratories are acting dishonestly, even though they may consider

themselves to be morally justified in doing what they do, because they know that ordinary people would consider these actions to be dishonest.”

Even if this were correct, it would still mean that the defendant who thinks that stealing from a bookmaker is not dishonest is entitled to be acquitted. It is no answer to say that he will be convicted if he realised that ordinary honest people would think that stealing from a bookmaker is dishonest, for by definition he does not realise this. Moreover, the court’s proposition was not correct, because it is not in the least unusual for the accused not to share the standards which ordinary honest people set for society as a whole. The acquisitive offender may, it is true, be the cheerful character who frankly acknowledges that he is a crook, but very often he is not, but, rather, justifies his behaviour to himself. Just as convincing himself is frequently the stock in trade of the confidence trickster, so the capacity of all of us to persuade ourselves that what we do is excusable knows few bounds. It cannot by any means be assumed that the appropriators of animals from laboratories, to whom the court referred in *Ghosh*, know that ordinary people would consider their actions to be dishonest; it is just as likely that they are so convinced, however perversely, of the justification for what they do that they persuade themselves that no one could call it dishonest. There is no reason why the law should excuse those who make a mistake about what contemporary standards of honesty are, whether in the context of insurance claims, high finance, market manipulation or tax evasion. The law does not, in principle, excuse those whose standards are criminal by the benchmarks set by society, nor ought it to do so. On the contrary, it is an important, even crucial, function of the criminal law to determine what is criminal and what is not; its purpose is to set the standards of behaviour which are acceptable. As it was put in *Smith’s Law of Theft* 9th ed (2007), para 2.296: “. . . the second limb allows the accused to escape liability where he has made a mistake of fact as to the contemporary standards of honesty. But why should that be an excuse?”

It is plain that in *Ghosh* the court concluded that its compromise second leg test was necessary in order to preserve the principle that criminal responsibility for dishonesty must depend on the actual state of mind of the defendant. It asked the question whether “dishonestly”, where that word appears in the Theft Act, was intended to characterise a course of conduct or to describe a state of mind. The court gave the following example, which was clearly central to its reasoning:

“Take for example a man who comes from a country where public transport is free. On his first day here he travels on a bus. He gets off without paying. He never had any intention of paying. His mind is clearly honest; but his conduct, judged objectively by what he has done, is dishonest. It seems to us that in using the word ‘dishonestly’ in the Theft Act 1968, Parliament cannot have intended to catch dishonest conduct in that sense, that is to say conduct to which no moral obloquy could possibly attach.”

But the man in this example would inevitably escape conviction by the application of the (objective) first leg of the *Ghosh* test. That is because, in order to determine the honesty or otherwise of a person's conduct, one must ask what he knew or believed about the facts affecting the area of activity in which he was engaging. In order to decide whether this visitor was dishonest by the standards of ordinary people, it would be necessary to establish his own actual state of knowledge of how public transport works. Because he genuinely believes that public transport is free, there is nothing objectively dishonest about his not paying on the bus. The same would be true of a child who did not know the rules, or of a person who had innocently misread the bus pass sent to him and did not realise that it did not operate until after 10.00 in the morning.

The answer to the court's question is that "dishonestly", where it appears, is indeed intended to characterise what the defendant did, but in characterising it one must first ascertain his actual state of mind as to the facts in which he did it. It was not correct to postulate that the conventional objective test of dishonesty involves judging only the actions and not the state of knowledge or belief as to the facts in which they were performed. What is objectively judged is the standard of behaviour, given any known actual state of mind of the actor as to the facts. . . .

These several considerations provide convincing grounds for holding that the second leg of the test propounded in *Ghosh* does not correctly represent the law and that directions based upon it ought no longer to be given. . . . When dishonesty is in question the fact-finding tribunal must first ascertain (subjectively) the actual state of the individual's knowledge or belief as to the facts. The reasonableness or otherwise of his belief is a matter of evidence (often in practice determinative) going to whether he held the belief, but it is not an additional requirement that his belief must be reasonable; the question is whether it is genuinely held. When once his actual state of mind as to knowledge or belief as to facts is established, the question whether his conduct was honest or dishonest is to be determined by the fact-finder by applying the (objective) standards of ordinary decent people. There is no requirement that the defendant must appreciate that what he has done is, by those standards, dishonest.

Therefore in the present case, if, contrary to the conclusions arrived at above, there were in cheating at gambling an additional legal element of dishonesty, it would be satisfied by the application of the test as set out above. The judge did not get to the question of dishonesty and did not need to do so. But it is a fallacy to suggest that his finding that Mr. Ivey was truthful when he said that *he* did not regard what he did as cheating amounted to a finding that his behaviour was honest. It was not. It was a finding that he was, in that respect, truthful. Truthfulness is indeed one characteristic of honesty, and untruthfulness is often a powerful indicator of dishonesty, but a dishonest person may sometimes be truthful about his dishonest opinions, as indeed was the defendant in *Gilks*. For the same reasons which show that Mr. Ivey's conduct was, contrary to his own opinion, cheating, the better view would be, if the question arose, that his conduct was, contrary to his own opinion, also dishonest.

Problem 2-3

How does the problem of what constitutes “cheating” in *Ivey*, and especially the English law concept of “dishonesty,” help our understanding of the law of fraud might work in the U.S.? How do these ideas in *Ivey* relate to Judge Posner’s idea in the last sentence of his opinion in *Dial*?

B. Mail and Wire Fraud: Jurisdiction and Materiality

Most practitioners of federal criminal law will agree that the mail and wire fraud statutes are the broadest, most flexible, and most commonly employed tools in prosecuting white collar crime in federal court. First, consider the text of the statutes. Do the normal criminal law drill and figure out their elements. Where is the actus reus? Where is the mens rea? What attendant circumstances must be proved in addition? Is there more than one theory on which a prosecutor can proceed under these statutes? How do the jurisdictional provisions appear to work?

18 U.S.C. § 1341. Frauds and swindles

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both. . . .

18 U.S.C. § 1343. Fraud by wire, radio, or television

Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. . . .

1. Jurisdiction

As you can see, the mail and wire fraud statutes are written with fairly broad jurisdictional elements. Just how far do these provisions reach? The following case provides the framework for litigating questions of jurisdiction in mail and wire fraud.

SCHMUCK v. UNITED STATES, 489 U.S. 705 (1989)

Justice BLACKMUN delivered the opinion of the Court.

In August 1983, petitioner Wayne T. Schmuck, a used-car distributor . . . was indicted on 12 counts of mail fraud, in violation of 18 U.S.C. §§ 1341 and 1342.

The alleged fraud was a common and straightforward one. Schmuck purchased used cars, rolled back their odometers, and then sold the automobiles to Wisconsin retail dealers for prices artificially inflated because of the low-mileage readings. These unwitting car dealers, relying on the altered odometer figures, then resold the cars to customers, who in turn paid prices reflecting Schmuck's fraud. To complete the resale of each automobile, the dealer who purchased it from Schmuck would submit a title-application form to the Wisconsin Department of Transportation on behalf of his retail customer. The receipt of a Wisconsin title was a prerequisite for completing the resale; without it, the dealer could not transfer title to the customer and the customer could not obtain Wisconsin tags. The submission of the title-application form supplied the mailing element of each of the alleged mail frauds.

Before trial, Schmuck moved to dismiss the indictment on the ground that the mailings at issue—the submissions of the title-application forms by the automobile dealers—were not in furtherance of the fraudulent scheme and, thus, did not satisfy the mailing element of the crime of mail fraud. . . .

“The federal mail fraud statute does not purport to reach all frauds, but only those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law.” *Kann v. United States*. To be part of the execution of the fraud, however, the use of the mails need not be an essential element of the scheme. . . . It is sufficient for the mailing to be “incident to an essential part of the scheme,” or “a step in [the] plot.” . . .

Schmuck . . . argues that mail fraud can be predicated only on a mailing that affirmatively assists the perpetrator in carrying out his fraudulent scheme. The mailing element of the offense, he contends, cannot be satisfied by a mailing, such as those at issue here, that is routine and innocent in and of itself, and that, far from furthering the execution of the fraud, occurs after the fraud has come to fruition, is merely tangentially related to the fraud, and is counterproductive in that it creates a “paper trail” from which the fraud may be discovered. We disagree both with this characterization of the mailings in the present case and with this description of the applicable law. . . .

We begin by considering the scope of Schmuck's fraudulent scheme. Schmuck was charged with devising and executing a scheme to defraud Wisconsin retail automobile customers who based their decisions to purchase certain automobiles at least in part on the low-mileage readings provided by the tampered odometers. This was a fairly large-scale operation. Evidence at trial indicated that Schmuck had employed a man known only as “Fred” to turn back the odometers on about 150 different cars. Schmuck then

marketed these cars to a number of dealers, several of whom he dealt with on a consistent basis over a period of about 15 years. . . . Thus, Schmuck's was not a "one-shot" operation in which he sold a single car to an isolated dealer. His was an ongoing fraudulent venture. A rational jury could have concluded that the success of Schmuck's venture depended upon his continued harmonious relations with, and good reputation among, retail dealers, which in turn required the smooth flow of cars from the dealers to their Wisconsin customers.

Under these circumstances, we believe that a rational jury could have found that the title-registration mailings were part of the execution of the fraudulent scheme, a scheme which did not reach fruition until the retail dealers resold the cars and effected transfers of title. Schmuck's scheme would have come to an abrupt halt if the dealers either had lost faith in Schmuck or had not been able to resell the cars obtained from him. These resales and Schmuck's relationships with the retail dealers naturally depended on the successful passage of title among the various parties. Thus, although the registration-form mailings may not have contributed directly to the duping of either the retail dealers or the customers, they were necessary to the passage of title, which in turn was essential to the perpetuation of Schmuck's scheme. As noted earlier, a mailing that is "incident to an essential part of the scheme," *Pereira*, satisfies the mailing element of the mail fraud offense. The mailings here fit this description. . . .

Once the full flavor of Schmuck's scheme is appreciated, the critical distinctions between this case and the three cases in which this Court has delimited the reach of the mail fraud statute—*Kann*, *Parr*, and *Maze*—are readily apparent. The defendants in *Kann* were corporate officers and directors accused of setting up a dummy corporation through which to divert profits into their own pockets. As part of this fraudulent scheme, the defendants caused the corporation to issue two checks payable to them. The defendants cashed these checks at local banks, which then mailed the checks to the drawee banks for collection. This Court held that the mailing of the cashed checks to the drawee banks could not supply the mailing element of the mail fraud charges. The defendants' fraudulent scheme had reached fruition. "It was immaterial to them, or to any consummation of the scheme, how the bank which paid or credited the check would collect from the drawee bank."

In *Parr*, several defendants were charged, *inter alia*, with having fraudulently obtained gasoline and a variety of other products and services through the unauthorized use of a credit card issued to the school district which employed them. The mailing element of the mail fraud charges in *Parr* was purportedly satisfied when the oil company which issued the credit card mailed invoices to the school district for payment, and when the district mailed payment in the form of a check. Relying on *Kann*, this Court held that these mailings were not in execution of the scheme as required by the statute because it was immaterial to the defendants how the oil company went about collecting its payment.

Later, in *Maze*, the defendant allegedly stole his roommate's credit card, headed south on a winter jaunt, and obtained food and lodging at motels along the route by placing the charges on the stolen card. The mailing element of the mail fraud charge was supplied by the fact that the defendant knew that each motel proprietor would mail an invoice to the bank that had issued the credit card, which in turn would mail a bill to the card owner for payment. The Court found that these mailings could not support mail fraud charges because the defendant's scheme had reached fruition when he checked out of each motel. The success of his scheme in no way depended on the mailings; they merely determined which of his victims would ultimately bear the loss. . . .

The title-registration mailings at issue here served a function different from the mailings in *Kann*, *Parr*, and *Maze*. The intrabank mailings in *Kann* and the credit card invoice mailings in *Parr* and *Maze* involved little more than post-fraud accounting among the potential victims of the various schemes, and the long-term success of the fraud did not turn on which of the potential victims bore the ultimate loss. Here, in contrast, [t]he mailing of the title-registration forms was an essential step in the successful passage of title to the retail purchasers. Moreover, a failure of this passage of title would have jeopardized Schmuck's relationship of trust and goodwill with the retail dealers upon whose unwitting cooperation his scheme depended. Schmuck's reliance on our prior cases limiting the reach of the mail fraud statute is simply misplaced.

To the extent that Schmuck would draw from these previous cases a general rule that routine mailings that are innocent in themselves cannot supply the mailing element of the mail fraud offense, he misapprehends this Court's precedents. In *Parr* the Court specifically acknowledged that "innocent" mailings—ones that contain no false information—may supply the mailing element. In other cases, the Court has found the elements of mail fraud to be satisfied where the mailings have been routine.

We also reject Schmuck's contention that mailings that someday may contribute to the uncovering of a fraudulent scheme cannot supply the mailing element of the mail fraud offense. The relevant question at all times is whether the mailing is part of the execution of the scheme as conceived by the perpetrator at the time, regardless of whether the mailing later, through hindsight, may prove to have been counterproductive and return to haunt the perpetrator of the fraud. The mail fraud statute includes no guarantee that the use of the mails for the purpose of executing a fraudulent scheme will be risk free. Those who use the mails to defraud proceed at their peril.

Justice SCALIA, with whom Justice BRENNAN, Justice MARSHALL, and Justice O'CONNOR join, dissenting.

The purpose of the mail fraud statute is "to prevent the post office from being used to carry [fraudulent schemes] into effect." *Durland v. United States*. The law does not establish a general federal remedy against fraudulent conduct, with use of the mails as the jurisdictional hook, but reaches only "those limited instances in which the use of the mails is a part of the execution of the fraud, leaving all other cases to be dealt with by appropriate state law." *Kann v. United States*. In other words, it is mail fraud, not mail

and fraud, that incurs liability. This federal statute is not violated by a fraudulent scheme in which, at some point, a mailing happens to occur-nor even by one in which a mailing predictably and necessarily occurs. The mailing must be in furtherance of the fraud. . . .

For though the Government chose to charge a defrauding of retail customers (to whom the innocent dealers resold the cars), it is obvious that, regardless of who the ultimate victim of the fraud may have been, the fraud was complete with respect to each car when petitioner pocketed the dealer's money. As far as each particular transaction was concerned, it was as inconsequential to him whether the dealer resold the car as it was inconsequential to the defendant in *Maze* whether the defrauded merchant ever forwarded the charges to the credit card company. . . .

And I think it particularly significant that in *Kann* the Government proposed a theory *identical* to that which the Court today uses. Since the scheme was ongoing, the Government urged, the fact that the mailing of the two checks had occurred after the defendants had pocketed the fraudulently obtained cash made no difference. "[T]he defendants expected to receive further bonuses and profits," and therefore "the clearing of these checks in the ordinary course was essential to [the scheme's] further prosecution." The dissenters in *Kann* agreed. "[T]his," they said, "was not the last step in the fraudulent scheme. It was a continuing venture. Smooth clearances of the checks were essential lest these intermediate dividends be interrupted and the conspirators be called upon to disgorge." The Court rejected this argument, concluding that "the subsequent banking transactions between the banks concerned were merely incidental and collateral to the scheme and not a part of it." I think the mailing of the title application forms equivalently incidental here. . . .

2. Materiality

Materiality is one of those multi-purpose legal concepts, like reasonableness or duty, that are important to understand because they arise in so many areas of law. Materiality's application varies with legal context, of course, but the central concept is a universal one in law. After you read the cases in this section, see if you can articulate the concept of materiality as a general legal concept in the form of a single sentence or phrase.

NEDER v. UNITED STATES, 527 U.S. 1 (1999)

Chief Justice REHNQUIST delivered the opinion of the Court.

In the mid-1980's, petitioner Ellis E. Neder, Jr., an attorney and real estate developer in Jacksonville, Florida, engaged in a number of real estate transactions financed by fraudulently obtained bank loans. Between 1984 and 1986, Neder purchased 12 parcels of land using shell corporations set up by his attorneys and then immediately resold the land at much higher prices to limited partnerships that he controlled. Using inflated appraisals, Neder secured bank loans that typically amounted to 70% to 75% of the inflated resale price of the land. In so doing, he concealed from lenders that he controlled the shell corporations, that he had purchased the land at prices substantially lower than

the inflated resale prices, and that the limited partnerships had not made substantial down payments as represented. In several cases, Neder agreed to sign affidavits falsely stating that he had no relationship to the shell corporations and that he was not sharing in the profits from the inflated land sales. By keeping for himself the amount by which the loan proceeds exceeded the original purchase price of the land, Neder was able to obtain more than \$7 million. . . .

We . . . granted certiorari in this case to decide whether materiality is an element of a “scheme or artifice to defraud” under the federal mail fraud (18 U.S.C. § 1341), wire fraud (§ 1343), and bank fraud (§ 1344) statutes. The Court of Appeals concluded that the failure to submit materiality to the jury was not error because the fraud statutes do not require that a “scheme to defraud” employ *material* falsehoods. We disagree.

Under the framework set forth in *United States v. Wells*, we first look to the text of the statutes at issue to discern whether they require a showing of materiality. In this case, we need not dwell long on the text because, as the parties agree, none of the fraud statutes defines the phrase “scheme or artifice to defraud,” or even mentions materiality. Although the mail fraud and wire fraud statutes contain different jurisdictional elements (§ 1341 requires use of the mails while § 1343 requires use of interstate wire facilities), they both prohibit, in pertinent part, “any scheme or artifice to defraud” or to obtain money or property “by means of false or fraudulent pretenses, representations, or promises.” The bank fraud statute, which was modeled on the mail and wire fraud statutes, similarly prohibits any “scheme or artifice to defraud a financial institution” or to obtain any property of a financial institution “by false or fraudulent pretenses, representations, or promises.” Thus, based solely on a “natural reading of the full text,” materiality would not be an element of the fraud statutes.

That does not end our inquiry, however, because in interpreting statutory language there is a necessary second step. It is a well-established rule of construction that “[w]here Congress uses terms that have accumulated settled meaning under . . . the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.” . . . Neder contends that “defraud” is just such a term, and that Congress implicitly incorporated its common-law meaning, including its requirement of materiality, into the statutes at issue.

The Government does not dispute that both at the time of the mail fraud statute’s original enactment in 1872, and later when Congress enacted the wire fraud and bank fraud statutes, actionable “fraud” had a well-settled meaning at common law. Nor does it dispute that the well-settled meaning of “fraud” required a misrepresentation or concealment of *material* fact. Indeed, as the sources we are aware of demonstrate, the common law could not have conceived of “fraud” without proof of materiality. See *BMW of North America, Inc. v. Gore*. Thus, under the rule that Congress intends to incorporate the well-settled meaning of the common-law terms it uses, we cannot infer from the absence of an express reference to materiality that Congress intended to drop that element from the fraud statutes. On the contrary, we must *presume* that Congress

intended to incorporate materiality “‘unless the statute otherwise dictates.’” *Nationwide Mut. Ins.* . . .

The Government relies heavily on *Durland v. United States*, our first decision construing the mail fraud statute, to support its argument that the fraud statutes sweep more broadly than common-law fraud. But *Durland* was different from this case. There, the defendant, who had used the mails to sell bonds he did not intend to honor, argued that he could not be held criminally liable because his conduct did not fall within the scope of the common-law crime of “false pretenses.” We rejected the argument that “the statute reaches only such cases as, at common law, would come within the definition of ‘false pretenses,’ in order to make out which there must be a misrepresentation as to some existing fact and not a mere promise as to the future.” Instead, we construed the statute to “includ[e] everything designed to defraud by representations as to the past or present, or suggestions and promises as to the future.” Although *Durland* held that the mail fraud statute reaches conduct that would not have constituted “false pretenses” at common law, it did not hold, as the Government argues, that the statute encompasses more than common-law fraud.

In one sense, the Government is correct that the fraud statutes did not incorporate *all* the elements of common-law fraud. . . . By prohibiting the “scheme to defraud,” rather than the completed fraud, the elements of reliance and damage would clearly be inconsistent with the statutes Congress enacted. But while the language of the fraud statutes is incompatible with these requirements, the Government has failed to show that this language is inconsistent with a materiality requirement. Accordingly, we hold that materiality of falsehood is an element of the federal mail fraud, wire fraud, and bank fraud statutes.

UNITED STATES v. BOGUCKI, 2019 WL 1024959 (N.D. Cal. 2019)

CHARLES R. BREYER, United States District Judge:

Defendant is charged with one count of conspiracy to commit wire fraud affecting a financial institution, in violation of 18 U.S.C. § 1349, and six counts of wire fraud affecting a financial institution, in violation of 18 U.S.C. §§ 1343 and 2, and associated forfeiture allegations. [The defendant Robert Bogucki was the head of Barclays’ foreign currency exchange trading desk in New York. The government alleged that he committed fraud in connection with his negotiation of the unwinding of a deal in options for British currency (pounds sterling) with the Hewlett Packard corporation (HP), which acquired a large position in pounds to complete its purchase of a British company. The core of the government’s theory was that Bogucki caused Barclays to trade ahead of HP’s planned unwind transaction in the market for pounds, in order to profit Barclays’ own positions in that market.]

The parties agree that the charge[] of wire fraud affecting a financial institution requires the Government to prove five elements. First, the defendant must have knowingly participated in, devised, or intended to devise a scheme or plan to defraud, or a scheme

or plan for obtaining money or property by means of false or fraudulent pretenses, representations, or promises or omitted facts; second, the statements made or facts omitted as part of the scheme were material; third, the defendant acted with the intent to defraud, that is, the intent to deceive or cheat; fourth, the defendant used, or caused to be used, an interstate or foreign wire communication to carry out or attempt to carry out an essential part of the scheme; fifth, the scheme affected a financial institution.

The parties stipulated prior to trial that the alleged scheme affected a financial institution. Nor is there any dispute that the alleged scheme involved the use of an interstate wire communication. The parties do dispute the other elements of Defendant's wire fraud and conspiracy to commit wire fraud charges. Specifically, Defendant has argued that there is insufficient evidence to permit a reasonable jury to find that the Government has met its burden on the first, second, or third elements. . . . The Court is primarily concerned with the Defendant's argument that the government has not satisfied the second element of wire fraud, which requires the Government to prove that the statements Defendant made [to HP] were "material." . . .

Here, there are two pieces of evidence that are crucial to understand the context in which the allegedly materially false statements that Defendant provided to HP occurred: an International Swaps Dealers Association agreement between HP and Barclays, also known as an "ISDA," and the generally-understood industry practice of "pre-positioning."

The ISDA between HP and Barclays expressly stated that both HP and Barclays entered into "each Transaction as principal (and not as agent or in another capacity, fiduciary or otherwise)." It further stated that:

This agreement and each transaction have been entered into by each party in reliance only upon its judgment in order to accomplish legitimate business needs. Neither party holds itself out as advising, or any of its employees or agents as having any authority to advise, the other party as to whether or not it should enter into this agreement or any transaction. Neither party is receiving any compensation from the other party for providing advice in respect of this agreement or any transaction, and any such advice provided to such other party will not form the primary basis for the investment decision of such other party.

Put simply, the ISDA establishes that the backdrop of the unwind was that HP and Barclays were engaged as principals at opposite sides of an arms-length transaction.

In his testimony, Zac Nesper, an HP employee who during the relevant period was the manager of HP's foreign exchange team and was the primary point of contact between HP and Barclays, reinforced this understanding. He agreed that the ISDA was the "master agreement" governing transactions between HP and Barclays. Nesper also stated that he was aware that the ISDA governed HP's relationship with Barclays in 2011 when

the events at issue in this trial occurred. Most relevantly, he confirmed that the ISDA “accurately describe[d] [his] own thinking about [his] relationship with Barclays when it came to the unwind,” stating that he “was making [his] own decision about what was best for HP.” Indeed, Nesper acknowledged that he “bluffed” or was “BS-ing” Barclays during the parties’ interactions—that is, he was not entirely truthful with Barclays—about the prices Nesper was seeing from other banks. He also indicated that he understood some of what Barclays told him to be “posturing,” rather than entirely honest.

The ISDA, HP’s corresponding understanding of the relationship between HP and Barclays and HP’s own dishonesty are not the only background conditions in place at the time that are necessary to understand whether Defendant’s allegedly false statements were capable of influencing an entity in HP’s position to part with money or property. As the Ninth Circuit has instructed, the “standards generally applied in the lending industry at the time” are relevant to the materiality inquiry. *Green*.

Here, the Government’s expert testified that banks like Barclays engage in “pre-positioning,” also known as “hedging,” wherein the bank changes its position prior to taking on an asset. Such “pre-positioning” could “[p]otentially” mean that “the bank would act in advance of a transaction,” that is, “place trades in advance of that transaction.” Indeed, Barclays’ compliance manual expressly distinguishes between impermissible “frontrunning” and permissible “bona fide hedges.” That compliance goes on to state that “[p]ositions may be established that are bona fide hedges (opposite side of the market) of either proprietary positions or the risk that is assumed or agree to be assumed in facilitating the execution of a related transaction.” The parties agree that there are no rules or regulations, beyond banks’ internal policies and any agreement that may be formed between two particular parties, that regulate pre-positioning, pre-hedging, or front-running of the type at issue here. So, even assuming that FX options trading falls within the gambit of conduct prohibited by the rule against frontrunning—and the Government has offered no evidence for its intent-based reading of “bona fide,” there are undisputedly some types of pre-positioning that are permitted.

All of this matters because someone in Nesper’s position would evaluate the statements Bogucki made to him against this backdrop. And so the statements the Government argues satisfy the materiality element must also be evaluated in this context. The Court must thus determine whether, taking the facts in the light most favorable to the Government, a reasonable jury could conclude beyond a reasonable doubt that the statements the Government alleges were false or misleading would have been objectively capable of influencing someone in Nesper’s position to part with money or property. . . .

Viewing the evidence in the light most favorable to the Government, there is simply no evidence in the record that, in the context of an arms-length transaction in which the parties bluffed and “BS-[ed]” each other, operated as principals, looked out for their own interests, and understood the other party to be “posturing,” rather than providing strictly

true information, someone in HP's position could, objectively, be induced by the statements in this case to part with money or property.

Nor does Nesper's subjective belief alter this conclusion. As the Government has repeatedly pointed out to the Court . . . the standard for materiality is objective. Whether Nesper or HP were gullible, guileless, naïve, or actually took Defendant to be representing that Barclays would not take action that undermined the value of HP's options, in light of the relationship of the parties, the agreement governing their interactions, industry practice, HP's own dishonesty, and Nesper's expectations as to Barclays' dishonesty, no reasonable jury could conclude beyond a reasonable doubt that it was objectively reasonable for HP to be influenced by the statements the Government has identified. . . .

A touchstone of our criminal law is that no person "shall be held criminally responsible for conduct which he could not reasonably [have] understand to be proscribed." *United States v. Lanier*. Here, the Government has pursued a criminal prosecution on the basis of conduct that violated no clear rule or regulation, was not prohibited by the agreements between the parties, and indeed was consistent with the parties' understanding of the arms-length relationship in which they operated. The Court cannot permit this case to go to the jury on such a basis.

C. Mail and Wire Fraud: Limiting Principles

As many cases in this chapter illustrate, the federal courts give fairly standard recitations of the elements of mail and wire fraud. Unfortunately, because fraud is such a malleable and contextual concept, those "black letter" statements don't get you far enough, at least not in any debatable case. Setting aside the statutes for the moment, we might say—with refinement to follow—that a viable criminal fraud claim has to fulfill something like the following working definition (my words, not those of the statutes or the courts):

- (1) some deception (attempted or completed, by affirmative misrepresentation or nondisclosure)
- (2) about a material matter
- (3) with the intent to deceive
- (4) and with the object of obtaining something (what we might call the "corpus" or "object" of the fraud)
- (5) from an identifiable victim (or class of victims)

With that framework in mind, let's start looking at what principles might limit the exceedingly broad law of criminal fraud. It has been hard for the federal courts to fashion workable sub-doctrine to limit the scope of the mail and wire fraud statutes. What might explain the courts' difficulty? (Consider, in this connection, the English court's discussion of cheating and dishonesty in *Ivey*.)

Two things are going on in the next case. First, the facts allow further exploration of the concept of materiality. Why shouldn't lies used to "get a foot in the door" be eligible to count as fraud? Second, the appellate court is grasping for concepts that might limit the mail fraud statute. What's the limiting concept here? Does it work? Does the more recent Second Circuit case that follows *Regent Office Supply* help explain further the function of this limiting concept?

UNITED STATES v. REGENT OFFICE SUPPLY CO., 421 F.2d 1174 (2d Cir. 1970)

MOORE, Circuit Judge:

The appellants are in the business of selling stationery supplies through salesmen (called 'agents') who solicit orders for their merchandise by telephone. . . . Accordingly they stipulated in writing that their agents 'secured sales' by making false representations to potential customers that:

- (a) the agent had been referred to the customer by a friend of the customer.
- (b) the agent had been referred to customer firms by officers of such firms.
- (c) the agent was a doctor, or other professional person, who had stationery to be disposed of.
- (d) stationery of friends of the agent had to be disposed of because of a death and that the customer would help to relieve this difficult situation by purchasing it. . .

For its defense, the accused corporations called the president of Regent, Harold Hartwig, who testified that the firms sell well-known, nationally advertised brands of stationery, such as Swingline staples, Faber pencils, Perma-Write pens, etc., and some paper to large users among which are corporations such as Goodyear, General Electric and Rexall; that many of these customers provide a large volume of reorder business; that the Regent-Oxford enterprise has over 20,000 customers; that sales are made exclusively through their customers' purchasing agents; that the false representations listed in the stipulation were made as a preliminary part of the salesmen's solicitation; that price and quality of the merchandise are always discussed honestly; that the price offered has been lower than the purchasing agent is or was paying at the time of the solicitation; that the goods could be returned if found to be unsatisfactory; and that when a complaint is made an additional discount is offered to induce the customer to keep the goods.

Cross-examination elicited that visits to the Regent-Oxford offices had been made by the Better Business Bureau and by a Post Office Inspector; that the 'lies' were to 'get by' secretaries on the telephone and to get 'the purchasing agent to listen to our agent'; and that for business reasons various fictitious names were used both for their companies in different localities and for individuals. . . .

The important substantive question on this appeal is: Does solicitation of a purchase by means of false representations not directed to the quality, adequacy or price of goods to be sold, or otherwise to the nature of the bargain, constitute a 'scheme to defraud' or 'obtaining money by false pretenses' within the prohibition of 18 U.S.C. § 1341? We hold that, as here presented, it does not and the convictions should be reversed. We do not, however, condone the deceitfulness such business practices represent nor do we approve the cynical view advanced in defendants' rhetorical flourishes that such blatant dishonesty should be encouraged by reason of its 'social utility' and 'social necessity . . . in keeping with the most praiseworthy standards of business morality and worthy competitive enterprise.' We do not find the practices defended by counsel to be 'innocuous' or conduct 'which at worst may evoke in the breast of the perfectionistic moral idealist a sense of reproach towards the imperfections of man's soul during the mortal span.' On the contrary, we find these 'white lies' repugnant to 'standards of business morality.' Nevertheless, the facts as stipulated in the case before us do not, in our view, constitute a scheme to defraud or to obtain money by false pretenses punishable under section 1341. But this is not to say that we could not, on different facts or more specific proof, arrive at a different conclusion. . . .

It is generally stated that there are two elements to the offense of mail fraud: use of the mails and a scheme to defraud. Since only a 'scheme to defraud' and not actual fraud is required for conviction, we have said that 'it is not essential that the Government allege or prove that purchasers were in fact defrauded. . . .' But this does not mean that the government can escape the burden of showing that some actual harm or injury was contemplated by the schemer. Proof that someone was actually defrauded is unnecessary simply because the critical element in a 'scheme to defraud' is 'fraudulent intent,' . . . and therefore the accused need not have succeeded in his scheme to be guilty of the crime. . . . But the purpose of the scheme 'must be to injure, which doubtless may be inferred when the scheme has such effect as a necessary result of carrying it out.' *Horman v. United States*.

The government has offered no direct proof that any customer was actually defrauded by the Regent-Oxford selling campaign. Instead it offers a stipulation which shows that false representations were made, and that they were made by defendants' agents with knowledge of their falsehood. As a result of the transactions of which the untrue statements were a part, money and property changed hands. With no further proof, the government urges upon us the inference that customers were induced to part with their money because of the false representations, and that such calculated inducement amounted to fraud in the terminology of section 1341. The defendants helped the government over the difficult hurdle of proving that the false representations were 'reasonably calculated' to induce purchasing agents of 'ordinary prudence,' to buy their wares by admitting in writing that the representations were made to secure sales. On this stipulation an intent to deceive, and even to induce, may have been shown; but this does not, without more, constitute the 'fraudulent intent' required by the statute.

If there is no proof that the defendants expected to get ‘something for nothing,’ *Harrison v. United States*, or that they intended to get more for their merchandise than it was worth to the average customer, it is difficult to see any intent to injure or to defraud in the defendants’ falsehoods. Instead of offering proof of some tangible injury to the objects of the Regent-Oxford promotion, the government argues in the negative that ‘it is not essential (to) prove that purchasers were in fact defrauded,’ and therefore that ‘pecuniary loss’ need not be shown for fraud to exist. It may be true, as Judge Learned Hand stated in *United States v. Rowe*, that:

. . . (a) man is none the less cheated out of his property, when he is induced to part with it by fraud, because he gets a quid pro quo of equal value. It may be impossible to measure his loss by the gross scales available to a court, but he has suffered a wrong; he has lost his chance to bargain with the facts before him.

Nevertheless, neither the Rowe case nor the language quoted will support the conclusion that no definable harm need be contemplated by the accused to find him guilty of mail fraud. For that is what the government is arguing: that these false representations, in the context of a commercial transaction, are per se fraudulent despite the absence of any proof of actual injury to any customer. . . .

[W]e have found no case in which an intent to deceive has been equated with an ‘intent to defraud’ where the deceit did not go to the nature of the bargain itself. Where the false representations are directed to the quality, adequacy or price of the goods themselves, the fraudulent intent is apparent because the victim is made to bargain without facts obviously essential in deciding whether to enter the bargain. In closer cases, where the representations do not mislead as to the quality, adequacy of inherent worth of the goods themselves, fraud in the bargaining may be inferable from facts indicating a discrepancy between benefits reasonably anticipated because of the misleading representations and the actual benefits which the defendant delivered, or intended to deliver. In either instance, the intent of the schemer is to injure another to his own advantage by withholding or misrepresenting material facts. Although proof that the injury was accomplished is not required to convict under 1341, we believe the statute does require evidence from which it may be inferred that some actual injury to the victim, however slight, is a reasonably probable result of the deceitful representations if they are successful. . . .

The government asks us to infer some injury from the mere fact of the falseness of the representations and their connection with a commercial transaction. On the evidence before us, consisting principally of the stipulated falsehoods and the testimony of the defendants’ president, we conclude that the defendants intended to deceive their customers but they did not intend to defraud them, because the falsity of their representations was not shown to be capable of affecting the customer’s understanding of the bargain nor of influencing his assessment of the value of the bargain to him, and thus no injury was shown to flow from the deception. . . .

UNITED STATES v. JABAR, 19 F.4th 66 (2d Cir. 2021)

WALKER JR., Circuit Judge:

The United States appeals from a post-verdict judgment of acquittal entered by the District Court for the Western District of New York (Lawrence J. Vilardo, *J.*) with respect to the convictions of defendants Steve S. Jabar and Deborah Bowers for wire fraud, in violation of 18 U.S.C. § 1343, and conspiracy to commit wire fraud, in violation of 18 U.S.C. § 371. The government argues that a reasonable jury could infer that the defendants had an intent to defraud the United Nations (UN) when they diverted for personal use more than \$65,000 of grant money awarded to their non-profit organization. Viewing the evidence in the light most favorable to the government, we conclude that there was sufficient evidence for the jury to convict on the wire fraud and related counts. . . .

This case arises from defendants’ personal use of grant money that the UN awarded to their non-profit organization, Opportunities for Kids International, Inc. (OKI). Jabar and Bowers applied for and obtained a grant in the amount of \$500,000 (\$150,000 of which was later withheld) for the sole purpose of establishing a radio station in Iraq dedicated to women’s programming. Instead, the defendants siphoned off more than \$65,000 of the grant to pay personal debts, bills, and taxes. . . .

The elements of wire fraud are: “(1) a scheme to defraud, (2) money or property as the object of the scheme, and (3) use of the wires to further the scheme.” *United States v. Binday*; see 18 U.S.C. § 1343. Conspiracy to commit wire fraud requires merely the agreement between defendants to engage in the foregoing and an overt act by one of the conspirators in furtherance of the conspiracy. 18 U.S.C. § 371.

“Essential to a scheme to defraud is fraudulent intent.” *D’Amato*. Fraudulent intent may be inferred “[w]hen the ‘necessary result’ of the actor’s scheme is to injure others.” *Id.* (quoting *United States v. Regent Office Supply Co.*). Intent may also be proven “through circumstantial evidence, including by showing that defendant made misrepresentations to the victim(s) with knowledge that the statements were false.” *Guadagna*. Because an intent to deceive alone is insufficient to sustain a wire fraud conviction, “[m]isrepresentations amounting only to a deceit . . . must be coupled with a contemplated harm to the victim.” *United States v. Starr*. “Such harm is apparent where there exists a discrepancy between benefits reasonably anticipated because of the misleading representations and the actual benefits which the defendant delivered, or intended to deliver.” Proof of actual injury to the victim is not required because the scheme need not have been successful or completed. *United States v. Dinome*.

Comparing two of our previous decisions clarifies that the misrepresentations must be central, not just collateral, to the bargain between the defendant and the victim. In *United States v. Starr*, owners of a bulk mailing company schemed to conceal higher rate mailings from customers in lower rate bulk mailings without paying the additional postage to the postal service or refunding their customers’ excess postage payments.

Defendants “represented that funds deposited with them would be used only to pay for their customers’ postage fees,” but upon defrauding the postal service, defendants sent fraudulent receipts to their customers and appropriated the remainder of the funds for their own use. We concluded that because the customers’ mail was delivered on time to the correct location, whatever harm there was did not “affect the very nature of the bargain itself.” At most, the government’s evidence showed defendants’ intent to deceive or induce customers into the transaction but not a fraudulent intent.

In *United States v. Schwartz*, the defendants schemed to purchase U.S.-manufactured military equipment for their international clients. One producer, Litton Industries, “expressly demanded assurances” that its devices would not be exported unlawfully, including that: the condition be incorporated into the sales agreement, the defendants disclose the customer’s identity, and the customer obtain the requisite export certificates. Rather than comply, the defendants fed Litton false information and fabricated documents to secure the purchase. On appeal, we concluded that evidence of the defendants’ deceitful acts supported a finding of fraudulent intent and thus upheld the wire fraud convictions. We distinguished these facts from the false representations in *Starr*, which “did not cause any discrepancy between benefits reasonably anticipated and actual benefits received” and, therefore, “did not go to an essential element of the bargain.” The scheme in *Starr* “only defeated [defendants’] customers’ expectation that the money they paid to the defendants would be fully used to pay for postage, an expectation *that was not the basis of the bargain*.” To the contrary, the defendants’ misrepresentations in *Schwartz* were not “simply fraudulent inducements,” but went to an essential element of the bargain: the *lawful* export of military equipment. The defendants made “*explicit* promises . . . in response to Litton’s demands” and evidence showed that the deceived party “would not have sold its product” to defendants if they “had not been able to guarantee these conditions.” Therefore, even though it received payment, Litton was deprived of “the right to define the terms for the sale of its property” and “good will because equipment [that] Litton, a government contractor, sold was exported illegally.” The wire fraud statute captured these non-pecuniary harms. . . .

The district court ultimately concluded that the evidence was insufficient to prove that the defendants had the intent to defraud the UN because ultimately, they built “\$350,000 worth of a radio station.” In reaching this decision, the district court rejected the notion that a reasonable jury could find Jabar and Bowers’s use of grant funds for personal expenses was itself a harm to the UN. We do not agree that the evidence compels a finding that the benefit of the bargain to UNIFEM was confined to a brick-and-mortar radio station. The evidence was sufficient for the jury to determine reasonably that OKI’s representation in the Cooperation Agreement that it would spend the grant funds pursuant to UNIFEM’s specifications was equally essential to the issuance of the grant.

The Cooperation Agreement required compliance with numerous spending provisions that controlled OKI’s use of the \$500,000. OKI agreed to “utilize the funds ... provided by UNIFEM in strict accordance with the Project Document.” Although the government failed to offer the Project Document and Project Budget into evidence, a reasonable jury

could rely on other evidence that *was* offered to infer that a restriction on the use of grant funds was part of the basis of the bargain. The defendants' own budget proposal, received in evidence, unsurprisingly stated that every dollar of the grant proceeds would be allocated to a VOW-related expense. And a UNIFEM official testified that the agency as a matter of course demands assurances from grant recipients that they will devote the awarded money exclusively towards the project. The Cooperation Agreement also required that Jabar and Bowers return to UNIFEM any funds not spent on the project. UNIFEM mandated the return of all unused funds precisely because the proper use and management of funds was central to the bargain. . . .

In sum, the government's theory at trial was that the construction of the radio station was only part of the bargain and that it served to conceal defendants' fraudulent acts with respect to the rest of the bargain—OKI's agreement to spend the entirety of the grant exclusively pursuant to the terms of the Cooperation Agreement. To the extent defendants insisted that the contractual bargain was confined to building the radio station, the jury was free to reject that claim based on its assessment of the weight of the evidence and reasonable inferences it could draw from that evidence. . . .

What should we do with “intent to injure”? The Second Circuit's use of intent to injure or harm as a limiting device in application of the mail and wire fraud statutes is perhaps useful, but can be confusing. Much of the confusion involves the relationship between this requirement and the elements of materiality and intent to defraud. The court related the requirement to fraudulent intent, but the element also seems to function in an overlapping way with the requirement of materiality. It thus remains unclear whether the “intent to injure” requirement is really adding anything to the basic elements of mail/wire fraud, and whether it does any limiting work. Moreover, federal courts have not uniformly stated that the elements of mail and wire fraud include proof of “intent to injure (harm),” and have said that this element does not apply to some other quite similar fraud statutes. For example, in *Shaw v. United States*, 137 S. Ct. 462 (2016), the Supreme Court held that the federal bank fraud statute, 18 U.S.C. § 1344, includes no such requirement. The *Shaw* Court said, “We have found no case from this Court interpreting the bank fraud statutes as requiring that the victim ultimately suffer financial harm, or that the defendant intend that the victim bank suffer such harm.”

Perhaps it is most helpful to focus on the Second Circuit and other courts' discussions of, so to speak, what “the bargain really was” in these cases. After all, the court does not really mean that the fraud perpetrator must want the victim to suffer harm—the fraudster is interested in profit, not spite. See *United States v. Miller*, 953 F.3d 1095, 1101–03 (9th Cir. 2020) (Rakoff, J., sitting by designation) (explaining the distinction as between (1) a mere intent to deceive and (2) an intent to deceive the victim coupled with an intent to cheat the victim out of something). Several circuits have said that proof of an intent to injure is not required even under the mail and wire fraud statutes. See, e.g., *United States v. Kenrick*, 221 F.3d 19, 27–29 (1st Cir. 2000); *United States v. Segal*, 644 F.3d 364, 367 (7th Cir. 2011); *United States v. Welch*, 327 F.3d 1081, 1104 (10th

Cir. 2003); *see also* Joseph Lanuti, *Mail and Wire Fraud*, 56 AM. CRIM. L. REV. 1151, 1155 (2019). *But see* *United States v. Greenlaw*, 84 F.4th 325 (5th Cir. 2023) (in reviewing convictions for wire and securities fraud under 18 U.S.C. §§ 1343 and 1348, stating that proof of “intent to defraud” under those statutes requires proof of both intent to deceive and “intent to cheat,” that is, intent to deprive the victim of money or property).

Some further clarity may be coming from the Supreme Court. On June 17, 2024, the Court granted certiorari in *Kousisis v. United States*, a case from the Third Circuit, in which the questions presented are “(1) Whether deception to induce a commercial exchange can constitute mail or wire fraud, even if inflicting economic harm on the alleged victim was not the object of the scheme; (2) whether a sovereign’s statutory, regulatory, or policy interest is a property interest when compliance is a material term of payment for goods or services; and (3) whether all contract rights are ‘property.’” Question (1) goes to the issue in *Regent Office Supply* and related cases. Questions (2) and (3) go to the issue of what counts as “property,” discussed in Section D below.

The next case, dealing with the line between fraud and permissible deception in negotiations, is another example of a federal circuit court seeking limitations on the breadth of criminal fraud liability. How would you state the limitation on fraud liability that underlies the Seventh Circuit’s reversal of convictions in this case?

UNITED STATES v. WEIMERT, 819 F.3d 351 (7th Cir. 2016)

HAMILTON, Circuit Judge:

In the midst of the 2008–09 financial crisis, a Wisconsin bank called AnchorBank was struggling to stay above water. Under pressure to find cash to pay its own lenders, the bank’s president told vice president David Weimert to try to sell the bank’s share in a commercial real estate development in Texas. Weimert, who is the defendant and appellant in this criminal wire fraud case, successfully arranged a sale that exceeded the bank’s target price by about one third. The deal also relieved the bank of a liability of twice the sale price.

Given the version of the facts we must accept for this appeal, however, Weimert saw an opportunity to insert himself into the deal personally. He persuaded two potential buyers that he would be a useful partner for them. Both buyers included in their offer letters a term having Weimert buy a minority interest in the property. The bank agreed. It also agreed to pay Weimert an unusual bonus to enable him to buy the minority interest. We must also assume that the successful buyer, at least, would have been willing to go forward without Weimert as a partner, and that Weimert deliberately misled his board and bank officials to believe that the successful buyer would not close the deal if he were not included as a minority partner. The government prosecuted Weimert for wire fraud on the theory that his actions added up to a scheme to obtain money or property by fraud, and the jury convicted him on five of six counts of wire fraud under 18 U.S.C. § 1343.

We reverse and order judgment of acquittal. Federal wire fraud is an expansive tool, but as best we can tell, no previous case at the appellate level has treated as criminal a person's lack of candor about the negotiating positions of parties to a business deal. In commercial negotiations, it is not unusual for parties to conceal from others their true goals, values, priorities, or reserve prices in a proposed transaction. When we look closely at the evidence, the only ways in which Weimert misled anyone concerned such negotiating positions. He led the successful buyer to believe the seller wanted him to have a piece of the deal. He led the seller to believe the buyer insisted he have a piece of the deal. All the actual terms of the deal, however, were fully disclosed and subject to negotiation. There is no evidence that Weimert misled anyone about any material facts or about promises of future actions. While one can understand the bank's later decision to fire Weimert when the deception about negotiating positions came to light, his actions did not add up to federal wire fraud. Weimert is entitled to judgment of acquittal. We order his prompt release from federal prison, on the stated terms of supervised release in his sentence, pending issuance of our mandate. . . .

Before giving a detailed account of the evidence, we explain the legal standards we apply. The wire fraud statute prohibits schemes to defraud or to obtain money or property by means of "false or fraudulent pretenses, representations, or promises" if interstate wire or electronic communications are used to execute the scheme. 18 U.S.C. § 1343. To convict a person under § 1343, the government must prove that he "(1) was involved in a scheme to defraud; (2) had an intent to defraud; and (3) used the wires in furtherance of that scheme." *United States v. Faruki* (quoting *Durham*).

To prove a scheme to defraud, the government must show that Weimert made a material false statement, misrepresentation, or promise, or concealed a material fact. *United States v. Powell*; see also *Neder v. United States* (holding "materiality of falsehood" is an element of federal mail and wire fraud statutes). Intent to defraud requires proof that the defendant acted willfully "with the specific intent to deceive or cheat, usually for the purpose of getting financial gain for one's self or causing financial loss to another." *Faruki* (quoting *United States v. Howard*).

Like its cousin mail fraud, the wire fraud statute has been interpreted to reach a broad range of activity. Courts have taken an expansive approach to what counts as a material misrepresentation or concealment in a scheme to defraud. As we will see, it is possible to put together broad language from courts' opinions on several different points so as to stretch the reach of the mail and wire fraud statutes far beyond where they should go.

First, for example, materiality has been defined in broad and general terms as having a tendency to influence or to be capable of influencing the decision-maker.

Second, the concept of a misrepresentation is also broad, reaching not only false statements of fact but also misleading half-truths and knowingly false promises. It can also include the omission or concealment of material information, even absent an affirmative duty to disclose, if the omission was intended to induce a false belief and action to the advantage of the schemer and the disadvantage of the victim.

Third, wire fraud does not require the false statement to be made directly to the victim of the scheme. Deception of someone else can suffice if it carries out the scheme.

Fourth, it is no defense that the intended victim of wire fraud was too trusting and gullible or, on the other hand, was too smart or sophisticated to be taken in by the deception.

These and other expansive glosses on the mail and wire fraud statutes have led to their liberal use by federal prosecutors. As one future federal judge put it during his tenure as a prosecutor, these statutes are “our Stradivarius, our Colt 45, our Louisville Slugger, our Cuisinart—and our true love.” Jed S. Rakoff, *The Federal Mail Fraud Statute (Part I)*, 18 Duq. L. Rev. (1980). Mail and wire fraud statutes “have long provided prosecutors with a means by which to salvage a modest, but dubious, victory from investigations that essentially proved unfruitful.” John C. Coffee, Jr. & Charles K. Whitehead, *The Federalization of Fraud: Mail and Wire Fraud Statutes*, in *White Collar Crime: Business and Regulatory Offenses* § 9.05 (1990). . . .

This case presents a test of how far the mail and wire fraud statutes reach when parties negotiate a substantial commercial transaction that involves, as almost all will, the use of the mails or interstate wire communications. Some deceptions in commercial negotiations certainly can support a mail or wire fraud prosecution. A party may not misrepresent material facts about an asset during a negotiation to sell it. For example, a seller or his agent may not falsely tell potential buyers or investors that a piece of property has no history of environmental problems if soil and groundwater contamination on the property was discovered the year before. The buyer would be led to purchase a property worth far less than she was led to believe, given the looming remediation costs. Similarly, a company may not inform a potential investor that it expects patent protection for its key intellectual property if its patent application was recently rejected as barred by prior art. The investor would be led to believe that he was investing in a valuable asset that was actually worthless. The misrepresentations materially alter one party’s understanding of the subject of the deal. . . .

From strands of case law, it is true, one can piece together a mail or wire fraud case based on such deception about negotiating positions. To track the specific rules we discussed above: First, information about a party’s negotiating position is surely material in the sense that it is capable of influencing another party’s decisions. Second, actionable deception can include false statements of fact, misleading half-truths, deceptive omissions, and false promises of future action. All of these descriptions may fit deceptions about negotiating positions, at least if a negotiator’s present state of mind is treated as a fact. Third, the false statement may be made to someone other than the owner or holder of the money or property targeted by the scheme. And fourth, it is no defense that the intended victim either trusted the defendant too much or was too savvy to be fooled.

But Congress could not have meant to criminalize deceptive misstatements or omissions about a buyer’s or seller’s negotiating positions. See *United States v. Coffman* (“it would

not do to criminalize business conduct that is customary rather than exceptional and is relatively harmless”). Buyers and sellers negotiate prices and other terms. To state the obvious, they will often try to mislead the other party about the prices and terms they are willing to accept. Such deceptions are not criminal.

To take a simple example based on price, suppose a seller is willing to accept \$28,000 for a new car listed for sale at \$32,000. A buyer is actually willing to pay \$32,000, but he first offers \$28,000. When that offer is rejected and the seller demands \$32,000, the buyer responds: “I won’t pay more than \$29,000.” The seller replies: “I’ll take \$31,000 but not a penny less.” After another round of offers and demands, each one falsely labeled “my final offer,” the parties ultimately agree on a price of \$30,000. Each side has gained from deliberately false misrepresentations about its negotiating position. Each has affected the other side’s decisions. If the transaction involves interstate wires, has each committed wire fraud, each defrauding the other of \$2,000? Of course not. But *why* not?

The government’s answer at oral argument was the absence of “intent to defraud.” That answer begs the question. How do we recognize “intent to defraud” if a party has gained a better deal by misleading the other party about its negotiating position? If a party’s negotiation position is material for purposes of the mail and wire fraud statutes, each has obtained a financial gain by deliberately misleading the other.

The better answer is that negotiating parties, and certainly the sophisticated businessmen in this case, do not expect complete candor about negotiating positions, as distinct from facts and promises of future behavior. Deception about negotiating positions—about reserve prices and other terms and their relative importance—should not be considered material for purposes of mail and wire fraud statutes. . . .

About February 16, Weimert asked Richard Petershack, an outside lawyer for IDI, to draft a proposed “template” letter of intent for potential buyers of the Chandler Creek interest. Petershack testified that Weimert told him to use \$8.5 million as the purchase price, with financing of \$6.5 million available through AnchorBank. Weimert also told Petershack to include a term that Weimert said buyers were requiring: that Weimert himself “stay in the deal because of my institutional knowledge of the project.” Petershack also testified that Weimert told him that IDI had agreed to compensate him for his efforts in “facilitating the deal and finding potential investors” by paying him a fee of four percent of the purchase price. On this record, we must assume that Weimert was lying to Petershack at that time about the buyers requiring that he participate and IDI agreeing to the four percent fee. . . .

On February 22, 2009, Weimert called Kalka and his investment partner. Both Weimert and the partner agreed that Weimert’s involvement as a buyer would be beneficial; Weimert knew the property and had worked with the Burkes for several years. (Kalka’s testimony was unclear as to whether his partner or Weimert first proposed that Weimert participate as a buyer.) In a follow-up email to Weimert, Kalka later confirmed “it is imperative that you David Weimert be involved personally in the Chandler Creek

transaction.” Weimert’s involvement needed to be “economic” to assure Kalka of Weimert’s services in overseeing the investment. Kalka wrote that Weimert “might show this,” presumably the email, “to your Board to make sure that this is happening.”

The following day, February 23, Weimert sent the IDI board of directors a memorandum on the Chandler Creek negotiations. He summarized key points from his conversations with Kalka and his partner. Kalka was to serve as a “stalking horse” in the investment and had ample funds to make the investment. In exchange, Kalka would receive \$75,000 as a break-up fee if his offer was not selected. Finally, Weimert added: “It is imperative that Mr. Weimert be involved economically to assure his management—and investment liaison involvement in perpetuity while Mr. Kalka and or his investors are involved.” Weimert went on to note as a “bottom line ... [that] Kalka will not do this without me being a Manager of the Investment and Liaison to his Group and the Burke’s. . . .” As best we can tell from the record, this statement to the board about Kalka and his partner was true. . . .

By late February 2009, then, Weimert had secured two offers that exceeded Timmerman’s target price for Chandler Creek by at least \$2 million. But both offers also posed what all IDI directors and other bank officials recognized as a conflict of interest: Weimert was both a buyer and an officer of the seller. Weimert submitted both letters of intent to the IDI board of directors along with two memoranda that were central to the government’s case.

The first, called “A Personal Note,” was a short summary of the evolution of the deal. Weimert wrote falsely that he had “had no intention of being involved in this Project.” But the deal had evolved, he said, so that “The Kalka’s Group required [Weimert’s involvement], . . . and Bill Burke actually felt that [Weimert] would continue to ‘Add a Positive Dimension’ to the Management of Chandler Creek.” In addition to describing his involvement falsely as “inadvertent,” Weimert said he needed to participate to close the deal.

Weimert’s second document, called “Evolution of This Deal,” also reported on his negotiations with Kalka and the Burkes. As part of the Kalka offer, Kalka had “insisted” that Weimert “run this investment” and “have money in the deal so ‘I don’t run away.’” As for the Burkes, Weimert falsely told the board that they continued to “be especially focused on my continued involvement.” Weimert concluded by recommending selling to The Burke Group. Although it was offering a lower purchase price, the Burke deal would also release IDI from its potential \$15 million liability to Bank of America on the Chandler Creek mortgage. . . .

[An] attorney advised the board that Weimert’s involvement was not illegal. He asked the board two questions: first, whether the transaction could be completed without Weimert’s involvement; and second, whether the transaction was necessary and in the best interest of the company. The board members said they understood that Weimert “had to be involved or the Burkes were not going to be a purchaser,” and that the deal was good for the company, especially with the need to raise cash to make the looming

payment due to U.S. Bank at the end of March. The attorney advised the board to waive the conflict and go forward with the sale. On this advice, the board waived the conflict, accepted The Burke Group's purchase offer, and approved the four percent fee for Weimert in the amount of \$311,000. . . .

All terms of the transaction, including Weimert's participation as a buyer, were disclosed to all interested parties. The government's evidence of deception—all of it—addressed not material facts or promises but rather parties' negotiating positions, which are not material for purposes of mail and wire fraud. . . .

IDI was not misled as to the nature of the asset it was selling or the consideration it received. . . . At bottom, even the centerpiece of the government's case—Weimert falsely told the IDI board and Omanchinski that the Burkes required his participation—amounted to no more and no less than a false prediction about how the Burkes would respond to a counteroffer to exclude Weimert's participation. In other words, it was deception about a party's negotiating position. Weimert's false story about who had first come up with the idea to have him participate would have been material only for what it signaled about how important his participation was to the parties. In other words, it was important only in predicting how various parties were likely to respond to a counteroffer proposing to reduce or eliminate his role. . . .

The government's strongest argument is that Weimert's actions amounted to a scheme to defraud IDI because, even if an outsider might be permitted to mislead it about negotiating positions, Weimert could not do so about his own role in the transaction. Based on the testimony of IDI directors, we must assume that they trusted Weimert on all aspects of the Chandler Creek deal, including what he told them about the buyer insisting that he participate in the deal. . . .

Since Weimert had such a substantial financial interest in the deal that was disclosed to the board, it is helpful to view the role of Weimert's fiduciary duty as if this were a transaction involving Weimert's own compensation. If Weimert's role as a corporate officer with fiduciary duties were to play a decisive role here, it would be because he would have owed a duty to the corporation to be completely honest regarding the Chandler Creek sale, including how his participation in the deal came about and what he knew about how the Burkes were likely to have responded to a counteroffer excluding Weimert. So, to the extent that fiduciary standards are relevant to this criminal case, the best guidance concerns the extent of a corporate officer's fiduciary duty toward the corporation in negotiating his own compensation. . . .

Taken literally, such a broad fiduciary duty could require a corporate officer negotiating with the corporation about his own compensation to reveal the weaknesses in his own negotiating position as part of his duty of good faith. He might be required, for example, to disclose that he would be willing to take less compensation than he is asking for. And under that reasoning, Weimert would have been obliged to tell the directors that the Burkes probably would have been willing to go forward with the purchase even without his participation. That is not the law with corporate fiduciary duties or with other

fiduciary duties, however, or at the very least it is not so clearly the law as to support a criminal conviction. . . .

FLAUM, Circuit Judge, dissenting.

I respectfully disagree with the analysis and conclusion of the majority. At the outset, I do not believe that the scenario presented in this case can be viewed as an arms-length, three-party transaction. Weimert, as president of IDI, was acting on behalf of IDI in negotiating the deal. Unlike a situation involving three independent parties, in the transaction at hand, the IDI board had every reason to expect that Weimert would fairly and honestly represent its interests. The record does not reflect an expectation at the start of negotiations that Weimert would be entitled to equity or any sort of bonus arising out of the Chandler Creek deal. Thus, I cannot accept the majority's conclusion that this situation amounts to hard bargaining among disinterested parties, and that the IDI board received what it agreed to and expected in the Chandler Creek sale. In fact, IDI likely would have received a higher purchase price had Weimert not taken a bite out of the deal. IDI received roughly 96 percent, rather than 100 percent, of the purchase price due to Weimert's creation of equity for himself.

I also do not agree that this case is similar to a routine negotiation among buyers and sellers in which the parties benefit from deliberately false misrepresentations about their negotiating positions. Such situations, which the majority contends are customary and relatively harmless, entail actual arms-length transactions among independent parties. By contrast, Weimert, the president of IDI, was not at arms-length with the IDI board. Moreover, in the typical negotiation involving a buyer and seller, the parties are aware that they are solely bargaining with one another; in the case at hand, the IDI board had no reason to believe that it was also negotiating with Weimert, in addition to the potential buyers.

Although the final contract terms were disclosed when the IDI board considered and approved the deal, the evidence suggests that the IDI board only approved the deal because Weimert represented that it would not get done without his involvement. All of the board members later testified that they would not have voted to waive the conflict of interest and pay Weimert's fee if they had known that the Burkes did not require his involvement. This evidence undermines the notion that the IDI board simply agreed to the terms that were in plain view and received what it expected. Rather, the deal the board approved was based on misrepresentations by its own representative and the board would not have approved the deal if it had known the truth. Further, I find the majority's assertion that the final contract terms were "in fact discussed and negotiated by the interested parties" to be an incomplete portrayal of the facts, since the only parties to negotiate the letter of intent that the IDI board approved were Weimert, as IDI's representative, and the Burkes. Although the final contract terms were slightly different than those initially approved by the board, that letter of intent formed the basis for a transaction in which the parties assumed and ultimately mandated Weimert's participation.

If one focuses on Weimert's misrepresentations to the IDI board while he was supposedly acting on its behalf, the materiality inquiry is different than the majority proffers. Even if Weimert's statements to Kalka and the Burkes—parties at arms-length—were closer to puffery, Weimert's deception of the IDI board and his ABCW/AnchorBank supervisors was more insidious than mere bluffing. Furthermore, even assuming Weimert's participation was a non-core term of the deal, IDI was misled as to the amount it could receive for the property as well as Weimert's interest in seeing the deal completed. Weimert's misrepresentations induced the IDI board to approve the deal and were, therefore, material to the board's decision. . . .

D. Mail and Wire Fraud: Property

Next, we explore the part of criminal fraud law that deals with the thing the perpetrator is after, what we might call the "corpus" or "object" of the fraud. As you will see, that thing can range from clearly tangible property (like cash) to things that are less tangible (like intellectual property rights). The next series of cases deals, in different ways, with the general question of what kinds of property—or perhaps better, property *rights*—count as valid objects of fraud under the mail and wire fraud statutes. This aspect of mail and wire fraud law is in flux due to the Supreme Court recently moving to limit the statutes' coverage.

UNITED STATES v. SIEGEL, 717 F.2d 9 (2d Cir. 1983)

GEORGE C. PRATT, Circuit Judge:

Leonard S. Siegel and Martin B. Abrams appeal from judgments of conviction... after a jury trial. Both defendants were found guilty of fifteen counts of wire fraud, in violation of 18 U.S.C. §§ 1343 and 2. . . .

During the period covered by the indictment, Mego Int'l was a publicly held international manufacturer and distributor of toys and games. Mego was one of its wholly owned subsidiaries. Abrams was chairman of the board of Mego Int'l and its president until 1980. Siegel was secretary of Mego Int'l and executive vice president of Mego.

The fraudulent scheme underlying defendants' convictions involved unrecorded cash sales of Mego merchandise which had either been closed out and marked down for clearance or returned because of damage or defect. The evidence presented at trial showed that the scheme had been furthered in various ways. Abrams conducted some cash transactions himself. Siegel also dealt in cash transactions, supervising cash sales through a retail store of imported shirts worth over \$30,000. Other cash transactions were conducted with the aid of William Stuckey, who was manager of Mego's Long Island warehouse and who became a principal witness for the government. At the direction of Abrams and Siegel, Stuckey sold Mego merchandise to various street peddlers and merchants for cash. The "off the books" sales together generated in excess of \$100,000 in cash. . . .

Even though . . . the cash sales were not recorded on Mego's books, Siegel and Abrams told Mego's auditors that there were no unrecorded assets. In addition, no information about the cash sales was divulged to Mego's stockholders. The jury was thus entitled to find that Siegel and Abrams, top executives in Mego, generated a secret fund of over \$100,000 from cash sales of company assets without disclosing their activities to their stockholders, that they used the cash in part for private benefit, in part for illegal payments to buyers, and in part for illegal payoffs to labor unions, and that they did not account for any sum that may have remained in the fund. . . .

The government charged that Abrams and Siegel engaged in a scheme to defraud Mego and Mego stockholders by violating their fiduciary duties to act honestly and faithfully in the best interest of the corporation and to account for the sale of all Mego property entrusted to them. . . .

[W]e have held that the [mail fraud] statute is violated when a fiduciary fails to disclose material information "which he is under a duty to disclose to another under circumstances where the non-disclosure could or does result in harm to the other." While the prosecution must show that some harm or injury was contemplated by the scheme, it need not show that direct, tangible economic loss resulted to the scheme's intended victims. . . . In this record there is sufficient evidence from which the jury could reasonably have concluded that defendants received the cash proceeds and used them for non-corporate purposes in breach of their fiduciary duties to act in the best interest of the corporation and to disclose material information to Mego and its stockholders. . . .

Abrams argues that because the sums involved were insignificant when compared with Mego's overall sales volume, there was no affirmative duty to report the cash sales to the stockholders of Mego. While he is correct that, to prove a violation of the wire fraud statute, the government must show that the corporate officer or employee failed to disclose material information, we cannot accept as "immaterial" a failure to disclose unrecorded cash sales exceeding \$100,000 over a period of nine years. Moreover, the jury was instructed, without defense objection, that "a material fact is one which would be important to a reasonable person in deciding whether to engage in a particular transaction or to engage in certain conduct", and certainly on this record the jury could reasonably have concluded that the failure to disclose the misappropriation of more than \$100,000 was a fact which would be important to a Mego stockholder or corporate officer in his decision-making. Thus, failure to reveal the misappropriation violated defendants' fiduciary duty to disclose material information.

Defendants do not seriously contend that the wire fraud statute is not violated when a corporate officer or employee breaches his fiduciary duty to the corporation by taking the proceeds from unrecorded cash sales and using them for his own benefit. Rather, they argue that even if they did participate in the unrecorded cash sales, the record is devoid of any evidence that the money was used for other than corporate purposes and thus fails to support a finding of a breach of fiduciary duty. Defendants claim that at best the evidence merely shows that Abrams and Siegel received the proceeds from the cash

sales and that Siegel periodically placed the money in the corporate safe deposit box. While neither Abrams nor Siegel testified, they argue that they received none of it for personal use and that any use of the proceeds for labor payoffs served a legitimate corporate purpose and was not in violation of any fiduciary duty. . . .

[W]e conclude that the record as a whole does support the determination that Abrams and Siegel used the money for their own enrichment . . . [T]here was testimony which showed that Abrams and Siegel personally received the proceeds from the cash sales and either pocketed them or placed them in the corporate safe deposit box. Further, although the cash sales generated in excess of \$100,000, the testimony concerning the use to which the money was put accounted for approximately \$31,000, used mainly for illicit payoffs. The reasonable mind can think of several destinations for the more than \$69,000 that was missing, and, since we have rejected the view that a jury may not rely upon an inference to support an essential allegation unless no opposite inference may be drawn from the proof, we conclude that the jury could have inferred that Abrams and Siegel used some or all of the remainder of the proceeds for their own benefit. . . .

WINTER, Circuit Judge, dissenting in part and concurring in part:

Today we read the wire fraud statute to create a federal law of fiduciary obligations imposed on corporate directors and officers, thereby setting the stage for the development of an expandable body of criminal law regulating intra-corporate affairs.

The majority's legal theory is that wire fraud occurred because some of Mego's funds were diverted "for noncorporate purposes in breach of [the defendants'] fiduciary duties to act in the best interest of the corporation and to disclose material information to Mego and its stockholders." The evidence is that Mego, a corporation with sales ranging between \$30 million and \$109 million, during the relevant period, had off-book transactions engineered by the defendants averaging slightly over \$11,000 per year. There is no evidence—*none*—that any of the money was diverted to the personal use of either Siegel or Abrams. The government's *prima facie* case is thus made out solely by a showing of improper corporate record keeping.

State corporate laws universally impose upon corporate directors and officers certain obligations labelled fiduciary duties which are implied from the corporate relationship. These duties are of a contractual nature. However, because of the high transaction costs of organizing numerous parties and the difficulty of spelling out precise rules to govern future transactions, fiduciary obligations are developed and applied on a case by case basis by state courts.

There is nothing in the language or legislative history of the wire fraud statute remotely suggesting that it was intended as a vehicle for the enforcement of fiduciary duties imposed upon corporate directors or officers by state law. To allow it to be so used would thus be a grave error. However, what the majority does is infinitely worse, for it holds that the wire fraud statute creates a *federal* law of fiduciary obligations. There is no pretense that the source of the fiduciary duty at issue in this case was anything but federal

law. There is no reference in the majority opinion to state law or even to Mego's state of incorporation. The jury simply was told that it was up to it to decide whether, as part of the obligation "to act in the best interest of the corporation," the defendants were under a duty to disclose the off-book transactions to shareholders.

The creation of this federal fiduciary duty is no minor step. The relationship of federal and state law in the governance of corporations is a matter of great debate, in which the proponents of federal regulation have strenuously argued that state law governing the conduct of corporate directors and officers is too lax. Over the years, Congress has responded by mandating disclosure through the various securities laws, 15 U.S.C. §§ 77a–78kk (1976), but has generally declined to enact substantive regulation of corporate transactions. . . .

Problem 2-4

As to *Regent Office Supply*, *Weimert*, and *Siegel*, what, if any, of these facts was missing in each fraud prosecution and why?

- (a) Proof of materiality;
- (b) Proof of intent to defraud;
- (c) Proof of a deceptive statement, conduct, or omission;
- (d) Proof of an identifiable propert-like interest (or "corpus") sought by the perpetrator.

The next case involves a matter of insider trading. Here is an important note to refer back to when Chapter 4 takes up insider trading law in earnest: This case was decided before the Supreme Court, in *United States v. O'Hagan*, validated the "misappropriation" theory of insider trading (the Court split 4-4 on the insider trading question in this case and that part of the discussion has been omitted here). When reviewing the course materials later, take note of how the government was able to win this case on a mail fraud theory instead of the misappropriation theory of insider trading that you will read about in Chapter 4.

CARPENTER v. UNITED STATES, 484 U.S. 19 (1987)

Justice WHITE delivered the opinion of the Court.

In 1981, [Foster] Winans became a reporter for the Wall Street Journal (the Journal) and in the summer of 1982 became one of the two writers of a daily column, "Heard on the Street." That column discussed selected stocks or groups of stocks, giving positive and negative information about those stocks and taking "a point of view with respect to investment in the stocks that it reviews." Winans regularly interviewed corporate executives to put together interesting perspectives on the stocks that would be highlighted in upcoming columns. . . . Because of the "Heard" column's perceived quality and integrity, it had the potential of affecting the price of the stocks which it examined. The District Court concluded on the basis of testimony presented at trial that

the “Heard” column “does have an impact on the market, difficult though it may be to quantify in any particular case.”

The official policy and practice at the Journal was that prior to publication, the contents of the column were the Journal’s confidential information. Despite the rule, with which Winans was familiar, he entered into a scheme in October 1983 with Peter Brant and petitioner Felis, both connected with the Kidder Peabody brokerage firm in New York City, to give them advance information as to the timing and contents of the “Heard” column. This permitted Brant and Felis and another conspirator, David Clark, a client of Brant, to buy or sell based on the probable impact of the column on the market. Profits were to be shared. The conspirators agreed that the scheme would not affect the journalistic purity of the “Heard” column. . . . Over a 4-month period, the brokers made prepublication trades on the basis of information given them by Winans about the contents of some 27 “Heard” columns. . . .

In affirming the mail and wire fraud convictions, the Court of Appeals ruled that Winans had fraudulently misappropriated “property” within the meaning of the mail and wire fraud statutes and that its revelation had harmed the Journal. It was held as well that the use of the mail and wire services had a sufficient nexus with the scheme to satisfy §§ 1341 and 1343. The petition for certiorari challenged these conclusions. . . .

We held in *McNally* that the mail fraud statute does not reach “schemes to defraud citizens of their intangible rights to honest and impartial government,” and that the statute is “limited in scope to the protection of property rights.” Petitioners argue that the Journal’s interest in prepublication confidentiality for the “Heard” columns is no more than an intangible consideration outside the reach of § 1341. . . . This is not a case like *McNally*, however. The Journal, as Winans’ employer, was defrauded of much more than its contractual right to his honest and faithful service, an interest too ethereal in itself to fall within the protection of the mail fraud statute, which “had its origin in the desire to protect individual property rights.” *McNally*. Here, the object of the scheme was to take the Journal’s confidential business information—the publication schedule and contents of the “Heard” column—and its intangible nature does not make it any less “property” protected by the mail and wire fraud statutes. *McNally* did not limit the scope of § 1341 to tangible as distinguished from intangible property rights.

Both courts below expressly referred to the Journal’s interest in the confidentiality of the contents and timing of the “Heard” column as a property right and we agree with that conclusion. Confidential business information has long been recognized as property. . . . The Journal had a property right in keeping confidential and making exclusive use, prior to publication, of the schedule and contents of the “Heard” column.

Petitioners’ arguments that they did not interfere with the Journal’s use of the information or did not publicize it and deprive the Journal of the first public use of it . . . miss the point. The confidential information was generated from the business, and the business had a right to decide how to use it prior to disclosing it to the public. Petitioners cannot successfully contend . . . that a scheme to defraud requires a monetary

loss, such as giving the information to a competitor; it is sufficient that the Journal has been deprived of its right to exclusive use of the information, for exclusivity is an important aspect of confidential business information and most private property for that matter.

We cannot accept petitioners' further argument that Winans' conduct in revealing prepublication information was no more than a violation of workplace rules and did not amount to fraudulent activity that is proscribed by the mail fraud statute. Sections 1341 and 1343 reach any scheme to deprive another of money or property by means of false or fraudulent pretenses, representations, or promises. . . . The concept of "fraud" includes the act of embezzlement, which is "the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another." *Grin v. Shine*.

The District Court found that Winans' undertaking at the Journal was not to reveal prepublication information about his column, [but] we noted the similar prohibitions of the common law, that "even in the absence of a written contract, an employee has a fiduciary obligation to protect confidential information obtained during the course of his employment." As the New York courts have recognized: "It is well established, as a general proposition, that a person who acquires special knowledge or information by virtue of a confidential or fiduciary relationship with another is not free to exploit that knowledge or information for his own personal benefit but must account to his principal for any profits derived therefrom."

We have little trouble in holding that the conspiracy here to trade on the Journal's confidential information is not outside the reach of the mail and wire fraud statutes, provided the other elements of the offenses are satisfied. The Journal's business information that it intended to be kept confidential was its property; the declaration to that effect in the employee manual merely removed any doubts on that score and made the finding of specific intent to defraud that much easier. . . .

Government functions and powers as the objects of fraud? In *Cleveland v. United States*, 531 U.S. 12 (2000), the defendants deceived the state of Louisiana in applications for licenses to operate video poker machines. The Supreme Court held that such a state license cannot constitute property for purposes of the mail and wire fraud statutes. The Court reasoned that licenses have value to applicants, but they are not property in the hands of the state (the alleged victim in *Cleveland*) because they involve only a power to regulate, not a property-like interest or right. The Court was also concerned about the potential federalism implications of allowing federal prosecutors to use the mail and wire fraud statutes to respond to misconduct in people's dealings with state and local authorities. The next two cases are part of a recent and broader effort by the Court to articulate the limits of federal prosecutors' ability to use the mail and wire fraud statutes to attack corruption within government based on creative theories of what can constitute property.

KELLY v. UNITED STATES, 140 S. Ct. 1565 (2020)

KAGAN, J., delivered the opinion of the Court.

For four days in September 2013, traffic ground to a halt in Fort Lee, New Jersey. The cause was an unannounced realignment of 12 toll lanes leading to the George Washington Bridge, an entryway into Manhattan administered by the Port Authority of New York and New Jersey. For decades, three of those access lanes had been reserved during morning rush hour for commuters coming from the streets of Fort Lee. But on these four days—with predictable consequences—only a single lane was set aside. The public officials who ordered that change claimed they were reducing the number of dedicated lanes to conduct a traffic study. In fact, they did so for a political reason—to punish the mayor of Fort Lee for refusing to support the New Jersey Governor’s reelection bid.

Exposure of their behavior led to the criminal convictions we review here. The Government charged the responsible officials under the federal statutes prohibiting wire fraud and fraud on a federally funded program or entity. *See* 18 U. S. C. §§1343, 666(a)(1)(A). Both those laws target fraudulent schemes for obtaining property. *See* §1343 (barring fraudulent schemes “for obtaining money or property”); §666(a)(1)(A) (making it a crime to “obtain[] by fraud . . . property”). The jury convicted the defendants, and the lower courts upheld the verdicts.

The question presented is whether the defendants committed property fraud. The evidence the jury heard no doubt shows wrongdoing—deception, corruption, abuse of power. But the federal fraud statutes at issue do not criminalize all such conduct. Under settled precedent, the officials could violate those laws only if an object of their dishonesty was to obtain the Port Authority’s money or property. The Government contends it was, because the officials sought both to “commandeer” the Bridge’s access lanes and to divert the wage labor of the Port Authority employees used in that effort. We disagree. The realignment of the toll lanes was an exercise of regulatory power—something this Court has already held fails to meet the statutes’ property requirement. And the employees’ labor was just the incidental cost of that regulation, rather than itself an object of the officials’ scheme. We therefore reverse the convictions.

The setting of this case is the George Washington Bridge. Running between Fort Lee and Manhattan, it is the busiest motor-vehicle bridge in the world. Twelve lanes with tollbooths feed onto the Bridge’s upper level from the Fort Lee side. Decades ago, the then-Governor of New Jersey committed to a set allocation of those lanes for the morning commute. And (save for the four days soon described) his plan has lasted to this day. Under the arrangement, nine of the lanes carry traffic coming from nearby highways. The three remaining lanes, designated by a long line of traffic cones laid down each morning, serve only cars coming from Fort Lee.

The case’s cast of characters are public officials who worked at or with the Port Authority and had political ties to New Jersey’s then-Governor Chris Christie. The Port

Authority is a bi-state agency that manages bridges, tunnels, airports, and other transportation facilities in New York and New Jersey. At the time relevant here, William Baroni was its Deputy Executive Director, an appointee of Governor Christie and the highest ranking New Jersey official in the agency. Together with the Executive Director (a New York appointee), he oversaw “all aspects of the Port Authority’s business,” including operation of the George Washington Bridge. David Wildstein (who became the Government’s star witness) functioned as Baroni’s chief of staff. And Bridget Anne Kelly was a Deputy Chief of Staff to Governor Christie with special responsibility for managing his relations with local officials. She often worked hand-in-hand with Baroni and Wildstein to deploy the Port Authority’s resources in ways that would encourage mayors and other local figures to support the Governor.

The fateful lane change arose out of one mayor’s resistance to such blandishments. In 2013, Governor Christie was up for reelection, and he wanted to notch a large, bipartisan victory as he ramped up for a presidential campaign. On his behalf, Kelly avidly courted Democratic mayors for their endorsements—among them, Mark Sokolich of Fort Lee. As a result, that town received some valuable benefits from the Port Authority, including an expensive shuttle-bus service. But that summer, Mayor Sokolich informed Kelly’s office that he would not back the Governor’s campaign. A frustrated Kelly reached out to Wildstein for ideas on how to respond. He suggested that getting rid of the dedicated Fort Lee lanes on the Bridge’s toll plaza would cause rush-hour traffic to back up onto local streets, leading to gridlock there. Kelly agreed to the idea in an admirably concise e-mail: “Time for some traffic problems in Fort Lee.” In a later phone conversation, Kelly confirmed to Wildstein that she wanted to “creat[e] a traffic jam that would punish” Mayor Sokolich and “send him a message.” And after Wildstein relayed those communications, Baroni gave the needed sign-off.

To complete the scheme, Wildstein then devised “a cover story”—that the lane change was part of a traffic study, intended to assess whether to retain the dedicated Fort Lee lanes in the future. Wildstein, Baroni, and Kelly all agreed to use that “public policy” justification when speaking with the media, local officials, and the Port Authority’s own employees. And to give their story credibility, Wildstein in fact told the Port Authority’s engineers to collect “some numbers on how[] far back the traffic was delayed.” That inquiry bore little resemblance to the Port Authority’s usual traffic studies. According to one engineer’s trial testimony, the Port Authority never closes lanes to study traffic patterns, because “computer-generated model[ing]” can itself predict the effect of such actions. And the information that the Port Authority’s engineers collected on this singular occasion was mostly “not useful” and “discarded.” Nor did Wildstein or Baroni show any interest in the data. They never asked to review what the engineers had found; indeed, they learned of the results only weeks later, after a journalist filed a public-records request. So although the engineers spent valuable time assessing the lane change, their work was to no practical effect.

Baroni, Wildstein, and Kelly also agreed to incur another cost—for extra toll collectors—in pursuit of their object. Wildstein’s initial thought was to eliminate all

three dedicated lanes by not laying down any traffic cones, thus turning the whole toll plaza into a free-for-all. But the Port Authority's chief engineer told him that without the cones "there would be a substantial risk of sideswipe crashes" involving cars coming into the area from different directions. So Wildstein went back to Baroni and Kelly and got their approval to keep one lane reserved for Fort Lee traffic. That solution, though, raised another complication. Ordinarily, if a toll collector on a Fort Lee lane has to take a break, he closes his booth, and drivers use one of the other two lanes. Under the one-lane plan, of course, that would be impossible. So the Bridge manager told Wildstein that to make the scheme work, "an extra toll collector" would always have to be "on call" to relieve the regular collector when he went on break. Once again, Wildstein took the news to Baroni and Kelly. Baroni thought it was "funny," remarking that "only at the Port Authority would [you] have to pay a toll collector to just sit there and wait." Still, he and Kelly gave the okay.

The plan was now ready, and on September 9 it went into effect. Without advance notice and on the (traffic-heavy) first day of school, Port Authority employees placed traffic cones two lanes further to the right than usual, restricting cars from Fort Lee to a single lane. Almost immediately, the town's streets came to a standstill. According to the Fort Lee Chief of Police, the traffic rivaled that of 9/11, when the George Washington Bridge had shut down. School buses stood in place for hours. An ambulance struggled to reach the victim of a heart attack; police had trouble responding to a report of a missing child. Mayor Sokolich tried to reach Baroni, leaving a message that the call was about an "urgent matter of public safety." Yet Baroni failed to return that call or any other: He had agreed with Wildstein and Kelly that they should all maintain "radio silence." A text from the Mayor to Baroni about the locked-in school buses—also unanswered—went around the horn to Wildstein and Kelly. The last replied: "Is it wrong that I am smiling?" The three merrily kept the lane realignment in place for another three days. It ended only when the Port Authority's Executive Director found out what had happened and reversed what he called their "abusive decision." (e-mail of Patrick Foye). . . .

The Government in this case needed to prove *property* fraud. The federal wire fraud statute makes it a crime to effect (with use of the wires) "any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." 18 U.S.C. § 1343. Construing that disjunctive language as a unitary whole, this Court has held that "the money-or-property requirement of the latter phrase" also limits the former. *McNally v. United States*. The wire fraud statute thus prohibits only deceptive "schemes to deprive [the victim of] money or property." Similarly, the federal-program fraud statute bars "obtain[ing] by fraud" the "property" (including money) of a federally funded program or entity like the Port Authority. § 666(a)(1)(A). So under either provision, the Government had to show not only that Baroni and Kelly engaged in deception, but that an "object of the[ir] fraud [was] 'property.'" *Cleveland v. United States*.

That requirement, this Court has made clear, prevents these statutes from criminalizing all acts of dishonesty by state and local officials. . . .

According to the Government's theory of the case, Baroni and Kelly "used a lie about a fictional traffic study" to achieve their goal of reallocating the Bridge's toll lanes. The Government accepts that the lie itself—*i.e.*, that the lane change was part of a traffic study, rather than political payback—could not get the prosecution all the way home. As the Government recognizes, the deceit must also have had the "object" of obtaining the Port Authority's money or property. The scheme met that requirement, the Government argues, in two ways. First, the Government claims that Baroni and Kelly sought to "commandeer[]" part of the Bridge itself—to "take control" of its "physical lanes." Second, the Government asserts that the two defendants aimed to deprive the Port Authority of the costs of compensating the traffic engineers and back-up toll collectors who performed work relating to the lane realignment. On either theory, the Government insists, Baroni's and Kelly's scheme targeted "a 'species of valuable right [or] interest' that constitutes 'property' under the fraud statutes."

We cannot agree. As we explain below, the Government could not have proved—on either of its theories, though for different reasons—that Baroni's and Kelly's scheme was "directed at the [Port Authority's] property." Baroni and Kelly indeed "plotted to reduce [Fort Lee's] lanes." But that realignment was a quintessential exercise of regulatory power. And this Court has already held that a scheme to alter such a regulatory choice is not one to appropriate the government's property. *See Cleveland*. By contrast, a scheme to usurp a public employee's paid time is one to take the government's property. But Baroni's and Kelly's plan never had that as an object. The use of Port Authority employees was incidental to—the mere cost of implementing—the sought-after regulation of the Bridge's toll lanes. . . .

Contrary to the Government's view, the two defendants did not "commandeer" the Bridge's access lanes (supposing that word bears its normal meaning). They (of course) did not walk away with the lanes; nor did they take the lanes from the Government by converting them to a non-public use. Rather, Baroni and Kelly regulated use of the lanes, as officials responsible for roadways so often do—allocating lanes as between different groups of drivers. To borrow *Cleveland's* words, Baroni and Kelly exercised the regulatory rights of "allocation, exclusion, and control"—deciding that drivers from Fort Lee should get two fewer lanes while drivers from nearby highways should get two more. They did so, according to all the Government's evidence, for bad reasons; and they did so by resorting to lies. But still, *what* they did was alter a regulatory decision about the toll plaza's use—in effect, about which drivers had a "license" to use which lanes. And under *Cleveland*, that run-of-the-mine exercise of regulatory power cannot count as the taking of property.

A government's right to its employees' time and labor, by contrast, can undergird a property fraud prosecution. Suppose that a mayor uses deception to get "on-the-clock city workers" to renovate his daughter's new home. *United States v. Pabey*. Or imagine that a city parks commissioner induces his employees into doing gardening work for political contributors. *See United States v. Delano*. As both defendants agree, the cost of those employees' services would qualify as an economic loss to a city, sufficient to meet

the federal fraud statutes' property requirement. No less than if the official took cash out of the city's bank account would he have deprived the city of a "valuable entitlement." *Pasquantino*.

But that property must play more than some bit part in a scheme: It must be an "object of the fraud." Or put differently, a property fraud conviction cannot stand when the loss to the victim is only an incidental byproduct of the scheme.⁸ In the home-and-garden examples cited above, that constraint raised no problem: The entire point of the fraudsters' plans was to obtain the employees' services. But now consider the difficulty if the prosecution in *Cleveland* had raised a similar employee-labor argument. As the Government noted at oral argument here, the fraud on Louisiana's licensing system doubtless imposed costs calculable in employee time: If nothing else, some state worker had to process each of the fraudster's falsified applications. But still, the Government acknowledged, those costs were "[i]ncidental." The object of the scheme was never to get the employees' labor: It was to get gaming licenses. So the labor costs could not sustain the conviction for property fraud.

This case is no different. The time and labor of Port Authority employees were just the implementation costs of the defendants' scheme to reallocate the Bridge's access lanes. Or said another way, the labor costs were an incidental (even if foreseen) byproduct of Baroni's and Kelly's regulatory object. Neither defendant sought to obtain the services that the employees provided. The back-up toll collectors—whom Baroni joked would just "sit there and wait"—did nothing he or Kelly thought useful. Indeed, those workers came onto the scene only because the Port Authority's chief engineer managed to restore one of Fort Lee's lanes to reduce the risk of traffic accidents. In the defendants' original plan, which scrapped all reserved lanes, there was no reason for extra toll collectors. And similarly, Baroni and Kelly did not hope to obtain the data that the traffic engineers spent their time collecting. By the Government's own account, the traffic study the defendants used for a cover story was a "sham," and they never asked to see its results. Maybe, as the Government contends, all of this work was "needed" to realize the final plan—"to accomplish what [Baroni and Kelly] were trying to do with the [B]ridge." Even if so, it would make no difference. Every regulatory decision (think again of *Cleveland*) requires the use of some employee labor. But that does not mean every scheme to alter a regulation has that labor as its object. Baroni's and Kelly's plan aimed to impede access from Fort Lee to the George Washington Bridge. The cost of the employee hours spent on implementing that plan was its incidental byproduct.

To rule otherwise would undercut this Court's oft-repeated instruction: Federal prosecutors may not use property fraud statutes to "set[] standards of disclosure and good

⁸ Without that rule, as Judge Easterbrook has elaborated, even a practical joke could be a federal felony. See *United States v. Walters*, 997 F.2d 1219, 1224 (CA7 1993). His example goes: "A [e-mails] B an invitation to a surprise party for their mutual friend C. B drives his car to the place named in the invitation," thus expending the cost of gasoline. *Ibid.* "But there is no party; the address is a vacant lot; B is the butt of a joke." *Ibid.* Wire fraud? No. And for the reason Judge Easterbrook gave: "[T]he victim's loss must be an objective of the [deceitful] scheme rather than a byproduct of it." *Id.*, at 1226.

government for local and state officials.” *McNally*. Much of governance involves (as it did here) regulatory choice. If U.S. Attorneys could prosecute as property fraud every lie a state or local official tells in making such a decision, the result would be—as *Cleveland* recognized—“a sweeping expansion of federal criminal jurisdiction.”. And if those prosecutors could end-run *Cleveland* just by pointing to the regulation’s incidental costs, the same ballooning of federal power would follow. In effect, the Federal Government could use the criminal law to enforce (its view of) integrity in broad swaths of state and local policymaking. The property fraud statutes do not countenance that outcome. . . .

CIMINELLI v. UNITED STATES, 143 S.Ct. 1121 (2023)

Justice THOMAS delivered the opinion of the Court.

In this case, we must decide whether the Second Circuit’s longstanding “right to control” theory of fraud describes a valid basis for liability under the federal wire fraud statute, which criminalizes the use of interstate wires for “any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises.” 18 U.S.C. § 1343. Under the right-to-control theory, a defendant is guilty of wire fraud if he schemes to deprive the victim of “potentially valuable economic information” “necessary to make discretionary economic decisions.” *United States v. Percoco*. Petitioner Louis Ciminelli was charged with, tried for, and convicted of wire fraud under this theory. And the Second Circuit affirmed his convictions on that same basis.

Because “potentially valuable economic information” “necessary to make discretionary economic decisions” is not a traditional property interest, we now hold that the right-to-control theory is not a valid basis for liability under § 1343. Accordingly, we reverse the Second Circuit’s judgment.

This case begins with then-New York Governor Andrew Cuomo’s “Buffalo Billion” initiative. On its face, the initiative was administered through Fort Schuyler Management Corporation, a nonprofit affiliated with the State University of New York (SUNY) and the SUNY Research Foundation. It aimed to invest \$1 billion in development projects in upstate New York. Later investigations, however, uncovered a wide-ranging scheme that involved several of former Governor Cuomo’s associates, most notably Alain Kaloyeros and Todd Howe. Kaloyeros was a member of Fort Schuyler’s board of directors and was in charge of developing project proposals for Buffalo Billion; Howe was a lobbyist who had deep ties to the Cuomo administration. Each month, Kaloyeros paid Howe \$25,000 in state funds to ensure that the Cuomo administration gave Kaloyeros a prominent position in Buffalo Billion.

Ciminelli had a similar arrangement. His construction company, LPCiminelli, paid Howe \$100,000 to \$180,000 each year to help it obtain state-funded jobs. In 2013, Howe and Kaloyeros devised a scheme whereby Kaloyeros would tailor Fort Schuyler’s bid process to smooth the way for LPCiminelli to receive major Buffalo Billion contracts.

First, on Kaloyeros' suggestion, Fort Schuyler established a process for selecting "preferred developers" that would be given the first opportunity to negotiate with Fort Schuyler for specific projects. Then, Kaloyeros, Howe, and Ciminelli jointly developed a set of requests for proposal (RFPs) that treated unique aspects of LPCiminelli as qualifications for preferred-developer status. Those RFPs effectively guaranteed that LPCiminelli would be (and was) selected as a preferred developer for the Buffalo projects. With that status in hand, LPCiminelli secured the marquee \$750 million "Riverbend project" in Buffalo. . . .

Consistent with the right-to-control theory, the District Court instructed the jury that the term "property" in § 1343 "includes intangible interests such as the right to control the use of one's assets." The jury could thus find that the defendants harmed Fort Schuyler's right to control its assets if Fort Schuyler was "deprived of potentially valuable economic information that it would consider valuable in deciding how to use its assets." The District Court further defined "economically valuable information" as "information that affects the victim's assessment of the benefits or burdens of a transaction, or relates to the quality of goods or services received or the economic risks of the transaction." The jury found Ciminelli guilty of wire fraud and conspiracy to commit wire fraud and the District Court sentenced him to 28 months' imprisonment followed by 2 years' supervised release. . . .

The wire fraud statute criminalizes "scheme[s] or artifice[s] to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises." § 1343. Although the statute is phrased in the disjunctive, we have consistently understood the "money or property" requirement to limit the "scheme or artifice to defraud" element because the "common understanding" of the words "to defraud" when the statute was enacted referred "to wronging one in his property rights." . . . Accordingly, the Government must prove not only that wire fraud defendants "engaged in deception," but also that money or property was "an object of their fraud." *Kelly*. . . .

As developed by the Second Circuit, the theory holds that, "[s]ince a defining feature of most property is the right to control the asset in question," "the property interests protected by the wire fraud statute include the interest of a victim in controlling his or her own assets." *United States v. Lebedev*. Thus, a "cognizable harm occurs where the defendant's scheme denies the victim the right to control its assets by depriving it of information necessary to make discretionary economic decisions." *United States v. Bunday*.

The right-to-control theory cannot be squared with the text of the federal fraud statutes, which are "limited in scope to the protection of property rights." *McNally*. The so-called "right to control" is not an interest that had "long been recognized as property" when the wire fraud statute was enacted. *Carpenter v. United States*. Significantly, when the Second Circuit first recognized the right-to-control theory in 1991—decades after the wire fraud statute was enacted and over a century after the mail fraud statute was

enacted—it could cite no authority that established “potentially valuable economic information” as a traditionally recognized property interest. See *Wallach*. And, the Second Circuit has not since attempted to ground the right-to-control theory in traditional property notions. We have consistently rejected such federal fraud theories that “stray from traditional concepts of property.” *Cleveland*. For its part, the Government—despite relying upon the right-to-control theory for decades, including in this very case—now concedes that if “the right to make informed decisions about the disposition of one’s assets, without more, were treated as the sort of ‘property’ giving rise to wire fraud, it would risk expanding the federal fraud statutes beyond property fraud as defined at common law and as Congress would have understood it.” Thus, even the Government now agrees that the Second Circuit’s right-to-control theory is unmoored from the federal fraud statutes’ text. . . .

Finally, the right-to-control theory vastly expands federal jurisdiction without statutory authorization. Because the theory treats mere information as the protected interest, almost any deceptive act could be criminal. See, e.g., *United States v. Viloski* (affirming right-to-control conviction based on an employee’s undisclosed conflict of interest). The theory thus makes a federal crime of an almost limitless variety of deceptive actions traditionally left to state contract and tort law—in flat contradiction with our caution that, “[a]bsent [a] clear statement by Congress,” courts should “not read the mail [and wire] fraud statute[s] to place under federal superintendence a vast array of conduct traditionally policed by the States.” *Cleveland*. And, as it did below, the Second Circuit has employed the theory to affirm federal convictions regulating the ethics (or lack thereof) of state employees and contractors—despite our admonition that “[f]ederal prosecutors may not use property fraud statutes to set standards of disclosure and good government for state and local officials.” *Kelly* (alterations omitted). The right-to-control theory thus criminalizes traditionally civil matters and federalizes traditionally state matters.

In sum, the wire fraud statute reaches only traditional property interests. The right to valuable economic information needed to make discretionary economic decisions is not a traditional property interest. Accordingly, the right-to-control theory cannot form the basis for a conviction under the federal fraud statutes. . . .

The next case provides one example, in the context of a vivid and high-profile series of prosecutions, of how lower courts are reacting to claims that prosecutors’ theories of fraud have been curtailed by the Supreme Court’s decision in *Kelly*.

UNITED STATES v. MCGLASHAN, 78 F.4th 1 (1st Cir. 2023)

HOWARD, Circuit Judge.

In this appeal involving the scope of the federal wire fraud statute, 18 U.S.C. § 1343, defendant-appellant William McGlashan, Jr., argues in part that the indictment against him should have been dismissed for aiming at a property interest that was not the object

of his fraud. We, however, conclude that the relevant property alleged in the indictment was indeed an object of his fraud, and McGlashan's other arguments either are superfluous to our decision or have been waived. We therefore affirm the judgment of the district court. . . .

Along with fourteen other parents, McGlashan was named as a defendant in an indictment that resulted from “Operation Varsity Blues” (the “Operation”), an investigation into alleged fraudulent schemes designed to secure the defendants' children's admission to elite universities throughout the United States. As is most relevant to this appeal, McGlashan's involvement in the scheme charged in this case boils down to paying \$50,000 to have an ACT proctor change his son's test answers in order to increase his son's ACT score.

The ACT exam is a “standardized test that is widely used as part of the college admissions process in the United States,” and is run by ACT, Inc. (“ACT”), an Iowa-based nonprofit organization. As noted in the indictment, “[m]ost selective colleges and universities in the United States require prospective students to submit standardized test scores . . . as part of their application packages,” and these “scores are a material part of the admissions process.” The ACT exam is administered by proctors who the indictment alleges “are agents of ACT[, Inc.], . . . [who] owe a duty of honest services to th[at] organization[.]” Before administering the exam, the proctors “must typically certify” that they will abide by the ACT Administration Manual and “ensure that ‘the test materials are kept secure and confidential, used [by each] examinee only, and returned to ACT immediately after testing.’” The exam is “typically administered to large groups of students on specified dates and under strict time limits,” but “students with certain learning or other disabilities may qualify for testing accommodations, . . . and, in such circumstances, may take the test alone, under the supervision of a test administrator retained by ACT, Inc. . . .”

The indictment alleges that McGlashan agreed in fall 2017 to direct \$50,000 to a nonprofit corporation founded by William “Rick” Singer—the principal organizer of the schemes implicated in the Operation—as a “purported donation” in exchange for Singer arranging for a test proctor who would correct his son's exam answers. Singer instructed McGlashan to send a “Request for Arranged Testing” form to ACT, so that McGlashan's son would take the exam at a school in West Hollywood, California, rather than at his own high school. Having McGlashan's son take the ACT exam at the West Hollywood school was crucial to the plan, since it is alleged that Singer “bribed” Igor Dvorskiy—the director of the school and “a compensated standardized test administrator for ACT, Inc.”—to allow a proctor to correct McGlashan's son's test answers. Singer did so by “caus[ing]” the same nonprofit to which McGlashan had directed the \$50,000 to pay both Dvorskiy and the proctor for their role in “facilitating [the] cheating.”

All went to plan, at least initially. McGlashan's son took the ACT exam at the West Hollywood school on December 9, 2017, and the test proctor duly corrected his answers thereafter. Dvorskiy sent the exam materials to ACT's Iowa headquarters several days

later via Federal Express. Singer then paid Dvorskiy \$40,000 and the proctor \$35,000 through the above-mentioned nonprofit later that month for their respective services “for McGlashan’s son and other students.” After his son’s ACT score was released in early January, McGlashan texted Singer that “[y]ou have a very relieved and motivated young man! Very grateful.” The score was ultimately sent to several colleges—including Northeastern University, located in Massachusetts—on October 24, 2018. . . .

McGlashan contends that the indictment did not adequately allege a scheme to defraud ACT of its standardized tests. Relying on *Kelly*, he submits that the exam was a “mere implementation cost” of his scheme, and not an “object of the fraud.” . . .

McGlashan urges us to find that obtaining the ACT score was the sole object of his scheme, to the exclusion of the ACT exam itself. He points to the indictment’s allegation that one of the “principal purposes” of the scheme was “securing the admission of the defendants’ children to selective colleges using fraudulently obtained test scores” to support his claim. In his view, much like the extra toll collectors and engineers’ time and labor in *Kelly*, gaining access to the ACT test was “‘needed’ to realize the final plan” but ultimately a mere “implementation cost[]” of the scheme. He posits that he “was indifferent to obtaining the ACT exam as such,” and points out that his son could have simply accessed the test at his high school.

We find McGlashan’s arguments unpersuasive, and agree with the government that they “suffer[] from two fundamental flaws.” First, as the Second Circuit has concluded, “[d]efendants may have . . . multiple objectives, but property need only be ‘an object’ of their scheme, not the sole or primary goal.” *United States v. Gatto* (quoting *Kelly*). Second, and perhaps more importantly, McGlashan’s arguments also inappropriately downplay the *Kelly* Court’s emphasis on what the defendant “sought” in differentiating objects of the fraud from “incidental byproduct[s]” or mere “implementation costs[.]”

Mindful of these precepts, and employing the same holistic analysis that the Supreme Court used in *Kelly* (as McGlashan concedes) to parse the objects of his scheme, we are left with little doubt that the indictment adequately alleges that the ACT test was an object of the fraud. The indictment provides ample evidence to support the proposition that McGlashan actively sought to obtain the ACT test in the way Singer had devised, and not just the scores. To that end, the \$50,000 that he spent for the scheme covered not only the cost of increasing the test score, but—just as crucially—the cost of ensuring that the right proctor (namely, one who would be willing to facilitate the cheating) would both administer and then access the exam materials themselves. It was that need that underpinned the payment to Singer—indeed, the indictment points to the fact that the invoice that Singer’s accountant emailed McGlashan for the \$50,000 explicitly said it was “[r]egarding [the West Hollywood Testing Center][.]” Had the “entire point” of the scheme been merely to increase his son’s test scores, McGlashan could have, for example, simply paid Singer to forge a score report or even hack the ACT website to change the report. Such a plan might not have even required McGlashan’s son to take the exam.

But McGlashan's plan proved much more intricate than merely tampering with the scores. Rather, the “entire point” of the plan—the “alternative strategy,” as the indictment notes McGlashan told “a counselor at his son's high school”—was to pay for a proctor to access the exam materials in order to change McGlashan's son's test answers, which in turn would increase his son's test score. This scenario is easily distinguishable from the traffic study in *Kelly*, which the Court explicitly noted was “a cover story” meant to provide a pretext for the political retribution behind the lane closures, or the extra toll collectors, who one of the defendants “joked would just ‘sit there and wait.’” Here, by contrast, obtaining the ACT exam in the manner Singer had devised was not pretextual, but rather was a core service for which McGlashan paid tens of thousands of dollars. McGlashan was thus far from indifferent toward obtaining the test itself; as alleged in the indictment, doing so was not “some bit part in [the] scheme” at which he did not aim. . . .

Here is another colorful case involving fraud in the higher education industry that deals with theories of what can count as property for purposes of the mail and wire fraud statutes.

UNITED STATES v. PORAT, 76 F.4th 213 (3d Cir. 2023)

CHUNG, Circuit Judge.

Moshe Porat, the former Dean of the Fox School of Business at Temple University (“Fox”), appeals his convictions for conspiracy to commit wire fraud, in violation of 18 U.S.C. § 371, and wire fraud, in violation of 18 U.S.C. § 1343. . . .

Porat was convicted for his scheme to raise Fox's “rankings” in U.S. News and World Report (“U.S. News”), a publication that rates colleges and graduate schools, including business schools. The government offered evidence that, while some have criticized these rankings as poor measures of a school's quality, many people rely on them to compare business schools. These include applicants, students, alumni, donors, employers, faculty, and the schools themselves.

Porat was Fox's Dean from 1996 to 2018. During his time at Fox, he was “almost obsessed with rankings.” Sometime in the early 2000s, Porat created a committee that met regularly to consider the data that Fox would provide for use by U.S. News in formulating rankings. It also studied the rankings and strategized ways by which Fox could improve its rankings. Over time, Porat came to work most closely on rankings with two Fox employees, Isaac Gottlieb and Marjorie O'Neill. Porat eventually eliminated the committee and consolidated responsibility for Fox's survey submissions in O'Neill, who reported directly to him. After that, Porat continued to confer with both Gottlieb and O'Neill on rankings strategy.

At some point, Porat's efforts to raise Fox's rankings crossed the line from strategy to falsification. Evidence at trial showed that Fox may have submitted false data to rankings

publications as early as 2010. By 2014, having reverse-engineered the methodology behind the U.S. News rankings, Porat, Gottlieb, and O'Neill used falsifications to manipulate Fox's rankings—in particular, the rankings for its Online MBA (“OMBA”) and Part-Time MBA (“PMBA”) programs. To better Fox's OMBA ranking, they falsely stated that 100 percent of Fox's OMBA students had taken the Graduate Management Admission Test (“GMAT”), when the actual number was much lower. They also misreported data on offers of admission, student debt, and average undergraduate grade point average. To better Fox's PMBA ranking, they combined data for Fox's PMBA program with data for its OMBA and Executive MBA (“EMBA”) programs to overstate the PMBA students' average work experience and the percentage of Fox's MBA students who were PMBA students. As with the OMBA program, they also falsely reported that 100 percent of Fox's PMBA students had taken the GMAT.

Partly because of these deceptions, Fox's OMBA program rose from its U.S. News rank of Number Nine in 2014 to Number One in 2015—a position that it held for four straight years. Fox's PMBA ranking climbed steadily over three years from Number Fifty-Three in 2014 to Number Seven in 2017.

Porat viewed Fox's high rankings as a key way to market Fox to students and to thus generate more tuition money. One Fox administrator testified that Porat believed Fox needed “good rankings and to publicize good rankings for enrollment.” In a book manuscript, Porat boasted about Fox's OMBA ranking as Number One and wrote that “enhancing the school's image” is “the single most important factor in assuring continuous demand from the students, the parents, and employees.” And with Porat's knowledge and involvement, Fox aggressively marketed its false high rankings. Fox advertised its deceptively obtained rankings on its website, on social media, and on billboards and signs. Porat also sent or approved emails touting Fox's false rankings to students, student recruiters, and donors. Porat also represented to students that Fox's high rankings would bring them continuing—and even increasing—benefits. In a 2017 speech, Porat told graduating Fox students, “I often say that your diploma is like a share of stock in an enterprise . . . in which you remain shareholder long after you have graduated.” He further said that “many leading publications”—including “U.S. News”—“rank our programs among the best in the world and they agree that our stock indeed has been appreciating in value.” During a 2017 “champagne toast” held to celebrate the rankings, Porat posed for a photo with students in front of a banner that read “YOUR STOCK IS SOARING.” Fox printed the banner and arranged the photo to use it for “PR.”

The advertising worked. At trial, former students testified that they chose Fox because of its rankings. One former student testified that he “decid[ed] to go with Temple University because of [its] Number 1 ranking.” He further explained that he chose Fox because he knew that “people look at [rankings],” and that “once [he] graduat[ed],” he wanted to have “been a part of” a program that “was ranked Number 1.” After learning that Fox's rankings were inflated, he regretted not choosing a school that would have given him the “same piece of paper” at a much lower cost. Another former student

testified that he believed employers hire students from schools with the best “brand” and that Fox’s highly ranked brand would help him “compete in the marketplace.” Ultimately, Fox’s Number One ranking “was the only factor in [his] decision making” in choosing Fox over another school. Enrollment numbers corroborate that Fox’s falsely inflated ranking influenced students’ enrollment decisions. Between the 2014–2015 and 2017–2018 academic years, enrollment in Fox’s OMBA and PMBA programs spiked from 133 students to 336 students and 88 students to 194 students, respectively. The increased enrollment was tremendously lucrative. The government estimated that Fox gained nearly \$40 million in tuition from the additional students who enrolled during this period (2014–2018).

As the money poured in, Porat’s team discussed how to keep the rankings high and make even more money. In a January 2015 email to Porat, Gottlieb emphasized Fox’s need to maintain its high rankings, cautioning that just as “being number one can potentially add over 1–200 students a year” and bring corresponding “financial value” to Fox, so could “moving down” in the rankings “result in financial losses associated with a reduction of the 100+ students.” Porat responded, “Good stuff.” In September 2015, Gottlieb copied Porat on an email about rankings for another Fox program, its Global MBA (“GMBA”). Gottlieb noted that Fox’s “OMBA and PMBA doubled in intake numbers when we had a striking increase in ranking,” and estimated that increasing Fox’s GMBA ranking would produce “a profit of over \$700,000 a year.”

Then, in early 2018, Porat’s scheme was exposed. On January 9, 2018, an article discussing Fox’s repeated Number One ranking highlighted Fox’s self-reported 100-percent GMAT figure. That figure raised an “enormous red flag” among other Fox administrators who knew that it was false. Nonetheless, and despite warnings from administrators that they should not proceed, Porat pushed ahead with a celebratory toast, saying “we’re going.” At the toast, Porat lauded Fox’s OMBA ranking. The next day, Fox administrators decided to disclose the false GMAT data to U.S. News. Yet even then, Porat continued to publicize the rankings. On January 22, 2018, he sent an email to his “Porat 100,” a VIP list that included Fox donors and potential donors, with the subject line “#1 Online MBA and #2 Online BBA in the nation AGAIN!” Two days later, on January 24, 2018, U.S. News announced that Fox’s “misreported data resulted in the school’s numerical rank being higher than it otherwise would have been,” and that “[b]ecause of the discrepancies,” it would move Fox’s OMBA program to the “Unranked” category. Fox then withdrew its other programs, including its PMBA program, from consideration in U.S. News’ rankings for that year.

The exposure was a disaster for Fox’s rankings. When U.S. News resumed ranking Fox, it placed both Fox’s OMBA and PMBA programs in forty-first place. And as Fox’s rankings fell, its enrollment did as well. Fox’s OMBA enrollment plummeted from its high of 336 students in the 2017–2018 academic year to 144 in 2018–2019, and 106 the year after. Fox’s PMBA enrollment dropped in each of the three years after the deception came to light, from its high of 194 students to 145, 117, and 89. . . .

Porat argues that he did not deprive his victims of money, and makes two arguments in support. First, Porat argues that students were deprived only of rankings, and “rankings are not property.” But Porat was not convicted on the theory that he deprived students of rankings; he was convicted for depriving them of tuition money. The Indictment charged that Porat used deception to “attract[] more students to apply to Fox, matriculate at Fox, and pay tuition to Fox.” The District Court instructed the jury that to convict Porat, it must find that he engaged in a scheme to defraud Fox “applicants, students, or donors of money,” and Porat did not object to the basic contours of this instruction. By convicting Porat, the jury necessarily found that he sought to defraud his victims of money. The jury's finding was reasonable, given evidence that Porat employed a scheme to “add . . . students” and thereby, their tuition, producing “financial value” through materially false representations of Fox's rankings. Thus, despite Porat's attempt to redirect focus to the rankings, money was an object of his scheme.

Second, Porat argues that even if he did aim to take money from his victims, he still did not deprive them of money or property, because they received the “essential benefit of the bargain,” an education. Porat further argues that the rankings, as intangible considerations, cannot legally be an essential part of the bargain because there is no “independent property interest in the U.S. News rankings.” Relying on cases from other circuits, Porat contends that there was no fraud here because the victims received a Fox education, which was the “full benefit of their bargain” or “exactly what they paid for.” *Id.* (first quoting *United States v. Binday*, abrogated by *Ciminelli*; and then quoting *United States v. Takhalov*). But the cases Porat relies upon do not stand for the proposition that the value of a bargain cannot include intangible considerations; rather, they suggest that a victim is only “deprived” of property when the false representation affects the very nature or value of the bargain. See, e.g., *United States v. Guertin* (fraud occurs when “defendant lies about the nature of the bargain itself” (quoting *Takhalov*); *Binday* (“[W]e have upheld convictions for mail and wire fraud where the deceit affected the victim's economic calculus or the benefits and burdens of the agreement.”)).

Moreover . . . the evidence at trial reflected that the nature of the bargain between Fox and the students included not only the actual education afforded them, but also the current value of a highly ranked program, and even the future value of Fox's MBA degrees. To be sure, it is commonly understood and fully expected that a school's ranking, and the current and future value of a particular school's degree, may fluctuate over time in the normal course, e.g., with changes in a school's administration, faculty, and student body, as well as changes in the overall marketplace. But it is not commonly understood or expected that a ranking will soar or plummet as a result of deceit or misrepresentation. While Porat asserts that the bargain only encompassed an exchange of tuition for education, the jury was free to come to a different conclusion, especially in light of the fact that Porat neither requested a jury instruction on this theory, nor argued it to the jury. In addition, and as set forth above, the evidence indicated that Fox's falsely inflated rankings impacted students' valuation of the bargain, impacting their assessment of a Fox education's worth and their assessment of the future yield of a Fox MBA, and causing many more students to enroll at Fox. Accordingly, we conclude that a rational

jury could find beyond a reasonable doubt that the students did not receive the full benefit of their bargain, and—in the language from the cases Porat cites—that Porat's false ranking representations affected their “economic calculus,” and that he “lie[d] about the nature of the bargain itself.” . . .

Problem 2-5

Tough question: Having read all the materials in this section, how would you now articulate what prosecutors must prove about the “corpus” or “object” of a defendant’s deceptive scheme in order to succeed under the primary federal fraud statutes (mail and wire fraud)? Consider whether it is clearer to articulate a rule about what the object of the fraud can be, what it cannot be, or both.

E. Mail and Wire Fraud: Honest Services Fraud

What if the “corpus” of the fraud is not property or even property rights or control, but something even less tangible like legal rights? This problem tends to arise in triangular relationships. In a basic fraud, A deceives B to get B to give A something of value. We might call that a two-party or linear fraud. But sometimes, A will deceive B to get C to give A something of value (and C may well be in on the plan with A). B has not given A anything of value, but B has still been cheated by A. We might call this a triangular fraud.

For example, suppose Anna is Burt’s and Cathy’s teacher. Cathy pays Anna to give Burt a lower grade so that Cathy’s grade will end up being the highest in the class. Anna and Cathy conceal this from Burt so that Burt will have no basis to seek recourse or to have Anna sanctioned by the school.

If criminal fraud always required a scheme to deprive of tangible property, there would be no way to hold Anna liable for defrauding (essentially, cheating) Burt because Anna did not deprive Burt of any property: Anna and Cathy have schemed to deprive Burt of Burt’s right to Anna’s honest grading as Burt’s teacher. (Unless we try to construct a strained theory about Burt having a property right in fair grading in exchange for having paid tuition to the school, but that could be difficult for a prosecutor to sell, especially given some of the discussions about *Kelly* above.)

There are many examples like this: a disloyal and conflicted lawyer harming one client’s interests for the benefit of another client; an elected official favoring one bidder over another in the awarding of a contract; a corporate officer steering the company to certain deals that benefit insiders, violating duties of loyalty to the company’s shareholders; and so on.

Starting in the 1950s, the federal courts developed a theory to cover these “triangle” cases, holding in a series of rulings that the mail and wire fraud statutes covered not just schemes to defraud individuals of property but also schemes to defraud others of “the right to the honest services [of people they have hired, voted for, etc.].” In the example above, teacher Anna has deprived student Burt of his right to the honest services of

teacher Anna—a right that comes, arguably, along with the nature of the contractual relationships among the school, the teachers, and the students.

In *McNally v. United States*, 483 U.S. 350 (1987), the Supreme Court held that the text of the mail and wire fraud statutes (which you read at the outset of this chapter) covered no such thing. The very next year, Congress said, “Yes it did” (or, at least, “now it does”) by enacting the following statute:

18 U.S.C. § 1346. Definition of “scheme or artifice to defraud”

For the purposes of this chapter, the term “scheme or artifice to defraud” includes a scheme or artifice to deprive another of the intangible right of honest services.

Congress’s new statute—as clear an example as you will see of a statute designed to reinstitute overruled case law—left unaddressed the difficulties with the “honest services” theory of mail and wire fraud. Even as the courts had been constructing that theory under the statutes, they (or some judges at least) were raising worries about the vagueness and potential overbreadth of the theory of defrauding a person of an “intangible right.”

In the case below, the Supreme Court finally addressed those worries, by narrowing the scope of Congress’s anti-*McNally* statute. (The defendant Jeffrey Skilling, former CEO of Enron—who will be discussed in Chapter 3—won here but lost on remand because there was plenty of evidence against him of securities fraud too, so the problem with the mail and wire fraud theory in his case didn’t turn out to matter to his conviction and sentence.)

To recap, the sequence goes like this: (1) Congress enacts the mail and wire fraud statutes; (2) the federal courts, over decades, interpret them as covering the honest services theory of fraud; (3) the Supreme Court holds in *McNally* that the statutes don’t cover that theory; (4) Congress enacts 18 U.S.C. § 1346, which states that deprivations of honest services are included within mail and wire fraud; (5) the Supreme Court, in the *Skilling* decision below, narrows the meaning of honest services fraud in order, it says, to save 18 U.S.C. § 1346 from constitutional difficulty.

SKILLING v. UNITED STATES, 561 U.S. 358 (2010)

Justice GINSBURG delivered the opinion of the Court.

In 2001, Enron Corporation, then the seventh highest-revenue-grossing company in America, crashed into bankruptcy. We consider in this opinion . . . questions arising from the prosecution of Jeffrey Skilling, a longtime Enron executive, for crimes committed before the corporation’s collapse.

Founded in 1985, Enron Corporation grew from its headquarters in Houston, Texas, into one of the world’s leading energy companies. Skilling launched his career there in 1990

when Kenneth Lay, the company's founder, hired him to head an Enron subsidiary. Skilling steadily rose through the corporation's ranks, serving as president and chief operating officer, and then, beginning in February 2001, as chief executive officer. Six months later, on August 14, 2001, Skilling resigned from Enron.

Less than four months after Skilling's departure, Enron spiraled into bankruptcy. The company's stock, which had traded at \$90 per share in August 2000, plummeted to pennies per share in late 2001. Attempting to comprehend what caused the corporation's collapse, the U.S. Department of Justice formed an Enron Task Force, comprising prosecutors and FBI agents from around the Nation. The Government's investigation uncovered an elaborate conspiracy to prop up Enron's short-run stock prices by overstating the company's financial well-being. In the years following Enron's bankruptcy, the Government prosecuted dozens of Enron employees who participated in the scheme. In time, the Government worked its way up the corporation's chain of command: On July 7, 2004, a grand jury indicted Skilling, Lay, and Richard Causey, Enron's former chief accounting officer.

These three defendants, the indictment alleged,

“engaged in a wide-ranging scheme to deceive the investing public, including Enron's shareholders, . . . about the true performance of Enron's businesses by: (a) manipulating Enron's publicly reported financial results; and (b) making public statements and representations about Enron's financial performance and results that were false and misleading.”

Skilling and his co-conspirators, the indictment continued, “enriched themselves as a result of the scheme through salary, bonuses, grants of stock and stock options, other profits, and prestige.”

Count 1 of the indictment charged Skilling with conspiracy to commit securities and wire fraud; in particular, it alleged that Skilling had sought to “depriv[e] Enron and its shareholders of the intangible right of [his] honest services.” The indictment further charged Skilling with more than 25 substantive counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading. . . .

We . . . consider whether Skilling's conspiracy conviction was premised on an improper theory of honest-services wire fraud. The honest-services statute, § 1346, Skilling maintains, is unconstitutionally vague. Alternatively, he contends that his conduct does not fall within the statute's compass.

To place Skilling's constitutional challenge in context, we first review the origin and subsequent application of the honest-services doctrine.

Enacted in 1872, the original mail-fraud provision, the predecessor of the modern-day mail- and wire-fraud laws, proscribed, without further elaboration, use of the mails to advance “any scheme or artifice to defraud.” See *McNally v. United States*. In 1909,

Congress amended the statute to prohibit, as it does today, “any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises.” § 1341. Emphasizing Congress’ disjunctive phrasing, the Courts of Appeals, one after the other, interpreted the term “scheme or artifice to defraud” to include deprivations not only of money or property, but also of intangible rights.

In an opinion credited with first presenting the intangible-rights theory, *Shushan v. United States*, the Fifth Circuit reviewed the mail-fraud prosecution of a public official who allegedly accepted bribes from entrepreneurs in exchange for urging city action beneficial to the bribe payers. “It is not true that because the [city] was to make and did make a saving by the operations there could not have been an intent to defraud,” the Court of Appeals maintained “A scheme to get a public contract on more favorable terms than would likely be got otherwise by bribing a public official,” the court observed, “would not only be a plan to commit the crime of bribery, but would also be a scheme to defraud the public.”

The Fifth Circuit’s opinion in *Shushan* stimulated the development of an “honest-services” doctrine. Unlike fraud in which the victim’s loss of money or property supplied the defendant’s gain, with one the mirror image of the other, the honest-services theory targeted corruption that lacked similar symmetry. While the offender profited, the betrayed party suffered no deprivation of money or property; instead, a third party, who had not been deceived, provided the enrichment. For example, if a city mayor (the offender) accepted a bribe from a third party in exchange for awarding that party a city contract, yet the contract terms were the same as any that could have been negotiated at arm’s length, the city (the betrayed party) would suffer no tangible loss. Even if the scheme occasioned a money or property *gain* for the betrayed party, courts reasoned, actionable harm lay in the denial of that party’s right to the offender’s “honest services.”

“Most often these cases . . . involved bribery of public officials,” *United States v. Bohonus*, but courts also recognized private-sector honest-services fraud. In perhaps the earliest application of the theory to private actors, a District Court, reviewing a bribery scheme, explained:

“When one tampers with [the employer-employee] relationship for the purpose of causing the employee to breach his duty [to his employer,] he in effect is defrauding the employer of a lawful right. The actual deception that is practised is in the continued representation of the employee to the employer that he is honest and loyal to the employer’s interests.” *United States v. Procter & Gamble Co.*

Over time, “[a]n increasing number of courts” recognized that “a recreant employee”—public or private—“c[ould] be prosecuted under [the mail-fraud statute] if he breache[d] his allegiance to his employer by accepting bribes or kickbacks in the course of his employment,” *United States v. McNeive*; by 1982, all Courts of Appeals had embraced the honest-services theory of fraud.

In 1987, this Court, in *McNally v. United States*, stopped the development of the intangible-rights doctrine in its tracks. *McNally* involved a state officer who, in selecting Kentucky's insurance agent, arranged to procure a share of the agent's commissions via kickbacks paid to companies the official partially controlled. The prosecutor did not charge that, "in the absence of the alleged scheme[,] the Commonwealth would have paid a lower premium or secured better insurance." Instead, the prosecutor maintained that the kickback scheme "defraud[ed] the citizens and government of Kentucky of their right to have the Commonwealth's affairs conducted honestly."

We held that the scheme did not qualify as mail fraud. "Rather than constru[ing] the statute in a manner that leaves its outer boundaries ambiguous and involves the Federal Government in setting standards of disclosure and good government for local and state officials," we read the statute "as limited in scope to the protection of property rights." "If Congress desires to go further," we stated, "it must speak more clearly."

Congress responded swiftly. The following year, it enacted a new statute "specifically to cover one of the 'intangible rights' that lower courts had protected . . . prior to *McNally*: 'the intangible right of honest services.'" *Cleveland v. United States*. In full, the honest-services statute stated:

"For the purposes of th[e] chapter [of the United States Code that prohibits, *inter alia*, mail fraud, § 1341, and wire fraud, § 1343], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services." § 1346.

Congress, Skilling charges, reacted quickly but not clearly: He asserts that § 1346 is unconstitutionally vague.

According to Skilling, § 1346 meets neither of the two due process essentials. First, the phrase "the intangible right of honest services," he contends, does not adequately define what behavior it bars. Second, he alleges, § 1346's "standardless sweep allows policemen, prosecutors, and juries to pursue their personal predilections," thereby "facilitat[ing] opportunistic and arbitrary prosecutions." . . .

In urging invalidation of § 1346, Skilling swims against our case law's current, which requires us, if we can, to construe, not condemn, Congress' enactments.

We agree that § 1346 should be construed rather than invalidated. First, we look to the doctrine developed in pre-*McNally* cases in an endeavor to ascertain the meaning of the phrase "the intangible right of honest services." Second, to preserve what Congress certainly intended the statute to cover, we pare that body of precedent down to its core: In the main, the pre-*McNally* cases involved fraudulent schemes to deprive another of honest services through bribes or kickbacks supplied by a third party who had not been deceived. Confined to these paramount applications, § 1346 presents no vagueness problem.

There is no doubt that Congress intended § 1346 to refer to and incorporate the honest-services doctrine recognized in Court of Appeals' decisions before *McNally* derailed the intangible-rights theory of fraud. . . .

“The definite article ‘the’ suggests that ‘intangible right of honest services’ had a specific meaning to Congress when it enacted the statute—Congress was recriminalizing mail- and wire-fraud schemes to deprive others of *that* ‘intangible right of honest services,’ which had been protected before *McNally*, not *all* intangible rights of honest services whatever they might be thought to be. . . .” *United States v. Rybicki*.

In parsing the Courts of Appeals decisions, we acknowledge that Skilling's vagueness challenge has force, for honest-services decisions preceding *McNally* were not models of clarity or consistency. While the honest-services cases preceding *McNally* dominantly and consistently applied the fraud statute to bribery and kickback schemes—schemes that were the basis of most honest-services prosecutions—there was considerable disarray over the statute's application to conduct outside that core category. In light of this disarray, Skilling urges us, as he urged the Fifth Circuit, to invalidate the statute *in toto*. . . .

It has long been our practice, however, before striking a federal statute as impermissibly vague, to consider whether the prescription is amenable to a limiting construction. . . .

Although some applications of the pre-*McNally* honest-services doctrine occasioned disagreement among the Courts of Appeals, these cases do not cloud the doctrine's solid core: The “vast majority” of the honest-services cases involved offenders who, in violation of a fiduciary duty, participated in bribery or kickback schemes. . . . Indeed, the *McNally* case itself, which spurred Congress to enact § 1346, presented a paradigmatic kickback fact pattern. . . .

In view of this history, there is no doubt that Congress intended § 1346 to reach *at least* bribes and kickbacks. Reading the statute to proscribe a wider range of offensive conduct, we acknowledge, would raise the due process concerns underlying the vagueness doctrine. To preserve the statute without transgressing constitutional limitations, we now hold that § 1346 criminalizes *only* the bribe-and-kickback core of the pre-*McNally* case law.

The Government urges us to go further by locating within § 1346's compass another category of proscribed conduct: “undisclosed self-dealing by a public official or private employee—*i.e.*, the taking of official action by the employee that furthers his own undisclosed financial interests while purporting to act in the interests of those to whom he owes a fiduciary duty.” “[T]he theory of liability in *McNally* itself was nondisclosure of a conflicting financial interest,” the Government observes, and “Congress clearly intended to revive th[at] nondisclosure theory.” Moreover, “[a]lthough not as numerous

as the bribery and kickback cases,” the Government asserts, “the pre-*McNally* cases involving undisclosed self-dealing were abundant. . . .”

Although the Courts of Appeals upheld honest-services convictions for “some schemes of non-disclosure and concealment of material information,” *Mandel*, they reached no consensus on which schemes qualified. In light of the relative infrequency of conflict-of-interest prosecutions in comparison to bribery and kickback charges, and the intercircuit inconsistencies they produced, we conclude that a reasonable limiting construction of § 1346 must exclude this amorphous category of cases. . . .

In sum, our construction of § 1346 “establish[es] a uniform national standard, define[s] honest services with clarity, reach[es] only seriously culpable conduct, and accomplish[es] Congress’s goal of ‘overruling’ *McNally*.” “If Congress desires to go further,” we reiterate, “it must speak more clearly than it has. . . .”

It remains to determine whether Skilling’s conduct violated § 1346. Skilling’s honest-services prosecution, the Government concedes, was not “prototypical.” The Government charged Skilling with conspiring to defraud Enron’s shareholders by misrepresenting the company’s fiscal health, thereby artificially inflating its stock price. It was the Government’s theory at trial that Skilling “profited from the fraudulent scheme . . . through the receipt of salary and bonuses, . . . and through the sale of approximately \$200 million in Enron stock, which netted him \$89 million.”

The Government did not, at any time, allege that Skilling solicited or accepted side payments from a third party in exchange for making these misrepresentations. . . . It is therefore clear that, as we read § 1346, Skilling did not commit honest-services fraud. . . .

Justice SCALIA, with whom Justice THOMAS joins, and with whom Justice KENNEDY joins except as to Part III, concurring in part and concurring in the judgment.

In my view, the specification in 18 U.S.C. § 1346 (2006 ed., Supp. II) that “scheme or artifice to defraud” in the mail-fraud and wire-fraud statutes, §§ 1341 and 1343 (2006 ed.), includes “a scheme or artifice to deprive another of the intangible right of honest services,” is vague, and therefore violates the Due Process Clause of the Fifth Amendment. The Court strikes a pose of judicial humility in proclaiming that our task is “not to destroy the Act . . . but to construe it,” *ante*, at 2930 (internal quotation marks omitted). But in transforming the prohibition of “honest-services fraud” into a prohibition of “bribery and kick-backs” it is wielding a power we long ago abjured: the power to define new federal crime. . . .

I agree that Congress used the novel phrase to adopt the lower-court case law that had been disapproved by *McNally*—what the Court calls “the pre-*McNally* honest-services doctrine,” *ante*, at 2930. The problem is that that doctrine provides no “ascertainable standard of guilt,” and certainly is not limited to “bribes or kickbacks”

The *Skilling* decision left work for the courts. In the bigger picture, the question is the extent to which prosecutors will be able to refashion what used to be honest services fraud cases as property fraud cases, using creative theories about property, as attempted in *Kelly*. Meanwhile, in honest services fraud prosecutions, several questions persist:

- (1) what is a bribe for purposes of section 1346?
- (2) what is a kickback for purposes of section 1346?
- (3) if a fiduciary relationship is required, what kind(s) of relationships qualify?

The following cases indicate how this unfolding story is developing in the federal courts of appeals. Note that it has always been the case that the honest services theory covers both “public” (political corruption) and “private” (business) cases. *Skilling* affects both kinds of cases. But the decision undoubtedly cut back more on what prosecutors can do with the statute in the private context—or at least it will force them back to the drawing board for new theories to cover corporate frauds with the mail and wire fraud statutes.

It is entirely predictable, maybe even certain, that circuit splits will develop on these and other issues. The following cases are a sample, not a survey. In an introduction to the field, you should expect to understand the current issues under the statute, not know what each of the circuits has said about them. The latter is a matter for legal research.

The first case nicely combines analysis of both whether a “property fraud” theory works and whether, alternatively, an “honest service fraud” theory works. It arose in the context of the now infamous “Varsity Blues” scandal. These defendants were the only ones out of many in the scandal who proceeded to trial and prevailed on appeal.

1. “Bribe”

UNITED STATES v. ABDELAZIZ, 68 F.4th 1 (1st Cir. 2023)

LYNCH, Circuit Judge.

The convictions underlying this appeal arise from a government criminal prosecution of alleged misconduct related to college admissions. The government alleged that Rick Singer—a college admissions consultant—and his clients engaged in various forms of bribery and fraud to help secure those clients’ children’s admission to competitive universities. Singer, who pleaded guilty in a separate case to multiple charges and cooperated with the government’s investigation, is not a defendant here, and his culpability is well established.

The defendants-appellants in this case are two parents, Gamal Abdelaziz and John Wilson, who hired Singer. Both men agreed with Singer to make payments purportedly to university accounts in exchange for university employees’ securing their children’s admission as athletic recruits—a path to admission Singer referred to as the “side door.” Their defense at trial and on appeal is that they believed Singer’s services and the side door to be legitimate and that they acted in good faith.

The government . . . alleged that Abdelaziz and Wilson conspired with other parents to commit two types of mail and wire fraud: honest services fraud, by using their payments to deprive the universities of the honest services of their employees, and property fraud, by depriving the universities of property in the form of “admissions slots.” See *id.* §§ 1341, 1343, 1346, 1349....

[Abdelaziz and Wilson] contend that payments to university accounts cannot . . . constitute honest services fraud because the payments were intended for accounts owned by the universities—the alleged victims of the scheme. They argue that the property fraud theory is invalid because admissions slots are not property, or, in the alternative, that their convictions must be vacated because the district court erred by instructing the jury that admissions slots are property as a matter of law. . . . Nothing in this opinion should be taken as approval of the defendants’ conduct in seeking college admission for their children.

We . . . hold that the government’s honest services theory is invalid as a matter of law under the Supreme Court’s decision in *Skilling v. United States*, and that, on the arguments offered by the government, the district court erred in instructing the jury that admissions slots constitute property. Accordingly, we vacate the defendants’ mail and wire fraud convictions. . . .

It is undisputed that Abdelaziz agreed with Singer in approximately June 2017 to pursue side-door admission to USC for his daughter. Abdelaziz maintains that he believed this option to be at least tacitly approved by the school and to entail “preferential admissions treatment to students like [Abdelaziz’s daughter] who could assist athletic teams as practice players or team managers and whose parents donated to the athletic department.” At the time, Abdelaziz’s daughter had not played competitive basketball in over a year; she had played for her school’s junior varsity team until January or February 2016 but had stopped playing after failing to make the varsity team. A USC admissions officer testified that Abdelaziz’s daughter was also not an academically competitive applicant outside the athletic recruitment process.

On July 16, 2017, Singer sent Abdelaziz an email with the subject line “For Me to complete USC athletic profile” that requested information about Abdelaziz’s daughter’s scholastic and athletic accomplishments, including “If they play the sport-Basketball,” “Accolades if they have them,” and “Action Picture.” Abdelaziz forwarded the email to his wife, but the record does not otherwise show any response. Eleven days later, Singer emailed Abdelaziz again to request “an action photo or two of [Abdelaziz’s daughter] playing basketball.” Abdelaziz responded: “Got it.” He then sent Singer five photos of high school girls’ basketball games, four of which—as Abdelaziz represents in his brief and the government does not dispute—contained his daughter, and one of which did not. The file names for the photos used generic letters and numbers (for example, “DSC_0007.JPG”) and differed only in the numbers. Singer responded: “We will use this one.” His email identified the chosen photo—the one that did not contain Abdelaziz’s daughter—only by the file name.

Singer instructed one of his associates to prepare the profile. The associate did so; the result included the photo Singer had selected and various basketball statistics and accolades that the associate invented and that Abdelaziz's daughter had not earned. Singer sent this profile to Abdelaziz in early August, together with a message from his associate: "Let me know if you want me to add any other awards to her profile or if you think that is enough." . . .

Singer then sent the profile to an administrator in the USC Athletics Department who had agreed with Singer to facilitate Abdelaziz's daughter's side-door admission. That administrator added additional falsehoods to the profile—including a photo of a different girl. This version of the profile became the basis for the profile presented to "Subco," a subcommittee of USC admissions officers responsible for overseeing admission of athletic recruits. Based on this profile, Subco considered and approved Abdelaziz's daughter's admission on October 5, 2017.

On October 10, the same athletics administrator who revised Abdelaziz's daughter's profile sent Singer a letter from the Dean of Admissions conditionally admitting Abdelaziz's daughter as a recruited athlete, pending her submission of a full application packet and other administrative tasks. Singer emailed this letter to Abdelaziz the same day.

In early November, Abdelaziz forwarded the letter to a Singer employee, together with an email that stated: "[Singer] asked that we work with you to complete USC's application . . ." Abdelaziz later exchanged emails with this employee, Singer, and another Singer associate about his daughter's application. In these emails, Singer noted that it was important for the application to discuss "basketball as a passion [sic]." Abdelaziz later "reminde[d]" the others of this "direction" when it came time to edit his daughter's application essays.

In early January 2018, Abdelaziz's daughter sent Abdelaziz and the Singer employee an application essay in which she described "[t]he basketball court [as her] art studio" and wrote: "Whether I am playing alone or in a pickup game with friends or in front of a crowd of two hundred people at school, I feel an enormous release from my everyday life when I am on the court." Abdelaziz responded in the same email thread that he had "read [his daughter's] essays," and opined that "overall [they were] . . . good." His daughter had not played on the school basketball team for nearly two years at the time. The Singer employee submitted Abdelaziz's daughter's USC application the following day.

Abdelaziz and the government agree that Abdelaziz's daughter was formally admitted in March 2018, although they do not cite any exact date in the record.

On March 16, 2018, a foundation run by Singer sent Abdelaziz an invoice for \$300,000, purportedly for a "[p]rivate [c]ontribution." Abdelaziz wired that sum to the foundation ten days later. Where that money ultimately went is unclear from the record, but an FBI agent testified that Singer's "general pitch [to parents] was that [a side-door payment]

was a donation to a program,” and government counsel acknowledged at trial that Singer told Abdelaziz the payment would go to a university account. The government does not argue on appeal that the jury could have found that Abdelaziz intended the payment to go to any USC employee personally.

Abdelaziz’s daughter enrolled at USC in fall 2018. She never played for or otherwise associated with the women’s basketball team.

In September 2018, the FBI approached Singer, and he agreed to cooperate with the government’s investigation of his clients and university insiders. As part of this cooperation agreement, Singer made various recorded calls at the government’s direction.

The government cites two such calls involving Abdelaziz. The first occurred on October 25, 2018. During the call, Singer told Abdelaziz that his foundation was being audited and that the IRS had “asked . . . about” Abdelaziz’s payment. Singer further stated that he was “not going to tell the IRS anything about the fact that your \$300,000 . . . was paid to . . . [an athletics administrator] at USC to get [Abdelaziz’s daughter] into school even though she wasn’t a legitimate basketball player at that level.” Abdelaziz responded: “OK.” Singer asked: “You’re OK with that, right?” Abdelaziz answered: “Of course.” A moment later, he added:

No, I—I mean, I—you know, I mean . . . my intention was to, uh, donate the money to the foundation and, uh, what—you know, and then from there obviously, uh—I don’t think—Uh, do they have the intention of reaching out to the people that sent those payments?

Singer said he did not know and that he “wanted to make sure our stories are correct.” He told Abdelaziz that he was “going to essentially say that [the] \$300,000 payment . . . was made to our foundation to help underserved kids,” and “wanted to make sure [Abdelaziz was] OK with that.” Abdelaziz replied: “I am.”

In the same exchange, Singer told Abdelaziz that the USC athletics administrator with whom Singer had arranged the side door had called Singer to say that she “loved” the profile created for Abdelaziz’s daughter and that “going forward, anybody who isn’t a real basketball player that’s a female, [she] want[ed] [Singer] to use that profile.” Abdelaziz responded: “I love it.”

The second call took place on January 3, 2019. Singer told Abdelaziz that the same athletics administrator had called him to “give [him] a heads up” that the Admissions Department had “asked . . . why [Abdelaziz’s daughter] did not show up for Women’s Basketball in the fall,” and that the administrator had “told them that [Abdelaziz’s daughter] had an injury.” Abdelaziz asked whether the Admissions Department would ask his daughter about the situation and whether he needed to “prepare her.” Singer stated that they would not contact Abdelaziz’s daughter and that he had “wanted

[Abdelaziz] to know what” the administrator had told the Admissions Department. Abdelaziz responded: “I will answer the same, uh, should they call me.”

Wilson engaged Singer’s services to facilitate side-door admission for his children on multiple occasions between 2013 and 2019: first for his son, and then, years later, for his twin daughters.

Beginning in spring 2013, Wilson worked with Singer to secure his son’s admission to USC through the side door as a purported water polo recruit. Singer explained to Wilson by email that the USC men’s water polo coach was “giving [him] 1 boys slot,” available on a “first come first [sic]” basis. In response to Wilson’s asking when payment was due, Singer responded: “No payment of money till [sic] [the USC men’s water polo coach] gets a verbal and written [sic] from admissions”

Wilson’s son did play high school water polo, but his high school coach testified that he was not a player of the level ordinarily recruited by USC, a noted water polo powerhouse. In emails sent at the time, Wilson expressed doubts about whether his son would fit in on the team, asking Singer whether “it w[ould] be known that [his son was] a bench warming candidate” and whether his son would “be so weak as to be a clear misfit at practice,” and stating that “[o]bviously his [son’s] skill level m[ight] be below the other freshmen” and that he “want[ed] to be sure [his son would] not [be] a lepper [sic].” Singer responded that “the commitment is to be on the roster[,] not attend all practices[;] ... he will have to attend drug tests and other mandatory functions for 1 year [but then can] walk away/ frankly after the 1st semester he can move on.”

In August 2013, Singer noted in an email to Wilson that the water polo coach needed “a player profile so he [could] add [Wilson’s son] to his recruit list and present him to admissions in October,” and that Singer had the necessary materials to create the profile. Wilson responded: “Great - let me know when [you] have verified [you] have it all completed and into [sic] [the water polo coach].” In October, Singer updated Wilson: “[The water polo coach] has [Wilson’s son’s] stuff and asked me to embellish his profile more, which I am doing.” A few days later, Singer emailed the profile to Wilson. It misrepresented several aspects of Wilson’s son’s athletic qualifications — for instance, by erroneously describing him as a captain of his high school team and listing implausibly fast swim times. Wilson’s counsel argued both at trial and on appeal that the government did not prove Wilson was aware of the falsehoods in the profile. Wilson’s counsel emphasized that an FBI agent whose testimony the government used to introduce the email containing the profile acknowledged that he was not aware of emails or other evidence showing Wilson read or responded to Singer’s message, and that the profile listed the wrong home address and used Wilson’s son’s SAT scores rather than his more impressive ACT scores, which Wilson purportedly would have wanted included.

An assistant water polo coach at USC relied on this profile to prepare the athletic profile used by Subco to consider whether to admit Wilson’s son.

Subco considered and approved Wilson's son's admission on February 28, 2014, relying in part on the falsified athletic profile.

The day after Subco approved his son's admission, Wilson emailed Singer to "[t]hank[] [him] again for making this happen." He asked about "the options for the payment" and requested an invoice "for consulting or whatever from [Singer's business] so that [Wilson could] pay it from [his private equity firm's] corporate account." After some further discussion of payment mechanics, Wilson's firm wired \$220,000 to a combination of Singer, his business, and his foundation on April 7, 2014. The government does not contend that any USC employee personally received a portion of this payment. Singer passed \$100,000 along to the USC men's water polo team and, so far as the record shows, retained the other \$120,000.

Wilson's son quit the water polo team after his first semester at USC.

Several years later, in September 2018, Wilson called Singer about the possibility of helping Wilson's twin daughters, then juniors in high school, with their college applications. The government recorded this call, which took place before Singer began cooperating with the government, without the participants' knowledge. Singer explained that for Wilson's daughters to gain admission to the highly competitive schools they were interested in "on their own" would require "essentially perfect grades" and excellent standardized test scores, but added that "if you said you wanted to ... go through a different door you c[ould] do that." Wilson inquired about "the other door," asking if it was "like ... water polo and [a] donation," and Singer explained the price and availability of admission through the side door at various universities. Singer informed Wilson that side-door admission to Stanford or Harvard would cost "a minimum of [\$]1.2 million," since a coach would have to "giv[e] up his spot" to a purported recruit who is "not a good enough athlete[] to compete," but would provide a "done deal. Just like with [Wilson's son]." Singer explained that the sport "d[id]n't matter," saying he "would make them a sailor or something." Wilson laughed in response. Wilson observed that they were discussing "big numbers," since "there's so many people that want to do th[is]," and asked if "there [was] any way to make [the payments] tax deductible as like donations to the school." Singer stated that payments would be deductible as contributions to his foundation.

Wilson and Singer continued to discuss the use of the side door for Wilson's daughters after Singer began cooperating with the government. From this point on, Singer's references to university insiders willing to facilitate side-door admission were part of a ruse created by investigators.

In a September 29 call, Wilson confirmed that, while his daughters remained undecided on what schools they wanted to attend, he was "interested about the side door and that stuff" and asked what schools and sports were available. Singer assured him that the side door "is gonna . . . happen where you want it to happen," and that crew or sailing might be potential sports options. Wilson asked: "[W]hat if they're not really that good?" Singer responded: "[A]t the end of the day . . . I may be able to go to the sailing coach

and say, 'Hey, this family's willing to make the contributions. . . . [The child] may not be up to the level you are, but . . . you're gonna get a benefit, and the family's gonna get [a] benefit.'" Wilson also asked how the payment would work. Singer stated that "the money [went] into [his] foundation," and that he would then "split the money potentially to the coach or other . . . parties that are at that school that need the money[.] . . . Or it may go right to the coach, . . . depend[ing] on the school."

In October, Wilson called Singer to discuss "making some donations now, whatever—how that can work." Singer stated that he worked with "a bunch of schools," including Harvard and Stanford, on a "first come, first served" basis, and that, "if [he] were to get a deposit . . . [of] like half a million dollars in the bank," they could "figure out where [Wilson's daughters] wanna go" later. "[H]aving the money already, in advance, [would] make[] it much easier" because coaches "don't want to give up a spot" unless "the family guarantee[s] . . . that they're gonna ante up and they're gonna make a payment." Wilson asked whether his daughters "actually ha[d] to do th[e] sport" or whether "[t]hey could just go in and . . . be like . . . the scorekeeper[,] . . . water girl[,] . . . [or] manager." Singer confirmed that they could be "[m]anager[s] or whatever you want to call 'em," and that Wilson's daughters were "athletic and . . . big" enough that he could "sell to anybody that they're athletic enough to be able to take 'em and there'll be no question." Singer further assured Wilson that, if he used the side door, admission would be "a done deal." Wilson requested that Singer send him wiring information, and confirmed with Singer that if he sent "[h]alf a million" he would be "locked in for 2." Wilson's private equity firm wired \$500,000 to Singer's foundation two days later at Wilson's direction.

Later that month, Singer told Wilson that he had spoken with Stanford's sailing coach, that the coach was willing to "guarantee[] a spot for next year," and that Wilson could "have first dibs" if Singer sent the coach the "[\$500,000 that [Wilson] wired into [Singer's] account to secure the spot for one of [Wilson's] girls." Singer also mentioned that he had "asked [the coach] for a second spot in sailing and [the coach] said he c[ould]n't do that because he ha[d] to actually recruit some real sailors so that Stanford d[id]n't . . . catch on." Wilson laughed and said "[r]ight." Wilson asked for more time for his daughters to decide where they wanted to go, and inquired whether there was "any news on the Harvard side." Singer promised to get back to him.

On November 29, Singer informed Wilson that they had "got a spot if . . . [Wilson's daughter] want[ed] to go to Harvard." He claimed that "the senior women's administrator at Harvard [was] going to give [Wilson's daughter] a spot," in exchange for which Wilson would "have to give . . . her . . . \$500,000" through Singer's foundation to "fund the senior women's administrator." He added: "I've already paid [the Stanford sailing coach] the [\$500 [thousand] and now we'll give the senior women's administrator [\$500 [thousand] [Y]our total's going to be [\$]1.5 [million]. [\$]250 [thousand] will come in the spring for Stanford and [\$]250 [thousand] for Harvard in the spring and we'll . . . be done." Wilson responded: "OK, great." When Wilson asked what sport his daughter would need to play, Singer answered: "[The Harvard administrator will] figure it out. . . . [I]t doesn't matter the sport at this point. She will . . . just get her

in through . . . athletics in one of the sports but it won't matter." Singer also noted that Wilson's other daughter "w[ould]n't have to sail but we're going to put her through sailing" at Stanford. Wilson responded that "sailing is actually a logical thing. She could be even the mascot, whatever, but she knows sailing." He confirmed that the plan "sound[ed] fantastic" and was "great news." Wilson's private equity firm wired a further \$500,000 to Singer's foundation on December 11, again at Wilson's direction.

As with Abdelaziz, the government acknowledged at trial that Singer "told the parents," including Wilson, "that the money would go to the athletic program at the schools." On appeal, it does not argue that the jury could have found that Wilson intended any of his payments to go to insiders' personal accounts, rather than to university-owned accounts related to the insiders' positions. . . .

The defendants contend that their payments to the universities, the parties whose interests were purportedly betrayed by their agents, cannot constitute bribes under Skilling's interpretation of § 1346. There is no charge of kickbacks in the indictment.

In response, the government relies on Skilling's statement that its narrow construction of § 1346's "prohibition on bribes . . . draws content not only from the pre-McNally case law, but also from federal statutes proscribing—and defining—similar crimes. See, e.g., 18 U.S.C. §§ 201(b), 666(a)(2); 41 U.S.C. § 52(2)" The government relies on this language to argue that § 1346 effectively incorporates a version of § 666, such that—borrowing the language of § 666—§ 1346 covers "[w]hoever . . . corruptly gives, offers, or agrees to give anything of value to any person, with intent to influence or reward an agent of [a principal]." 18 U.S.C. § 666.

Although the question is a close one, we conclude that the government's reliance on this single statement in Skilling is misplaced. The government's reading is, for several reasons, impossible to reconcile with Skilling's language and its core holding that § 1346 covers only "the bribe-and-kickback core of the pre-McNally case law." The government has not identified any pre-McNally case involving a purported bribe paid to the victim of an alleged bribery scheme. Further, the statutes in force while courts developed the pre-McNally case law defining "bribery" do not support the conclusion that payments to the purportedly betrayed party constitute "bribes" as that term is traditionally understood or used in Skilling. Nor is there any support for that view in other legal sources defining "bribery." Rather than interpreting the language the government cites to override these considerations, we understand it instead to constrain the honest services doctrine's sweep. And this understanding that Skilling's reference to other statutes does not mean that § 1346 is coextensive with these other statutes draws additional support from the facts that those statutes define offenses broader than traditional bribery and that those statutes may vary from each other in their coverage. . . .

Independently of honest services fraud, the government argues that we should affirm the defendants' mail and wire fraud convictions on the distinct property fraud theory. . . .

The asserted “property” that the government argues was obtained here is “admissions slots.” Indeed, the district court instructed the jury that, “[f]or purposes of the mail and wire fraud statutes, admission[s] slots are the property of the [u]niversities.” . . .

We reject the government’s argument that admissions slots at any university always qualify as property for purposes of the mail and wire fraud statutes. The government’s categorical argument fails, for example, to recognize even the well-known variations in types of admissions slots offered at the university level; for instance, early admission, rolling admission, conditional admission, waiting-list admission, and deferred admission. Nor does the government’s categorical approach account for the fact that admissions occur at all levels of education, from nursery school through postgraduate studies, and involve millions of students and parents. We reject, too, the defendants’ equally categorical contention to the contrary and so reject their argument that their property-based convictions under these statutes must be reversed on the ground that the government did not prove that property was involved in the commission of those offenses because “admissions slots” cannot be property.

But we do agree with the defendants’ more limited fallback argument that the jury instruction erred in stating, based on the arguments and record in this case, that “admission[s] slots are the property of the [u]niversities.” We see no basis for concluding that such a categorical statement is invariably true of any admissions slot, and the government has not identified any basis in the record that would indicate that the instruction could be upheld on the ground that there was evidence that the admissions slots in question in the charged offenses in this case qualified as property as a matter of law.

We emphasize the narrowness of our holding: We do not hold that admissions slots cannot ever be property. Nor do we hold that the jury instruction given by the district court could never be appropriate. The resolution of these questions will require much more detail, both legal and factual, on the nature of the purported property interest at issue. . . .

[E]ven to the extent the government argues that admissions slots are always property because they are, by their nature, both exclusive and economically valuable, its proposed test sweeps too broadly. . . .

At the same time, we must also reject the defendants’ argument that no admissions slot at any university can qualify as property for purposes of the mail and wire fraud statutes and thus that their property-based convictions under those statutes must be reversed on this basis. The defendants characterize admissions slots as mere “offer[s] to engage in a transaction: The college is offering to provide educational services to a student in exchange for tuition payments.” However, the defendants do not address the complexities that would arise were there to be evidence that a particular admissions slot is more than a mere offer to transact. The same complexities which undercut the government’s argument undercut this argument by the defense. . . .

[W]e find persuasive the defendants' . . . contention that the jury instruction was erroneous here because it instructed that "admission[s] slots are the property of the [u]niversities." There is some ambiguity as to whether, in making this instruction, the district court accepted the government's contention that any admissions slot at any university necessarily qualifies as property. If so, then we have already explained why that conclusion is incorrect. . . .

We do not understand admissions processes to be universally the same across universities, and the meaning of "admissions slot" may differ across institutions, yet the government's argument treats them interchangeably and in sweeping terms. Indeed, the government has cited no evidence and offered no argument specific to the admissions slots at the schools at which these two defendants sought admission for their children. Nor does the government offer any guidance—or record citations—for understanding the contours of these specific universities' admissions policies and processes or the rights, benefits, or obligations, if any, associated with obtaining an admissions slot at these universities. It develops no argument, for example, that either a student's application or a university's offer of admission creates a contractual relationship between the applicant and the school. Nor does it argue that every student awarded an admissions slot will eventually enroll—in fact, it acknowledges, as it clearly must, that some will not. . . .

We recognize that our analysis leaves considerable uncertainty as to how district courts should apply the mail and wire fraud statutes' property requirement in cases involving admission to educational institutions. There are sound reasons to be prudent and cautious about criminalizing conduct, even unethical conduct, in this complicated area affecting so many students and parents. . . .

Given the ongoing curtailment of honest services fraud doctrine, what about a charge of honest services fraud involving bribery across international boundaries? In the next opinion, currently the subject of a government appeal to the Second Circuit, a district judge concluded that recent Supreme Court decisions prevent prosecutors from pursuing such a case.

UNITED STATES v. FULL PLAY GROUP, S.A., 690 F. Supp. 3d 5 (E.D.N.Y. 2023)

PAMELA K. CHEN, United States District Judge:

Defendants Full Play Group, S.A. ("Full Play"), an Argentine sports marketing company, and Hernán Lopez ("Lopez"), the former Chief Executive Officer ("CEO") of Fox International Channels ("FIC"), are among dozens of individuals and entities charged in an almost decade-long prosecution targeting corruption in international soccer. The wide-ranging prosecution has resulted in the convictions of dozens of former officials of the Fédération Internationale de Football Association ("FIFA") and affiliated continental and regional soccer confederations, such as la Confederación Sudamericana

de Fútbol (“CONMEBOL”) and the Confederation of North, Central America and Caribbean Association Football (“CONCACAF”), as well as executives and employees of certain sports broadcasting and media rights companies, along with the companies themselves.

Here, Defendants Full Play and Lopez (collectively, “Defendants”) were charged with being participants in an intricate scheme to pay bribes and kickbacks to CONMEBOL officials for the purpose of obtaining the broadcasting and marketing rights for popular regional soccer tournaments. Specifically, Full Play was charged with several wire-fraud and money-laundering schemes related to the Copa Libertadores and Copa América soccer tournaments, and various “friendly” matches (“friendlies”) and World Cup qualifiers amongst South American national teams; and Lopez was charged as a co-conspirator in the wire-fraud and money-laundering counts related to the Copa Libertadores scheme. On March 9, 2023, a jury found Full Play and Lopez guilty on all counts charged against them after a seven-week trial. . . .

Lopez argues that after the Supreme Court's decisions in *Percoco* and *Ciminelli*, this Court must hold that § 1346's scope does not extend to foreign commercial bribery. After extensive consideration, the Court agrees. The Supreme Court's latest wire fraud decisions—especially *Percoco*—and the absence of precedent applying honest services wire fraud to foreign commercial bribery, requires this Court to find that § 1346 does not criminalize the conduct alleged in this case and that therefore the evidence at trial was insufficient to sustain Defendants' convictions under that statute. . . .

In *Ciminelli*, the Supreme Court struck down “the Second Circuit's longstanding ‘right to control’ theory of fraud,” in which “a defendant is guilty of wire fraud if he schemes to deprive the victim of ‘potentially valuable economic information’ ‘necessary to make discretionary economic decisions.’” . . .

On the same day, the Supreme Court issued its decision in *Percoco*, addressing “whether a private citizen with influence over government decision-making can be convicted for [honest services] wire fraud on the theory that he or she deprived the public of its ‘intangible right of honest services.’” In the underlying case, Joseph Percoco (“Percoco”), former-Governor Cuomo's longtime Executive Deputy Secretary, was charged with, *inter alia*, two counts of conspiring to commit honest services wire fraud in connection with actions he took during an eight-month “hiatus” from his government position. The scheme began in July 2014, when Empire State Development (“ESD”), a state agency, informed Steven Aiello that his real-estate company was required to enter an expensive “Labor Peace Agreement” with local unions in order to receive state funding for a lucrative project. “Aiello reached out to Percoco through an intermediary so that Percoco could ‘help [him] with th[e] issue[.]’” Percoco agreed to help and Aiello's company paid him \$35,000 between August and October 2014. On December 3, 2014, “mere days” before rejoining Governor Cuomo's office, Percoco “called a senior official at ESD and urged him to drop the labor-peace requirement.” The very next day, ESD

dropped the requirement and informed Aiello that the labor-peace agreement was no longer necessary. . . .

[The] Court reversed Percoco's conviction, finding that . . . the trial court's jury instructions were unconstitutionally vague. . . . [T]he *Percoco* jury instructions, defined the test for when a private individual owes a fiduciary duty to the public as follows: Percoco "owed a duty of honest services to the public if (1) he 'dominated and controlled any governmental business' and (2) 'people working in the government actually relied on him because of a special relationship he had with the government.'" . . .

The Supreme Court relied on *Skilling* . . .:

Skilling's teaching is clear. "[T]he intangible right of honest services" must be defined with the clarity typical of criminal statutes and should not be held to reach an ill-defined category of circumstances simply because of a *smattering* of pre-*McNally* cases. With this lesson in mind, we turn to the question whether the . . . theory endorsed by the lower courts in this case gave § 1346 an uncertain breadth that raises "the due process concerns underlying the vagueness doctrine." . . .

[T]he Court pointed out that *Skilling* itself was a case rejecting § 1346's application to "undisclosed self-dealing" schemes because "the pre-*McNally* lower court decisions involving such conduct were 'inconsisten[t].'" . . . [T]he Court cautioned, "'the intangible right of honest services' must be defined with the clarity typical of criminal statutes and should not be held to reach an ill-defined category of circumstances simply because of a *smattering of pre-McNally decisions*." Applying this standard, the Court held that ". . . the jury instructions did not . . . define 'the intangible right of honest services' 'with sufficient definiteness that ordinary people can understand what conduct is prohibited,' or 'in a manner that does not encourage arbitrary and discriminatory enforcement.'" . . .

[D]ecisions interpreting § 1346 have variously, and sometimes confusingly, parsed honest services fraud with respect to four different issues: (1) the *defendant's identity*; (2) the *type of conduct* that can give rise to honest services fraud; (3) the *source of the fiduciary duty* that was breached (or sought to be breached) by the fraud scheme; and (4) the *location of the bribery scheme*.

The Court finds these distinctions useful to explain why *Skilling*'s proclamation, that "it has always been 'as plain as a pikestaff that' bribes and kickbacks constitute honest-services fraud," does not save the § 1346 prosecution in this case. Although *Skilling* clarified the *type of conduct* that can give rise to a § 1346 prosecution (category two above), it did not address the *source of the fiduciary duty* that, if breached, gives rise to such prosecution (category three above). That is what *Percoco* has now done. . . .

While the Court recognizes that, in creating § 1346, Congress may have intended to criminalize conduct that deprives foreign organizations of their employees' honest

services, the question before this Court is whether such conduct violates § 1346 as interpreted by the Supreme Court in *Skilling* and now as further clarified in *Percoco*.

In *Percoco*, the Supreme Court was focused on the nature and source of the fiduciary duty that could—or could not—give rise to a § 1346 honest services wire fraud charge. The Court held that the Second Circuit had erroneously affirmed a jury instruction advising that the defendant could be found to have a duty to provide honest services to the public while not serving as a public official, if he had “dominated and controlled any government business” and if “the government actually relied on him because of a special relationship he had with the government.” . . .

Here, there is not even a “smattering of pre-*McNally* decisions” (nor post-*McNally* decisions, for that matter) that support the application of § 1346 to foreign commercial bribery. Neither the parties nor the Court have been able to identify a single pre-*McNally* case applying honest services wire fraud to foreign commercial bribery, i.e., bribery of foreign employees of foreign non-government employers. . . . This absence of authority, when viewed in light of the Supreme Court’s strongly worded rebukes in *Percoco* and *Ciminelli* against expanding the federal wire fraud statutes, compels this Court to find that § 1346 does not apply to foreign commercial bribery.)). Indeed, Defendants’ convictions are the casualties of the “‘fundamental indeterminacy’ in honest-services-fraud theory,” despite decades of jurisprudence that has struggled to “explain[] what kinds of fiduciary relationships are sufficient to trigger a duty of honest services in the first place.” *Percoco*. . . .

[T]he Government argues that the Court should reject any distinction between foreign and domestic commercial bribery, claiming that “the wrongfulness of commercial bribery is self-evident,” and relies on various bodies of law supporting an employer-employee fiduciary relationship. However, none of the Government’s appeals to common law, state law, civil law, foreign law, or codes of conduct, overcome the basic fact that there is no precedential authority to support the application of *this* federal criminal statute, § 1346, to foreign commercial bribery, which the Supreme Court has now made clear in *Percoco* is required. . . .

In sum, the Court concludes that in light of *Percoco*, the evidence at trial was insufficient to sustain Defendants’ honest services wire fraud convictions under § 1346 because the statute does not apply to foreign commercial bribery schemes. As a result, Defendants’ convictions for money laundering, predicated on their honest services wire fraud convictions, also cannot be sustained. The Court therefore grants Defendants’ motions to acquit on all counts of conviction.

2. “Kickback”

UNITED STATES v. DEMIZIO, 741 F.3d 373 (2d Cir. 2014)

KEARSE, Circuit Judge:

In the securities industry, financial institutions and their customers sometimes participate in transactions such as “short sales”—i.e., sales of stock not then owned by the seller—that require them to borrow securities from other financial institutions. The present prosecution charged [Defendant Darin DeMizio] principally with conspiracy to commit securities fraud and wire fraud by causing his employer, Morgan Stanley & Co. Inc. (“Morgan Stanley”), to conduct stock-loan transactions through intermediary firms in a manner that, at Morgan Stanley’s expense, caused large sums of money to be paid to DeMizio’s brother and father for little or no work. . . .

On appeal, DeMizio contends principally that he is entitled to a judgment of acquittal on Count One, arguing that the evidence at trial was insufficient to prove an honest-services fraud conspiracy. He contends that (a) a payment in the private sector qualifies as a kickback only when the recipient does not perform any work other than the conferral of business in connection with the payment, and [his brother and father] did perform work; (b) a payment in the private sector qualifies as a kickback only when it is the employee who receives the payment, and [DeMizio] never received any money from the alleged schemes; and (c) there is no violation of § 1346 without nondisclosure of material information to the employer by the employee, and [his father’s] involvement . . . was fully disclosed. . . .

In *Skilling*, addressing a contention that § 1346 was void for vagueness, the Supreme Court concluded that the section is not unconstitutionally vague to the extent that it covers schemes involving bribery and kickbacks. The Court reasoned that fraudulent schemes involving bribery and kickbacks had long been held to be within the scope of §§ 1341 and 1343, and that in enacting § 1346 in the wake of *McNally* to proscribe fraudulent schemes for deprivation of the intangible right of honest services, Congress “no doubt . . . intended § 1346 to reach at least “schemes to defraud involving “bribes and kickbacks.” (emphasis in original). The *Skilling* Court concluded that § 1346 cannot be interpreted to reach an “amorphous category” such as “conflict-of-interest” cases, and that the section “criminalizes only the bribe-and-kickback core of the pre-*McNally* case law,” (emphasis in original).

A kickback scheme typically involves an employee’s steering business of his employer to a third party in exchange for a share of the third party’s profits on that business. *See, e.g.,* Black’s Law Dictionary 948 (9th ed. 2009) (defining “kickback” as the “return of a portion of a monetary sum received, esp. as a result of coercion or a secret agreement”). We reject at the outset DeMizio’s suggestion that, in determining whether the evidence against him was sufficient under § 1346, we should ignore cases involving public officials. The *Skilling* Court noted that although honest-services cases most often involved bribery of public officials, private sector honest-services fraud had been

recognized at least as early as 1942. The Court analyzed cases involving public officials as well as cases involving employees in the private sector in deciding the appeal brought by Skilling himself, a private-sector employee; and it noted that while the principal federal bribery statute, 18 U.S.C. § 201, “generally applies only to federal public officials, . . . § 1346’s application to . . . private-sector fraud reaches misconduct that might otherwise go unpunished.”

We also reject DeMizio’s argument that kickbacks (a) do not include payments made to entities other than the employee who steers his employer’s business to a third party in exchange for those payments, and (b) do not include payments of large sums of money to those recipients so long as they perform some minimal amount of work. Although the kickback amount frequently is paid directly to the employee who steered the contract, the scheme is no less a kickback scheme when the employee directs the third party to share its profits with an entity designated by the employee in which the employee has an interest. For example, as noted in *Skilling*, a statute prohibiting kickbacks with respect to federal contracts defined “kickback,” in part, to include “any money, . . . thing of value, or compensation of any kind which is provided, directly or indirectly,” to a prime contractor or its employee “for the purpose of . . . rewarding favorable treatment in connection with . . . a subcontract relating to a prime contract,” 41 U.S.C. § 52(2) (2006). . . .

In this vein, payoff schemes have been viewed as involving kickbacks when the defendant has directed that the contracting party’s profit be shared with family, friends, or others loyal to the defendant.

In light of these authorities, and the failure of DeMizio to cite any authority to support his constrained conception of kickbacks, we reject his contention that a payment in a private-sector scheme does not qualify as a kickback unless the defendant employee himself or herself receives the payoff. The evidence overwhelmingly established that DeMizio directed Morgan Stanley stock-loan business to companies that agreed to pay commissions to his father and/or brother, in whom DeMizio plainly had an interest.

Further, there was evidence from which it could be inferred that the payoffs benefited DeMizio himself financially. For example, [a witness] testified DeMizio asked him to pay commissions to DeMizio’s brother Craig because DeMizio said Craig “wasn’t making a lot of money . . . and he needed help.” (Tr. 98.) [The witness] also testified that he formed [his company] in 1999 at the suggestion of DeMizio, who asked him to hire DeMizio’s father . . . in 2000. [Another witness] testified that around that time DeMizio was complaining . . . that [his father] was “hurting for money” and was requesting money from DeMizio.

As the district court reasoned, “the jury could have reasonably concluded that DeMizio benefited indirectly from the payments to his father and brother because he would otherwise have had to support them financially. By instead arranging for them to obtain substantial payments for little or no work, he relieved himself of the obligation to assist the individuals using his own wealth.” . . .

We agree with the district court's post-*Skilling* view that the rule advocated by DeMizio—i.e., that so long as “any” work at all is done by the recipient of a share of the contracting party's profits, that payoff is not a kickback—“would be untenable,” allowing “[p]otential fraudsters [to] shield themselves from criminal liability merely by performing some token labor in exchange for what would otherwise be an illegal kickback.” And we agree with the district court that there was ample evidence from which a reasonable jury could have inferred that the payments to [the father and brother] were kickbacks. They performed work on no more than 10 to 20 percent of the transactions for which they were paid. The work they did perform was of minimal quality and difficulty, and there was even evidence that they were not competent to perform work as finders. In exchange for this “work,” they received in excess of \$1.5 million in payments. While DeMizio was free to argue to the jury that these payments were in exchange for legitimate work, the jury reasonably found otherwise.

Finally, we reject DeMizio's contention that the government's evidence was insufficient to show fraud, i.e., that Morgan Stanley was unaware of his kickback schemes. [A witness] testified to the existence of “a code that [DeMizio] would use with [him] to discuss these transactions”; that DeMizio said he wanted to use code “because he didn't want the people seated next to him to hear” him “instruct[ing the witness to] . . . put his brother in” on stock-loan tickets, . . . [b]ecause Morgan Stanley did not want him to deal with his brother.” (Tr. 98–99.) [Another witness] testified that he and DeMizio did not discuss the arrangement . . . “to pay his brother Craig in front of other people,” and [the witness] “did . . . not tell the other traders” at Freeman about the arrangement because “it was illegal” and “Darin didn't want anybody else to know about it.” Evangelista also testified that DeMizio told him that if anyone found out about the arrangement “[DeMizio] would deny the whole thing.” . . .

3. “Fiduciary Duty”

PERCOCO v. UNITED STATES, 143 S.Ct. 1130 (2023)

Justice ALITO delivered the opinion of the Court.

In this case, we consider whether a private citizen with influence over government decision-making can be convicted for wire fraud on the theory that he or she deprived the public of its “intangible right of honest services.” 18 U.S.C. §§ 1343, 1346. Petitioner Joseph Percoco was charged with conspiring to commit honest-services wire fraud during a period of time that included an eight-month interval between two stints as a top aide to the Governor of New York. Percoco was convicted of this offense based on instructions that required the jury to determine whether he had a “special relationship” with the government and had “dominated and controlled” government business. We conclude that this is not the proper test for determining whether a private person may be convicted of honest-services fraud, and we therefore reverse and remand for further proceedings.

Percoco was a longtime political associate of former New York Governor Andrew Cuomo. Except for a brief but important hiatus in 2014, Percoco served as the Governor's Executive Deputy Secretary from 2011 to 2016, and that position gave him a wide range of influence over state decision-making. In April 2014, Percoco resigned from this position to manage the Governor's reelection campaign, but after the Governor was reelected, he resumed his role as Executive Deputy Secretary in December 2014.

The question we address today arises from Percoco's activities during his break in government service. In July 2014, Empire State Development (ESD), a state agency, informed developer Steven Aiello that his real-estate company, COR Development, needed to enter into a "Labor Peace Agreement" with local unions if he wished to receive state funding for a lucrative project. Interested in avoiding the costs of such an agreement, Aiello reached out to Percoco through an intermediary so that Percoco could "help us with this issue while he is off the 2nd floor," *i.e.*, the floor that housed the Governor's office. Percoco agreed and received two payments totaling \$35,000 from Aiello's company in August and October 2014. On December 3, mere days before returning to his old job, Percoco called a senior official at ESD and urged him to drop the labor-peace requirement. ESD promptly reversed course the next day and informed Aiello that the agreement was not necessary. . . .

Over defense counsel's objection, the court instructed that Percoco could be found to have had a duty to provide honest services to the public during the time when he was not serving as a public official if the jury concluded, first, that "he dominated and controlled any governmental business" and, second, that "people working in the government actually relied on him because of a special relationship he had with the government." The jury convicted Percoco on count 10, as well as two other charged counts relating to additional conduct, but acquitted him on the other charges. The court then denied Percoco's motion for judgment of acquittal, and he was sentenced to 72 months' imprisonment. . . .

In *Margiotta*, . . . Joseph Margiotta chaired the Republican Party Committees for Nassau County and the town of Hempstead, New York, and he used the influence that came with those positions to carry out a kickback scheme. He was indicted for honest-services mail fraud, and although he held "no elective office," the prosecution argued that he nevertheless breached a duty to render honest services because his party positions "afforded him sufficient power and prestige to exert substantial control over public officials."

A divided Second Circuit panel agreed. The majority found that "there is no precise litmus paper test" for determining when a private person "owes a fiduciary duty to the general citizenry" but that "two time-tested measures of fiduciary status [were] helpful." These were (1) whether "others rel[ied] upon [the accused] because of [his] special relationship in the government" and (2) whether he exercised "de facto control" over "governmental decisions." Admitting that the case before it was "novel" and that determining when a private person owes a duty of honest services was "a most difficult

enterprise,” the majority nevertheless concluded that a private person could commit honest-services fraud if he or she “dominate[d] government.” In a strongly worded partial dissent, Judge Winter complained that the majority’s interpretation lacked “the slightest basis in Congressional intent, statutory language or common canons of statutory interpretation” and that it erroneously treated a variety of “politically active persons” who have informal but strong influence over government as subject to the same duties as officeholders. . . .

Skilling’s approach informs our decision in this case. Here, the Second Circuit concluded that “Congress effectively reinstated the *Margiotta*-theory cases by adopting statutory language that covered the theory.” But *Skilling* was careful to avoid giving § 1346 an indeterminate breadth that would sweep in any conception of “intangible rights of honest services” recognized by some courts prior to *McNally*.

This is illustrated by *Skilling*’s rejection of the Government’s argument that § 1346 should be held to reach cases involving “undisclosed self-dealing by a public official or private employee—*i.e.*, the taking of official action by the employee that furthers his own undisclosed financial interests while purporting to act in the interests of those to whom he owes a fiduciary duty.” Because the pre-*McNally* lower court decisions involving such conduct were “inconsisten[t],” we concluded that this “amorphous category of cases” did not “constitute core applications of the honest-services doctrine.” . . .

[W]e reject the argument that a person nominally outside public employment can *never* have the necessary fiduciary duty to the public. Without becoming a government employee, individuals not formally employed by a government entity may enter into agreements that make them actual agents of the government. An “agent owes a fiduciary obligation to the principal,” see, *e.g.*, 1 Restatement (Third) of Agency § 1.01, Comment *e*, p. 23 (2005), and therefore an agent of the government has a fiduciary duty to the government and thus to the public it serves. In this Court, Percoco has agreed that individuals who are “delegated authority to act on behalf” of a public official and to perform government duties have a duty to provide honest services. This well-established principle suffices to confirm that the lower courts correctly rejected Percoco’s *per se* rule and, in doing so, did not stretch § 1346 past heartland cases.

Rejecting this absolute rule, however, is not enough to sustain Percoco’s convictions on the wire fraud conspiracy counts. “[T]he intangible right of honest services” codified in § 1346 plainly does not extend a duty to the public to *all* private persons, and whether the correct test was applied in this case returns us to *Margiotta*. . . .

Directly applying *Margiotta*, the trial judge told the jury that Percoco owed a duty of honest services to the public if (1) he “dominated and controlled any governmental business” and (2) “people working in the government actually relied on him because of a special relationship he had with the government.” But *Margiotta*’s standard is too vague. From time immemorial, there have been *éminence grises*, individuals who lacked any formal government position but nevertheless exercised very strong influence over

government decisions. Some of these individuals have been reviled; others have been respected as wise counselors. The *Margiotta* test could be said to apply to many who fell into both of these camps. It could also be used to charge particularly well-connected and effective lobbyists. . . .

The Government does not defend these jury instructions as an accurate statement of the law, but it argues that their imprecision was harmless. Specifically, the Government argues that a private individual owes a duty of honest services to the public “in two discrete circumstances”: (1) “when the person has been selected to work for the government” in the future and (2) “when the person exercises the functions of a government position with the acquiescence of relevant government personnel.”

The first theory differs substantially from the jury instructions, which did not tell the jury that Percoco could be found to owe a duty of honest services because he had been selected for future government service. While the prosecution offered evidence that Percoco intended to return to government service after the election and had made plans to do so, the jury could have found that the requirements set out in the jury instructions were satisfied without relying on that evidence. Thus, even if we assume for the sake of argument that there is some merit in the Government’s first new theory, it is far from clear that the erroneous jury instructions would be harmless.

The Government’s second new theory—*i.e.*, that a private citizen owes a duty to render honest services “when the person exercises the functions of a government position with the acquiescence of relevant government personnel”—appears, as defined in its brief, to restate *Margiotta*’s erroneous construction of the law.

For these reasons, the judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion. . . .

Problem 2-6

- (a) Can the following case be charged as mail/wire fraud: Albert, a professor of engineering at the University of Texas, grants PhDs to three students who fail the examination in a required course on statistical methods; the three students obtain jobs with NASA in Houston and later recommend that Albert be hired as a consultant on a project for which NASA pays Albert \$10,000 for his work. (Many wire communications across state lines occur in the course of the matter.)
- (b) Can the following case be charged as mail/wire fraud: Lucy, a partner at a large New York law firm, is asked to represent Corp B, a Delaware corporation, in a bid for a very large construction contract with the City of New York. During the “conflicts check,” Lucy’s partners tell her she can’t represent Corp B because another partner at the firm is representing Corp A, a New Jersey corporation, which is bidding for the same construction contract. Lucy continues to represent Corp B, and collects a fee for doing so, while hiding her representation of Corp B from her partners.
- (c) Under what circumstances do you think a senior officer (the CEO, for example) of a large publicly held corporation could be charged with honest services fraud after *Skilling*?

3. SECURITIES FRAUD

In this chapter and the following chapter on insider trading, we take the idea of fraud—developed fully in Chapter 2—and apply it to the matter of criminal fraud in markets for securities (roughly, investment products). These two chapters cover much of what is commonly thought of as “Wall Street crime,” or what scholars think of as the criminal law aspect of financial market regulation. The fundamental concept of fraud remains much the same, while the facts of the cases become a bit more complex and varied, given the rapid pace of innovation and the enormous incentives to discover new sources and means of profits in global financial markets.

Part A first sets forth the distinctive statutory and regulatory scheme for fraud that applies in securities markets—largely a product of the New Deal of the 1930s and its aftermath, as well as subsequent American financial crises. The prohibited wrongdoing is still fraud, but the “statutory hook” shifts from a mailing or wiring to conduct “in connection with” purchases and sales of securities. Part A then provides examples of recent criminal securities fraud cases that illustrate the application of the last chapter’s principles about fraud to current securities dealing. Part B introduces the recurring scenario in securities cases of corporate accounting fraud and provides a few examples of common methods for such fraud. Through materials from several high-profile cases, Part C takes up the problem of trading fraud by bankers—with particular attention to the heated controversy over the paucity of criminal prosecutions relating to the market in mortgage-backed securities that was at the center of the historic 2008 financial crisis.

A. The Statutes and the Basics

Securities fraud is a common theory of prosecution in cases of corporate crime for two reasons. First, when Congress reformed regulation of financial markets as part of the 1930s New Deal, it enacted comprehensive and potent federal laws against securities fraud, which have been made more powerful since. Second, the legal definition of “security” under federal law (a subject covered extensively in courses on securities regulation) is so broad that these anti-fraud laws cover most significant investment products used today, including stock, common debt instruments, and many forms of derivatives.

This section of these materials is as much about facts as law. You can’t master the nuances of financial fraud in the corporate world without working on some of these cases, and maybe even having some simple training in accounting rules and practices—which can’t be provided in an introductory course on corporate crime. Read the materials in the spirit of training yourself to be interested in financial cases, not afraid of them. Remind yourself: The people who designed this stuff are no more capable than you. Also, take a course on securities regulation, even if it has a reputation for being harder than average in the law school curriculum. The practitioner of corporate crime must understand the basics of American financial markets and the regulatory structure that governs them.

Not surprisingly, given what we saw in Chapter 2, most or all courts have said that the concept of “intent to harm,” whatever it may mean, is not applicable under the laws against securities fraud. *See, e.g., United States v. Tagliaferri*, 820 F.3d 568 (2d Cir. 2016).

What types of *behaviors* count as criminal fraud remains, more or less, the same problem.

One can roughly divide most common criminal securities fraud prosecutions into five categories:

1. accounting fraud—cooking the books to defraud investors, most often purchasers and sellers of equity shares, about the value of the firm;
2. investment fraud—ripping off investors’ money, most famously through Ponzi schemes, which usually are not all that interesting legally: the conduct is one step removed from outright theft, with the perpetrator’s express lies typically large, numerous, and flagrant. This chapter does not include any legal materials on Ponzi schemes but the psychology of both perpetrators and victims in such cases is very interesting, so perhaps find an evening to watch the HBO film about Bernard Madoff;
3. “looting”—when managers divert corporate assets (such as apartments and airplane rides) for themselves and others;
4. trading fraud—sellers and buyers of financial instruments, like mortgage-backed securities, defrauding each other, often while employed by the world’s largest financial institutions; and
5. the special scenario of insider trading, covered separately in Chapter 4.

Most of the criminal statutes and regulations governing securities fraud arrived in two waves: first, in the 1930s and 1940s, when New Deal legislation included the monumental framework of American securities law; and second, in the 2000s, when the aftermath of the Enron scandal and others produced extensive revisions in securities laws. The New Deal wave generated the 1933 Act (the “’33 Act” or “Securities Act”), which regulates the process of new offerings by issuers of securities and includes criminal penalties for some violations, and the 1934 Act (the “’34 Act” or “Exchange Act”) which regulates the post-issuance trading of securities in secondary markets by all persons and includes criminal penalties for some violations. These enactments both created the Securities and Exchange Commission and empowered it to, among other things, make regulations in furtherance of the legislation’s objectives.⁹ Thus, criminal securities fraud is defined by both statute and regulation. In the early 2000s, the Enron-

⁹ Basic familiarity with the principles and processes of federal administrative law in the United States is also an important tool for the practitioner of corporate crime.

era scandals produced the Sarbanes-Oxley Act, which included both stiffer punishments for criminal securities fraud and some additional (and substantially overlapping) definitions of criminal securities offenses. Most recently, the financial crisis of 2008–09 spawned the Dodd-Frank Act, which covered a variety of regulatory areas and included some changes in securities laws, with the addition of a whistleblower program for SEC enforcement particularly important for corporate enforcement practice.

The criminal provisions of these major pieces of legislation now appear in both Title 18 (federal crimes) and Title 15 (securities regulation) of the United States Code. You should be familiar with all of the statutes below. Find the key elements in them. What is the *actus reus*? What is the *mens rea*? What, if anything, is different on the face of these statutes from the mail and wire fraud statutes? In what ways might the mail and wire fraud laws and the securities fraud laws be used to cover some of the same conduct (as federal prosecutors often use them)?

15 U.S.C. §78j. Manipulative and deceptive devices (often referred to as “Section 10 of the ’34 Act”)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

[Pursuant to the regulatory powers that Congress granted to it through Section 10 of the ’34 Act (above), the SEC enacted “Rule 10b-5” (below), which can fairly claim to be the most impactful and frequently litigated rule in the entire Code of Federal Regulations.]

17 C.F.R. § 240.10b-5. Employment of manipulative and deceptive devices (referred to as “Rule 10b-5”)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

1. To employ any device, scheme, or artifice to defraud,
2. To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

3. To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

15 U.S.C. § 78ff. Penalties

(a) Willful violations; false and misleading statements

Any person who willfully violates any provision of this chapter (other than section 78dd-1 of this title), or any rule or regulation thereunder the violation of which is made unlawful or the observance of which is required under the terms of this chapter, or any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this chapter or any rule or regulation thereunder or any undertaking contained in a registration statement as provided in subsection (d) of section 78o of this title, or by any self-regulatory organization in connection with an application for membership or participation therein or to become associated with a member thereof which statement was false or misleading with respect to any material fact, shall upon conviction be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both, except that when such person is a person other than a natural person, a fine not exceeding \$25,000,000 may be imposed; but no person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.

18 U.S.C. § 1348. Securities and commodities fraud (enacted as part of the Sarbanes-Oxley Act)

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

1. to defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or
2. to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); shall be fined under this title, or imprisoned not more than 25 years, or both.

18 U.S.C. § 1350. Failure of corporate officers to certify financial reports (enacted as part of the Sarbanes-Oxley Act)

(a) Certification of periodic financial reports.—Each periodic report containing financial statements filed by an issuer with the Securities Exchange Commission pursuant to section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a) or 78o(d)) shall be accompanied by a written statement by the chief executive officer and chief financial officer (or equivalent thereof) of the issuer.

(b) Content.—The statement required under subsection (a) shall certify that the periodic report containing the financial statements fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)) and that information contained in the periodic report fairly presents, in all material respects, the financial condition and results of operations of the issuer.

(c) Criminal penalties.—Whoever—

1. certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$1,000,000 or imprisoned not more than 10 years, or both; or
2. willfully certifies any statement as set forth in subsections (a) and (b) of this section knowing that the periodic report accompanying the statement does not comport with all the requirements set forth in this section shall be fined not more than \$5,000,000, or imprisoned not more than 20 years, or both.

Omissions under Rule 10b-5: It had long been understood that theories of securities fraud based on omissions to disclose material facts should be analyzed similarly to theories of fraud by omission under the mail and wire fraud statutes. As the Supreme Court said long ago in *Basic, Inc. v. Levinson*, 485 U.S. 224, 239 (1988), “Silence, *absent a duty to disclose*, is not misleading under Rule 10b-5” (emphasis added).

However, last term, in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.*, 144 S.Ct. 885 (2024), the Court stated, “Even a duty to disclose . . . does not automatically render silence misleading under Rule 10b-5(b). . . . [F]ailure to disclose information required by [SEC regulations] can support a Rule 10b-5(b) claim only if the omission renders affirmative statements made misleading.” The Court similarly stated, “Rule 10b-5(b) does not proscribe pure omissions. The Rule prohibits omitting material facts necessary to make the ‘statements made ... not misleading. Put differently, it requires disclosure of information necessary to ensure that statements already made are clear and complete. . . . This Rule therefore covers half-truths, not pure omissions.”

While one can read *Macquarie* as not affecting theories of duty-based fraud by omission under 10b-5(a) (“scheme to defraud”) and 10b-5(c) (“operate as a fraud”), it is advisable

to pay attention to what the lower federal courts do with *Macquarie's* textualist reading of 10b-5(b).

To illustrate the application of these statutes and rules, we begin with the saga of a securities fraud prosecution that relates to the now infamous market in mortgage-backed securities (MBS) and demonstrates how the law of securities fraud mirrors, overlaps, and sometimes differs with the various components of mail and wire fraud. Here you will see discussion in the securities trading context of important issues addressed in Chapter 2, including “intent to harm,” “intent to defraud” (versus “good faith”), and materiality.

Why did the government have such a hard time sustaining the fraud convictions of this trader, who was dealing (albeit after the financial crash of 2008) in a market widely believed by outsiders to have been infected by fraud?

UNITED STATES v. LITVAK, 808 F.3d 160 (2d Cir. 2015) (Litvak I)

STRAUB, Circuit Judge:

The charges in this case arise from Litvak’s conduct as a securities broker and trader at Jefferies & Company (“Jefferies”), a global securities broker-dealer and investment banking firm. . . .

As a bond trader at Jefferies during the relevant time period, Litvak bought and sold RMBS [residential mortgage-backed securities] on Jefferies’s behalf, sometimes as a middleman (holding the RMBS only briefly when facilitating a transaction between two other parties) and sometimes holding the RMBS for a longer period of time in Jefferies’s “inventory.” Between 2009 and 2011, Litvak made three types of misrepresentations to representatives of the counterparties with whom he transacted on Jefferies’s behalf in order to increase Jefferies’s profit margin on the transactions in which he engaged. First, he misrepresented to purchasing counterparties Jefferies’s acquisition costs of certain RMBS. For example . . . Litvak falsely represented to Michael Canter, a representative of the AllianceBernstein Legacy Securities Fund (“AllianceBernstein Fund”), a PPIF, that Jefferies had purchased certain RMBS at a price of \$58.00 (based on \$100.00 face value), when in fact Litvak knew that Jefferies had purchased those securities at \$57.50. Jefferies subsequently sold the securities to the AllianceBernstein Fund at a price of \$58.00. Canter testified that this difference would have “mattered” and been “important” to him. If Jefferies and the AllianceBernstein Fund had instead transacted at a price of \$57.50, the Fund would have paid approximately \$60,000 less for the securities (the total cost was approximately \$12 million).

Second, Litvak misrepresented to selling counterparties the price at which Jefferies had negotiated to resell certain RMBS. . . . Litvak falsely stated to a representative of York Capital Management (“York”), a hedge fund that owned certain RMBS, that Litvak had arranged for Jefferies to resell those securities to a third party at a price of \$61.25 (based

on \$100.00 face value). Litvak and York's representative, Kathleen Corso, agreed that Jefferies would purchase the securities from York at a price of \$61.00, in order to allow Jefferies to reap a \$0.25 profit when resold to the third party at \$61.25. However, Litvak had actually arranged for Jefferies to resell the securities to the third party at a price of \$62.375. Indeed, York sold the securities to Jefferies at a price of \$61.00 and Jefferies then resold the securities to the third party at a price of \$62.375 (for a profit of \$1.375). Corso testified that this difference would have been "important" to her. If Jefferies and York had instead transacted at a price of \$62.125, providing Jefferies with a profit of \$0.25, as Litvak had represented to Corso, Jefferies would have paid York approximately \$228,500 more for the securities (the total cost was approximately \$20 million).

Third, Litvak misrepresented to purchasing counterparties that Jefferies was functioning as an intermediary between the purchasing counterparty and an unnamed third-party seller, where in fact Jefferies owned the RMBS and no third-party seller existed. . . . Litvak falsely represented to a representative of Magnetar Capital ("Magnetar"), a hedge fund, that Litvak was actively negotiating with a seller of certain RMBS (i.e., acting as a middleman) when, in fact, Litvak knew that Jefferies held the securities in its inventory. Litvak's negotiations with Vladimir Lemin, Magnetar's representative, began with Lemin's offer to purchase the securities at a price of \$50.50. Litvak then described to Lemin a fictional back-and-forth between himself and an unnamed, non-existent third-party seller, which concluded with Litvak's false representation to Lemin that he had contemporaneously purchased the securities on Jefferies's behalf at a price of \$53.00. Lemin then agreed for Magnetar to purchase from Jefferies the securities at a price of \$53.25, in order to allow Jefferies to reap a \$0.25 profit (or "commission") when resold. However, the securities purchased from Jefferies by Magnetar were actually held in Jefferies's inventory and had been acquired by Jefferies several days prior at a price of \$51.25. Lemin testified that this distinction reflected "a very different situation" from that which he understood at the time of the transaction. If Jefferies and Magnetar had instead transacted at a price of \$53.00, the agreed-upon transaction price of \$53.25 less the understood \$0.25 "commission" for Jefferies, Magnetar would have paid Jefferies approximately \$14,000 less for the securities (the total cost was approximately \$5.5 million). . . .

Litvak argues that the misrepresentations he made to counterparties during negotiations for the sale of bonds are immaterial as a matter of law because they did not relate to the bonds' value (as opposed to their price). Although the District Court did not squarely address this argument, it held that the trial evidence sufficiently supported a finding of materiality. We reject Litvak's argument because, on the trial record before us, a rational jury could have concluded that Litvak's misrepresentations were material. . . .

A misrepresentation is material under Section 10(b) of the Securities Exchange Act and Rule 10b-5 where there is "a substantial likelihood that a reasonable investor would find the . . . misrepresentation important in making an investment decision." *United States v. Vilar*. Where the misstatements are "so obviously unimportant to a reasonable investor

that reasonable minds could not differ on the question of their importance,” we may find the misstatements immaterial as a matter of law. *Wilson v. Merrill Lynch & Co., Inc.*

We conclude that, on the trial record before us, a rational jury could have found that Litvak’s misrepresentations were material. The trial record includes testimony from several representatives of Litvak’s counterparties that his misrepresentations were “important” to them in the course of the transactions on which the securities fraud charges were predicated, and that they or their employers were injured by those misrepresentations. This testimony precludes a finding that no reasonable mind could find Litvak’s statements material. . . .

Litvak contends that the scienter element of Section 10(b) requires proof of “contemplated harm” (or “intent to harm”), that the District Court erred in failing to so instruct the jury, and that the evidence adduced at trial was insufficient to permit a rational jury to find that Litvak had such intent. In ruling on Litvak’s post-trial motions, the District Court reaffirmed its view that “intent to harm” is not an element of securities fraud. We agree.

“Liability for securities fraud [] requires proof that the defendant acted with scienter, which is defined as ‘a mental state embracing intent to deceive, manipulate or defraud.’” *United States v. Newman* (quoting *Ernst & Ernst v. Hochfelder*). Litvak urges us to read “intent to deceive, manipulate or defraud,” *Hochfelder*, in the same manner in which we have interpreted “intent to defraud” in the mail and wire fraud contexts (*i.e.*, as requiring proof of “contemplated harm”). Litvak’s view, however, is contrary to our precedent. . . .

In sum, because “intent to harm” is not a component of the scienter element of securities fraud under Section 10(b), the District Court did not err in refusing to provide such an instruction to the jury and we need not inquire into whether the evidence was sufficient for the jury to conclude that such intent was proven. . . .

Litvak challenges the District Court’s exclusion of “testimony and documents about the widespread use of similar negotiation tactics at Jefferies” which “would have shown that others at Jefferies engaged in the same conduct and that it was approved by supervisors and by Jefferies’ compliance department.” The “good faith” evidence Litvak proffered at trial may be separated into two categories: (1) evidence of Litvak’s supervisors’ knowledge or approval of *Litvak’s* “price misrepresentation[s]” and “inventory misrepresentation[s]” and (2) evidence of Jefferies managers’, including Litvak’s supervisors, knowledge or approval of *other employees’* similar conduct. The District Court permitted the first category of evidence, allowing Litvak to adduce evidence that his supervisors “approved” or “encouraged” him to misrepresent price, cost, or a seller’s identity because such evidence that “tend[s] to prove the absence of intent” and could provide a basis for the jury to make “a reasonable inference . . . that they should find no intent to defraud given the nature of what happened at Jefferies.”

The second category of evidence was the subject of a lengthy colloquy between Litvak's counsel and the District Court. After the District Court called the relevance of this evidence into question, Litvak's counsel responded as follows:

This is an ongoing alleged scheme . . . with the same supervisors in place for the entire time with repeated examples of the two types of alleged misrepresentations we have been talking about here. So, your Honor, I think that evidence that supervisors approve this conduct and participate in the conduct on a repeated basis is a fair basis upon which to infer that when Mr. Litvak did the very same thing, that the supervisors saw and approved of as standard operating procedure, that Mr. Litvak lacked the intent to defraud. That's a fair inference from that evidence. It is a circumstantial basis to infer that Mr. Litvak had a belief, as we have contended, that he was not committing fraud. . . .

(Litvak's counsel explain[ed] that "the supervisors understood what Mr. Litvak had done not to be fraudulent because it was approved [and] because [they] were sales tactics that were widely employed That's the environment in which Mr. Litvak is operating. It all goes back to state of mind."). The District Court rejected this argument and prohibited Litvak from adducing evidence of "other people at Jefferies engaging in the same type of conduct" or "any supervisor approving others engaging in the conduct" because such evidence is "*irrelevant* when it does not involve [Litvak]." . . .

Litvak sought to introduce evidence that, during the relevant time period, supervisors at Jefferies—including his supervisors—regularly approved of conduct identical to that with which Litvak was charged. The District Court characterized the proffered evidence as improperly "suggest[ing] that everybody did it and therefore it isn't illegal." But Litvak's counsel did not proffer the evidence for that purpose and such an argument in summation could have been properly proscribed by the District Court. As Litvak's counsel stated at trial, this evidence would provide "a fair basis upon which to infer that when Mr. Litvak did the very same thing, . . . the supervisors saw and approved of [it] as standard operating procedure." Such an inference would support Litvak's attempt to introduce a reasonable doubt as to his intent to defraud, *i.e.*, that he held an honest belief that his conduct was not improper or unlawful, a belief the jury may have found more plausible in light of his supervisors' approval of his colleagues' substantially similar behavior. . . . [T]he District Court exceeded its allowable discretion in concluding that this testimony was not relevant under the low threshold set forth by Federal Rule of Evidence 401 in determining whether Litvak "held an honest belief that his actions . . . were proper and not in furtherance of any unlawful activity," *see United States v. Brandt* ("since [good faith] may be only inferentially proven, no events or actions which bear even remotely on its probability should be withdrawn from the jury unless the tangential and confusing elements interjected by such evidence clearly outweigh" its relevance (internal citation omitted)). . . .

The first expert witness Litvak proffered was Ram Willner. According to Litvak's expert disclosure to the government, Willner holds advanced degrees in business administration with a focus on finance, served as a professor at leading business schools, and gained "extensive experience in portfolio management in the fixed income asset class, including extensive experience in the analysis and purchase of Residential Mortgage Backed Securities" during his employment by, at various times, Bank of America, Morgan Stanley, PIMCO, and a hedge fund. . . .

Litvak contends that the District Court erred in barring Willner from testifying "about the process investment managers use to evaluate a security, and the irrelevance of the broker-dealer's acquisition price to that process, [which] was directly probative of whether Mr. Litvak's misstatements would have been material to a reasonable investor."

Before the District Court, Litvak proposed that Willner opine, in pertinent part, as follows:

[T]hat where a manager follows rigorous valuation procedures, as was the case here, consideration of, or reliance on, statements by sell-side salesmen or traders concerning the value of a RMBS or the price at which the broker-dealer acquired it or could acquire it, are not relevant to that fund's determination with respect to how much to pay for a bond. In Mr. Willner's opinion, such statements from sell-side sales representatives or traders are generally biased, often misleading, and unworthy of consideration in trading decisions. Accordingly, such statements from sell-side sales representatives or traders are not material to a professional investment manager's decision-making.

Litvak also offered Willner to testify in respect of "the process of selecting and valuing RMBS for inclusion in an investment portfolio, including analytical tools and methods available to an investment manager, and the development of an investment thesis for a particular RMBS." The District Court excluded the entirety of Willner's proffered testimony.

The government defends the District Court's ruling on the ground that "[t]he materiality of Litvak's lies was for the jury to decide." But . . . the District Court did not exclude Willner's testimony on "ultimate issue" grounds. Rather, the District Court appears to have excluded all of Willner's proffered testimony on relevance grounds (relying on Rule 401, Rule 403, or possibly both), without ruling specifically on this part of Willner's proposed testimony.

We conclude that the District Court exceeded its allowable discretion in excluding Willner's testimony in respect of the process by which investment managers value RMBS and the likely impact on the final purchase price of a broker's statements made to a counterparty during the course of negotiating a RMBS transaction. These portions of Willner's testimony would have been highly probative of materiality, the central issue in the case. This is particularly true because of the meaningful distinction between the

complex securities at issue in this case and the common equities and bonds traded in “traditional,” efficient markets (e.g., shares of corporate entities traded on the New York Stock Exchange). The pricing of RMBS is “more complicated” because it “tend[s] to be more subjective, [is] available mainly or only from dealers, and [is] often based on models to as opposed to prices from prior transactions.” Thomas P. Lemke, Gerald T. Lins & Marie E. Picard, *Mortgage-Backed Securities* § 5:14 (Westlaw 2015).

Consistent with this understanding, Willner’s proffered testimony could have educated the jury (which was likely only familiar, if at all, with securities traded on public exchanges) about the highly-specialized field of RMBS trading. Because RMBS lack an efficient, transparent secondary market through which value can be determined objectively, traders set the value of the security, and hence the price each is willing to accept as a seller or buyer, by engaging in “rigorous valuation procedures” involving the use of certain “analytical tools and methods.” Thus, firms trading RMBS rely upon sophisticated computer-pricing models, often developed by professionals with applied-mathematics backgrounds, to determine the subjective “value” of the securities. Certain testimony at trial supported a conclusion that this process, and a determination of the amount an investment manager is willing to pay for a security, nearly always takes place prior to the manager approaching a dealer such as Jefferies, here represented by Litvak, to negotiate the price of that security.

With such testimony before it, a jury could reasonably have found that misrepresentations by a dealer as to the price paid for certain RMBS would be immaterial to a counterparty that relies not on a “market” price or the price at which prior trades took place, but instead on its own sophisticated valuation methods and computer model. The full context and circumstances in which RMBS are traded were undoubtedly relevant to the jury’s determination of materiality.

Aside from Willner’s testimony in respect of the nature of the RMBS market, there are few ways in which Litvak could put forth evidence to rebut the alleged victims’ testimony that Litvak’s misstatements were important to them, or otherwise counter the government’s argument that a reasonable investor would have found Litvak’s statements material. . . .

If we were to conclude otherwise, Litvak would be put in an untenable position whereby he could not introduce testimony that either (1) the specific statements at issue in the case would not be important to a reasonable investor (due to “ultimate issue” concerns) or (2) the types of statements at issue are generally not important to a reasonable investor. Litvak would be left only with the “victims” of his conduct as sources of potential testimony on this issue, an odd limitation where the jury is to evaluate materiality in an objective manner. We conclude that this error was not harmless. . . .

The prosecutors retried the *Litvak* case and secured a more limited conviction. Litvak again appealed, and again prevailed. On the second appeal, the court explained further how the particular nature and structure of the market in which Litvak operated were

essential to evaluating whether the government had fairly proved the crime of securities fraud.

UNITED STATES v. LITVAK, 889 F.3d 56 (2d Cir. 2018) (Litvak II)

WINTER, Circuit Judge:

Jesse Litvak appeals from his conviction, after a trial by a jury before Chief Judge Hall, on one count of securities fraud pursuant to 15 U.S.C. §§ 78j(b), 78ff. This is the second time this matter has been before us. . . .

He challenges his conviction on the one count principally on the ground that his misstatements were, as a matter of law, immaterial to a reasonable investor in the market for residential mortgage-backed securities (“RMBS”). We reject that argument. However, the district court erred in admitting evidence that the individual representing the counterparty in the transaction for which appellant was convicted believed appellant to be an agent acting on the counterparty’s behalf. All parties agree that the belief in an agency relationship was erroneous and that appellant acted solely as a principal in the transaction underlying this appeal. Indeed, the testimony of the counterparty’s representative indicated that the counterparty, his employer, had informed him that no agency relationship existed but that the representative disagreed. The district court instructed the jury that no agency relationship existed.

Because the applicable materiality test is an objective one, evidence of the idiosyncratic and erroneous belief of the counterparty’s representative was irrelevant. The belief of the counterparty’s representative in an agency relationship was, as discussed *infra*, the only evidence distinguishing appellant’s count of conviction from those of the nine transactions on which he was acquitted. The evidence was, therefore, prejudicial, as our earlier opinion in this proceeding foreshadowed, and we cannot conclude with fair assurance that the jury would have convicted appellant absent such evidence. Accordingly, we vacate the judgment of conviction and remand. . . .

Most, if not all, institutional investor-buyers use computer models to establish the highest amount at which they would be willing to buy or sell a particular RMBS. These analyses can be quite complex. Factors considered include the priority level of the bond, the likely number of individuals that will prepay their mortgages, the likely number of mortgage defaults, the potential severity of the loss on a defaulted mortgage, the locations of the real property mortgaged, unemployment rates in those locations, the effectiveness of the home loan servicer in receiving payments, and the credit scores of individual homeowners. . . .

A BWIC trade was involved in the sole count on which appellant was convicted. A BWIC [bids-wanted-in-competition] trade . . . involves an auction in which a putative seller sends a bid-list to multiple broker-dealers. These broker-dealers solicit expressions of interest and price ranges from potential buyers. The broker-dealer then places a bid in the auction of a particular security. The bid price is selected by the broker-dealer and

may well differ from prices suggested by putative buyers. If the broker-dealer's bid is successful, the broker-dealer buys the bond and then offers to sell it to the interested investor. Communications are generally carried out through online instant messages. . . .

An essential feature of all of these trades . . . is that the broker-dealer acts solely in its own interest as a principal. The broker-dealer continually tracks potential buyers and sellers, their interests in particular kinds of RMBS, and their ongoing acceptable price ranges. It seeks to profit from transactions in the securities by buying low and selling high. The size of the year-end discretionary bonus given to each broker-dealer's trader is largely based on the profitability of the individual's trades. The broker-dealer assumes the risk of buying the bond, and an institutional investor can refuse to purchase a bond held by the broker-dealer even when the investor caused the broker-dealer to purchase it by an expression of interest, i.e., in an order or BWIC trade. Such an investor may also have no investment purpose but may intend to resell the bond immediately, and at a higher price, to another institution it knows to be interested.

A broker-dealer is not, therefore, an agent for its counterparties in these trades and owes them no special or fiduciary duty. In a sale by a counterparty to a broker-dealer, the counterparty has no legitimate expectation that the broker-dealer will resell the bond at the price paid to the counterparty. Similarly, in a purchase, the counterparty has no legitimate expectation of purchasing a bond at the price paid by the broker-dealer. Rather, the broker-dealer and counterparty each have their own price ranges in which they will consummate their ends of the transactions. The final price is determined in an arms-length negotiation and, if agreed upon, will be somewhere in the overlap of price ranges.

Market participants protect themselves against behavior that departs from market norms of good faith largely without resort to expensive and time-consuming litigation. Institutional investors simply refuse to do business with perceived bad actors for either a period of time or indefinitely. This is referred to in the industry as placing an individual or firm in the "penalty box" and is "not out of the ordinary." . . .

Appellant, on behalf of Jefferies, was involved in selling a RMBS in a BWIC trade to Invesco Ltd., an investment management company with nearly \$1 trillion of assets under management. On July 1, 2010, having received a bid-list of bonds from a putative seller, appellant circulated the bid-list to, inter alia, Brian Norris, who represented Invesco. Invesco's credit research team determined that Invesco would make a worthwhile profit on a particular RMBS on the list, SARM 2005-21 7A1, if the purchase price were at, or under, \$80 per \$100 of face value. Norris then suggested to appellant that he bid 79-24 for the bond, and further told appellant that he had "some room" to bid higher than 79-24.

Appellant purchased the bond and informed Norris that Jefferies won the auction, stating in an online chat that "[I] bid your level," that is, he bid 79-24. In fact, however, appellant bid and purchased the bond for 79-16. Norris then proposed to buy the bond from appellant for 79-30, asking "6 ticks cool? 79-30 to me?" Appellant accepted, saying

“6/32s is great.” The difference between fourteen ticks and six amounts to \$73,018.53. The total amount Invesco paid Jefferies for the bond was approximately \$23.6 million.

Before appellant’s second trial, appellant made motions in limine to bar counterparty representatives from testifying that they believed appellant was acting as their agent. Notwithstanding the concession at oral argument on the first appeal, the government proposed to offer such testimony, and the district court allowed it. . . .

A misstatement in a securities transaction is material so long as there is “a substantial likelihood that a reasonable investor would find the . . . misrepresentation important in making an investment decision.” A misrepresentation is important if there is “a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Basic Inc. v. Levinson*. . . .

The objective nature of the “reasonable investor” standard is of particular importance in this case. To prove materiality, the government relied heavily on the testimony of counterparty traders—purported victims—that they considered appellant’s misstatements to be an important factor, among others, in their investment decisions. The district court believed it important that counterparty traders testify to “their own point of view.” This approach is permissible in a case like this, but only so long as the testimony about the significance of the content of a defendant’s misstatements and each trader’s “own point of view” is shown to be within the parameters of the thinking of reasonable investors in the particular market at issue. In other words, there must be evidence of a nexus between a particular trader’s viewpoint and that of the mainstream thinking of investors in that market. Materiality cannot be proven by the mistaken beliefs of the worst informed trader in a market. . . .

However, on Count Four, there was sufficient evidence for a rational jury to find appellant’s misstatements material beyond a reasonable doubt, whether or not Norris paid “the price he proposed to pay.” As noted, the determination of the materiality of a misstatement or omission “is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor.” *TSC Indus.* A finding of materiality, therefore, requires a showing only of importance, not “actual reliance.” . . .

Appellant also argues that his misstatements cannot, as a matter of law, be material because they were not relevant to the intrinsic value of the bond, at best affecting only “the negotiation over price.” This argument appears to have been considered and rejected in *Litvak I*. Nothing in the record of the second trial causes us to reach a different result.

We cannot agree that, because statements about the price paid by the broker-dealer for a RMBS are not intended, or understood, as relevant to the intrinsic value of the bond, such assertions are not material as a matter of law. When the broker-dealer seeks a profit for its role in procuring and selling a security desired by a buyer, the profit becomes part of the price paid by the buyer. The value of the security may be the most important factor governing the decision to buy, but the price must be considered in determining whether

the purchase is deemed profitable. The broker-dealer's profit is part of the price and lies about it can be found by a jury to "significantly alter[] the 'total mix' of information . . . available." *Basic*.

Appellant argues that the district court erred by admitting Norris's testimony that appellant was Invesco's agent, and that this evidence may have tipped the balance in favor of the jury's conviction on that count. We agree. . . .

In the first trial, the issue of whether appellant was acting as a principal or as an agent in the various charged transactions was disputed. Only at oral argument of the first appeal did the government concede that appellant was acting as a principal. Nevertheless, in the second trial and at the government's urging, the district court again admitted testimony from Norris that appellant was acting as Invesco's agent during the trade. The district court held that the testimony was relevant to the materiality of appellant's misstatements and to appellant's fraudulent intent. The court also noted that the testimony was unlikely to confuse or prejudice the jury because it went only to Norris's "own point of view." . . .

It is now undisputed that appellant never acted as Invesco's or Norris's agent during the trade in question. Appellant acted as a principal: Jefferies bought the bond from one party, held it for a brief period of time, and then sold it to Invesco. The transaction was at arms-length, and appellant owed no fiduciary duties to the buyer. As the owner of the bond, Jefferies did not have to convey the bond to Invesco and assumed the risk that Invesco would walk away from the deal after Jefferies had bought the bond. . . .

While the individual views of a counterparty trader may usually be relevant to the nature of the market involved and as to the beliefs of a reasonable investor, a reasonable investor would not misperceive the role of a broker-dealer in the RMBS market. In fact, Norris received material from Invesco's legal and compliance department stating that, in transactions such as the one here, broker-dealers act as principals. His disagreement with that advice was unreasonable. Norris's indisputably idiosyncratic and unreasonable viewpoint is not, therefore, probative of the views of a reasonable, objective investor in the RMBS market. Even if Norris's testimony had relevance, the district court abused its discretion under Rule 403. Relevant evidence may be excluded "if its probative value is substantially outweighed by a danger of one or more of the following: unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence." Fed. R. Evid. 403. At best, Norris's testimony about the supposed agency relationship had a high probability of confusing the jury by asking it to consider as relevant the perception of a counterparty representative that was entirely wrong. At worst, Norris's testimony on an agency relationship would mislead the jury based on the government's argument that a perceived relationship of trust showed materiality. This argument itself is flawed because it equates an indisputably incorrect personal belief with an objective test of materiality. . . .

In light of the jury's verdict, therefore, we cannot "conclude with fair assurance" that Norris's testimony did not "substantially influence the jury" in convicting appellant. We

conclude that the district court's error in admitting testimony on agency was not harmless and requires a vacatur.

For an epilogue to *Litvak* that is telling on the concept of fraud, see *United States v. Gramins*, 939 F.3d 429 (2d Cir. 2019). The court, in affirming the convictions of another trader working in the same distressed RMBS market, described how defense counsel contested in summations whether intent to defraud—and specifically “consciousness of wrongdoing”—had been proven, based on whether or not defendants in the case had attended a compliance session of their firm at which Litvak's indictment and prosecution were described and traders were told “you can say this in a chat, but you can't say that.”

B. Accounting Fraud

A recurring form of securities fraud is known as “accounting fraud.” If you agree to buy my small farm after I've given you an inventory listing six pigs and, when you take possession, it turns out there were ever only two pigs on the farm, I've committed accounting fraud. If I do the same while instead selling you investment shares in my farm, then my accounting fraud might also be securities fraud.

Take that example to modern financial markets. Investors in most things, especially publicly traded corporations, rely on disclosures about assets, liabilities, profits, and losses as a way of valuing investments and making decisions whether to buy, sell, hold, or run for the hills. Economic theory says that people who want to raise funds from investors will engage in disclosure out of self-interest to attract investors. But there are problems with that theory, including that voluntary disclosure would be heterogeneous, making it hard for investors to compare one business to another.

In the United States, again thanks to the New Deal securities legislation, we have mandatory uniform disclosure for public companies and many other types of entities that wish to sell securities and have them traded on secondary markets. For public companies, disclosure principally occurs through their filing of required quarterly and annual reports (“10Qs and 10Ks”) with the Securities and Exchange Commission that include detailed financial statements immediately available to the world on the web.

Investors, market analysts, and others who sell services to investors, rely heavily on financial data in assessing the value of companies. Those data therefore drive stock prices and debt costs. The accounting rules (known as “GAAP,” for generally accepted accounting principles) are extensive and complex. Corporate insiders, whose compensation is usually tied to stock price and other metrics of financial performance, have an informational advantage with regard to the company's data. All of these factors combine to generate a motive to commit accounting fraud: misleading investors about the strength of the company by manipulating the company's financial data and/or the application of the accounting rules, which dictate what to report and how to report it.

For example (and oversimplifying), GAAP requires that companies “reserve” earnings to cover substantial expected liabilities, such as large damages awards likely to be imposed in a major products liability class action. Because there is often ample judgment involved in both whether such a reserve is necessary and the amount that should be reserved, these accounts provide an opportunity to place some earnings in a “cookie jar” during a good quarter to take out (“release from reserves”) in a future not-so-good quarter in order that the company’s earnings trajectory remains upwards and smooth. This is a misuse of reserve accounts but can be difficult to prove since it may come down to a question of motive.

Given the complexity of both modern corporate finance and the accounting rules, accounting fraud can take a wide variety of forms. This section is designed to give a sense of how accounting fraud works with just a few examples—two of them (Worldcom and Enron) being probably the most famous accounting fraud prosecutions in history.

UNITED STATES v. EBBERS, 458 F.3d 110 (2d Cir. 2006)

WINTER, Circuit Judge:

Bernard J. Ebbers appeals from his conviction by a jury on nine counts of conspiracy, securities fraud, and related crimes and from the 25-year jail sentence imposed by Judge Jones.

Ebbers was the Chief Executive Officer (“CEO”) of WorldCom, Inc., a publicly traded global telecommunications company. During the pertinent times—from the close of the fourth quarter of the 2000 fiscal year through the first quarter of the 2002 fiscal year—he engineered a scheme to disguise WorldCom’s declining operating performance by falsifying its financial reports. Although the scheme was multi-faceted, the fraud primarily involved the treating of hundreds of millions of dollars of what had always been recorded operating costs as capital expenditures for several fiscal quarters. After a seven week trial, the jury convicted Ebbers on all counts. He was sentenced to 25 years’ imprisonment, to be followed by 3 years’ supervised release.

On appeal, Ebbers principally contends that the district court erred in permitting the government to introduce testimony by immunized witnesses while denying immunity to potential defense witnesses who were rendered unavailable to Ebbers by their invocation of the privilege against self-incrimination. He also claims that the court should not have given a conscious avoidance instruction and that the government should have been required to allege and prove violations of Generally Accepted Accounting Principles (“GAAP”). Finally, he challenges his sentence as based on an inaccurate calculation of losses to investors, as significantly greater than those imposed on his co-conspirators, and as unreasonable in length. We affirm.

There is an element of tragedy here in that it was not a lack of legitimate entrepreneurial skills that caused Ebbers to resort to fraud. Before WorldCom, he was, among other things, a teacher, coach, and warehouse manager. He was a motel operator when, in 1983,

he first invested in Long Distance Discount Services (“LDDS”), a small long distance company in Mississippi. When LDDS was in danger of failing in 1985, Ebbers agreed to become its CEO and led it to profitability by merging with other long distance providers. In 1989, LDDS went public by merging with Advantage Companies, another telecommunications company that was listed on NASDAQ. In 1995, LDDS changed its name to WorldCom, Inc. After WorldCom acquired MCI, Inc., in 1998, it was a global company with subsidiaries in Brazil, Mexico, and Canada. WorldCom then tried to acquire Sprint, but the Justice Department and the European Union stopped the merger on antitrust grounds. Having exhausted the market for acquisition targets in the long distance business, WorldCom began to acquire web hosting services. By 2000, WorldCom had about 90,000 employees in 65 countries, and reported revenues of \$39 billion.

As part of its business, WorldCom built a global network of fiber-optic cables and telephone wires to transmit data and telephone calls. It also leased capacity on other companies’ network facilities to transmit data and calls. The cost of the leasing was WorldCom’s single largest expense-styled “line costs.” When the “dot-com bubble” burst in early 2000, WorldCom’s business slowed dramatically as some of its dot-com customers were unable to pay their bills and demand for WorldCom’s internet services declined. Anticipating growth rather than declining demand, WorldCom had added 10,000 new employees, continued to invest heavily in new equipment, and had taken on long-term line leases with fixed monthly payments. By the end of the third quarter of 2000, as its revenue growth decreased and its expenses increased, the company could no longer meet investors’ expectations of revenue and profit growth.

By this time, Ebbers had powerful personal as well as occupational motives to see that investors’ expectations were met and that WorldCom’s stock price did not fall. Although Ebbers had become very wealthy since his earlier days, his consumption and investment habits outpaced his income. Ebbers had accumulated millions of shares of WorldCom stock but had borrowed over \$400 million from banks, using his stock in WorldCom as collateral. As WorldCom’s stock price began to drop in 2000, Ebbers received margin calls from the banks, requiring him either to put up more stock as collateral or to pay back a portion of the money he owed. Because he had used much of the borrowed money to buy relatively illiquid assets, such as a ranch, timber lands, and a yacht-building company, Ebbers could not use those assets to meet the margin calls. As WorldCom’s stock price continued to fall, Ebbers pledged more of his WorldCom stock until every share he owned was collateral for the loans. By October 2000, Ebbers entered into a forward sale transaction, allowing Bank of America to sell some of his WorldCom stock at a future date in exchange for \$70.5 million in cash to pay off his margin debts. WorldCom assumed the liability for the debts to the banks in October 2000, requiring Ebbers to make payments directly to WorldCom in the amount the company owed the banks; the debts to WorldCom and to the banks were still secured by Ebbers’ WorldCom stock.

As a public company, WorldCom was required to file quarterly financial statements and annual reports with the SEC. When it became clear that the company would be unable to meet analysts' expectations in the third quarter of 2000, Ebbers and WorldCom's Chief Financial Officer ("CFO") Scott Sullivan reviewed the monthly revenue reports and discussed the company's options. Sullivan told Ebbers that WorldCom's financial performance had deteriorated and that they should issue an earnings warning to investors. Ebbers refused. Sullivan then told Ebbers that to meet expectations the company would have to make an improper adjustment to the revenue figure. Ebbers replied that "[W]e have to hit our numbers." Sullivan instructed others to increase the publicly reported revenues by adding \$133 million in anticipated under-usage penalties to the revenue calculation, even though he believed that those penalties were not likely to be collected.

Soon after, Sullivan learned that line cost expenses would be almost \$1 billion greater than expected. He reported that to Ebbers, who reiterated that the company had to hit its quarterly earnings estimates. Sullivan instructed Controller David Myers and his subordinates Buford Yates, Betty Vinson, and Troy Normand to reduce line cost expense accounts in the general ledger while also reducing reserves in the same amounts, which lowered the reported line costs by about \$828 million. As a result, WorldCom's reported earnings were increased by the same amount.

Vinson and Normand believed the entries were wrong and considered resigning. When Sullivan told Ebbers that the accounting staff might quit, Ebbers told Sullivan that "we shouldn't be making adjustments; we've got to get the operations of this company going; we shouldn't be putting people in this position." Ebbers then spoke to Controller Myers, apologizing for the position that Myers and his staff were put in. In November 2000, WorldCom lowered its future earnings estimates and offered new guidance to analysts.

WorldCom's revenues and line costs did not improve in the fourth quarter of 2000. In January 2001, Ebbers and Sullivan agreed that WorldCom would not be able to meet even the analysts' revised expectations if it reported its actual results. Sullivan asked Ebbers if he would again reduce the earnings estimate given to analysts, but Ebbers refused to do so. Sullivan asked Myers to alter the reported revenue and expense numbers to meet expectations. The commissions paid to airlines as part of a marketing partnership were no longer removed from the reported revenues, increasing the revenue reported by about \$42 million.

WorldCom's line cost expenses were \$800 million above analysts' expectations. Sullivan directed Myers to bring the reported line costs in line with expectations. Myers and his staff then reduced the income tax reserve by \$407 million, and altered other accounts until they were able to reduce the reported line costs by \$797 million for the fourth quarter. Monthly reports sent to Ebbers, referred to at trial as the Monthly Budget Variation Reports ("MBVRs"), detailed the company's financial results and included the reduced line costs, giving the company an apparent gross margin of 78% in September

2000 and 74% in December 2000—margins that had never been achieved by WorldCom before. The 2000 annual report and Form 10-K also contained the false information.

In early 2001, WorldCom's line costs were still hundreds of millions of dollars higher than the company had predicted, again making it impossible to meet analysts' expectations without further manipulation of the company's financial reports. The staff had been asked to find ways to reduce line costs, but the proposed cost savings were far smaller than needed to meet expectations. When the first quarter ended, reserves had been largely exhausted and could no longer be used to reduce line costs. Sullivan suggested capitalization of the line costs, that is, shifting a portion of the costs out of reported current expenses into capital expenses. Because line costs had always been treated as operating expenses, their unannounced treatment as capital expenses would disguise the decline in earnings. Myers and his staff agreed to capitalize about \$771 million in line costs, although they believed it to be improper. At a dinner in Washington in March 2001, Sullivan and Ebbers discussed the line cost problem. Sullivan told Ebbers that the planned allocation of current expenses to capital expenses—in an amount over \$500 million—"wasn't right." Ebbers did not deter him from the allocation.

Ebbers approved the capitalization of line costs in a later conversation with Sullivan. He told Sullivan that "[w]e have to grow our revenue and we have to cut our expenses, but we have to hit the numbers this quarter." Sullivan told Myers to change the general ledger to capitalize a portion of the line cost expenses in an amount totaling hundreds of millions of dollars. Ebbers later told Sullivan to change the format of the reports to remove the line cost figures. When Ebbers spoke to analysts and the public about WorldCom's first quarter performance in the earnings conference call, he did not mention the change in how the company was booking line costs. Instead, he said "there were no storms on the horizon," urging them to "go out and buy stock."

Capitalizing WorldCom's line cost expenses left another problem unaddressed: revenues were not growing at the 12% annual rate that Ebbers had predicted. Missing the revenue growth target was likely to lower WorldCom's stock price. Sullivan, Ebbers, and a handful of other executives created a new program called "Close the Gap" to "get [the] operating performance . . . up to the market guidance expectations" by finding new items to include in revenue. Each month, and sometimes more often, the business operations group presented revenue data to Ebbers in detail as part of the "Close the Gap" program. Sullivan told Ebbers that there was no basis for including many of the opportunities presented in the "Close the Gap" program in reported revenues. In a voicemail to Ebbers, Sullivan described some of the items eventually included in reported revenues as "accounting fluff," "one-time stuff," and "junk." In July 2001, Ebbers sent a memorandum to Chief Operating Officer ("COO") Ron Beaumont, who was involved in the "Close the Gap" program, asking him "[w]here we stand on those one time events that had to happen in order for us to have a chance to make our numbers." Ebbers and Sullivan were aware that the company's true results fell far short of analysts' expectations, but ordered the improper revenue accounting so that those expectations would be met.

Once again, Sullivan told Ebbers that the company could reach the analysts' estimates only by capitalizing a portion of its line costs. Ebbers attended one of the line cost meetings around this time, and explained to the employees there that his "lifeblood was in the stock of the company" and that if the price fell below about \$12 per share, he would be wiped out financially by margin calls. Although the line costs had improved slightly since the previous quarter, the accounting staff still had to capitalize over \$610 million in line costs in order to meet earnings estimates.

In the third quarter of 2001, WorldCom's actual revenue growth rate, as reported internally to Ebbers, had fallen to about 5.5%. However, Ebbers announced that WorldCom had sustained its 12% revenue growth rate when the third quarter results were reported. The "Close the Gap" program added several new revenue items, largely one-time items not previously counted in revenue. Sullivan told Ebbers that the purpose of the adjustments to revenue was to reach the 12% growth target. WorldCom's press release announcing the quarterly results quoted Ebbers as saying the company had "delivered excellent growth this quarter." During the earnings conference call with analysts, Ebbers said "[w]e were able to achieve very solid growth." However, over \$700 million in line costs had to be capitalized to create the appearance of meeting the earnings target for the quarter.

At the time, WorldCom was in merger negotiations with Verizon. Concerned that Verizon might discover the capitalization of line costs and the revenue adjustments in the course of a due diligence inquiry, Ebbers abruptly ended the merger negotiations.

At the board meeting in June 2001, board members began to ask about the "Close the Gap" program when COO Ron Beaumont presented several slides on it to them. One board member approached Sullivan privately to question the program. When Sullivan broached the subject with Ebbers, Ebbers told Beaumont and Sullivan that the next board presentation should be at a higher level and not include "Close the Gap" information. Beaumont's next board presentation, in September 2001, did not include any information about the "Close the Gap" program.

By the fourth quarter of 2001, even the "Close the Gap" program could not generate enough one-time revenue opportunities to create double-digit revenue growth. Nor could the staff find ways to adjust the line cost expenses sufficient to hit the earnings target. After Myers capitalized over \$941 million in line costs, the accounting staff still had to adjust the SG&A (sales, general, and administrative) expenses in order to reach the target. On the fourth quarter earnings conference call, Ebbers assured investors that "[w]e stand by our accounting," and later said in a CNBC interview that "[w]e've been very conservative on our accounting."

WorldCom's revenue declined in the first quarter of 2002. The accounting staff added new sources of revenue to improve the results but were unable to bring the revenue up to analysts' expectations. Sullivan informed Ebbers that even with the improper revenue adjustments and the capitalization of line costs, the company would be unable to meet investors' expectations that quarter. The accounting staff capitalized about \$818 million

in line costs, but WorldCom still had to announce that its results had fallen below investors' expectations. . . .

"A conscious-avoidance charge is appropriate when (a) the element of knowledge is in dispute, and (b) the evidence would permit a rational juror to conclude beyond a reasonable doubt that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact." "We review a claim of error in jury instructions *de novo*, reversing only where, viewing the charge as a whole, there was a prejudicial error."

At trial, Ebberts testified as follows:

Q: Did you ever believe that any of the statements contained in those public filings were not true?

A: No, sir.

Q: Did you ever believe that WorldCom had reported revenue that it was not entitled to report?

A: No, sir.

Q: Did you ever believe that WorldCom had an obligation to announce changes in accounting practices that it had failed to announce?

A: No, sir.

Q: Did you ever believe that WorldCom was putting out bad numbers in its financial statements in any way at all?

A: No.

He also denied that he knew about discrepancies in the actual and reported line costs; that Sullivan had told him he would make a transfer of line costs to lower the reported number; that he looked at the SG & A reports he was sent; that he knew of improper entries made in the books; that he knew of the special MonRev report given to the accountants; and that he thought any of the "Close the Gap" process was illegitimate. The first prong of the test, that knowledge be disputed, is therefore easily met.

The evidence that Ebberts either actually knew or was aware of the high probability that the financial statements were false was not limited to Sullivan's testimony, as Ebberts claims. Ebberts testified that he attended some of the line cost meetings, that he read the preliminary and final MonRev reports, and that he went to "Close the Gap" meetings with Sullivan and Beaumont. He also testified to practices that would allow a jury to find that he was consciously avoiding information: using a procedure for signing documents he didn't bother to read in full, including the 10-Ks, and tossing the management budget variance report in the trash without reading it.

The district court found that Ebberts' own testimony rendered the instruction proper, because, based on that testimony, a rational juror could find he was consciously trying to avoid knowledge that the financial reports were inaccurate. We agree. . . .

Ebbers argues that the government should have been required to allege and prove violations of GAAP [Generally Accepted Accounting Principles]. . . . He claims that where a fraud charge is based on improper accounting, the impropriety must involve a violation of GAAP, because financial statements that comply with GAAP necessarily meet SEC disclosure requirements. . . .

To be sure, GAAP may have relevance in that a defendant's good faith attempt to comply with GAAP or reliance upon an accountant's advice regarding GAAP may negate the government's claim of an intent to deceive. Good faith compliance with GAAP will permit professionals who study the firm and understand GAAP to accurately assess the financial condition of the company. This can be the case even when the question of whether a particular accounting practice complies with GAAP may be subject to reasonable differences of opinion.

However, even where improper accounting is alleged, the statute requires proof only of intentionally misleading statements that are material, *i.e.*, designed to affect the price of a security. If the government proves that a defendant was responsible for financial reports that intentionally and materially misled investors, the statute is satisfied. The government is not required in addition to prevail in a battle of expert witnesses over the application of individual GAAP rules. . . .

To be sure—and to repeat—differences of opinion as to GAAP's requirements may be relevant to a defendant's intent where financial statements are prepared in a good faith attempt to comply with GAAP. The rules are no shield, however, in a case such as the present one, where the evidence showed that accounting methods known to be misleading—although perhaps at times fortuitously in compliance with particular GAAP rules—were used for the express purpose of intentionally misstating WorldCom's financial condition and artificially inflating its stock price. . . .

Problem 3-1

After *Ebbers*, the Supreme Court had the following to say about conscious avoidance doctrine, which happens to have arisen in the context of a civil patent case that came before the Court:

“The doctrine of willful blindness is well established in criminal law. Many criminal statutes require proof that a defendant acted knowingly or willfully, and courts applying the doctrine of willful blindness hold that defendants cannot escape the reach of these statutes by deliberately shielding themselves from clear evidence of critical facts that are strongly suggested by the circumstances. The traditional rationale for this doctrine is that defendants who behave in this manner are just as culpable as those who have actual knowledge. Edwards, *The Criminal Degrees of Knowledge*, 17 Mod. L. Rev. 294, 302 (1954) (hereinafter Edwards) (observing on the basis of English authorities that “up to the present day, no real doubt has been cast on the proposition that [willful blindness] is as culpable as actual knowledge”). It is also said that persons who know enough to blind themselves to direct proof of critical facts in effect have actual knowledge of those facts. . . .

While the Courts of Appeals articulate the doctrine of willful blindness in slightly different ways, all appear to agree on two basic requirements: (1) the defendant must subjectively believe that there is a high probability that a fact exists and (2) the defendant must take deliberate actions to avoid learning of that fact. We think these requirements give willful blindness an appropriately limited scope that surpasses recklessness and negligence. Under this formulation, a willfully blind defendant is one who takes deliberate actions to avoid confirming a high probability of wrongdoing and who can almost be said to have actually known the critical facts. *See* G. Williams, *Criminal Law* §57, p. 159 (2d ed. 1961) (“A court can properly find wilful blindness only where it can almost be said that the defendant actually knew”). By contrast, a reckless defendant is one who merely knows of a substantial and unjustified risk of such wrongdoing, *see* ALI, *Model Penal Code* §2.02(2)I (1985), and a negligent defendant is one who should have known of a similar risk but, in fact, did not, *see* §2.02(2)(d).”

Global-Tech Appliances, Inc. v. SEB S.A., 563 U.S. 754 (2011).

1. In light of this statement of the doctrine, was *Ebbers* a proper case for an instruction on willful blindness?
2. Is the following fact pattern a proper case for a willful blindness instruction: Ebbers received the accounting reports from Sullivan, but chose not to read them because he was too busy “growing the company” and preferred to leave financial reporting to his staff.

Continuing with accounting fraud, the next case is one in which such a prosecution failed. Was the problem in this case the legal theory, the evidence, or both?

UNITED STATES v. GOYAL, 629 F.3d 912 (9th Cir. 2010)

CLIFTON, Circuit Judge:

Prabhat Goyal, former chief financial officer of Network Associates, Inc. (“NAI”), appeals from his convictions on fifteen counts of securities fraud and making materially false statements to auditors. The government alleged that NAI, under Goyal’s supervision, violated generally accepted accounting principles (“GAAP”) by recognizing revenue from certain software sales earlier than it should have. Goyal was indicted for concealing the allegedly improper accounting from NAI’s outside auditors and for filing reports with the Securities and Exchange Commission that, because of NAI’s accounting, allegedly misstated revenue in certain reporting periods between 1998 and 2000. Goyal argues that no jury could have found him guilty beyond a reasonable doubt, as the jury below did, based on the evidence the prosecution presented at trial. We agree, and we reverse his convictions on all counts.

From approximately 1997 to 2001, Goyal was chief financial officer of NAI. NAI, formerly known as McAfee, was and remains a major vendor of antivirus and network security software.

Before 1998, NAI used a “direct sales” business model, meaning that it primarily sold its software directly to end users. In 1998, the company added a “distribution channel” model, selling products through distribution companies. These distributors in turn sold NAI’s software to retail stores that resold the software to end users.

The prosecution’s case against Goyal challenged the accounting method that NAI used, under Goyal’s supervision as CFO, to recognize revenue from sales to its largest domestic distributor, Ingram Micro. In particular, the government took issue with the accounting method NAI used to recognize large sales that it made to Ingram at the end of financial quarters between 1998 and 2000. Following a practice common in the software industry, which the government did not contend was illegal, NAI negotiated significant quarter-end deals with Ingram, called “buy-in” transactions, to help meet its quarterly revenue projections. To close these sales, NAI granted Ingram substantial discounts, rebates, and other favorable sales terms. One enticement that NAI offered Ingram in the last two quarters of 1998 and the first quarter of 1999, was a guarantee that its wholly owned subsidiary, NetTools, would repurchase unsold product from Ingram in specified amounts. NetTools would then sell the repurchased product to customers.

The government did not contend that any of the sales concessions that NAI gave Ingram in the buy-in deals were improper or that NAI claimed revenue that it never earned. Rather, the government objected to the timing of NAI’s recognition of revenue from these deals. The government maintained that NAI violated GAAP by using “sell-in” accounting to recognize revenue from these deals earlier than it should have and thereby overstated its revenue. Under sell-in accounting, a manufacturer like NAI recognizes revenue when it ships products to its distributors (i.e., “sells in” to the distribution

channel). The manufacturer must estimate the amount of future rebates, discounts or returns and then reduce its stated revenue by this amount.

By contrast, a company using “sell-through” accounting recognizes revenue when its distributors sell the product to a reseller (i.e., “sells through” the distribution channel). Sell-through accounting recognizes revenue later than sell-in accounting does and nets out rebates, discounts, and returns. Thus the manufacturer does not need to estimate their effect on its revenue.

The jury convicted Goyal of one count of securities fraud and seven counts of making false filings with the SEC (collectively, “the securities counts”), and seven counts of making materially false statements to NAI’s auditors at PricewaterhouseCoopers (“PwC”) (the “lying-to-auditors counts”). . . .

All of the securities counts—one count of securities fraud and seven counts of making false filings with the SEC—required the government to prove that NAI materially misstated the revenue it earned in certain quarters and years through its choice of accounting method. NAI’s reports of allegedly inflated revenue furnished the “untrue statement of material fact” required for each of the false filing counts, as well as the “misleading statement or omission of a material fact made with scienter” needed to sustain a fraud conviction under the general antifraud provision of § 10(b) of the Securities Exchange Act of 1934.

The government’s contention that NAI materially overstated its revenue necessarily entailed two claims: (1) that NAI recognized revenue at a different time than it should have; and (2) that NAI’s accounting produced artificially higher revenue figures in certain periods that “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *Basic Inc. v. Levinson*. The government relied on GAAP to make its case, on the first point, that sell-through accounting was required in instances where NAI used the sell-in method. But we need not decide whether NAI actually violated GAAP, because the government clearly failed to carry its burden on the second point, materiality. The prosecution offered no evidence adequate to prove that any GAAP violations materially affected the revenue that NAI reported.

The government relied at trial on the parties’ stipulations that applying sell-through accounting to NAI’s entire business would have resulted in “a revenue figure that is materially less than the reported figure” for the periods charged in the false filing counts.

These stipulations are fatally overbroad, however, because the government did not contend that GAAP required NAI to use sell-through accounting for all sales. The government only offered evidence that sell-through accounting was required for the Ingram buy-in transactions, and the stipulations did not provide that applying sell-through accounting to those transactions alone would have made a material difference in any given period. Without evidence of how much less revenue NAI would have recognized on the Ingram deals if it had used sell-through accounting, the jury had no

basis to conclude that the misstatement of reported revenue resulting from the Ingram transactions was material. Even presuming, as we must, that the jury drew all reasonable inferences in the prosecution's favor, there was no way it could have properly inferred materiality from the evidence it had before it.

Confronted with this problem, the government argued after the verdict that the jury could have inferred materiality from the mere fact that the buy-in deals with Ingram were substantial. The dollar amounts in the purchase orders for these transactions, according to the government's calculations, "represented approximately 24% of the total revenue for NAI during 1998, 1999, and 2000" and "between approximately 7% to 40% of NAI's total revenue" on a quarterly basis.

But this argument failed to bridge the materiality gap because Goyal's jury had to make the materiality findings that his convictions required, and it never saw these figures. *See United States v. Rigas* (declining, in a sufficiency-of-the-evidence challenge, to "consider in the first instance arguments regarding materiality that were not presented to the jury").

The jury could not have inferred materiality from this evidence even if it had seen it, because it was not the absolute magnitude of the buy-in deals that mattered. The jury needed to assess whether NAI's use of sell-in accounting for the Ingram transactions materially increased NAI's overall revenue when compared to using sell-through accounting. But the jury had no evidentiary basis for making the required comparisons. There was simply no evidence that the effect of using sell-in rather than sell-through accounting for the Ingram transactions was so substantial that it made a material difference. By the government's own calculations, non-Ingram sales always accounted for most of NAI's revenue. It would have been "mere speculation, rather than reasonable inference" for the jury to conclude that applying sell-through accounting to the revenue from the Ingram sales by themselves would have made a material difference in the company's total revenue figures. Because Goyal's jury had no competent evidence of materiality before it, it could not have properly convicted him on any of the securities counts. . . .

Even viewing the evidence in the light most favorable to the prosecution, no reasonable juror could have found Goyal guilty beyond a reasonable doubt of any of the charges against him. . . .

Chief Judge KOZINSKI, concurring:

This case has consumed an inordinate amount of taxpayer resources, and has no doubt devastated the defendant's personal and professional life. The defendant's former employer also paid a price, footing a multimillion dollar bill for the defense. And, in the end, the government couldn't prove that the defendant engaged in *any* criminal conduct. This is just one of a string of recent cases in which courts have found that federal prosecutors overreached by trying to stretch criminal law beyond its proper bounds. *See Arthur Andersen LLP v. United States; United States v. Reyes; United States v. Brown;*

cf. United States v. Moore (breadth of 18 U.S.C. § 1001 creates risk of prosecutorial abuse).

This is not the way criminal law is supposed to work. Civil law often covers conduct that falls in a gray area of arguable legality. But criminal law should clearly separate conduct that is criminal from conduct that is legal. This is not only because of the dire consequences of a conviction—including disenfranchisement, incarceration and even deportation—but also because criminal law represents the community’s sense of the type of behavior that merits the moral condemnation of society. *See United States v. Bass*, (“[C]riminal punishment usually represents the moral condemnation of the community”); *see also Wade v. United States* (“[T]he declaration that a person is criminally responsible for his actions is a moral judgment of the community. “). When prosecutors have to stretch the law or the evidence to secure a conviction, as they did here, it can hardly be said that such moral judgment is warranted.

Mr. Goyal had the benefit of exceptionally fine advocacy on appeal, so he is spared the punishment for a crime he didn’t commit. But not everyone is so lucky. The government shouldn’t have brought charges unless it had clear evidence of wrongdoing, and the trial judge should have dismissed the case when the prosecution rested and it was clear the evidence could not support a conviction. Although we now vindicate Mr. Goyal, much damage has been done. One can only hope that he and his family will recover from the ordeal. And, perhaps, that the government will be more cautious in the future.

The following excerpts from one of the Fifth Circuit’s decisions in the Enron prosecutions give a fuller explanation of the nature of the Enron accounting fraud than the Supreme Court’s decision dealing with the honest services fraud issue that we read in the last chapter. Enron was really a conglomerate of different companies in the energy and related sectors, and much of the fraud had to do with how the company used financial engineering to move profits and losses across its major lines of business, and conceal losses in some of its newer businesses.

Recall that after former CEO Jeffrey Skilling won on the honest services fraud issue in the Supreme Court, he nonetheless lost on remand because the Fifth Circuit concluded that the evidence amply supported the charges of securities fraud also lodged against Skilling, which of course carried no requirement of proving a bribe or kickback, or other elements of honest services mail or wire fraud.

UNITED STATES v. SKILLING, 554 F.3d 529 (5th Cir. 2009)

PRADO, Circuit Judge:

A jury convicted former Enron Corporation CEO Jeffrey K. Skilling (“Skilling”) for conspiracy, securities fraud, making false representations to auditors, and insider trading. Skilling’s rise at Enron began when he founded Enron’s Wholesale business in 1990. In 1997, he became Enron’s President and Chief Operating Officer and joined the

Board of Directors. In February 2001, he became Enron's CEO, and on August 14, 2001, Skilling resigned from Enron.

About four months after Skilling's departure, Enron crashed into sudden bankruptcy. An initial investigation uncovered an elaborate conspiracy to deceive investors about the state of Enron's fiscal health. That conspiracy allegedly included overstating the company's financial situation for more than two years in an attempt to ensure that Enron's short-run stock price remained artificially high. With Congress looking on, the President appointed a team of investigators, the Enron Task Force. The investigation led to criminal charges against Skilling and many others.

According to the government, the conspiracy, led by Skilling and Ken Lay ("Lay"), Enron's CEO until Skilling took over (and again after his abrupt exit), worked to manipulate Enron's earnings to satisfy Wall Street's expectations. Other top Enron officials were key players in the unlawful scheme, including Richard Causey ("Causey"), the Chief Accounting Officer ("CAO"); Andrew Fastow ("Fastow"), the Chief Financial Officer ("CFO"); and Ben Glisan ("Glisan"), the Treasurer.

Several of Skilling's convictions stem from allegations of conspiracy and securities fraud. The government presented evidence that Skilling engaged in fraud in several of Enron's business endeavors. As an international, multi-billion dollar enterprise, Enron had elaborate financial dealings. At the time of its bankruptcy, the company was comprised of four major businesses: Wholesale, which bought and sold energy; Transportation and Distribution, which owned energy networks; Retail, or Enron Energy Services ("EES"), which sold energy to end-users; and Broadband, or Enron Broadband Services ("EBS"), which bought and sold bandwidth capacity. The government alleged that Skilling took specific fraudulent actions with respect to Wholesale, EES, and EBS.

Wholesale, the most profitable division, accounted for nearly 90% of Enron's revenue. The government presented evidence to show that the conspirators lied about the nature of Wholesale, calling it a "logistics company," even though it was a much more economically volatile "trading company." Construing Wholesale as a "logistics company" had important ramifications for how investors valued the division. In fact, Skilling reportedly told Ken Rice ("Rice"), EBS's CEO, that if investors perceived Enron as a trading company, its stock would "get whacked." The alleged artifice also included masking the losses of Enron's other struggling subdivisions by shifting the losses to Wholesale. That made the struggling divisions appear financially sound and thus encouraged additional investment.

EES was a retail undertaking that Enron created to sell natural gas to customers in deregulated markets. Although Enron had high expectations for EES's profitability after its initial start-up period, EES did not meet these expectations. As of the fall of 2000, various utilities in California owed Enron substantial fees, which Enron had already booked as profits under its "mark-to-market accounting." The utilities, however, were suffering heavy financial losses and stopped paying these fees. Under general accounting rules, Enron should have recorded a loss of hundreds of millions of dollars based on the

failure of the utilities to pay the fees, but Skilling and his co-conspirators tried to hide the harm by transferring the losses to Wholesale so that EES would continue to show promise, at least on paper.

The government claims that Skilling hid EES's other problems as well. For example, in early 2001, EES employees allegedly realized that Enron was not properly valuing EES's contracts and that, again because of Enron's use of mark-to-market accounting, Enron would need to record a loss of many millions of dollars. Skilling allegedly told David Delainey, who was in charge of EES, to "bleed the contract issues over time" instead of recognizing the loss all at once.

Skilling again concealed EES's losses within Wholesale in late March 2001, after the California Public Utilities Commission decided to add a surcharge to electricity. Enron lost hundreds of millions of dollars as a result of this surcharge because, under its contracts, it could not pass the extra fees on to its customers. After Skilling was consulted and signed off, Enron shifted the EES losses to Wholesale by transferring EES's risk-management books to Wholesale. Business at EES did not improve, and by August 2001, when Skilling left Enron, EES had lost over \$700 million in that year alone. Enron failed to account for these losses properly, making EES appear to be in better financial shape than it really was.

EBS was Enron's attempt to enter the telecommunications industry. Enron invested more than \$1 billion in EBS, but lost money every quarter as EBS struggled to meet earnings targets. The government claims that in 2000, EBS managed to reach its earnings targets, but only by means of transactions afield from its core business (such as selling and monetizing corporate assets). Skilling allegedly hid from investors EBS's failure to meet earnings targets through core business activities.

The government claims that Skilling knew EBS was struggling, at least based on its record of performance, but that he wanted to announce to the investing public that EBS was doing well and would do even better in 2001. Although EBS's executives said it was impossible, Skilling set EBS's earnings targets for 2001 to be a loss of only \$65 million. EBS's personnel initially thought a loss estimate of nearly \$500 million was more realistic, and, even with the best circumstances, they projected losses of at least \$110 million. Rice, EBS's CEO, warned Skilling that the earnings targets for EBS were wrong, but Skilling apparently would not change them. Skilling told Rice that certain international assets were not producing sufficiently and that "we really need to hang in there for a year or two until EES and EBS could pick up the slack," because Enron "didn't need any more bad news."

In 2001, EBS was projected to lose \$35 million in the first quarter, but Rice quickly realized that losses would actually be around \$150 million. Skilling allegedly found out but would not budge on earnings targets, instead authorizing EBS to fire employees and engage in more non-core business to boost revenues. It worked for the first quarter, although Rice likened the monetizations to "one more hit of crack cocaine on these earnings." EBS fared a little better in the second quarter of 2001, reporting losses of

approximately \$100 million. Given that EBS continued to lose money, however, Enron decided to merge EBS [with] Wholesale. Ultimately, Enron lost the entire \$1 billion that it initially invested in EBS.

Many of the allegations of fraud also stem from Skilling's representations to investors about the financial standing of Wholesale, EES, and EBS. Skilling, as a high ranking corporate officer, held conference calls with investors to update them on the company's progress. The government claims that Skilling misled investors during these calls. For example, on January 22, 2001, Enron released its earnings report for the previous quarter, and Skilling told investors that "the situation in California [regarding the utilities] had little impact on fourth quarter results. Let me repeat that. For Enron, the situation in California had little impact on fourth quarter results." Skilling also stated that "nothing can happen in California that would jeopardize" earnings targets.

However, when he made these statements, Skilling allegedly knew that the California utilities likely could not pay the fees that Enron was expecting and that Enron might have to write off a loss of hundreds of millions of dollars. He also listened silently as Mark Koenig ("Koenig"), Enron's Director of Investor Relations, assured investors that non-core business revenues were a "fairly small" amount of EBS's earnings, which the government alleges was not actually the case.

Three days later, Skilling spoke at Enron's annual analysts conference, claiming that EES and EBS, like Enron's other major businesses, had "sustainable high earnings power." Skilling argues that this statement was merely harmless puffery. At the conference, he also reasserted that Wholesale was "not a trading business. We are a logistics company."

On March 23, 2001, Enron held a special conference call with analysts. Enron's stock price had been declining, and investors began surmising that EBS was having financial difficulties. Skilling comforted investors, saying that EBS was "having a great quarter" and that Enron was "highly confident" that EES would meet its earning target. According to the government, however, Skilling knew both divisions were in extreme financial turmoil.

On April 17, 2001, Skilling hosted another conference call in which he explained the transfer of EES's risk-management books to Wholesale by saying that there was "such capacity in our wholesale business that we just weren't taking advantage of that in managing our portfolio at the retail side. And this retail portfolio has gotten so big so fast that we needed to get the best—the best hands working on risk management there." In fact, the government claims that Skilling used the transfer to hide losses. Skilling also said that the "first quarter results were great" at EES, even though they were down substantially, and he again praised EBS, explaining that there was a "very strong development of the marketplace in the commoditization of bandwidth" and "we're feeling very good about the development of this business." Skilling was silent again while Rice and Koenig understated EBS's non-core revenues.

On July 17, 2001, Skilling told investors that EES “had an outstanding second quarter” and was “firmly on track to achieve” its earnings targets. That quarter alone, EES lost hundreds of millions of dollars. Skilling reiterated that the EES reorganization was based on a concern for management efficiency, while the government contends that the only purpose of the EES reorganization was to hide EES’s losses.

Skilling also allegedly committed fraud when he manipulated Enron’s reserves to hit specific earnings targets in the fourth quarter of 1999, the second quarter of 2000, and the fourth quarter of 2000. Stock analysts made various projections regarding the earnings that Enron would announce each quarter, and the average of these estimates was known as the “consensus estimate.” The government claims that Skilling was particularly committed to hitting or beating the consensus estimate. In January 2000, the consensus estimate for the fourth quarter of 1999 was earnings of 30¢ per share, which Enron could meet based on its earnings for that quarter. The day before the company was to announce its earnings, however, Koenig brought Skilling unwelcome news: the consensus estimate had jumped a penny per share. Skilling purportedly decided to announce earnings high enough to reach the estimate, even though the increase was not merited by any change in Enron’s underlying financial portrait.

Skilling allegedly took a similar unwarranted action at the end of the second quarter of 2000.

At that time, the consensus estimate was 32¢ per share. A draft earnings report showed that Enron was going to announce earnings that met the estimate. Skilling, however, wanted to beat the consensus estimate by reporting 34¢ per share. To do that, he allegedly told Wholesale to increase its earnings by \$7 million, and then by an additional \$7 million. Wholesale acquiesced both times, reopening its books and adding \$14 million from a reserve account that it had set aside to cover potential liabilities. The government claims that Enron did not have a business reason for using its reserves to increase Wholesale’s earnings, instead doing so solely to exceed analysts’ expectations.

The government contends that Skilling improperly used the reserve accounts again later that year. Wholesale’s business was very profitable during the second half of 2000, and by late December it had placed over \$850 million in reserves. The decision to put that money away was not based on feared future liabilities; instead, Wholesale set that money aside specifically to use in the event of an unfavorable consensus estimate. At the end of the fourth quarter, Skilling ordered that Enron recall some of that money to guarantee that Enron could announce a specific level of earnings.

Another avenue of Skilling’s alleged fraud came from his use of pseudo third-party entity LJM (and later LJM2) to improperly hedge its investments, doing so through four “secret” oral side deals. Fastow, Enron’s CFO, proposed to Skilling and Causey that they create an entity to help Enron more easily meet market expectations. The impetus for creating LJM was the \$200 million that Enron had received from an investment in a company called Rhythms Net. Enron wanted to book that money, but it was possible that the value of the investment would drop, meaning that the asset’s expected value would

have to be reduced. By transferring the asset to a pseudo third-party, however, Enron could hedge its investment without needing to pay market rates for this hedging service. The government claims that LJM became that pseudo third-party. Enron contributed \$234 million of its own shares in seed money to form LJM. Fastow, who was LJM's general partner, contributed \$1 million, and outside investors contributed \$15 million.

Enron encountered a potential problem, however, with using LJM to hedge its investments.

Fastow faced a conflict of interest, because he was both Enron's CFO and LJM's general partner. Before Enron could sign a deal with LJM, Enron's code of conduct required the Office of the Chairman, which consisted of Skilling and Lay, to waive the conflict rules, and Enron would have to disclose this waiver in its Securities and Exchange Commission ("SEC") filings. The Office of the Chairman granted the waiver, but allegedly not without first creating controversy within Enron's senior leadership.

After forming LJM to hedge the Rhythms Net investment, Enron's first deal with LJM involved an interest in a Brazilian power plant, known as Cuiaba, that Enron sold to LJM in 1999. Enron was concerned that its South American unit would not meet its earnings targets, so it decided to sell its interest in Cuiaba to obtain additional revenue. Initially, Enron tried to find a third party to buy the interest in Cuiaba, but was unsuccessful. Skilling, the government claims, then called Fastow and tried to sell Enron's interest in Cuiaba to LJM. Fastow at first was not interested; not only was the asset a bad investment, there was no time for due diligence. Skilling allegedly replied, "Don't worry. I'll make sure that you're all right on the project. You won't lose any money." That oral understanding did not appear in the deal write-up, and the accountants treated it as a real sale, even though, based on the alleged oral understanding between Skilling and Fastow, it was not a legitimate sale.

Enron eventually bought back the Cuiaba interest, paying full value (notwithstanding depreciation) plus 13%. Allegedly to camouflage the deal by avoiding round numbers, LJM received an extra \$42,000 above the 13%. To allay further scrutiny, before Enron bought back the interest, Fastow apparently "sold" his interest in LJM to Michael Kopper ("Kopper"), a former Enron executive. That way, Enron did not need to describe the Cuiaba buyback as a transaction with a related party. For this to work, however, Skilling needed to honor his secret oral promise to Fastow that LJM would not lose money on the deal, despite Kopper becoming LJM's chief; the government claims that Skilling orally confirmed that he would do so.

The second allegedly fraudulent secret side deal between Enron and LJM involved the sale of Nigerian barges. The government claims that in the waning days of 1999, LJM warehoused assets for Enron, allowing Enron to claim earnings during 1999 while it arranged for permanent buyers after the end of the year. With respect to the Nigerian barges deal, in late 1999, Enron sought to sell its interest in a group of barges anchored off the coast of Nigeria to meet an earnings target at the end of the quarter. Most investors were nervous about putting money into Nigeria, so Enron could not find a buyer.

Skilling allegedly called Fastow into his office and asked for LJM to buy the barges, again saying he would “make sure” that LJM would not lose money. Fastow initially was reluctant, because he was trying to raise money for LJM and did not want to scare off investors. However, he told Skilling that LJM would purchase the Nigerian barges if Enron could not find another investor within six months.

Fastow, on behalf of Enron, then arranged for Merrill Lynch to buy the Nigerian barges from Enron. Although Merrill Lynch did not really want to purchase the barges, Fastow purportedly made an oral “guarantee”—although he likely did not use that word—that Merrill Lynch would have to hold the barges for only six months in return for a risk-free profit. Because Merrill Lynch’s investment was not at risk, the government alleges that Enron improperly treated the transaction as a sale and should not have recorded any earnings from the deal. At the end of the six months, Enron still could not find another buyer, so LJM purchased the interest from Merrill Lynch, apparently without even negotiating over price. Causey allegedly assured LJM that it would earn a guaranteed return on the deal, meaning that there was no transfer of risk to LJM. In sum, the government asserts that the sale of the Nigerian barges was not a true sale and that Enron improperly recognized earnings from the deal.

The third secret oral side deal involved the “Raptors,” which were special purpose entities (“SPE”) that would hedge assets for Enron, meaning that if the assets decreased in value, a Raptor would cover the difference—at least on paper. The government asserts that for Enron to validly hedge an asset, a third party must own at least three percent of the SPE’s equity, and that equity must be at risk. The government alleges that LJM acted as that “third party” even though it was not really a separate entity, agreeing to provide the equity that would bear risk.

The government contends that to fund the Raptors, LJM contributed \$30 million and Enron spent \$400 million of its own stock. Apparently, Fastow was at first against mixing LJM with the Raptors, but the government argues that Skilling convinced him through a “secret” side deal, whereby after funding the Raptors, LJM would recoup its \$30 million and would receive an additional \$11 million. To do this, Enron agreed to pay \$41 million to the Raptors to purchase a “put” on the stock Enron had contributed to the Raptors. The Raptors then transferred that \$41 million to LJM. In return, the Raptors had to pay Enron if the price of the stock Enron used to capitalize the Raptors fell below a certain level. LJM thus had nothing at risk; if the hedged assets dropped in value, the hedging Raptor, not LJM, was liable for the loss, and LJM recouped the capital it initially invested in the Raptors, along with an additional \$11 million.

To make this transaction work, however, Enron’s accountants had to sign off. Arthur Andersen, Enron’s external auditor, approved the \$41 million payment to LJM once it was described as a return “on” capital to LJM and not a return “of” capital. The auditors allegedly were not told that LJM and Enron did not haggle over the value of the hedged assets or that LJM was not actually a true third party. The government terms this entire

deal—both Enron’s “put” and LJM’s return promise to allow Enron to hedge an asset at any value—the “quid pro quo.”

The Raptors were also involved in other transactions. For example, in 2000, Enron hedged EBS’s investment in Avici, an internet company, into one of the Raptors. That asset, at its highest value, was worth around \$160 million, but the value was decreasing. Enron allegedly hedged the Avici interest with a Raptor at its highest value. The asset plummeted in value over the next few months, but because of the allegedly fraudulent hedge, Enron did not record the loss. Under the government’s theory, Skilling knew all about the deceit and even told Fastow to “[k]eep it up.” The alleged fraud continued throughout 2000. In fact, by the end of 2000, another one of the Raptors lost more than \$100 million because of similar hedging. In total, Enron’s use of the Raptors allegedly kept nearly \$500 million in losses off of Enron’s books in 2000. . . .

When Skilling resigned from Enron in August 2001, Enron’s internal financial numbers were ghastly. On September 6, 2001, Skilling allegedly called his broker and tried to sell 200,000 shares of Enron stock. The sale did not go through, however, because the SEC still listed Skilling as an Enron “affiliate.” This designation meant that the broker had to disclose the sale to the SEC and the public, which Skilling wished to avoid. Skilling allegedly told his broker to wait to complete the transaction until he obtained a letter from Enron saying that he was no longer a part of Enron’s management.

Skilling sent that letter to his broker on September 10. Because of the terrorist attacks of September 11, Skilling was unable to sell his shares until September 17, the first day the markets reopened. He allegedly called his broker on that day, reiterated his order to sell, and told him he did not want the people at Enron to know about it. When Skilling testified before the SEC in December 2001, he stated that he sold the shares because he became “scared” after the September 11 attack and that “[t]here was no other reason other than September 11th that I sold the stock.” The government contends that Skilling’s testimony was a lie and that the sale amounted to insider trading. . . .

Skilling . . . asserts that the district court erred in failing to provide the jury with adequate guidance on the legal meaning of “materiality” with regard to the charges against him. . . . Skilling first challenges the district court’s materiality instruction on the ground that the court should have specifically instructed the jury on puffery. He sought to have the court tell the jury that even if a statement is false or misleading, it is mere “puffery” and therefore immaterial if it is “so lacking in specificity, or so clearly constituting the opinions of the speaker, that no reasonable investor could find the statement important to the total mix of information he or she would consider when making an investment decision.” Such statements, he notes, include “generalized, positive statements about [a] company’s competitive strengths . . . and future prospects.”

Although Skilling is correct that “an expression of opinion not made as a representation of fact,” can constitute puffery, not all such statements of opinion are properly classified as puffery. Similarly, although Skilling correctly points out that “generalized, positive statements about [a] company’s competitive strengths . . . and future prospects” can in

some cases constitute immaterial puffery, such statements of opinion by corporate insiders are not *per se* immaterial. In *Virginia Bankshares, Inc. v. Sandberg*, the Supreme Court considered statements that a merger proposal would give shareholders “a high value for their shares,” and held that such statements could be deemed material. The Court explained,

[i]t is no answer to argue, as petitioners do, that the quoted statement on which liability was predicated did not express a reason in dollars and cents, but focused instead on the “indefinite and unverifiable” term, “high” value, much like the similar claim that the merger’s terms were “fair” to shareholders. The objection ignores the fact that such conclusory terms in a commercial context are reasonably understood to rest on a factual basis that justifies them as accurate, the absence of which renders them misleading. Provable facts either furnish good reasons to make a conclusory commercial judgment, or they count against it, and expressions of such judgments can be uttered with knowledge of truth or falsity just like more definite statements, and defended or attacked through the orthodox evidentiary process that either substantiates their underlying justifications or tends to disprove their existence. In this case, whether \$42 was “high,” and the proposal “fair” to the minority shareholders, depended on whether provable facts about the Bank’s assets, and about actual and potential levels of operation, substantiated a value that was above, below, or more or less at the \$42 figure, when assessed in accordance with recognized methods of valuation.

Virginia Bankshares thus instructs that conclusory statements of reasons, belief, or opinion—e.g., “high value” and “fair”—may be so contrary to the verifiable historical facts that they falsely “misstate the speaker’s [true] reasons” and “mislead about the stated subject matter.” Indeed, the Supreme Court expressly explained that “there is no room to deny that a statement of belief by corporate directors about a recommended course of action, or an explanation of their reasons for recommending it,” can be material.

Skilling’s statements about the financial health of Enron were similar to those deemed potentially material in *Virginia Bankshares*. For example, at the 2001 analyst conference (count 23), Skilling claimed that all of Enron’s businesses, including EES and EBS, were “uniquely strong franchises with sustainable high earnings power.” He also characterized Wholesale as a “stable, high-growth business” and “not a trading business.” Similarly, on the March 23, 2001 analyst call (count 24), he claimed EBS was having “a great quarter on the intermediation side of the bandwidth business.” Summarizing EBS, he said that there was “essentially strong growth on the intermediation side, strong growth on the content services side, in terms of people, budgets, the whole thing.”

The jury was entitled to find those and similar statements material. The government presented evidence of contrary, verifiable historical facts regarding the actual condition of EES, EBS, and Wholesale at the time Skilling made these statements: EES was facing a potentially enormous loss; EBS had an unsupportable cost structure, was losing money, was reducing the number of its employees, and had few customers or profitable deals; and Wholesale was number of its employees, and had few customers or profitable deals; and Wholesale was heavily dependent on unstable, speculative trading.

Moreover, in addressing the question of “whether statements of reasons, opinions, or beliefs are statements ‘with respect to . . . fact[s]’ so as to fall within the strictures of [the securities laws],” the Supreme Court has concluded that such statements by directors “are factual in two senses: [(1)] as statements that the directors do act for the reasons given or hold the belief stated and [(2)] as statements about the subject matter of the reason or belief expressed,” These statements thus cannot, as a matter of law, be deemed immaterial puffery, and the district court was correct to leave the determination of their materiality to the jury. . . .

Problem 3-2

- (a) From the *Ebbers*, *Goyal*, and *Skilling* cases, list methods one learns from these three examples by which corporate managers might manipulate the reported financial results of a public company. As to each method, which aspect(s) of financial performance is (are) being manipulated: the value of the company’s assets, the extent of its liabilities (including debt), the amount of its income, or the amount of its expenses?
- (b) Why did Ebbers get 25 years whereas Goyal received a virtual judicial apology? Why do some types of white collar criminal defendants seem more worthy of punishment than others?
- (c) Is stock option compensation a good idea?

Problem 3-3

Now we are ready to analyze some complex fraud cases on our own, without the help of judicial opinions. The following is a criminal complaint filed on August 9, 2013 against a former employee of JP Morgan Chase & Co. in the so-called “London Whale” matter. After the prosecution began, the employee moved to Spain, where he successfully defeated extradition to the United States. (In addition, while the case dragged on for several years, the government’s main witness decided to recant his testimony and write a book claiming he did nothing wrong.)

Had the defendant here been extradited to the U.S., would the government have been likely to obtain a conviction? At what point did the defendant’s actions arguably become an accounting fraud? Could the government have brought charges against any higher-level employees of JP Morgan in the same matter? What possible defense arguments might have been raised at trial?

**COMPLAINT, UNITED STATES V. JAVIER MARTIN-ARTAJO
NO. 13 MAG 1975 (S.D.N.Y. AUG. 9, 2013)**

COUNT ONE

**(Conspiracy to Falsify Books and Records, to Commit Wire Fraud
and to Falsify SEC Filings)**

1. From at least in or about March 2012, through and including in or about May 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, together with others known and unknown, willfully and knowingly, did combine, conspire, confederate, and agree together and with each other to commit offenses against the United States, to wit, (a) falsification of books and records, in violation of Sections 78m(b)(2)(A), 78m(b)(5) and 78ff of Title 15, United States Code, and Title 17, Code of Federal Regulations, Section 240.13b2-1; (b) wire fraud, in violation of Title 18, United States Code, Section 1343; and (c) falsification of filings with the Securities and Exchange Commission ("SEC"), in violation of Title 15, United States Code, Sections 78m(a) and 78ff, and Title 17, Code of Federal Regulations, Sections 240.13a-11 and 240.13a-13.

Objects of the Conspiracy

False Books and Records

2. It was a part and an object of the conspiracy that JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, would and did, directly and indirectly, falsify and cause to be falsified books, records, and accounts of JP Morgan Chase & Company ("JPM") subject to Section 13(b)(2) of the Exchange Act of 1934, namely books, records, and accounts of JPM, an issuer with a class of securities registered pursuant to Section 12 of the Securities and Exchange Act of 1934, which JPM was required to make and keep in reasonable detail, accurately and fairly reflecting the transactions and dispositions of the assets of JPM, in violation of Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, and Title 17, Code of Federal Regulations, Section 240.13b2-1.

Wire Fraud

3. It was further a part and an object of the conspiracy that JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations, and promises, for the purpose of executing such scheme and artifice and attempting to do so, would and did transmit and cause to be transmitted by means of wire, radio, and television communication in interstate and foreign commerce, writings, signs, signals, pictures, and sounds, all in violation of Title 18, United States Code, Section 1343.

False SEC Filings

4. It was further a part and an object of the conspiracy that JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, made and caused to be made statements in reports and documents required to be filed with the SEC under the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, which statements were false and misleading with respect to material facts, all in violation of Title 15, United States Code, Sections 78m(a) and 78ff, and Title 17, Code of Federal Regulations, Sections 240.13a-11 and 240.13a-13. . . .

(Title 18, United States Code, Section 371.)

COUNT TWO

(False Books and Records)

5. From at least in or about March 2012, through and including in or about May 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, did, directly and indirectly, falsify and cause to be falsified books, records, and accounts subject to Section 13(b)(2) of the Exchange Act, namely books, records, and accounts of JPM, an issuer with a class of securities registered pursuant to the Exchange Act, which JPM was required to make and keep in reasonable detail, accurately and fairly reflecting the transactions and dispositions of the assets of JPM, to wit, MARTIN-ARTAJO falsified and caused others to falsify marks relating to JPM's securities positions in a synthetic credit portfolio in order to conceal hundreds of millions of dollars in losses.

(Title 15, United States Code, Sections 78m(b)(2)(A), 78m(b)(5) and 78ff, Title 17, Code of Federal Regulations, Section 240.13b2-1 and Title 18, United States Code, Section 2.)

COUNT THREE

(Wire Fraud)

6. From at least in or about March 2012, through and including in or about May 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, willfully and knowingly, having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations and promises, did transmit and cause to be transmitted by means of wire and radio communication in interstate and foreign commerce, writings, signs, signals, pictures, and sounds, to wit, for example, a telephone conversation on or about March 30, 2012, between London and New York, for the purpose of executing such scheme and artifice, to wit, MARTIN-ARTAJO's efforts to fraudulently manipulate the reported value of JPM securities positions in a synthetic credit portfolio in order to conceal hundreds of millions of dollars in losses.

(Title 18, United States Code, Sections 1343 and 2.)

COUNT FOUR

(False Filings With The SEC)

7. On or about April 13, 2012 and May 10, 2012, in the Southern District of New York and elsewhere, JAVIER MARTIN-ARTAJO, the defendant, and others known and unknown, willfully and knowingly, made and caused to be made, statements in reports and documents required to be filed with the SEC under the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, which statements were false and misleading with respect to material facts, to wit, MARTIN-ARTAJO caused the submission to the SEC of an inaccurate Form 8-K for JPM on April 13, 2012, and an inaccurate Form 10-Q for JPM on May 10, 2012, for the fiscal quarter ending March 30, 2012.

(Title 15, United States Code, Sections 78m(a) and 78ff; Title 17, Code of Federal Regulations, Sections 240.13a-11 and 240.13a-13; and Title 18, United States Code, Section 2.)

BACKGROUND

Relevant Persons and Entities

8. At all times relevant to this Complaint, JPMorgan Chase & Company (“JPM”) was a global financial services company headquartered in New York, New York. JPM is one of the oldest and largest financial institutions in the United States.

9. At all times relevant to this Complaint, JPM’s common stock traded on the New York Stock Exchange.

10. At all times relevant to this Complaint, JPM was required to comply with the federal securities laws, which are designed to ensure that a company’s financial information is accurately recorded and accurately disclosed to the public. Specifically, pursuant to the Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder, JPM was required, among other things, to make and keep books, records, and accounts that accurately and fairly reflected JPM’s business transactions.

11. At all times relevant to this Complaint, JPM maintained a group within its Corporate/Private Equity segment known as the Chief Investment Office, or “CIO.” CIO has offices in both New York and London, and at all times relevant to this Complaint had more than 100 traders. One of the purposes of CIO, as described by JPM, was to manage the bank’s excess deposits (the amount deposited with the bank, minus the amount it had loaned) of its corporate and individual customers. In 2012, those deposits managed by CIO totaled approximately \$350 billion.

12. Since approximately 2007, the CIO has traded in so-called synthetic credit derivative products. One common such product is known as a “credit default swap,” or CDS. A CDS is, in essence, an insurance contract on an underlying credit risk. For example, Company A may issue corporate bonds. Company B can purchase those bonds, and therefore be exposed to the risk that Company A will default on its bond payments (credit risk). To insure against that risk, Company B can “buy protection” in the form of a CDS that insures against the risk of Company A’s default. However, an investor such as Company B need not own the underlying bond in order to purchase (or sell) a CDS—it can trade in the credit default swaps by themselves. JPM’s CIO did just that, and in particular—and as discussed further below—traded so-called CDS “indices,” which are collections of CDSs that are packaged together, or sliced into segments and traded as “tranches.”

13. CIO traded these credit indexes and tranches in what it called its Synthetic Credit Portfolio, or “SCP.” By 2011, that portfolio had reached an approximate net notional size of \$51 billion, and during the first quarter of 2012, it more than tripled in size to approximately \$157 billion in net notional positions.

14. At all times relevant to this Complaint, JAVIER MARTIN-ARTAJO (“MARTIN-ARTAJO”), the defendant, was employed at JPM as a Managing Director, where he held the position of Head of Credit and Equity Trading for CIO. MARTIN-ARTAJO principally worked out of CIO’s London office, although his duties also brought him to JPM’s New York office. Among other things, MARTIN-ARTAJO oversaw CIO’s SCP.

15. At all times relevant to this Complaint, CC-1 was employed as a Vice President for CIO and a trader for the SCP. CC-1 was based in JPM’s CIO London office and reported to JAVIER MARTIN-ARTAJO, the defendant. CC-1 was responsible for the day-to-day “marking” of the CIO’s positions in the SCP, a process described in more detail below.

16. At all times relevant to this Complaint, another co-conspirator not named as a defendant herein (“CW-1”) was a CIO trader based in JPM’s London office. CW-1 was the head trader of the SCP, and reported to JAVIER MARTIN-ARTAJO, the defendant.

17. The SCP was, over the years, very profitable for CIO and JPM. In 2009, its most profitable year, the SCP produced over \$1 billion in revenue for JPM. The SCP also was profitable in 2010 and 2011. In fact, the SCP had last reported an unprofitable quarter in 2010, and had not reported significant quarterly losses since the first quarter of 2009. Since its inception in 2006, the SCP produced approximately \$2 billion in gross revenues for JPM.

Background of CIO Trading Activities

18. As described above, the SCP principally consisted of a variety of different credit derivative securities, including credit indices and tranches. A credit index is a security

that operates as a collection, or basket, of selected credit instruments. A particular credit index references a particular collection of selected credit instruments, often CDSs. As of March 2012, JPM records indicate that CIO held more than one hundred different types of credit indices, and among the largest positions in the SCP were three particular kinds of indices: the CDX.NA.IG, which references securities in investment grade corporations in North America; COX.NA.HY, which references securities in high yield North American corporations; and the iTraxx Europe, which references securities in investment grade companies in Europe.

19. Another type of security traded in the SCP was credit index tranches. A credit index tranche is an instrument that relates to a particular part of a credit index.

20. JPM traders who traded these types of securities—within CIO as well as the rest of the bank—were required at all times to price securities they held at their fair value, that is, on a “mark-to-market” basis, determined by reference to the current market price of the asset or liability, or the current market price for a similar asset or liability. The positions in the SCP were, and were required to be, marked on a daily basis. The marks were transmitted electronically by the trader setting the mark to the other bank personnel in the Operations Department, and ultimately became part of the bank’s books and records.

21. Because credit indices and credit tranches are not traded over an exchange, JPM traders were required to look to other indicia in order to determine the fair value of the assets on their books. Traders would consult three principal sources of information in order to determine the fair value of the securities in the SCP: recently executed transaction prices in the security they were valuing, or in similar securities; buy and sell prices (known as “bids” and “offers”) posted by dealers in the securities they were valuing, or for similar securities; and published averages of dealer bids and offers, including those published by financial information services such as MarkIT and Totem, which provide, among other things, independently gathered valuation data. It was widely understood within JPM that traders were to consult these data points when setting prices for credit indices and credit tranches within the SCP. Under bank policy and U.S. Generally Accepted Accounting Principles (“GAAP”), traders were required to set the value, or mark, for a particular security at a price at which they believed they could exit the position.

22. JPM’s accounting policy stated that the “starting point for the valuation of a derivatives portfolio is mid-market.” The policy also stated that for securities for which dealer quotes are available, the prices to be used for purpose of marking these securities “must be obtained [from dealers] at the same time each business day.”

Overview of the Scheme to Defraud

23. From at least in or about March 2012, through and including in or about May 2012, JAVIER MARTIN-ARTAJO, the defendant, together with his co-conspirators, manipulated and inflated the value of position marks in the SCP in order to achieve

specific daily and month-end profit and loss (“P&L”) objectives; in other words, MARTIN-ARTAJO and his co-conspirators artificially increased the marked value of securities in order to hide the true extent of hundreds of millions of dollars of losses in that trading portfolio.

24. As a result of the scheme executed by JAVIER MARTIN-ARTAJO, the defendant, and others, there was a growing disparity between the values falsely ascribed to the positions in the SCP and what the traders truly believed the fair value of the positions to be. This gap reached hundreds of millions of dollars by the end of March 2012.

25. As a result of the scheme, JAVIER MARTIN-ARTAJO, the defendant, and his co-conspirators, falsely hid losses in the SCP, and caused JPM to (i) record false entries for the SCP for the first quarter of 2012; and (ii) report false quarter-end numbers for the first quarter 2012. MARTIN-ARTAJO and his co-conspirators persisted in this scheme of systematically and fraudulently valuing the securities in the SCP until at least May 2012.

26. Ultimately, in July 2012, JPM announced in a Form 8K that it would restate its first quarter results for net revenue by \$660 million, reflecting its loss of confidence that the marks made by CC-1 at the direction of JAVIER MARTIN-ARTAJO, the defendant, “reflect good faith estimates of fair value.”

MARTIN-ARTAJO and His Co-Conspirators Knowingly Mismarked Securities in Order to Hide Losses

27. For most of 2011 and into 2012, CIO traders had a practice of marking the securities in the SCP at or near the mid-point between the average bid and offer that the CIO received each day from a number of dealers who made a market in that particular security. The CIO traders sometimes referred to this mid-point as the “crude mid.”

28. Beginning in or about January 2012, the value of the positions in the SCP—as reflected by the execution prices of actual transactions, the bids and offers received from dealers, and by the prices listed by MarkIT and Totem—began to move against the SCP’s positions, and the SCP began to lose money. At the end of January 2012, CC-1 marked the positions in the SCP at or near the crude mid, and the CIO reported approximately \$130 million in mark-to-market losses in the SCP for the month.

29. The losses through January 2012 did not go unnoticed within the bank. When these losses were reported, the direct supervisor of JAVIER MARTIN-ARTAJO, the defendant, as well as the Chief Investment Officer became increasingly concerned, and inquired more regularly about the losses.

30. For example, on January 31, 2012, the supervisor of JAVIER MARTIN-ARTAJO, the defendant, sent him an e-mail expressing the “need to discuss the synthetic book [referring to the SCP],” noting that the current strategy did not seem to be working, stating that the “financial Performance [sic] is worrisome,” and indicating the need to “urgently reevaluate” the core position. Thereafter, MARTIN-ARTAJO was directed to focus all his attention on the performance of the SCP.

31. Despite strategic trading changes that involved an increase in the net notional positions of the SCP, the losses in the SCP continued through February 2012. As the losses continued to mount, JAVIER MARTIN-ARTAJO, the defendant, was subject to continued and increasing scrutiny and pressure from the executives senior to him. MARTIN-ARTAJO, in turn, began pressuring CC-1 and CW-1, to mark the SCP's positions in such a way as to show smaller losses. MARTIN-ARTAJO also urged CW-1 and CC-1 to "defend the positions" by executing trades, and attempting to execute trades, at favorable prices. MARTIN-ARTAJO put particular pressure on CC-1 and CW-1 to "defend the positions" near the end of the month, when the SCP's positions would be subjected to closer scrutiny through JPM's internal price testing process, described below, and when the SCP's P&L would be looked at more closely by senior bank executives.

32. In marking the SCP's securities at month-end in February 2012, CC-1 began to set some of the marks farther from the crude mid, at a price more favorable to the CIO's profits, somewhat mitigating the losses being suffered in the SCP. Nonetheless, at the end of February, CIO reported (based on CC-1's marks) approximately \$88 million in mark-to-market losses in the SCP for the month.

MARTIN-ARTAJO and CC-1 More Aggressively Hid CIO's Losses in March,
Causing False Entries in the Bank's Books and Records Both Intra-Month and at
Month-End

33. On March 1, 2012, the supervisor of JAVIER MARTIN-ARTAJO, the defendant, sent an email message to MARTIN-ARTAJO, suggesting that he "[f]ocus on the metrics and P+L of the synthetic book" and expressing a worry that, if the size of the SCP were reduced to accomplish a reduction in risk, "we will not be able to defend our positions . . ." and the SCP's profits would suffer.

34. In March 2012, the usual data points used to value the positions in the SCP—bid and offer quotes from dealers, MarkIT and Totem prices, and actual transaction prices—continued to move in a direction reflecting further losses in the SCP's positions. The losses mounted even as the CIO traders continued to dramatically increase the size of their positions in the SCP as part of a strategy designed in part to avert the losses.

35. In the beginning of March 2012, JAVIER MARTIN-ARTAJO, the defendant, directed CC-1 and CW-1, not to show any additional losses in the SCP if the losses were caused by the continued downward trend in the market data that the traders were receiving—but to continue to show gains. MARTIN-ARTAJO directed that, unless there was an identifiable and explainable market event that the traders could reference to explain the price movement—for example, a bankruptcy filing by one of the companies whose bonds were referenced in a credit index—no losses were to be reported in the marks or to the bank's management. MARTIN-ARTAJO claimed that this was what "New York"—that is, the bank's senior management in New York—wanted, explaining that those JPM officials did not want to see day-to-day market volatility.

36. On March 6, 2012, CW-1 told CC-1 in a recorded phone call, that CW-1 had just spoken with JAVIER MARTIN-ARTAJO, the defendant. CW-1 explained to CC-1 that MARTIN-ARTAJO had directed that “we have to try to show that the P and Lis stable” and “what Javier would like is that if you start to see some gains we have to report it”, but that “what they don’t want is for us to be down.” CW-1 told CC-1 that MARTIN-ARTAJO was trying to make the argument to more senior management that the positions in the SCP should be retained. MARTIN-ARTAJO did not want more management to take away the SCP from CIO, or direct that CIO change its strategy, and reporting additional losses would undermine this objective.

37. CW-1 was uncomfortable following the direction from JAVIER MARTIN-ARTAJO, the defendant, not to report losses for more than a brief period of time, because as objective price data indicated that the SCP was losing money, the gap between where the SCP was marked and that relevant market data was growing larger and larger. By at least on or about March 9, 2012, CW-1 asked CC-1 to create a spreadsheet for the express purpose of tracking the difference between CC-1’s manipulated marks on the one hand, and the crude mids—that is, the objective market data—on the other. CC-1 did so and, at CW-1’s request, CC-1 sent a copy of that spreadsheet to MARTIN-ARTAJO.

38. For example, on March 15, 2012, CW-1 told CC-1 in the course of an online chat, to “Send the pnl,” meaning to finalize and report within the bank the daily marks (and resulting P&L) for the SCP. CW-1 then asked CC-1, “Can u drop me here the breakdown of the lag [the difference between where the positions were marked and the crude mids], please? . . . And send it to [MARTIN-ARTAJO by]email. . . . put me in copy . . . I refer to the spreadsheet.” Later in the same chat, CW-1 clarified: Send to me and Javier the spreadsheet where u store the breakdown of the difference between our estimates and crude mids.”

39. Later that day, at approximately 6:45 p.m. Greenwich Mean Time, CC-1 sent an e-mail to JAVIER MARTIN-ARTAJO, the defendant, and CW-1, attaching a spreadsheet. The spreadsheet had columns, among others, entitled “Date,” “Distance,” “iTraxx,” “CDX.IG,” “iTraxx.Main,” “CDX.IG9 10y,” “COX.HY,” and “Distance YTD.” For example, the spreadsheet reflected, among other columns not reproduced here, the following information:

Date	Distance
12-Mar-12	(203)
13-Mar-12	(207)
14-Mar-12	(269)
15-Mar-12	(292)

CC-1’s spreadsheet, then, indicated one measure of the extent to which the SCP was mis-marked as of March 15, 2012: the marks made by CC-1, consistent with MARTIN-

ARTAJO's instructions, left the SCP overstated by approximately \$292 million as compared to where the book would have been marked had the traders continued their practice of marking to the crude mids.

40. Both CC-1 and CW-1 were aware of the instruction by JAVIER MARTIN-ARTAJO, the defendant, to stop reporting losses. During the March 15, 2012, chat referenced in paragraph 38, above, CC-1 reminded CW-1 that he was "not marking at mids as per a previous conversation." However, on March 15, 2012, it became clear that CC-1 and CW-1 had different ideas about how to accomplish MARTIN-ARTAJO's directive. CC-1 was trying to capture almost all the distance between the crude mids and the CIO marks by aggressively mis-marking one particular security, the CXD.NA.IG9-10Y, in which CIO held a large position. As a result, that one position was marked extremely far from the crude mid price—between 6 and 7 basis points away, which was far outside the bid-offer spread for that security, which was mis-marked by more than \$300 million. CW-1 indicated to CC-1 that he did not think the way in which CC-1 was marking was "realistic" and questioned whether it could be defended. CC-1 thereafter acknowledged that he did not think his own mark for the CXD.NA.IG9-10Y was realistic, writing to CW-1: "I mean, im trying to keep a relatively realistic picture here ig9 10y put aside."

41. The following day, March 16, 2012, CC-1 had an online chat with CW-1. CC-1 stated that he was "at minus 4 [million] with a lot of effort." CC-1 offered to do better but CW-1 told CC-1 not to make the additional effort to disguise the loss. During the chat, CW-1 stated his frustration with JAVIER MARTIN-ARTAJO, the defendant, because the distance between the actual fair value of the securities in the SCP and the level at which CC-1 had marked the securities, was persisting and even growing: "I don't know where he [MARTIN-ARTAJO] wants to stop, but it's getting idiotic."

42. The same day, CW-1 emailed JAVIER MARTIN ARTAJO, the defendant, increased to 300 [million] and stated that the "divergence has now . . . It has been like this since the start of the year and the drift keeps going. I reckon we get to 400 [million] difference very soon." CW-1 was concerned that as the available market data showed increasing losses for the SCP, MARTIN-ARTAJO's direction to not report those losses was growing "idiotic"—the marks in the SCP for the largest positions were approaching the point at which they would need to be outside the bid-offer spread in order for the losses not to be reported. That is, CIO would have to value the securities at prices that not only failed to reflect fair value, but that were beyond what any broker would quote as a conceivable price.

43. Also on March 16, 2012, CW-1 relayed prices at which he had traded certain securities to CC-1. Based on those fresh transaction prices, CW-1, in an online chat with CC-1, told CC-1 that the marks for the CXD.NA.IG9, five year maturity, should be at 72; the marks for the CXD.NA.IG9, seven year maturity, should be at 88; and the marks for the CXD.NA.IG9, ten year maturity should be at 110. CC-1 responded that he agreed and would mark those securities as CW-1 had indicated. In fact, however, CC-1 skewed

the marks in an even more favorable way for JPM than CW-1 had suggested: for the CXD.NA.IG9, five year maturity, at 70.25; for the seven year maturity, at 85.75; and for the ten year maturity, at 107.25 in each case, marking in a direction favorable to the SCP's P&L, and an additional two and three quarters basis points away from where CC-1 told CW-1 he would mark.

44. Between approximately March 16 and March 20, 2012, CW-1 urged JAVIER MARTIN-ARTAJO, the defendant, to reflect the losses in some way on the books of the bank: either by properly adjusting the marks in the SCP to reflect the true market data; or by taking a large, "one-off" loss to catch up to the market, possibly at month-end; or by taking some kind of other step to ensure that the bank's books were accurate. MARTIN-ARTAJO rebuffed these efforts. CW-1 and CC-1 subsequently discussed MARTIN-ARTAJO's refusal to have the losses reported, and the pressure this put on CC-1, who had responsibility for marking the positions on the SCP on a daily basis.

45. On March 20, 2012, CW-1 decided that the SCP's marks had to begin to reflect the market reality, that is, bigger losses in the SCP. CW-1 left a voicemail message for JAVIER MARTIN-ARTAJO, the defendant, saying that CW-1 thought that CIO "should start, start showing" the losses in the SCP. CW-1 then spoke with CC-1 and told CC-1 that the book should be marked in a way that reflected a loss for the day of \$40 million, bringing the reported year-to-date losses to \$275 million. CW-1 also prepared, for March 20, 2012, written commentary for the P&L report document that CC-1 circulated to CIO management every day, which warned, among other things, that the "lag in P&L is material (\$600–800M)."

46. On March 20, 2013, JAVIER MARTIN-ARTAJO, the defendant, reacted angrily after he received the document reporting the single-day loss of \$40 million. That same day, in a recorded call between MARTIN-ARTAJO and CW-1, MARTIN-ARTAJO asked "Why did you do that?" CW-1 replied, "I thought we should, you know, not do like minus 5 every day but just say okay boom you know there is something happening." MARTIN-ARTAJO responded: "I don't understand your logic mate, I just don't understand. I told [my boss], he told me that he didn't want to show the loss until we know what we are going to do tomorrow [at a scheduled meeting with the Chief Investment Officer]. But it doesn't matter I know that you have a problem you want to be at peace with yourself . . . I didn't want to show the P&L and [my boss] told me yesterday not to do it. So okay, we're just going to have to explain that this is getting worse, that's it." CW-1 then pointed out the portion of the commentary in which he had described the lag in P&L as reaching as high as \$800 million, and MARTIN-ARTAJO responded: "You're losing your mind here, man, you're sending an email that you would get, what is this 800 [million] bucks . . . [T]his is just what we explain tomorrow you don't need to explain in an email man . . . [W]hy do you do it today when we are going to explain it tomorrow?" CW-1 replied that he and CC-1 reported the loss because "that's what we saw today. . . ." MARTIN-ARTAJO responded "listen the problem that, okay it's fine you've done it I cannot really tell you, you know, not to do this, you've done it because you feel you have to do it, that's okay. What I don't understand is at all is why

are you explaining this, this way on the email? . . . because this only creates, it just creates more tension you understand? It's not going to help me as much, right? . . . What happens if [the Chief Investment Officer] tells me that we cannot keep going long?" MARTIN-ARTAJÓ went on to explain that "it just highlights that there are problems in the book" and that there was a chance that MARTIN-ARTAJÓ's immediate boss and the Chief Investment Officer would decide to have CIO unwind certain positions that MARTIN-ARTAJÓ wanted to keep.

47. Finally, JAVIER MARTIN-ARTAJÓ, the defendant, repeated that "I didn't want to show the P&L." CW-1 apologized, and MARTIN-ARTAJÓ responded that "you know, I think that you're an honest guy, you know, it's just that, I did not want you to do it this way, but I know you feel that the bid offer spreads are giving you a headache, and you want to release it this way."

48. On March 23, 2012, the market continued to move against the SCP. On that date, in a chat between CW-1 and JAVIER MARTIN-ARTAJÓ, the defendant, CW-1 stated that "we will lose more today ... this is going to happen across the book I reckon we have today a loss of 300M USING THE BEST BID ASKS . . . and 600m from [the crude] mids. . . ." In a different chat the same day, between CW-1 and CC-1, CC-1 stated that "it's around more than 500 anyway."

49. Later the same day, CC-1 reported to CW-1 that he had spoken with MARTIN-ARTAJÓ, and that "[w]e're gonna show between minus 5 and minus 10." CW-1 responded "ok, ok you tell Javier because it's not my business anymore, I don't want to know about it . . . it pisses me off tell him . . . tell him it's more than 500." Nonetheless, at the end of the day on March 23, 2012, CC-1 continued to falsely mark the book in such a way that the reported loss for the day was only \$9.5 million. That was accomplished, in part, by marking one large position, the IG9 ten year maturity, considerably outside the bid-offer spread for that security. Indeed, even if the position had been marked at the aggressive beneficial edge of the bid-offer spread for the best available bid that day, the SCP losses would have increased by \$91 million over what CC-1 reported that day.

50. As CIO's daily marks bore less and less resemblance to the actual fair value of its book, CW-1 worked with others at CIO to create a PowerPoint presentation that set forth the risks and issues with the SCP. On March 29, 2012, a draft of the PowerPoint presentation was circulated to JAVIER MARTIN-ARTAJÓ, the defendant, CC-1, CW-1, and others at CIO. In a section entitled "Core Credit Book: summary," the document listed the following: "target ytd: -\$750M." A separate slide of the presentation labeled "P&L explain" described the P&L as negative \$800 million, with the bulk of the loss driven by losses in the CXD.NA.IG9 positions. However, the P&L submitted by CC-1 the following day showed a year-to-date loss of only \$583 million, despite a very large loss on the last day of the month.

51. On March 30, 2012—the last business day of the first quarter of 2012—the early estimates of CC-1 showed the SCP down approximately \$250 million for the day. CC-1

discussed this with CW-1, who in turn told JAVIER MARTIN-ARTAJO, the defendant. MARTIN-ARTAJO asked if the loss could be only \$200 million; CW-1 reported this request to CC-1. Later in the day, CC-1 told CW-1 that he now estimated the loss for the day at approximately \$200 million. CW-1 reported this number to MARTIN-ARTAJO. MARTIN-ARTAJO then asked if the loss number could be reduced to as low as \$150 million; CW-1 responded that it was unlikely. MARTIN-ARTAJO then told CW-1 that he could leave for the day. While the SCP was typically marked at the London close of business, when CW-1 left at approximately 6:30 p.m. the books were still open, and they remained open despite inquiries to CC-1 from others waiting for the final numbers, until almost 8 p.m. London time.

52. Throughout the day on March 30, 2012, JAVIER MARTIN-ARTAJO, the defendant, received repeated inquiries urgently seeking his best estimate as to what the day's loss would be, on behalf of the Chief Investment Officer in New York. At 8:15 p.m. GMT, MARTIN-ARTAJO indicated that "[w]e are going to close the books in one hour and still around -150 MM." Before the books were closed, CC-1 spoke with CW-1 in a recorded phone call, explaining some of the marks he was making. CW-1 urged CC-1 to stay within the bid-offer range, and that it was better to do "something cleaner with a . . . you see . . . a lesser result." Finally, at 8:41 p.m. GMT, CC-1 sent an email to MARTIN-ARTAJO and CW-1, indicating that "my latest estimate for today's Pnl is (\$138M)." MARTIN-ARTAJO responded: "Excellent tks."

53. At March 2012 month-end, most of the marks for the largest SCP positions set by CC-1 were at the far side of the bid-offer spread in the direction favorable to CIO, and some of CC-1's marks even fell outside of the spread. For example, CC-1 marked the ITRAXX.MN.S09 10Y fully 6.3 basis points off of the consensus pricing, when the bid/offer spread in ITRAXX was consistently less than 3 basis points throughout the day. Given the large size of the ITRAXX position in the SCP, this discrepancy resulted in an approximately \$120 million P&L difference. Similarly, CC-1 marked the CXD.NA.IG9-10Y approximately 2.5 basis points from the consensus price, whereas the bid/offer spread was consistently no more than 2 basis points. This resulted in a more than \$100 million P&L difference.

54. Indeed, according to a subsequent analysis performed by JPM's Investment Bank, the difference across the SCP between the marks entered by CC-1 on the one hand, and the consensus pricing, on the other, across the SCP amounted to a \$767 million difference in CIO's favor as of the end of March.

The Mis-Marking of the SCP Continues in April

55. On Friday, April 6, 2012, Bloomberg and the Wall Street Journal published articles concerning CIO and its large positions in the credit derivatives market. On April 10, 2012—the first trading day after the articles were published—CC-1 circulated a P&L e-mail that reflected a daily loss of \$5.7 million, after speaking with JAVIER MARTIN-ARTAJO, the defendant. About 90 minutes later, however, CC-1 circulated a second

P&L e-mail. This one reflected a loss for the day of \$395 million. The P&L commentary reflected no explanation for this change.

56. On April 13, 2012, CC-1 spoke with CW-1 in a recorded call, and indicated that his “problem is what type of reporting should I do . . . you see, it’s highly scrutinized now . . . [t]he market moves (inaudible) and I don’t want to, I don’t want to show something that is too false.”

57. Toward the end of April, CIO had a series of collateral disputes with counterparties, indicating that those brokers were marking positions materially differently than CIO. At that time, CC-1 exchanged text messages with CW-1. In the exchange, CW-1 told CC-1 to “[s]peak to Javier about this collateral mark issue” and that they would have to return to the mid “fairly quickly.”

MARTIN-ARTAJO and His Co-Conspirators Hide the Mismarks by Taking
Advantage of CIO’s Valuation Control Group

58. At all times relevant to this Complaint, the CIO’s Valuation Control Group (“VCG”) was supposed to serve as an independent function within CIO, as it did in other parts of JPM. The VCG function was designed to serve as an independent check on the valuations assigned by traders to the securities that the traders were marking at month-end. In practice, however, the CIO VCG was neither independent nor rigorous.

59. Staffed in London with essentially a single employee (the “VCG Employee”), CIO VCG regularly received and relied upon trader views of the market, and reviewed selected broker price quotes provided by the traders. In addition, the VCG employed “thresholds” around its prices, which had the effect of tolerating some variance between the traders’ marks and the VCG Employee’s “independent” marks. In practice, however, the VCG Employee applied unreasonably wide thresholds, which had the effect (contrary to CIO VCG’s written policy and U.S. GAAP) of tolerating trader prices that were outside of the bid-offer spread.

60. Finally, as designed, CIO VCG had no review role whatsoever concerning intra-month marks, which were left to the unfettered discretion of the traders, even though those marks were recorded in JPM’s books and records.

61. As part of their scheme, JAVIER MARTIN-ARTAJO, the defendant, and his co-conspirators, took full advantage of the freedom that CIO’s VCG function offered. JAVIER MARTIN-ARTAJO and other CIO traders, regularly interacted with the VCG Employee, provided their views of the market to the VCG Employee, and provided their selection of broker quotes to the VCG Employee, with the result that CIO VCG ultimately did not perform a meaningful check on the trader valuations.

62. For example, for February 2012, the VCG price-testing had initially identified a discrepancy between VCG’s independent marks and CC-1’s marks that would have resulted in a \$95 million adjustment to the SCP’s P&L. CC-1 subsequently provided a selection of broker price quotes and other information to the VCG Employee, and as a

result, the VCG Employee reduced the difference to only \$7 million—and then decided to pass no adjustment whatsoever to the February 2012 marks in the SCP.

63. JAVIER MARTIN-ARTAJO, the defendant, also made efforts to influence the CIO VCG view on the marks for the positions in the SCP. In the latter part of March 2012, CW-1 told MARTIN-ARTAJO that, because the marks were moving so far from the crude mids and approaching the outer bounds of the bid-offer spread, it was inevitable that the VCG Employee would report a large difference—which would have the effect of revealing the very losses that MARTIN-ARTAJO was determined to hide. MARTIN-ARTAJO told CW-1 that he would take care of the situation.

64. In or about April 2012, as part of the month-end price testing process, the VCG Employee noticed that the marking methodology for the SCP had appeared to change, from roughly the crude mids in January and February 2012, to the favorable outer bounds of the bid-offer spread for most of the SCP's largest positions in March 2012. The VCG Employee asked CC-1, the defendant, about the change to the new pattern of marking to the beneficial edge of the bid-offer spread; CC-1 replied: "Ask management."

65. In late April and the beginning of May 2012—after the press reports about CIO's large positions in the SCP, and still-increasing losses—JPM's senior management began looking more closely at the process the traders used to value the securities in the SCP. As part of that effort, on or about May 8, 2012, an employee within JPM's Controller's office (the "Controller Employee") began speaking with the CIO traders.

66. On or about April 29, 2012, the Controller Employee spoke with JAVIER MARTIN-ARTAJO, the defendant, about the month-end marks in the SCP. MARTIN-ARTAJO told the Controller Employee, in substance, "I'm a trader. I do not mark the books to U.S. GAAP. My job is to manage risk."

67. On or about May 8, 2012, the Controller Employee spoke with CW-1 about the marks for the positions in the SCP as of March 30, 2012. During that conversation, CW-1 told the Controller Employee, in response to questions about the quarter-end marks for two particular positions, that those positions were marked incorrectly. As to one of the positions, CW-1 stated: "it's too wide, I agree, I agree. One to two basis points too wide." As to the other, the Controller Employee asked: "Broker mids were at 70 . . . The quotes are between 70 and 71, and yet we are appearing at 72 spot 75." When asked, "what was the thought process behind putting us at 72 spot 75?" CW-1 responded: "[b]asically, I think we went too wide, I think we went too wide on this one."

68. Also on or about May 8, 2012, the Controller Employee called JAVIER MARTIN-ARTAJO, the defendant, to ask about the March month-end marks. MARTIN-ARTAJO acknowledged that in January, the SCP marks "were all either mid or somewhere close to mid," whereas the marks for March had "migrated . . . to the aggressive side . . . from mid to somewhere closer to being at the . . . bounds of the bid or offer." Nonetheless, MARTIN-ARTAJO insisted that the SCP traders did not have a "bias," and that MARTIN-ARTAJO himself was not "particularly aggressive in March."

The April 13, 2012 Filing of JPM's Form 8-K and the May 10, 2012 Filing of JPM's Form 10-Q for the First Quarter

69. On or about April 13, 2012, JPM issued an earnings release setting forth its financial results for the first quarter 2012, which was filed on Form 8-K with the SEC. The earnings release, which JPM senior management described in a phone call with investors, disclosed JPM's consolidated financial results as well as results for its Corporate/Private Equity segment. Those results significantly understated the extent of the losses in the SCP, and as a result, the total losses in the Corporate/Private Equity segment.

70. On or about May 10, 2012, JPM filed its Form 10-Q with the SEC, setting forth its financial results for the first quarter 2012, and repeating the same financial results which it had stated on April 13, 2012 for the first quarter.

The July 2012 Restatement

71. On or about July 13, 2012, JPM filed a Form 8-K with the SEC announcing, among other things, that it would be restating its first quarter net earnings for income before income tax expense by \$660 million and restating its net income by \$459 million. That is, JPM's restatement had the effect of nearly doubling the total losses in the Corporate/Private Equity segment, from negative \$563 million (originally) to negative \$1.022 billion (restated).

72. Significantly, all of this write-down was attributable to the SCP and included position marks that JAVIER MARTIN-ARTAJO, the defendant, and others, manipulated and inflated in connection with their scheme. In explaining the reason for the restatement, JPM stated, regarding CIO, that it "discovered information that raises questions about the integrity of the trader marks and suggests that certain individuals may have been seeking to avoid showing the full amount of the losses in the portfolio during the first quarter." JPM also announced that "Management has determined that a material weakness existed in the Firm's internal control over financial reporting at March 31, 2012."

73. On or about August 9, 2012, JPM formally restated its first quarter financials, consistent with its July 13, 2012 announcement, by filing an amended 10-Q with the SEC. Among other things, JPM stated that it found that 107 of the 132 positions within the SCP were marked more favorably than the mid-market price at the end of the first quarter 2012, and that many of the positions were marked at the advantageous end of the bid-offer spread.

C. Trading Fraud and Bankers

Despite many public demands, very few criminal prosecutions were brought against the individuals and firms responsible for the transactions connected to the market for residential mortgage-backed securities (RMBS) that led to the collapse and near collapse

of banks in 2008. Why was this the case? Some argue that it was the result of political influence by the banks. Others have argued that prosecutions would have only further destabilized an already fragile economy. The laws itself have also been blamed, due to their complexity and the difficulty prosecutors face when it comes to proving certain elements, such as criminal intent, to jurors unfamiliar with these sophisticated financial instruments. Additionally, managers in financial institutions often further insulate themselves from criminal liability through pro forma disclosures that warn clients of risks.¹⁰

Even considering the difficulties with securities fraud prosecutions, should such theories have been pursued, at least with more resources devoted to investigative measures? A lot of people (including Steve Carell's character in *The Big Short*) certainly asked that question, and some are still asking it. However, recall that securities fraud cases can be pursued both criminally and civilly. What follows is the SEC's complaint in *SEC v. Tourre*, one important RMBS fraud case related to the financial crisis that was pursued civilly and then, in an unusual development for SEC cases, went to trial.

**AMENDED COMPLAINT, SEC V. FABRICE TOURRE
NO. 10-CV-3229 (S.D.N.Y. NOV. 22, 2010)**

Plaintiff, the United States Securities and Exchange Commission ("Commission"), for its Amended Complaint alleges as follows:

OVERVIEW

1. This action alleges securities fraud by Fabrice Tourre ("Tourre"), an employee of Goldman, Sachs & Co. ("GS&Co"), based on materially misleading statements and omissions in connection with a synthetic collateralized debt obligation ("CDO") that GS&Co structured and marketed to investors. This synthetic CDO, ABACUS 2007-Acl, was tied to the performance of subprime residential mortgage-backed securities ("RMBS") and was structured and marketed by GS&Co in early 2007 when the United States housing market and related securities were beginning to show signs of distress. Synthetic CDOs like ABACUS 2007-Acl contributed to the recent financial crisis by magnifying losses associated with the downturn in the United States housing market.
2. GS&Co marketing materials for ABACUS 2007-Acl—including the term sheet, flip book and offering memorandum for the CDO—all represented that the reference portfolio of RMBS underlying the CDO was selected by ACA Management LLC

¹⁰ Volumes have been written on this subject in the decade since. See, for example, SAMUEL W. BUELL, *CAPITAL OFFENSES: BUSINESS CRIME AND PUNISHMENT IN AMERICA'S CORPORATE AGE* (2016) (chapters 2 and 5); JESSE EISINGER, *THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES* (2017). For brief treatments of some of the issues, see Jeff Madrick & Frank Partnoy, *Should Some Bankers Be Prosecuted*, NEW YORK REVIEW OF BOOKS (Nov. 10, 2011), <https://www.nybooks.com/articles/2011/11/10/should-some-bankers-be-prosecuted>; Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted*, NEW YORK REVIEW OF BOOKS (Jan. 9, 2014), <https://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions>.

(“ACA”), a third-party with experience analyzing credit risk in RMBS. Undisclosed in the marketing materials and unbeknownst to investors, a large hedge fund, Paulson & Co. Inc. (“Paulson”), with economic interests directly adverse to investors in the ABACUS 2007-Acl CDO, played a significant role in the portfolio selection process. After participating in the selection of the reference portfolio, Paulson effectively shorted the RMBS portfolio it helped select by entering into credit default swaps (“CDS”) with GS&Co to buy protection on specific layers of the ABACUS 2007-Acl capital structure. Given its financial short interest, Paulson had an economic incentive to choose RMBS that it expected to experience credit events in the near future. GS&Co and Tourre did not disclose Paulson’s adverse economic interests or its role in the portfolio selection process in the term sheet, flip book, offering memorandum or other marketing materials provided to investors.

3. In sum, GS&Co and Tourre arranged a transaction at Paulson’s request in which Paulson heavily influenced the selection of the portfolio to suit its economic interests, but failed to disclose to investors, as part of the description of the portfolio selection process contained in the marketing materials used to promote the transaction, Paulson’s role in the portfolio selection process or its adverse economic interests.

4. Tourre was principally responsible for ABACUS 2007 AC1. Tourre devised the transaction, prepared the marketing materials and communicated directly with investors. Tourre knew of Paulson’s undisclosed short interest and its role in the portfolio selection process. Tourre concealed Paulson’s short interest and its participation in the portfolio selection during the marketing, offering and sale of ABACUS 2007-Acl securities and security-based swap agreements. Tourre also misled ACA into believing that Paulson invested approximately \$200 million in the equity of ABACUS 2007-Acl (a long position) and, accordingly, that Paulson’s interests in the portfolio selection process were aligned with ACA’s when in reality Paulson’s interests were sharply conflicting.

5. The deal closed on April 26, 2007. Paulson paid GS&Co approximately \$15 million for structuring and marketing ABACUS 2007-Acl. By October 24, 2007, 83% of the RMBS in the ABACUS 2007-Acl portfolio had been downgraded and 17% were on negative watch. By January 29, 2008, 99% of the portfolio had been downgraded. As a result, investors in the ABACUS 2007-Acl CDO lost over \$1 billion. Paulson’s opposite CDS positions yielded a profit of approximately \$1 billion for Paulson.

6. By engaging in the misconduct described herein, GS&Co and Tourre directly or indirectly engaged in transactions, acts, practices and a course of business that violated Section 17(a) of the Securities Act of 1933, 15 U.S.C. §77q(a) (“the Securities Act”), Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b) (“the Exchange Act”) and Exchange Act Rule 10b-5, 17 C.F.R. §240.10b-5. Tourre also aided and abetted violations of Section 10(b) of the Exchange Act by GS&Co. This action seeks injunctive relief, disgorgement of profits, prejudgment interest, civil penalties and other appropriate and necessary equitable relief based on the unlawful conduct alleged herein. . . .

FACTS

A. GS&CO'S CORRELATION TRADING DESK

7. GS&Co's structured product correlation trading desk, located in New York City, was created in and around late 2004/early 2005. Among the services it provided was the structuring and marketing of a series of synthetic CDOs called "ABACUS" whose performance was tied to RMBS. GS&Co sought to protect and expand this profitable franchise in a competitive market throughout the relevant period. According to an internal GS&Co memorandum to the Goldman Sachs Mortgage Capital Committee ("MCC") dated March 12, 2007, the "ability to structure and execute complicated transactions to meet multiple client's needs and objectives is key for our franchise," and "[e]xecuting this transaction [ABACUS 2007-Acl] and others like it helps position Goldman to compete more aggressively in the growing market for synthetics written on structured products."

B. PAULSON'S INVESTMENT STRATEGY

8. Paulson & Co. Inc. ("Paulson") is a hedge fund located in New York City and founded in 1994. Beginning in 2006, Paulson created two funds, known as the Paulson Credit Opportunity Funds, which took a bearish view on subprime mortgage loans by buying protection through CDS on various debt securities. A CDS is an over-the-counter derivative contract under which a protection buyer makes periodic premium payments and the protection seller makes a contingent payment if a reference obligation experiences a credit event.

9. RMBS are securities backed by residential mortgages. Investors receive payments out of the interest and principal on the underlying mortgages. Paulson developed an investment strategy based upon the belief that, for a variety of reasons, certain mid-and-subprime RMBS rated "Triple B," meaning bonds rated "BBB" by S&P or "Baa2" by Moody's, would experience credit events. The Triple B tranche is the lowest investment grade RMBS and, after equity, the first part of the capital structure to experience losses associated with a deterioration of the underlying mortgage loan portfolio.

10. CDOs are debt securities collateralized by debt obligations including RMBS. These securities are packaged and generally held by a special purpose vehicle ("SPV") that issues notes entitling their holders to payments derived from the underlying assets. In a synthetic CDO, the SPV does not actually own a portfolio of fixed income assets, but rather enters into CDSs that reference the performance of a portfolio (the SPV does hold some collateral securities separate from the reference portfolio that it uses to make payment obligations).

11. Paulson came to believe that synthetic CDOs whose reference assets consisted of certain Triple B-rated mid-and-subprime RMBS would experience significant losses

and, under certain circumstances, even the more senior AAA-rated tranches of these so-called “mezzanine” CDOs would become worthless.

C. GS&CO AND PAULSON DISCUSS A PROPOSED TRANSACTION

12. Paulson performed an analysis of recent-vintage Triple B-rated RMBS and identified various bonds it expected to experience credit events. Paulson then asked GS&Co to help it buy protection, through the use of CDS, on the RMBS it had adversely selected, meaning chosen in the belief that the bonds would experience credit events.

13. Paulson discussed with GS&Co possible transactions in which counterparties to its short positions might be found. Among the transactions considered were synthetic CDOs whose performance was tied to Triple B-rated RMBS. Paulson discussed with GS&Co the creation of a CDO that would allow Paulson to participate in selecting a portfolio of reference obligations and then effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO’s capital structure.

14. A Paulson employee explained the investment opportunity as of January 2007 as follows:

“It is true that the market is not pricing the subprime RMBS wipeout scenario. In my opinion this situation is due to the fact that rating agencies, CDO managers and underwriters have all the incentives to keep the game going, while ‘real money’ investors have neither the analytical tools nor the institutional framework to take action before the losses that one could anticipate based [on]the ‘news’ available everywhere are actually realized.”

15. At the same time, Tourre and GS&Co recognized that market conditions were presenting challenges to the successful marketing of CDO transactions backed by mortgage-related securities. For example, portions of an email in French and English sent by Tourre to a friend on January 23, 2007 stated, in English translation where applicable: “More and more leverage in the system, The whole building is about to collapse anytime now . . . Only potential survivor, the fabulous Fab[rice Tourre . . . standing in the middle of all these complex, highly leveraged, exotic trades he created without necessarily understanding all of the implications of those monstrosities!!!” Similarly, an email on February 11, 2007 to Tourre from the head of the GS&Co structured product correlation trading desk stated in part, “the cdo biz is dead we don’t have a lot of time left.”

D. INTRODUCTION OF ACA TO THE PROPOSED TRANSACTION

16. GS&Co and Tourre knew that it would be difficult, if not impossible, to market and sell the liabilities of a synthetic CDO if they disclosed to investors

that a short investor, such as Paulson, played a significant role in the portfolio selection process. By contrast, they knew that the identification of an experienced and independent third-party collateral manager as having selected the portfolio would facilitate the placement of the CDO liabilities in a market that was beginning to show signs of distress.

17. GS&Co and Tourre also knew that at least one significant potential investor, IKB Deutsche Industrie bank AG (“IKB”), was unlikely to invest in the liabilities of a CDO that did not utilize a collateral manager to analyze and select the reference portfolio.

18. GS&Co and Tourre therefore sought a collateral manager to play a role in the transaction proposed by Paulson. Contemporaneous internal correspondence reflects that GS&Co and Tourre understood that not every collateral manager would “agree to the type of names [of RMBS] Paulson want[s] to use” and put its “name at risk . . . on a weak quality portfolio.”

19. In or about January 2007, GS&Co approached ACA and proposed that it serve as the “Portfolio Selection Agent” for a CDO transaction sponsored by Paulson. ACA previously had constructed and managed numerous CDOs for a fee. As of December 31, 2006, ACA had closed on 22 CDO transactions with underlying portfolios consisting of \$15.7 billion of assets.

20. Internal GS&Co communications emphasized the advantages from a marketing perspective of having ACA associated with the transaction. For example, an internal email from Tourre dated February 7, 2007, stated: “One thing that we need to make sure ACA understands is that we want their name on this transaction. This is a transaction for which they are acting as portfolio selection agent, this will be important that we can use ACA’s branding to help distribute the bonds.”

21. Likewise, an internal GS&Co memorandum from Tourre and others to the Goldman Sachs MCC dated March 12, 2007 described the marketing advantages of ACA’s “brand-name” and “credibility”:

“We expect the strong brand-name of ACA as well as our market-leading position in synthetic CDOs of structured products to result in a successful offering.”

“We expect that the role of ACA as Portfolio Selection Agent will broaden the investor base for this and future ABACUS offerings.”

“We intend to target suitable structured product investors who have previously participated in ACA-managed cashflow COO transactions or who have previously participated in prior ABACUS transactions.”

“We expect to leverage ACA’s credibility and franchise to help distribute this Transaction.”

E. PAULSON'S PARTICIPATION IN THE PORTFOLIO SELECTION PROCESS

22. In late 2006 and early 2007, Paulson performed an analysis of recent-vintage Triple B RMBS and identified over 100 bonds it expected to experience credit events in the near future. Paulson's selection criteria favored RMBS that included a high percentage of adjustable rate mortgages, relatively low borrower FICO scores, and a high concentration of mortgages in states like Arizona, California, Florida and Nevada that had recently experienced high rates of home price appreciation. Paulson informed GS&Co that it wanted the reference portfolio for the contemplated transaction to include the RMBS it identified or bonds with similar characteristics.

23. On January 8, 2007, Tourre attended a meeting with representatives from Paulson and ACA at Paulson's offices in New York City to discuss the proposed transaction.

24. On January 9, 2007, GS&Co sent an email to ACA with the subject line, "Paulson Portfolio." Attached to the email was a list of 123 2006 RMBS rated Baa2. On January 9, 2007, ACA performed an "overlap analysis" and determined that it previously had purchased 62 of the 123 RMBS on Paulson's list at the same or lower ratings.

25. On January 9, 2007, GS&Co informed ACA that Tourre was "very excited by the initial portfolio feedback."

26. On January 10, 2007, Tourre sent an email to ACA with the subject line, "Transaction Summary." The text of Tourre's email began, "we wanted to summarize ACA's proposed role as 'Portfolio Selection Agent' for the transaction that would be sponsored by Paulson (the 'Transaction Sponsor')." The email continued in relevant part, "[s]tarting portfolio would be ideally what the Transaction Sponsor shared, but there is flexibility around the names."

27. On January 22, 2007, ACA sent an email to Tourre and others at GS&Co with the subject line, "Paulson Portfolio 1-22-10.xls." The text of the email began, "Attached please find a worksheet with 86 sub-prime mortgage positions that we would recommend taking exposure to synthetically. Of the 123 names that were originally submitted to us for review, we have included only 55."

28. On January 27, 2007, ACA met with a Paulson representative in Jackson Hole, Wyoming, and they discussed the proposed transaction and reference portfolio. The next day, on January 28, 2007, ACA summarized the meeting in an email to Tourre. Tourre responded via email later that day, "this is confirming my initial impression that [Paulson] wanted to proceed with you subject to agreement on portfolio and compensation structure."

29. On February 2, 2007, Paulson, Tourre and ACA met at ACA's offices in New York City to discuss the reference portfolio. Unbeknownst to ACA at the time, Paulson

intended to effectively short the RMBS portfolio it helped select by entering into CDS with GS&Co to buy protection on specific layers of the synthetic CDO's capital structure. Tourre and GS&Co, of course, were fully aware that Paulson's economic interests with respect to the quality of the reference portfolio were directly adverse to CDO investors. During the meeting, Tourre sent an email to another GS&Co employee stating, "I am at this aca paulson meeting, this is surreal." Later the same day, ACA emailed Paulson, Tourre, and others at GS&Co a list of 82 RMBS on which Paulson and ACA concurred, plus a list of 21 "replacement" RMBS. ACA sought Paulson's approval of the revised list, asking, "Let me know if these work for you at the Baa2 level."

30. On February 5, 2007, Paulson sent an email to ACA, with a copy to Tourre, deleting eight RMBS recommended by ACA, leaving the rest, and stating that Tourre agreed that 92 bonds were a sufficient portfolio.

31. On February 5, 2007, an internal ACA email asked, "Attached is the revised portfolio that Paulson would like us to commit to – all names are at the Baa2 level. The final portfolio will have between 80 and these 92 names. Are 'we' ok to say yes on this portfolio?" The response was, "Looks good to me. Did [Paulson] give a reason why they kicked out all the Wells [Fargo] deals?" Wells Fargo was generally perceived as one of the higher-quality subprime loan originators.

32. On or about February 26, 2007, after further discussion, Paulson and ACA came to an agreement on a reference portfolio of 90 RMBS for ABACUS 2007-AC1.

F. GS&CO MISLED INVESTORS BY REPRESENTING THAT ACA SELECTED THE PORTFOLIO WITHOUT DISCLOSING PAULSON'S SIGNIFICANT ROLE IN THE SELECTION AND ITS ADVERSE ECONOMIC INTERESTS

33. GS&Co's marketing materials for ABACUS 2007-AC1 were false and misleading because they represented that ACA selected the reference portfolio while omitting any mention that Paulson, a party with economic interests adverse to CDO investors, played a significant role in the selection of the reference portfolio.

34. For example, a 9-page term sheet for ABACUS 2007- AC1 finalized by GS&C on or about February 26, 2007, described ACA as the "Portfolio Selection Agent" and stated in bold print at the top of the first page that the reference portfolio of RMBS had been "selected by ACA." This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

35. Similarly, a 65-page flip book for ABACUS 2007-AC1 finalized by GS&Co on or about February 26, 2007 represented on its cover page that the reference portfolio of RMBS had been "Selected by ACA Management, LLC." The flip book included a 28-page overview of ACA describing its business strategy, senior management team, investment philosophy, expertise, track record and credit selection process, together with a 7-page section of biographical information on ACA officers and employees. Investors

were assured that the party selecting the portfolio had an “alignment of economic interest” with investors. This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

36. Tourre had primary responsibility for preparing the term sheet and flip book.

37. The Goldman Sachs MCC, which included senior-level management of GS&Co, approved the ABACUS 2007-AC1 transaction on or about March 12, 2007. GS&Co expected to earn between \$15 and \$20 million for structuring and marketing ABACUS 2007-AC1.

38. On or about April 26, 2007, GS&Co finalized a 178-page offering memorandum for ABACUS 2007-AC1. The cover page of the offering memorandum included a description of ACA as “Portfolio Selection Agent.” The Transaction Overview, Summary and Portfolio Selection Agent sections of the memorandum all represented that the reference portfolio of RMBS had been selected by ACA. This document contained no mention of Paulson, its economic interests in the transaction, or its role in selecting the reference portfolio.

39. Tourre reviewed portions of the offering memorandum, including the Summary section, before it was sent to potential investors.

40. Although the marketing materials for ABACUS 2007-AC1 made no mention of Paulson or its role in the transaction, internal GS&Co communications clearly identified Paulson, its economic interests, and its role in the transaction. For example, the March 12, 2007 MCC memorandum describing the transaction stated, “Goldman is effectively working an order for Paulson to buy protection on specific layers of the [ABACUS 2007-] AC1 capital structure.”

G. GS&CO AND TOURRE MISLED ACA INTO BELIEVING PAULSON WAS LONG EQUITY

41. GS&Co and Tourre also misled ACA into believing that Paulson was investing in the equity of ABACUS 2007-AC1 and therefore shared a long interest with COO investors. The equity tranche is at the bottom of the capital structure and the first to experience losses associated with deterioration in the performance of the underlying RMBS. Equity investors therefore have an economic interest in the successful performance of a reference RMBS portfolio. As of early 2007, ACA had participated in a number of CDO transactions involving hedge funds that invested in the equity tranche.

42. Had ACA been aware that Paulson was taking a short position against the CDO, ACA would have been reluctant to allow Paulson to occupy an influential role in the selection of the reference portfolio because it would present serious reputational risk to ACA, which was in effect endorsing the reference portfolio. In fact, it is unlikely that ACA would have served as portfolio selection agent had it known that Paulson was taking a significant short position instead of a long equity stake in ABACUS 2007-AC1.

Tourre and GS&Co were responsible for ACA's misimpression that Paulson had a long position, rather than a short position, with respect to the CDO.

43. On January 8, 2007, Tourre attended a meeting with representatives from Paulson and ACA at Paulson's offices in New York City to discuss the proposed transaction. Paulson's economic interest was unclear to ACA, which sought further clarification from GS&Co. Later that day, ACA sent a GS&Co sales representative an email with the subject line "Paulson meeting" that read: "I have no idea how it went—I wouldn't say it went poorly, not at all, but I think it didn't help that we didn't know exactly how they [Paulson] want to participate in the space. Can you get us some feedback?"

44. On January 10, 2007, Tourre emailed ACA a "Transaction Summary" that included a description of Paulson as the "Transaction Sponsor" and referenced a "Contemplated Capital Structure" with a "[0]% - [9]% pre-committed first loss" as part of the Paulson deal structure. The description of this [0]% - [9]% tranche at the bottom of the capital structure was consistent with the description of an equity tranche and ACA reasonably believed it to be a reference to the equity tranche. In fact, GS&Co never intended to market to anyone a "[0]% - [9]%" first loss equity tranche in this transaction.

45. On January 12, 2007, Tourre spoke by telephone with ACA about the proposed transaction. Following that conversation, on January 14, 2007, ACA sent an email to the GS&Co sales representative raising questions about the proposed transaction and referring to Paulson's equity interest. The email, which had the subject line "Call with Fabrice [Tourre] on Friday," read in pertinent part: "I certainly hope I didn't come across too antagonistic on the call with Fabrice [Tourre] last week but the structure looks difficult from a debt investor perspective. I can understand Paulson's equity perspective but for us to put our name on something, we have to be sure it enhances our reputation."

46. On January 16, 2007, the GS&Co sales representative forwarded that email to Tourre. As of that date, Tourre knew, or was reckless in not knowing, that ACA had been misled into believing Paulson intended to invest in the equity of ABACUS 2007-AC1.

47. Based upon the January 10, 2007, "Transaction Summary" sent by Tourre, the January 12, 2007 telephone call with Tourre and continuing communications with Tourre and others at GS&Co, ACA continued to believe through the course of the transaction that Paulson would be an equity investor in ABACUS 2007-AC1.

48. On February 12, 2007, ACA's Commitments Committee approved the firm's participation in ABACUS 2007-AC1 as portfolio selection agent. The written approval memorandum described Paulson's role as follows: "the hedge fund equity investor wanted to invest in the 0-9% tranche of a static mezzanine ABS CDO backed 100% by subprime residential mortgage securities." Handwritten notes from the meeting reflect discussion of "portfolio selection work with the equity investor."

H. ABACUS 2007-AC1 INVESTORSi. IKB

49. IKB is a commercial bank headquartered in Dusseldorf, Germany. Historically, IKB specialized in lending to small and medium-sized companies. Beginning in and around 2002, IKB, for itself and as an advisor, was involved in the purchase of securitized assets referencing, or consisting of, consumer credit risk including RMBS CDOs backed by U.S. mid-and-subprime mortgages. IKB's former subsidiary, IKB Credit Asset Management GmbH, provided investment advisory services to various purchasing entities participating in a commercial paper conduit known as the "Rhineland programme conduit."

50. The identity and experience of those involved in the selection of a CDO portfolio was an important investment factor for IKB. In late 2006 IKB informed GS&Co and Tourre that it was no longer comfortable investing in the liabilities of CDOs that did not utilize a collateral manager, meaning an independent third-party with knowledge of the U.S. housing market and expertise in analyzing RMBS. Tourre and GS&Co knew that ACA was a collateral manager likely to be acceptable to IKB.

51. GS&Co offered and sold ABACUS 2007-AC1 notes to IKB. Tourre played a principal role in the offer and sale of the securities to IKB.

52. In February, March and April 2007, GS&Co sent IKB copies of the ABACUS 2007-AC1 term sheet, flip book and offering memorandum, all of which represented that the RMBS portfolio had been selected by ACA and omitted any reference to Paulson, its role in selecting the reference portfolio and its adverse economic interests. Those representations and omissions were materially false and misleading because, unbeknownst to IKB, Paulson played a significant role in the collateral selection and had financial interests in the transaction directly adverse to IKB. Neither GS&Co nor Tourre informed IKB of Paulson's participation in the portfolio selection process and its adverse economic interests.

53. On or about February 15, 2007, GS&Co arranged for ABACUS 2007-AC1 marketing materials, including a term sheet and reference portfolio list, to be sent by email to IKB. Tourre was aware these materials would be delivered to IKB.

54. On February 19, 2007, at the direction of GS&Co personnel in New York, a GS&Co sales representative in London forwarded the marketing materials to IKB, explaining via email: "Attached are details of the ACA trade we spoke about with Fabrice [Tourre] in which you thought the AAAs would be interesting."

55. Tourre maintained direct and indirect contact with IKB in an effort to close the deal. On March 6, 2007, Tourre sent an email intended to press IKB to move forward with the transaction. The email stated, among other things, "This is a portfolio selected by ACA . . ." (Tourre subsequently described the portfolio in an internal GS&Co email as having been "selected by ACA/Paulson.") On March 19, 2007, an IKB representative

sent an email to Tourre and others asking “what your plan for the ACA deal is?” On March 23 and 26, 2007, GS&Co arranged for additional ABACUS 2007-AC1 marketing materials to be sent to IKB. On March 27, 2007, IKB indicated that it intended to recommend purchase of the ABACUS 2007-ACI notes. Later on March 27, Tourre sent an email to IKB promising to send updated documents relating to the transaction. The email to IKB from Tourre concluded: “Stay tuned! And thanks for getting your approval so quickly on this.”

56. On April 2, 2007, Tourre sent an email to IKB confirming that he would be sending IKB an offering circular for ABACUS 2007-AC1 blacklined to show differences from a previous ABACUS transaction. IKB sent an email to Tourre in response, asking Tourre to call. Later that day, Tourre sent an email to IKB attaching blacklined and clean copies of the ABACUS 2007- AC1 offering circular. On April 5, 2007, Tourre sent an email to IKB following up on the status of the transaction and stating, “as discussed please let me know if you have any issue with the preliminary offering circular, we can discuss on Monday or Tuesday of next week.”

57. ABACUS 2007-AC1 closed on or about April 26, 2007. IKB bought \$50 million worth of Class A-1 notes at face value. The Class A-1 notes paid a variable interest rate equal to LIBOR plus 85 basis points and were rated Aaa by Moody’s Investors Services, Inc. (“Moody’s”) and AAA by Standard & Poor’s Ratings & Services (“S&P”). IKB bought \$100 million worth of Class A-2 notes at face value. The Class A-2 notes paid a variable interest rate equal to LIBOR plus 110 basis points and were rated Aaa by Moody’s and AAA by S&P.

58. The ABACUS 2007-Acl offering memorandum stated that the offered notes would be “ready for delivery in book-entry form only in New York, New York,” that the notes were being offered by GS&Co “in the United States” and that GS&Co, a New York-based broker-dealer, was “offering” and “selling” the notes. The closing for the ABACUS 2007-AC1 transaction took place at One Battery Park Plaza in New York, New York. At the closing, GS&Co initially purchased the notes, received them through the book-entry facilities of the Depository Trust Company (“DTC”), located at 55 Water Street in New York, and then delivered the notes through the book-entry facilities of the DTC to a New York-based bank for further delivery.

59. At closing GS&Co delivered \$150 million representing the purchase price of the notes by federal funds wire transfer to LaSalle Bank National Association (“LaSalle Bank”), as trustee for ABACUS 2007-Acl. LaSalle Bank was headquartered in Chicago, Illinois during the relevant period.

60. The representation by GS&Co that the ABACUS 2007-AC1 reference portfolio had been selected by an independent third-party with experience and economic interests aligned with CDO investors was important to IKB. IKB would not have invested in the transaction had it known that Paulson played a significant role in the portfolio selection process while intending to take a short position against ABACUS 2007-AC1. Among other things, knowledge of Paulson’s role would have seriously undermined IKB’s

confidence in the portfolio selection process and led senior IKB personnel to oppose the transaction.

61. Within months of closing, the ABACUS 2007-AC1 Class A-1 and A-2 notes sold by GS&Co to IKB were nearly worthless. IKB lost almost all of its \$150 million investment. Most of this money was ultimately paid to Paulson in a series of transactions between GS&Co and Paulson. Specifically, on or about April 26, 2007, an affiliate of Paulson entered into CDS with an affiliate of GS&Co pursuant to which Paulson purchased protection on the layers of the ABACUS 2007- AC1 capital structure corresponding to the Class A-1 and Class A-2 notes. These CDS were security-based swap agreements offered and sold by GS&Co. Tourre played a principal role in the offer and sale of these CDS.

62. Securities or security-based swap agreements relating to ABACUS 2007-AC1 were marketed to additional investors through GS&Co's structured products syndicate desk located in New York. The structured products syndicate desk, among other things, emailed a new issue announcement of the transaction to a number of institutional investors, inviting them to contact, among others, any one of seven GS&Co sales representatives in New York.

ii. ACA/ABN AMRO

63. ACA's parent company, ACA Capital Holdings, Inc. ("ACA Capital"), with its principal office in New York, provided financial guaranty insurance on a variety of structured finance products including RMBS CDOs, through its wholly-owned subsidiary, ACA Financial Guaranty Corporation, also with its principal office in New York. On or about May 31, 2007, ACA Capital sold protection on or "wrapped" the \$909 million super senior tranche of ABACUS 2007-AC1 (through a Delaware-incorporated affiliate), meaning that it assumed the credit risk associated with that portion of the capital structure via a CDS in exchange for premium payments of approximately 50 basis points per year. At approximately the same time, an affiliate of Paulson entered into a CDS with an affiliate of GS&Co pursuant to which it purchased protection on the super senior tranche of ABACUS 2007-AC1. These CDS were security-based swap agreements offered and sold by GS&Co. Tourre played a principal role in the offer and sale of these CDS.

64. ACA Capital was unaware of Paulson's short position in the transaction. It is unlikely that ACA Capital would have written protection on the super senior tranche if it had known that Paulson, which played an influential role in selecting the reference portfolio, had taken a significant short position instead of a long equity stake in ABACUS 2007-AC1.

65. The super senior transaction with ACA Capital was intermediated by ABN AMRO Bank N.V. ("ABN"), which was one of the largest banks in Europe during the relevant period. This meant that, through a series of CDS between ABN and a GS&Co affiliate and between ABN and ACA Capital that netted ABN premium payments of approximately 17 basis points per year, ABN assumed the credit risk associated with the

\$909 million super senior portion of ABACUS 2007-AC1's capital structure in the event ACA Capital was unable to pay. The CDS entered into by ABN and ACA Capital were security-based swap agreements offered and sold by GS&Co. Tourre played a principal role in the offer and sale of these CDS. For example, on April 5, 2007, Tourre sent an email to ABN soliciting its participation in a "super senior swap trade" on the ABACUS 2007-AC1 reference portfolio, which Tourre represented had been "selected by ACA." The email from Tourre to ABN summarized the financial terms of the proposed CDS transaction.

66. GS&Co also sent ABN copies of the ABACUS 2007-AC1 term sheet, flip book and offering memorandum, all of which represented that the RMBS portfolio had been selected by ACA and omitted any reference to Paulson's role in the collateral selection and its adverse economic interest. These representations and omissions were materially false and misleading because, unbeknownst to ABN, Paulson played a significant role in the portfolio selection process and had a financial interest in the transaction that was adverse to ACA Capital and ABN.

67. In addition, on or about April 26, 2007, ACA Capital purchased \$42 million worth of ABACUS 2007-AC1 class A-2 notes at face value. GS&Co offered and sold the ABACUS 2007-AC1 notes purchased by ACA Capital. Tourre played a principal role on the offer and sale of these securities to ACA Capital. As described above, within months of the ABACUS 2007-AC1 closing, the notes were worthless.

68. At the end of 2007, ACA Capital was experiencing severe financial difficulties. In early 2008, ACA Capital entered into a global settlement agreement with its counterparties to effectively unwind approximately \$69 billion worth of CDSs, approximately \$26 billion of which were related to 2005-06 vintage subprime RMBS.

69. In late 2007, ABN was acquired by a consortium of banks that included the Royal Bank of Scotland ("RBS"). On or about August 7, 2008, RBS unwound ABN's super senior position in ABACUS 2007-Acl by paying GS&Co \$840,909,090. Most of this money was subsequently paid by GS&Co to Paulson.

After 13 hours of deliberations, a jury in the Southern District of New York, applying the civil preponderance-of-the-evidence standard, found Tourre liable for six of the seven counts brought against him by the SEC, though jurors were torn over whether Tourre was more "scapegoat" or "willing participant." (To be clear, being a "scapegoat" is not a legal defense, though it may have some jury appeal.) Ultimately, the SEC's lawyers prevailed by painting a picture of Wall Street avarice for a jury struggling to balance the fairness of pinning the blame on one cog in the machine and the greater need for the greed machine to be dismantled. For firsthand accounts of the jury's deliberations, see Susanne Craig, Ben Protess, & Alexandra Stevenson, *In Complex Trading Case, Jurors Focused on Greed*, N.Y. TIMES DEALBOOK (Aug. 2, 2013):

<https://dealbook.nytimes.com/2013/08/02/in-complex-trading-case-jurors-focused-on-greed>.

Problem 3-4

Why didn't the Justice Department charge the Goldman Sachs ABACUS case as a *criminal* case against Tourre? Against the Goldman Sachs firm? Should the government have charged individuals and/or the firm criminally, in connection with ABACUS and/or other mortgage-backed securities trading?

Problem 3-5

In the following materials, you learn about another high-profile matter in recent corporate crime, the "LIBOR scandal." What was the government's theory of fraud in the LIBOR cases, as reflected in this "statement of facts" from the DOJ's settlement with the bank UBS? Consider this question *before* you read the Second Circuit opinion that follows, in which the court explains its reasons for reversing criminal convictions in a prosecution involving a different bank enmeshed in the LIBOR scandal. (The document that follows is from a non-prosecution agreement (NPA). This form of corporate criminal settlement was mentioned in Chapter 1 and will be discussed in detail in Chapter 17.)

STATEMENT OF FACTS

This Statement of Facts is incorporated by reference as part of the non-prosecution agreement, dated December 18, 2012, between the United States Department of Justice, Criminal Division, Fraud Section, and UBS AG ("UBS"). The parties agree that the following information is true and accurate:

I. BACKGROUND

A. LIBOR, Euroyen TIBOR, and Euribor

1. Since its inception in approximately 1986, the London Interbank Offered Rate ("LIBOR") has been a benchmark interest rate used in financial markets around the world. Futures, options, swaps, and other derivative financial instruments traded in the over-the-counter market and on exchanges worldwide are settled based on LIBOR. The Bank of International Settlements has estimated that in the second half of 2009, for example, the notional amount of over-the-counter interest rate derivative contracts was valued at approximately \$450 trillion. In addition, mortgages, credit cards, student loans, and other consumer lending products often use LIBOR as a reference rate.

2. LIBOR is published under the auspices of the British Bankers' Association ("BBA"), a trade association with over 200 member banks that addresses

issues involving the United Kingdom banking and financial services industries. The BBA defines LIBOR as:

The rate at which an individual Contributor Panel bank could borrow funds, were it to do so by asking for and then accepting inter-bank offers in reasonable market size, just prior to 11:00 [a.m.] London time.

This definition has been in place since approximately 1998.

3. LIBOR rates were initially calculated for three currencies: the United States Dollar, the British Pound Sterling, and the Japanese Yen. Over time, the use of LIBOR expanded, and benchmark rates were calculated for ten currencies, including the original three.

4. The LIBOR for a given currency is the result of a calculation based upon submissions from a panel of banks for that currency (the “Contributor Panel”) selected by the BBA. Each member of the Contributor Panel submits its rates every London business day through electronic means to Thomson Reuters, as an agent for the BBA, by 11:10 a.m. London time. Once each Contributor Panel bank has submitted its rate, the contributed rates are ranked. The highest and lowest quartiles are excluded from the calculation, and the middle two quartiles (i.e., 50% of the submissions) are averaged to formulate the resulting LIBOR “fix” or “setting” for that particular currency and maturity.

5. The LIBOR contribution of each Contributor Panel bank is submitted to between two and five decimal places, and the LIBOR fix is rounded, if necessary, to five decimal places. In the context of measuring interest rates, one “basis point” (or “bp”) is one-hundredth of one percent (0.01%). . . .

6. According to the BBA, each Contributor Panel bank must submit its rate without reference to rates contributed by other Contributor Panel banks. The basis for a Contributor Panel bank’s submission, according to a clarification the BBA issued in June 2008, must be the rate at which members of the bank’s staff primarily responsible for management of the bank’s cash, rather than the bank’s derivative trading book, consider that the bank can borrow unsecured inter-bank funds in the London money market. Further, according to the BBA, a Contributor Panel bank may not contribute a rate based on the pricing of any derivative financial instrument. In other words, a Contributor Panel bank’s LIBOR submissions should not be influenced by its motive to maximize profit or minimize losses in derivatives transactions tied to LIBOR. . . .

7. Thomson Reuters, as an agent of the EBF, calculates and publishes the Euribor rates each business day. Each Euribor Contributor Panel bank submits its contributed rate to Thomson Reuters through electronic means, and then the contributed rates are ranked. The highest and lowest 15% of all the quotes are excluded from the calculation, and the remaining rates (i.e., the middle 70%) are averaged to formulate the resulting Euribor fix for each tenor. The published rates, and each Contributor Panel

bank's submitted rates, are made available worldwide through electronic means and through a variety of information sources.

8. From at least 2005 until 2012, UBS was also a member of the Contributor Panel for the Euroyen Tokyo Interbank Offered Rate ("TIBOR"). TIBOR is a reference rate overseen by the Japanese Bankers Association ("JBA"), which is based in Tokyo, Japan. While UBS was a member of the panel, the Euroyen TIBOR Contributor Panel was comprised of 16 banks. The term "Euroyen" refers to Yen deposits maintained in accounts outside of Japan. Euroyen TIBOR is what Contributor Panel banks deem to be prevailing lending market rates between prime banks in the Japan Offshore Market as of 11:00 a.m. Tokyo time. Euroyen TIBOR is calculated by discarding the two highest and two lowest submissions, and averaging the remaining rates. The published rates, and each Contributor Panel bank's submitted rates, are made available worldwide through electronic means and through a variety of information sources.

9. Because of the widespread use of LIBOR and other benchmark interest rates in financial markets, these rates play a fundamentally important role in financial systems around the world.

B. Eurodollar and Euroyen Futures Contracts, and Interest Rate Swaps

10. Eurodollar futures contracts are traded on the Chicago Mercantile Exchange ("CME"), and are settled based on LIBOR. Eurodollar futures contracts are highly liquid, and each has a notional value of \$1 million. A "Eurodollar" is a Dollar deposit with a bank outside of the United States. A Eurodollar futures contract is essentially the interest that would be paid on a Eurodollar deposit of \$1 million for a term of three months. Prior to the settlement date, the price of a 3-month Eurodollar futures contract is an indication of the market's prediction of the 3-month Dollar LIBOR on its settlement date. The actual settlement price of a 3-month contract is calculated as 100 minus the 3-month Dollar LIBOR on the settlement date. Most Eurodollar futures contracts settle on four quarterly International Monetary Market ("IMM") dates, which are the third Wednesday of March, June, September, and December. The last trading days are the second London bank business day prior to the third Wednesday (i.e., usually Monday) in those months. In 2009, according to the Futures Industry Association, more than 437 million Eurodollar futures contracts were traded on the CME.

11. Euroyen futures contracts are also traded on the CME and other exchanges around the world, and are settled based on Euroyen TIBOR. A Euroyen futures contract is essentially the interest that would be paid on a Euroyen deposit of ¥100,000,000 for a term of three months. The actual settlement price of a 3-month contract is calculated as 100 minus the 3-month Euroyen TIBOR on the settlement date. Most contracts settle on the four quarterly IMM dates. From 2007 through 2011, according to the CME, more than 758,000 Euroyen TIBOR futures contracts were traded on the CME.

12. An interest rate swap (“swap”) is a financial derivative instrument in which two parties agree to exchange interest rate cash flows. If, for example, a party has a transaction in which it pays a fixed rate of interest but wishes to pay a floating rate of interest tied to a reference rate, it can enter into an interest rate swap to exchange its fixed rate obligation for a floating rate one. Commonly, for example, Party A pays a fixed rate to Party B, while Party B pays a floating interest rate to Party A indexed to a reference rate like LIBOR. There is no exchange of principal amounts, which are commonly referred to as the “notional” amounts of the swap transactions. Interest rate swaps are traded over-the-counter; in other words, they are negotiated in transactions between counterparties and are not traded on exchanges.

C. UBS

13. UBS AG is a financial services corporation with headquarters located in Zurich, Switzerland. UBS AG has banking divisions and subsidiaries around the world, including in the United States, with its United States headquarters located in New York, New York and Stamford, Connecticut. One of its divisions is the Investment Bank, which operates through a number of legal entities including UBS Securities Japan Co., Ltd.,—which is a wholly-owned subsidiary of UBS AG that engages in investment banking and wealth management. UBS employs derivatives traders throughout the world—including in Stamford, London, Zurich, and Tokyo—who trade financial instruments tied to LIBOR, Euribor and Euroyen TIBOR, including interest rate swaps and Eurodollar and Euroyen futures contracts (“derivatives traders”).

14. UBS AG’s Group Treasury section is the part of UBS AG that monitors and oversees the financial resources of the entire bank, including the bank’s liquidity and funding. At all relevant times herein, Asset and Liability Management (“ALM”) is the part of the Investment Bank Division which managed the bank’s liquidity buffer and issuance of new commercial paper and certificates of deposit. Group Treasury provided guidance to ALM on funding issues. The head of ALM worked for the Investment Bank Division.

D. UBS’s LIBOR, Euroyen TIBOR, and Euribor Submissions

15. At various times from at least 2001 through June 2010, certain UBS derivatives traders—whose compensation from UBS was directly connected to their success in trading financial products tied to LIBOR, Euroyen TIBOR and Euribor—directly or indirectly exercised improper influence over UBS’s submissions for those benchmark interest rates.

16. Up until September 1, 2009, UBS’s LIBOR submissions were made by UBS derivatives traders. On September 1, 2009, ALM took over the LIBOR submission process from the derivatives trading desks. This change was the result of a decision of UBS’s Compliance Department (“Compliance”), based on the conclusion that there was an inherent conflict of interest in having derivatives traders determine the daily benchmark submissions. Nevertheless, under this new policy, derivatives traders

continued to provide input to ALM, which ALM submitters at times considered in determining UBS's LIBOR and Euribor submissions. Each day, approximately 15 minutes before ALM made its LIBOR and Euribor submissions, derivatives traders in a given currency would input their assessment of LIBOR and Euribor changes into a shared spreadsheet. The ALM submitters then considered that input along with the previous day's submission, but also factored in ALM's knowledge of UBS's cost of funds.

II. UBS'S MANIPULATION OF LIBOR, EUROYEN TIBOR AND EURIBOR SUBMISSIONS

17. From as early as 2001 through at least June 2010, certain UBS derivatives traders requested and obtained benchmark interest-rate submissions which benefited their trading positions. These derivatives traders requested, and sometimes directed, that certain UBS LIBOR, Euroyen TIBOR, and Euribor submitters submit benchmark interest rate contributions that would benefit the traders' trading positions, rather than rates that complied with the definitions of LIBOR, Euroyen TIBOR and Euribor. Those derivatives traders either requested or directed a particular LIBOR, Euroyen TIBOR or Euribor contribution for a particular tenor and currency, or requested that the rate submitter contribute a rate higher, lower, or unchanged for a particular tenor and currency. The derivatives traders made these requests in electronic messages, telephone conversations, and in-person conversations. The LIBOR, Euroyen TIBOR, and Euribor submitters regularly agreed to accommodate the derivatives traders' requests and directions for favorable benchmark interest rate submissions.

A. Yen LIBOR and Euroyen TIBOR

18. The market for derivatives and other financial products linked to benchmark interest rates for the Yen is global and is one of the largest and most active markets for such products in the world. A number of these products are traded in the United States—such as the Euroyen TIBOR futures contract traded on the CME—in transactions involving U.S.-based counterparties. For example, a meaningful portion of the total value of the transactions entered into by UBS's most successful Yen derivatives trader from 2007 through 2009 (“Trader-1”) involved U.S.-based counterparties.

19. Beginning in 2006, in Zurich, Tokyo, and elsewhere, several UBS employees engaged in sustained, wide-ranging, and systematic efforts to manipulate Yen LIBOR and, to a lesser extent, Euroyen TIBOR, to benefit UBS's trading positions. This conduct encompassed hundreds of instances in which UBS employees sought to influence benchmark rates; during some periods, UBS employees engaged in this activity on nearly a daily basis. In furtherance of these efforts to manipulate Yen benchmarks, UBS employees used several principal and interrelated methods, including the following:

- (a) internal manipulation within UBS of its Yen LIBOR and Euroyen TIBOR submissions;

- (b) use of cash brokers to influence other Contributor Panel banks' Yen LIBOR submissions by disseminating misinformation; and
- (c) efforts to collude directly with employees at other Contributor Panel banks, either directly or through brokers, in order to influence those banks' Yen LIBOR submissions.

Details and examples of this conduct are set forth below.

1) Manipulation Within UBS of its Yen LIBOR and Euroyen TIBOR Submissions

a. Yen LIBOR

20. Instances of accommodating Yen derivatives traders' requests dated back at least to 2002, when UBS's Yen LIBOR submitter—later promoted to manage UBS's Yen and Swiss Franc derivatives trading desks—occasionally accommodated his/her supervisor's instruction for submissions to benefit the supervisor's Yen derivatives trading positions.

21. The manipulation of Yen LIBOR submissions to benefit UBS derivatives traders' positions began to occur far more frequently after July 2006, when UBS hired Trader-1, a Tokyo-based Yen derivatives trader. Beginning in September 2006, and continuing until soon before he left UBS in September 2009, Trader-1, and occasionally other UBS Yen derivatives traders, regularly requested that UBS Yen LIBOR submitters contribute LIBOR submissions to benefit their trading books. Trader-1 and his/her colleagues engaged in this conduct on the majority of total trading days during this more-than-three-year period.

22. For example, on Monday, November 20, 2006, Trader-1 asked the UBS Yen LIBOR submitter ("Submitter-3"), who was substituting for the regular submitter ("Submitter-1") that day, "hi . . . [Submitter-1] and I generally coordinate ie sometimes trade if ity [sic] suits, otherwise skew the libors a bit." Trader-1 went on to request, "really need high 6m [6-month] fixes till Thursday." Submitter-3 responded, "yep we on the case there . . . will def[initely] be on the high side." The day before this request, UBS's 6-month Yen LIBOR submission had been tied with the lowest submissions included in the calculation of the LIBOR fix. Immediately after this request for high submissions, however, UBS's 6-month Yen LIBOR submissions rose to the highest submission of any bank in the Contributor Panel and remained tied for the highest until Thursday—as Trader-1 had requested.

23. In early 2007, a new UBS Yen LIBOR submitter ("Submitter-2") received training from Submitter-1, who was also a UBS manager and Yen derivatives trader. During that training, Submitter-2 was instructed that the primary factor in determining UBS's Yen LIBOR submissions each day was the UBS Yen derivatives traders' requests, which were to be accommodated. Submitter-2 followed that directive, and accommodated Trader-1 and other UBS Yen derivatives traders' requests for

LIBOR submissions through July 2009, when Submitter-2's responsibilities at UBS changed.

24. From at least August 2007 and at various times through at least September 2009, the manager of one of the Yen derivatives trading desks in Tokyo exerted pressure on Yen LIBOR submitters to take derivatives traders' positions into account when setting Yen LIBOR. Yen derivatives traders routinely requested that the submitters contribute Yen LIBOR submissions to benefit their trading books, and the submitters, in accordance with the instructions from their superiors at UBS, accommodated derivatives traders' requests.

25. An example of such an accommodation occurred on March 29, 2007, when Trader-1 asked Submitter-1, "can we go low 3[month] and 6[month] pls? . . . 3[month] esp." Submitter-1 responded "ok", and then the two had the following exchange by electronic chat:

Trader-1: what are we going to set?

Submitter-1: too early to say yet . . . prob[ably] .69 would be our unbiased contribution

Trader-1: ok wd really help if we cld keep 3m low pls

Submitter-1: as i said before – i [don't] mind helping on your fixings, but i'm not setting libor 7bp away from the truth . . . I'll get ubs banned if i do that, no interest in that.

Trader-1: ok obviously [sic] no int[erest] in that happening either . . . not asking for it to be 7bp from reality anyway any help appreciated [.]

Trader-1 received the help he requested. Although Submitter-1's "unbiased contribution" of the 3-month Yen LIBOR submission would have been .69 that day, he lowered his/her submission to .67, as Trader-1 requested.

26. As another example, a series of electronic chats between March 12 and 17, 2008, demonstrates that Trader-1 caused UBS's Yen LIBOR submission to move 3 basis points over a 5 day period. On Wednesday, March 12, 2008, Trader-1 asked Submitter-2 to raise the 3-month Yen LIBOR submission from the previous day's .99 contribution, because "we have [\$2 million] usd fix in 3[month] on Monday [March 17] per bp." Submitter-2 responded: "with yesterdays .99 i was already on the very high side. i need to go down a touch lower on the back to what happened yesterday . . . thought about .97." Trader-1 responded: "cool no chance of .98? anyway the actual fix is Monady [sic] [March 17] so that's the key day." Although Submitter-2 had intended to drop his/her LIBOR contribution down to .97 on March 12, he instead raised his/her LIBOR submission to .98. The following day, he raised it again to .99, and on Monday, March 17, the following exchange occurred:

Trader-1: been chatting with [your supervisor] . . . can we go . . . high 3[month] . . . obviously with the size of the fix today and confusion over levels if we could push it a bit more than usual it would be great

* * *

Submitter-2: Friday fixed 3mt at 0.09

Trader-1: thx [Submitter-2]

Submitter-2: shall I go fro [sic] 1%?

Trader-1: pls

Submitter-2: ok will do

As promised, Submitter-2 contributed a Yen LIBOR submission of 1% that day, 3 basis points higher than where he had intended to submit a few days earlier.

27. In a March 28, 2008 electronic chat between Trader-1 and Submitter-2, Trader-1 was again successful in manipulating UBS's LIBOR submission to benefit his trading positions:

Trader-1: just for my guide [Submitter-2] roughly wher are we going to set 3m and 6m?

Submitter-2: 3m0.92 6m 0.96

Trader-1: can we go lower?

Submitter-2: sure . . . dont think it will be that low though . . . but can do 090

* * *

Trader-1: so can we set 6m at .94 too? . . . 6m is much more urgent . . . most urgent of the lot

* * *

Submitter-2: i just put in 0.95 for 6mt

Trader-1: ok . . . Thx

True to his/her agreement to accommodate Trader-1, Submitter-2 lowered UBS's 3-month Yen LIBOR submission from .92 to .90, and lowered UBS's 6-month submission from .96 to .95.

28. On some occasions, UBS Yen LIBOR submitters would also amend, if possible, previously submitted Yen LIBOR contributions to accommodate UBS's

trading positions. For example, in an April 4, 2008 electronic chat between Trader-1 and Submitter-2, the following exchange occurred:

Trader-1: have you put the libors in?
Submitter-2: y[es] . . . any changes?
Trader-1: oh was going to ask high 6m if not too late
Submitter-2: i input 95 . . . which is on the lower side
Trader-1: ok is it too late to change? . . . if not no drama
Submitter-2: i try to change it now but cannot guarantee if it gets accepted

* * *

Submitter-2: just changed [sic] it to 0.98

The UBS 6-month Yen LIBOR submission that day was indeed .98, 3 basis points higher than Submitter-2's originally intended submission.

29. As another example, on June 29, 2009, Trader-1 contacted Submitter-2 by electronic chat, explaining that he had huge positions that day and asking, "can we [submit] 6 m libor high pls." Submitter-2 stated that based on the information he had, he would submit a 6- month Yen LIBOR of .7150. Trader-1 responded by asking, "can we go 74 or 75 [meaning .74 or .75] . . . we have [\$2 million per basis point exposure] for the next week." Submitter-2 agreed to accommodate this request, responding, "yes sure will. I go with .75 for you[.]" Thus, the submitter agreed to move his/her 6-month Yen LIBOR submission by 3.5 basis points that day to benefit the derivatives trader's position.

b. Euroyen TIBOR

30. From in or around 2007 through 2009, on some occasions, UBS Yen derivatives traders also requested that UBS Euroyen TIBOR submitters contribute TIBOR submissions to benefit their trading positions. The TIBOR submitters' manager, Submitter-1, routinely provided suggested TIBOR submissions based on the derivatives traders' positions, and the TIBOR submitters relied upon this input.

31. For example, in a November 8, 2007 electronic chat, Submitter-1, who was also a UBS Yen derivatives trader, instructed the TIBOR submitter: "pls remind me tomorrow . . . we need to move the 1mos tibar up . . . maybe +2 tomorrow . . . then 1 bp on each for a few days . . . swap guys having some fixings." The TIBOR submitter responded "ok, noted".

32. As another example, on July 23, 2009, Submitter-1 caused UBS's Euroyen TIBOR submissions to decrease for a different improper purpose. On that day,

Submitter-1 had the Euroyen TIBOR submitter drop UBS's 3-month TIBOR submission by 4 basis points simply to damage Trader-1's positions, and not because that is where he perceived Yen cash was trading.

In an electronic chat with Trader-B at another Contributor Panel bank, Trader-1 explained how he would rectify the situation by manipulating TIBOR settings higher the following week:

[Submitter-1, who caused TIBOR to drop] hates me and is going to zurich . . . [his/her] last day is Friday . . . so [s/he] tried to screw my pos[ition] . . . next week we have control . . . so will try to get it back up . . . or rather will do it . . . monday goes back up

Later that same day, in a separate electronic chat with a cash broker who handled transactions for Trader-1 ("Broker-A1"), Trader-1 described how he successfully reached out to the UBS TIBOR submitters to raise UBS's 3-month submission back up.

Trader-1: main thing is 3m tiber . . . i went to meet the guys who set it today

Broker-A1: you can asist there

Trader-1: they just set where we ask

Broker-A1: ;-) perfect

c. *The Role of UBS Managers*

33. Certain UBS managers, and senior managers, were aware of the internal manipulation of Yen LIBOR and Euroyen TIBOR submissions by derivatives traders as described above. For example, Trader-1's manager knew, at least as early as 2007, that internal pressure was placed on UBS Yen LIBOR submitters, and occasionally the Euroyen TIBOR submitters, to contribute submissions to benefit the Yen trading book. Further, certain Zurich based managers and more senior managers heading the derivatives desks in all currencies were informed of the pressure the Yen trading desk placed on the LIBOR submitters to contribute Yen LIBOR to benefit the traders' positions.

34. The majority of UBS Yen LIBOR and Euroyen TIBOR submitters, Yen derivatives traders, and their supervisors – as well as the more senior managers at UBS who were aware of this conduct – knew that the manipulation of Yen LIBOR and TIBOR submissions was inappropriate, yet continued to encourage, allow, or participate in this conduct. For example, Trader-1's manager, a senior manager in the Investment Bank, the primary Yen LIBOR and TIBOR submitters, and other derivatives traders knew it is inappropriate, and contrary to the definition of LIBOR or TIBOR, to consider derivative trading positions when contributing LIBOR or TIBOR submissions. Indeed, in an October 9, 2008 email, Submitter-1 complained to several other managers that: "one of

the things we signed up for when UBS agreed to join the fixing panel was the condition that fixing contributions shall be made regardless of trading positions.”

35. Because UBS’s Yen LIBOR submitters, derivatives traders, and their managers knew this conduct was improper, they tried to conceal the manipulation. For example, after an August 10, 2009 Trader-1 email request to lower 6-month Yen LIBOR, a LIBOR submitter (“Submitter-4”) complained to Trader-1’s manager that these requests should not be in writing. Moreover, Trader-1 would sometimes request that LIBOR submissions be moved in small increments over time to avoid detection.

36. Finally, and for the same reason, a UBS derivatives desk manager sought to obstruct the investigation into LIBOR manipulation. In December 2010, Submitter-4, the UBS derivatives desk manager who had supervised Submitter-2 in 2009, instructed Submitter-2 to lie when interviewed by UBS attorneys during the investigation into LIBOR manipulation. Among other things, the UBS manager instructed Submitter-2 to:

- falsely claim that the UBS Yen trading desks did not have any derivative positions with exposure to Yen LIBOR;
- avoid mentioning Trader-1;
- falsely indicate that the Yen LIBOR submission process did not take into account trading positions;
- falsely claim that they never moved the Yen LIBOR submissions to benefit the Yen trading desks;
- falsely claim that when contributing Yen LIBOR submissions, UBS tried to be “as close to the market as possible.”

2) *Use of Brokers to Manipulate Yen LIBOR*

37. From at least 2007 and at various times through January 2010, two UBS Yen derivatives traders also used cash brokers to manipulate Yen LIBOR submissions by enlisting these brokers to disseminate misinformation to other Contributor Panel banks regarding Yen LIBOR.

38. Cash brokers track bids and offers of cash in the market and assist derivatives and money market traders in arranging transactions between financial institutions and other market participants. As a result of their positions as intermediaries, some of these brokers developed relationships with traders and LIBOR submitters at various Contributor Panel banks and often possessed knowledge of interbank money market activity. Accordingly, it is not unusual for LIBOR submitters to collect information from cash brokers regarding the availability and price of cash in the money markets and elsewhere. This information can influence the LIBOR submissions of Contributor Panel banks.

a. Use of Brokers to Disseminate Misinformation

39. Certain UBS Yen derivatives traders sought and received assistance from cash brokers by asking them to disseminate false market information to Yen LIBOR submitters at other Contributor Panel banks. In this way, recipients of such misinformation could be influenced, often unwittingly, to contribute Yen LIBOR submissions that benefited UBS Yen derivatives traders' positions.

40. Trader-1 did a large volume of business in the Yen derivatives market, and he used brokers at several firms to help arrange his trades. Trader-1 also used some of those brokers, in different ways, as part of his scheme to manipulate Yen LIBOR. Trader-1 engaged in this conduct beginning in 2007, after discussing the strategy with his manager.

41. Trader-1 carried out one significant part of this scheme through his dealings with Brokerage-A. Trader-1 used Brokerage-A to broker derivative trades, and Broker-A1 serviced Trader-1's account. Another broker at that firm, Broker-A2, distributed a daily email to the Contributor Panel banks, which included "SUGGESTED LIBORS" purporting to represent where that broker thought Yen LIBOR should be set that day based on his/her market knowledge and experience. Trader-1 used Broker-A1 to pass along requests to Broker-A2 to adjust these suggested LIBORs to benefit Trader-1's trading positions. Broker-A2, at least on some occasions, accommodated these requests. Trader-1's manager, who was well-aware of this manipulative tactic, later estimated that during one six-month period in 2007, this scheme was used on a daily basis and had a 50% to 60% success rate.

42. As an example, in a Wednesday, August 15, 2007 electronic chat, Trader-1 and Broker-A1 discuss Trader-1's desire to raise the published 6 month Yen LIBOR fix:

Trader-1: need to keep 6m up till tues then let it collapse

Broker-A1: doing a good job so far . . . as long as the liquidity remains poor
we. Have a better chance of bullying the fix [.]

43. The next day, Thursday, August 16, 2007, Trader-1 reiterated his need for a high 6-month Yen LIBOR fix:

Trader-1: reall really really need high 6m

Broker-A1: yep think I realise that

* * *

Broker-A1: yes mate, will make myself useful

That day, consistent with Trader-1's request, Broker-A2 again raised his/her suggested LIBOR, this time by an additional 6.5 basis points, where it remained for several days.

44. Moreover, in a May 29, 2008 electronic chat, Trader-1 instructed Broker-A1 to “bring 3[-month LIBOR] down.” Broker-A1, acting as an intermediary for Broker A2, responded “[Broker-A2] had knocked 3m down small (already v low and says if it goes any further he will lose credibility).”

45. Further, in a May 12, 2009 electronic chat, Broker-A1 notified Trader-1 that “[Broker-A2] has moved 6m libor up another 1/2bp and [unchanged] for 3m and 1m down small.” Indeed, Broker-A2 modified his/her suggested LIBORs in precisely this fashion from the previous trading day.

46. These suggested LIBORs distributed from Brokerage A were influential; indeed, Broker-A2’s suggestions appear to have been wholly adopted by Yen LIBOR submitters at three other Contributor Panel banks during certain time periods. For example, of the 523 total trading days between January 1, 2008 and December 31, 2009, there were 308 days in which suggested Yen LIBOR in all 8 tenors listed in Broker-A2’s email were identical to those submitted by one Contributor Panel Bank (“Bank-E”). Further, there were many instances when Bank-E’s Yen LIBOR submissions for all 8 tenors changed identically each day with the changes in Broker-A2’s suggested LIBORs, often matching the suggestions to 5 decimal points.

47. Trader-1 was aware that Broker-A2’s suggested LIBORs, when adjusted to benefit UBS’s derivatives desk’s positions, disseminated false information into the market. The following exchange occurred in an August 12, 2007 electronic chat between Broker-A1 and Trader-1:

Broker-A1: like [Broker-A2] said to me last night, he can try and tweak
[Suggested LIBORs] by a point or 2 when its flying [sic] but if
he marks too far from the truth the banks tend to ignore him.

Trader-1: ok no probs . . . any help is better than none!

48. Trader-1 also enlisted cash brokers to improperly influence other Contributor Panel banks’ Yen LIBOR submissions through telephone conversations between brokers and Yen LIBOR submitters at the other panel banks. For example, in a February 9, 2009 electronic chat, Trader-1 asked Broker-C to cause a colleague to suggest to other Contributor Panel banks to lower their LIBOR submissions by stating that the broker’s Yen accounts “look[ed] a little softer.” While requesting that Brokerage-C disseminate this misinformation, Trader-1 identified at least two other brokerage houses that also assisted him in manipulating Yen LIBOR, and indicated that he would reward brokers for this type of assistance:

Trader-1: do you know your cash desk? . . . ie the guy who covers. Yen
on your cash desk

Broker-C: yes mate i do

Trader-1: right now on i need you to ask him a favour on the fixes . . . i will make sure it comes back to you . . . i already do it with [Brokerage-A] . . . basically can you ask him to broke 3m cash ie libor lower for me today . . . i will look after you off the back of it . . . i do that for [Brokerage-B] too . . . so emphasise the importance to you . . . just suggest it looks a little softer to his accounts

Broker-C: ok mate I understand I will go and speak to him

Trader-1: stuff like that . . . thanks mate . . . is very important to me today

After a five minute break, the two resumed their electronic chat:

Broker-C: just spoke to them and they are on the case

Trader-1: ok mate much appreciated

49. As another example, in a February 25, 2009 electronic chat, Trader-1 instructed Broker-B: “low 1m and 3m . . . we must keep 3m down . . . try for low on all of em.” Broker B responded “ok ill do my best for those tday.” Trader-1 then asked Broker-B to arrange for a “massive” trade and Broker-B acknowledged that the trade would generate profits for him/her.

Trader-1: we can do 150 [billion] 2 yrs bro both sides . . . ask [Trader-A2] . . . will that help?

Broker-B: ok mate that will make us make budget for the month so massive yes

Later that morning, Broker-B had a recorded telephone conversation with the Yen LIBOR submitter at Bank-F (“Submitter-F”), requesting that the submitter lower Bank-F’s 3-month Yen LIBOR submission, as follows:

Broker-B: Could I ask you a small favor?

Submitter-F: Yeah.

Broker-B: Where are you going to set your Libor threes today?

Submitter-F: Uh, same, 65.

Broker-B: Is there any way you might be able to take it down [one basis point] cause I’m getting a big trade out of it? . . . I’m getting someone to do me a big trade if they said I can help ‘em sort of get Libors down a little bit today.

Submitter-F had already entered the .65 3-month LIBOR submission on a form, which he had passed on to the Swiss Franc submitter sitting next to him. However, Submitter-F can be heard on the recorded conversation requesting the submitter next to him to

lower Submitter-F's 3- month Yen LIBOR submission from .65 to .64, pursuant to Broker-B's request: "Yeah, okay. Could you make the threes .64 []?" Bank-F's 3-month LIBOR submission dropped from .65 to .64 that day, lowering the resulting LIBOR fix in favor of Trader-1's positions.

50. As another example, in a March 31, 2009 electronic chat, Trader-1 asked Broker-C to help influence 9 of the 16 Contributor Panel banks by convincing them to lower their LIBOR submissions from the previous day, thus lower the resulting 1-month and 3-month Yen LIBOR fix.

Trader-1: mate we have to get 1m and 3m down . . . 1 m barely fell yesterday . . . real important

Broker-C: yeah ok

Trader-1: banks to have a go w in 1m are

Trader-1: [Bank-F]

Trader-1: [Bank-G]

Trader-1: [Bank-H]

Trader-1: [Bank-E]

Trader-1: [Bank-I]

Trader-1: [Bank-C]

Trader-1: [Bank-A]

Trader-1: [Bank-J]

Trader-1: and [Bank-K]

Trader-1: Pls

Broker-C: got it mate

That day, consistent with Trader-1's request, 6 of the 9 Contributor Panel banks listed above lowered their 1-month Yen LIBOR submissions relative to the previous day, and the resulting published 1-month Yen LIBOR fix dropped by a full basis point from the day before.

51. As another example, in a March 19, 2009 electronic chat, Broker-B confirmed that he accommodated Trader-1's request to influence Yen LIBOR submitters at other Contributor Panel banks:

Trader-1: need low everything pls try really hard to get [Bank-D] down

* * *

Broker-B: ok will try mate

Trader-1: ok try for [Bank-D] and the japanese and [Bank-G] as priority
. . . pls

Broker-B: Kkk

Trader-1: thx . . . pls push really hard

48 minutes later, Broker-B resumed the chat, confirming that he had spoken to the banks:

Broker-B: yes already had a word with a couple of them [Bank-D] and
[Bank-A] said they should be lower . . . workin on [Bank-G]
and [Bank-J]

52. Trader-1 also used brokers to disseminate misinformation through a technique known as “spoof bids,” whereby brokers, at Trader-1’s request, would describe a potential opportunity to engage in certain money market transactions to Contributor Panel banks in an attempt to influence those banks’ Yen LIBOR submissions. In truth, there was no intention of going through with the purported money market transactions, and the fictional bids were designed solely to influence Yen LIBOR. During a June 10, 2009 electronic chat, Trader-1 and Broker-B referred to this tactic when discussing efforts they would make that day to manipulate Yen LIBOR:

Trader-1: LOW 1m . . . LOW 3m . . . HIGH 6m . . . 6m is important today
mate . . . pls spoof bids

Broker-B: rite ok mate ill make a special effort

Later in the same chat, Broker-B remarked to Trader-1:

mate yur getting bloody good at this libor game . . . think of me when
yur on yur yacht in Monaco wont yu . . .

3) Efforts to Collude with Other Banks to Manipulate Yen LIBOR

53. From at least as early as January 2007 and at various times until at least approximately September 2009, Trader-1 communicated with derivatives traders at other Yen LIBOR Contributor Panel banks in an effort to manipulate Yen LIBOR to benefit his trading positions. Trader-1 requested that his counterpart traders at other Contributor Panel banks make requests to their respective Yen LIBOR submitters to contribute a particular LIBOR submission, or to move their submission in a particular direction (i.e., up or down). Trader-1 made these requests to his counterpart traders at other Contributor Panel banks on many occasions.

54. On February 2, 2007, Trader-1 described this method of manipulating LIBOR in an electronic chat with his counterpart Yen derivatives trader (“Trader-A1”) at another Contributor Panel bank (“Bank-A”):

Trader-1: 3[month] libor is too high cause I have kept it artificially high

Trader-A1: how[?]

Trader-1: being mates with the cash desks, [another Contributor Panel bank, (“Bank-C”) and I always help each other our too

Trader-A1: that’s useful to know.

55. By April 2007, Trader-1 had requested Trader-A1 to solicit Bank-A LIBOR submitters to contribute submissions which benefited UBS’s Yen trading positions. For example, in an April 20, 2007 electronic chat, Trader-1 stated to Trader-A1:

I know I only talk to you when I need something but if you could ask your guys to keep 3m low wd be massive help as long as it doesn’t interfere with your stuff . . . tx in advance

Approximately 30 minutes later, Trader-1 and Trader-A1 had the following chat:

Trader-1: mate did you manage to spk to your cash boys?

Trader-A1: yes u owe me they are going 65 and 71

Trader-1: thx mate yes I do . . . in fact I owe you big time . . .

Approximately 45 minutes later, after checking to see if Bank-A lowered its 3 month Yen LIBOR submission to 65, Trader-1 sent the following message to Trader-A1:

Mate[y] they set 64! . . . that’s beyond the call of duty!

56. Trader-1 also occasionally requested his counterpart derivatives trader (“Trader- B”) at another Contributor Panel bank (“Bank-B”) to have Bank-B contribute Yen LIBOR submissions to benefit UBS’s Yen trading positions. For example, on May 21, 2009 Trader-1 asked Trader-B: “cld you do me a favour would you mind moving you 6m libor up a bit today, I have a gigantic fix.” Trader-B—who also sometimes acted as the Yen LIBOR submitter for Bank-B—responded “I can do that.” As promised, Trader-B raised Bank-B’s 6-month Yen LIBOR submission by 6 basis points that day.

57. Trader-1 also asked his counterpart derivatives trader (“Trader-C”) at a third Contributor Panel bank (“Bank-C”) to have Bank-C contribute Yen LIBOR submissions to benefit UBS’s Yen derivatives trading positions. For example, in a January 29, 2007 electronic chat with Trader-1, Trader-C asked: “[A]nything you need on libors today? High 6m would help me.” Trader-1 responded, “high 3m I’ll sort our

6m rate for you thanks.” As promised, Trader-1 made a request to the UBS Yen LIBOR submitter for a high 6-month contribution.

58. As a final example, Trader-1 also contacted his counterpart derivatives trader (“Trader-D”) at a fourth Contributor Panel bank, (“Bank-D”), in an effort to influence Bank-D’s Yen LIBOR submissions in order to benefit UBS’s trading positions. For example, in a June 28, 2007 electronic chat with Trader-D, Trader-1 asked: “pls ask ur mate for high 6m mate . . . wd be really really grateful.” Trader-D responded: “will do, for the record he’s def not my ‘mate’! . . . but I’ll [send him an electronic chat].” As requested, approximately 15 minutes later, Trader-D sent an electronic chat to the Bank-D Yen LIBOR submitter stating, “high 6m yen libor would be gd according to my brother!” The Yen LIBOR submitter responded, “WILL DO MY BEST.”

59. Trader-1 knew that coordinating with other Contributor Panel banks to manipulate Yen LIBOR was wrong. In a July 22, 2009 electronic chat with Broker-A1, Trader-1 described his plan to coordinate Yen LIBOR submissions with other Contributor Panel banks over the next few weeks while staggering drops in submissions so as to avoid detection:

Trader-1: 11th aug is the big date . . . i still have lots of 6m fixings till the 10th

* * *

Broker-1: if you drop your 6m dramatically on the 11th mate, it will look v fish, especially if [Bank-D] and [Bank-B] go with you. I’d be v careful how you pay it, there might be cause for a drop as you cross into a new month but a couple of weeks in might get people questioning you.

Trader-1: don’t worry will stagger the drops . . . ie 5bp then 5bp

Broker-1: ok mate, don’t want you getting into sh t

Trader-1: us then [Bank-B] then [Bank-D] then us then [Bank-B] then [Bank-D]

Broker-1: great the plan is hatched and sounds sensible

60. As early as February 2007, certain other UBS derivatives traders and submitters were aware of Trader-1’s use of other Contributor Panel banks to manipulate the resulting published Yen LIBOR fix. For example, in a February 15, 2007 electronic chat between Trader-1 and Submitter-1, the following exchange occurred.

Trader-1: can we keep the fix down and let it jump tomorrow?

Submitter-1: i've asked [submitter who is filling in] to keep it low today . . . tomorrow u tell me what u prefer

Trader-1: ok if we can try to keep our move really really low wd be big help

Submitter-1: we do our very best . . . but will probably fall out [of the middle-two quartiles of submissions averaged to determine the LIBOR fix] anyway

Trader-1: ok you don't have anyone you know anywhere else you can have a word with? as a favour?

Submitter-1: got to pass i'm afraid . . . never having worked in london doesn't give me that edge; if i was [in the] same poz i'd ask you to have a word with [Bank C] ;-)

Trader-1: already done that . . . and [Bank A]

Submitter-1: good man

61. The following week, in a February 22, 2007 electronic chat, Trader-1 attempted to enlist Submitter-3 to contact other Contributor Panel banks to manipulate Yen LIBOR submissions to benefit UBS's Yen derivatives book:

Trader-1: ok hopefully we'll get the fixings down

Submitter-3: I try

Trader-1: thanks do you have any contacts in ldn you can ask also? ie other cash traders?

Submitter-3: other forward traders yes

Trader-1: thx [Submitter-3] any help appreciated . . . if they set libors!

. . . .

B. The Euro

62. From at least as early as September 2005 through approximately June 2010, certain UBS Euro derivatives traders occasionally requested that Euribor submitters contribute submissions to benefit the derivatives traders' positions. UBS submitters often accommodated such requests.

63. For example, in an October 2, 2006 electronic chat between a UBS Euro derivatives trader and the UBS Euribor submitter, the submitter solicited the trader's preference for that day's submission, asking, "any special wishes for the fixing?" The trader responded, "I lose 120k of a received fix today . . . so low would be good." The

trader then indicated that his/her request for low Euribor applied to both the 3-month and 6-month tenors, to which the submitter responded, “ok we go 42 and 57.”

64. As a further example, in a June 25, 2009 internal UBS chat with 58 viewers, including UBS’s representative on the BBA FX Money Market Committee (“UBS’s BBA Representative”),¹¹ the Euribor submitter solicited UBS derivatives traders for their submission preferences, asking, “boys, we send the fixings in about 1hr, so let us know pls.” A derivatives trader immediately responded with, “low 6s high 12s . . . please.” The submitter responded, “noted.”

65. The UBS Euribor submitter and UBS’s BBA Representative knew this practice of submitting a Euribor contribution for the benefit of derivatives traders’ positions was inappropriate. Indeed, as noted above, UBS’s BBA Representative was tasked with monitoring such conduct to preserve the integrity of the submission process. Moreover, five minutes after the June 25, 2009 chat described in the previous paragraph, in a separate electronic chat between the Euribor submitter and UBS’s BBA Representative, UBS’s BBA Representative admonished: “JUST BE CAREFUL DUDE.” The submitter responded, “I agree we shouldn’t ve been talking about putting fixings for our positions on public chat.”

66. UBS’s Fall, 2009 transfer of responsibility for LIBOR and Euribor submissions to ALM did not prevent its derivatives traders from attempting to manipulate these benchmarks. For example, in a June 29, 2010 electronic chat between the former Euribor submitter—who was still an active UBS Euro derivatives trader—and another UBS Euro derivatives trader, they stated:

Former Submitter:	u got 6mth fix position today?
Trader:	6mth fixing today? . . . nothing.
Former Submitter:	ok, gonna set fixing 1bp higher on the 6s for the turn then.
Trader:	didn’t think you set it!
Former Submitter:	i don’t but i give my opinion to the ALM desk . . . regarding change, higher/lower. . .

¹¹ The BBA FX Money Market Committee consisted of representatives from the Contributor Panel banks, who met approximately once a month. According to the BBA, as to all currencies, the Committee was responsible for scrutinizing the LIBOR submissions, and the submission process, for discrepancies, and for developing the “best practice for bank reporting standards and adherence to those standards.” According to internal UBS memoranda, beginning in June, 2008, UBS’s BBA Representative had “overall responsibility for the integrity of the [LIBOR submission] process and for oversight and monitoring of the rates submitted by UBS.”

C. *Implications of The Derivatives Traders' Requests*

67. When UBS derivatives traders made requests of UBS rate submitters in order to influence UBS's benchmark interest rate submissions, and when the submitters accommodated those requests, the manipulation of the submissions affected the fixed rates on various occasions.

68. Likewise, when UBS derivatives traders influenced the submissions of other Contributor Panel banks—either by (1) seeking and receiving accommodations from their counterparts at such banks, or (2) influencing the submissions from other banks with assistance from cash brokers who disseminated misinformation in the marketplace—the manipulation of those submissions affected the fixed benchmark rates on various occasions.

69. Indeed, the purpose of this activity was to manipulate benchmark submissions from UBS and other banks to influence the resulting fixes and thus to have a favorable effect on the derivatives traders' trading positions. Because traders' compensation was based in part on the profit and loss calculation of the trading books, derivatives traders' requests were intended to benefit their compensation as well.

70. Because of the high value of the notional amounts underlying derivatives transactions tied to LIBOR, Euroyen TIBOR and Euribor, even very small movements in those rates could have had a significant positive impact on the profitability of a trader's trading portfolio, and a correspondingly negative impact on their counterparties' trading positions.

71. UBS entered into interest rate derivatives transactions tied to LIBOR, Euroyen TIBOR and Euribor—such as derivatives, forward rate agreements, and futures—with counterparties to those transactions. Many of those counterparties were located in the United States. Those United States counterparties included, among others, asset management corporations, mortgage and loan corporations, and insurance companies. Those counterparties also included banks and other financial institutions in the United States or located abroad with branches in the United States.

72. In the instances when the published benchmark interest rates were manipulated in UBS's favor due to UBS's manipulation of its own or any other Contributor Panel bank's submissions, that manipulation benefitted UBS derivatives traders, or minimized their losses, to the detriment of counterparties, at least with respect to the particular transactions comprising the trading positions that the traders took into account in making their requests to the rate submitters. Certain UBS derivatives traders and rate submitters who tried to manipulate LIBOR, Euroyen TIBOR and Euribor submissions understood the features of the derivatives products tied to these benchmark interest rates; accordingly, they understood that to the extent they increased their profits or decreased their losses in certain transactions from their efforts to manipulate rates, their counterparties would suffer corresponding adverse financial consequences with respect to those particular transactions.

73. When the requests of derivatives traders for favorable LIBOR, Euroyen TIBOR and Euribor submissions were taken into account by the UBS rate submitters, UBS's rate submissions were false and misleading. Those false and misleading LIBOR and Euroyen TIBOR contributions affected or tended to affect the price of commodities, including futures contracts. Moreover, in making and in accommodating these requests, the derivatives traders and submitters were engaged in a deceptive course of conduct in an effort to gain an advantage over their counterparties. As part of that effort: (1) derivatives traders and submitters submitted and caused the submission of materially false and misleading LIBOR, Euroyen TIBOR and Euribor contributions; and (2) derivatives traders, after initiating and continuing their effort to manipulate LIBOR, Euroyen TIBOR and Euribor contributions, negotiated and entered into derivative transactions with counterparties that did not know that UBS employees were often attempting to manipulate the relevant rate. . . .

UNITED STATES v. CONNOLLY, 24 F.4th 821 (2d Cir. 2022)

KEARSE, Circuit Judge:

Defendants Matthew Connolly and Gavin Campbell Black appeal from judgments entered in the United States District Court for the Southern District of New York following a jury trial before Colleen McMahon, then-*Chief Judge*, convicting both defendants on one count charging a 2004-2011 conspiracy to commit wire fraud and bank fraud in violation of 18 U.S.C. § 1349, convicting Connolly on two counts of wire fraud in violation of 18 U.S.C. § 1343, and convicting Black on one count of wire fraud in violation of § 1343, all in connection with the submission of statements that could affect the London Interbank Offered Rate ("LIBOR"), on which many financial transactions rely. Connolly was sentenced principally to three concurrent terms of time served plus two years of supervised release (the first six months in home confinement), and was ordered to pay a \$100,000 fine. Black was sentenced principally to two concurrent terms of time served plus three years of supervised release (the first nine months in home confinement) to be served in his native United Kingdom, and was ordered to pay a \$300,000 fine. On appeal, defendants contend principally that the evidence at trial was insufficient to prove that the LIBOR submissions at issue were false, material, or made with fraudulent intent. . . .

Finding merit in defendants' contentions that the evidence was insufficient to show that the LIBOR-related statements that they induced were false, we reverse their convictions and remand to the district court for entry of judgments of acquittal. . . .

These prosecutions arise from the large-scale, widely publicized investigations conducted by financial regulators and prosecutorial authorities in the United States and the United Kingdom into the manipulation of LIBOR, described in detail in *United States v. Allen* ("*Allen*"). The principal focus of the investigations was interest-rate derivatives, financial instruments that derive their value from changes or disparities in interest rates. Connolly and Black were charged with conspiring with others to commit wire fraud and

bank fraud in violation of 18 U.S.C. § 1349, along with several substantive counts of wire fraud in violation of 18 U.S.C. § 1343, by inducing co-workers to submit to the British Bankers' Association ("BBA") false statements that could influence LIBOR rates, in order to increase their employer's profits—or decrease its losses—on existing derivatives contracts. . . .

LIBOR is an interest rate benchmark published daily by the BBA for loans of various durations (called loan "tenors")—typically ranging from overnight to one year—in each of the world's major currencies. LIBOR is meant to reflect, on a given day, the rates at which one bank can borrow money from other banks. [Government expert witness] Youle, one of the primary purposes served by LIBOR in modern markets is to provide a reference interest rate that financial instruments can incorporate to establish the terms of agreement. . . .

In order to arrive at a fixed LIBOR rate each day for the various loan tenors of each currency, the BBA relied on information contributed individually by selected banks that were active in the interbank market for that currency (a "LIBOR panel"). Under the heading "The BBA Libor fixing - definition," the BBA gave instructions to contributor banks with respect to their submissions as to rates ("BBA LIBOR Instruction"). . . .

During the relevant period, the LIBOR panel with regard to United States currency comprised 16 banks. In the BBA LIBOR Instruction, the "Instructions to BBA Libor Contributor Banks" stated that on each business day, between 11:00 and 11:10 a.m., London time, each panel bank—with respect to each of 15 loan tenors—was to submit for that panel's currency

the rate at which it could borrow funds, were it to do so by asking for and then accepting inter-bank offers in reasonable market size just prior to 1100

Dr. Youle testified that in this BBA LIBOR Instruction, "rate" referred to the "interest rate"; "funds" referred to "cash"; offers in "reasonable market size," referred to the "typical amount of borrowing" the bank would do, rather than to an "exact[] amount"; and the phrase "were it to do so by asking for and then accepting" called for an answer that was "hypothetical," not for information as to what, on that business day, "the bank actually did."

The process the BBA used to arrive at each U.S. dollar LIBOR fixed rate was as follows. Thomson Reuters, a data analytics company acting as the BBA's agent, received the 16 panel banks' rate submissions and eliminated from consideration, for each tenor, the four highest and the four lowest. The arithmetic average of the middle eight submitted rates—referred to as the "trimmed mean"—constituted the LIBOR daily "fix" for that tenor. The LIBOR fixes were then published by Thomson Reuters each day and transmitted by wire globally.

During the period 2004–2011, the LIBOR panel for United States currency included Deutsche Bank AG ("Deutsche Bank" or "DB"). Thus, shortly after 11 a.m. on each

business day in London, DB, in accordance with the BBA LIBOR Instruction, was to make for each tenor a submission as to the rate at which DB could borrow cash in the interbank market.

Connolly was employed by DB in its New York City office. From at least 2005 until March 2008, he was director of the “Pool Trading Desk,” *i.e.*, DB’s combined cash and money market derivatives desk. In that capacity he supervised several derivatives traders, including Parietti. Connolly’s principal responsibilities, however, were “fund[ing] the bank” and “running the cash desk.”

Black, from approximately 1997 until 2015, was employed in DB’s London office. During the period of the alleged conspiracy, he was a director of that office’s Money Market Derivatives and Pool Trading Desks, and his principal responsibility was to trade U.S. dollar money market derivatives. Black was also a “market maker,” which had the practical effect that, within DB, “anyone who wanted to trade an interest rate swap or a U.S. dollar derivative would go to Gavin Black and ask for the price in that particular swap.” Because Black traded in financial products that were tied to LIBOR, his success was to some extent dependent on his ability to predict the movement of LIBOR.

Neither Connolly nor Black had responsibility for making DB’s LIBOR submissions to the BBA. That job fell largely to London office employees Curtler and King. From 2003 to 2012, King’s responsibilities included working on the U.S. dollar money market trading desk and on the cash desk, borrowing money in the interbank market in order to fund DB’s cash needs. Throughout his tenure at DB, King was supervised by Curtler, who, during the period relevant to this case, also supervised Black.

Curtler had a series of positions at DB. From about 2000, he too worked on the U.S. currency cash desk, trading dollars to secure funding for the bank. In 2005-2010, his principal responsibility was running the cash desk. He also traded derivatives—principally futures, options, and swaps products—that were tied to LIBOR, and was one of DB’s “largest U.S. dollar derivatives traders.” King likewise traded derivatives that were tied to LIBOR, and he was actively encouraged by Curtler to engage in such trading.

King served as the principal submitter of DB’s U.S. dollar LIBOR rates to the BBA. When King was unavailable, Curtler was the most frequent “backup submitter” of those LIBOR rates.

King, who had received a non-prosecution agreement in exchange for his cooperation, testified as to the process by which he and his boss Curtler normally arrived at the LIBOR rates DB would submit to the BBA. King, as the person responsible for ensuring that DB always had sufficient cash to fund its operations, was in charge of borrowing cash from the interbank market and lending that money to DB’s other units—referred to as “DBQ.”

With respect to such internal loans, DBQ and the cash desk engaged in a bid-and-offer process, with DBQ asking to borrow at a proposed interest rate, and the cash desk offering the loan at a higher rate, typically “about 4 basis points” above the DBQ bid. In determining the rate of interest at which the cash desk would lend the U.S. dollars that DBQ needed to fund their operations, King used, *inter alia*, a spreadsheet that he and Curtler referred to as a “pricer.” The pricer “had a live data feed to the market” and therefore was “automatically updated as the market data changed.” The primary function of the pricer was to help King determine the rates at which the cash desk would lend money to DBQ.

King testified that other DB units had their own pricing tools, which in fact were more sophisticated than the one he used, because the derivatives traders needed to be able to make accurate interest-rate predictions in order for their DB transactions to be profitable. In addition, the cash desk “had to show . . . a live price throughout London hours to everyone in the bank.” But DBQ units with their own pricers were quite aware of current market conditions; so if those units believed an interest rate the cash desk was offering DBQ was unduly low, DBQ groups would borrow more money than they needed; and if they believed the cash desk was offering a rate that was unduly high, DBQ would deposit money with the cash desk to earn that rate.

Accordingly, the cash desk offers to DBQ needed to be realistic. King and Curtler would begin their day at 7 a.m. by noting the previous day’s LIBOR rates and checking their respective pricers. Although King testified that he and Curtler used the same pricer, Curtler testified that he and King each had his own pricer, and that while similar, they were not identical. Curtler said his pricer “didn’t work exactly the same as Mr. King’s pricer,” and that they “didn’t have a standard pricer that had to be used.”

While the pricers automatically changed every day during the day with incoming market data, King and Curtler also proceeded to manually “put in various factors,” “based on various things,” and “added in various spreads *to reach the cash prices* that we—*that we wanted to use internally*” because “we had to make sure that the prices that we were showing on the spreadsheet were actual cash prices.”

King testified that “for a long time” the cash desk’s offering rates to DBQ were used as DB’s LIBOR submission of the rates at which DB could borrow in the interbank market. Thus, the spreadsheet contained a column headed “LIBOR” to show what that day’s DB LIBOR submissions would be.

However, because the cash desk’s offers to DBQ “had to be accurate,” King and Curtler were repeatedly “manual[ly]” “changing” items and “spreads in the pricer”; and since the LIBOR column was a function of DB’s internal offered rate to DBQ, King’s “manual change[s]” to arrive at “the internal rates” also changed “[DB’s] LIBOR submission rates.”

In addition, there were manual changes directed solely at the rate to be submitted for LIBOR. Asked how he made changes to LIBOR submissions “when . . . requests” were received from DB’s derivatives “traders,” King testified that

as part of the morning process, we would put in all the different factors into what every LIBOR submission should be. And then *that produced the column . . . head[ed] “LIBOR.” And then I would manually change the rate in or on the spreadsheet itself*, so put in sort of a plus or minus to make the change within the spreadsheets.

King testified that he also “added these spreads manually even on days when [he] didn’t get a communication from one of the derivatives traders.” . . . [T]he LIBOR rates were thus not based entirely on market data and were not automatically generated.

In addition to the above alterations in the pricer, King each day consulted, *inter alia*, five interbank cash brokers before settling on DB’s LIBOR submissions. He testified that it was logical to “change the [LIBOR submission] rates . . . so that they lined up with what the brokers were predicting” because “the brokers have access to all the banks, they know where we can borrow money or they think they know where we can borrow money.” But King said that while sometimes the rates the brokers were suggesting were all similar, “there [we]re periods when the rates are vastly different”; and then “[we] have to come up with something that we feel is a fair reflection of our rate.” Thus, in submitting LIBOR rates, “some days [King] went with the pricer, some days [he] went with the broker, [and] some days [he] went with the middle.” King testified that he believed that the reference to “reasonable market size” in the BBA LIBOR Instruction—a term the BBA did not define—“gave [him] flexibility as to where [he] could actually submit his LIBOR.”

The above kinds of manual changes to the figures produced by the pricer were routinely made by King and Curtler to arrive at DB’s LIBOR submissions with or without any requests having been made by DB derivatives traders for alterations of the LIBOR submissions.

King and Curtler testified that they sometimes received requests from Connolly or Black to make LIBOR submissions that would be beneficial to DB derivatives traders’ positions, *i.e.*, “trader-influenced” LIBOR submissions. King testified that “Gavin Black occasionally asked me to manipulate the rates or to put in a submission that was higher or lower than I would have done *to benefit his trading position*,” and that “Matthew Connolly on occasion made requests for me to change our LIBOR rates and *to benefit the trader’s position*.”

Curtler testified about a November 2005 email exchange with Connolly concerning a 1-month LIBOR, in which Connolly said “WE WOULD PREFER IT HIGHER . . . WE HAVE ABOUT 15 BB 1MO RECEIVES,” meaning that DB’s New York derivatives traders (supervised by Connolly) expected to receive payments on notional amounts totaling some \$15 billion. Curtler, who apparently had estimated that DB’s LIBOR

submission for that tenor was “looking like 29”—*i.e.*, 4.29 percent—accommodated Connolly’s request by submitting a rate of 4.295 percent rather than 4.29 percent and informed Connolly “we went in 295 for u.” DB’s 4.295 percent rate was one of the middle eight panel bank submissions; each of the other seven middle submissions was 4.29 percent. Thus, the trimmed middle constituting the 1-month LIBOR fix was 4.29063 percent, instead of 4.29 percent as it would have been if DB’s submission had been 4.29 rather than 4.295.

The government also introduced other emails and electronic messages to DB’s LIBOR submitters requesting modifications of the LIBOR submissions in order to benefit DB’s existing trading positions. They included one from Black on May 15, 2008, requesting a low 1-month LIBOR rate because he was “paying on 18 [billion]”; another from Black on February 21, 2005, requesting a high 6-month LIBOR rate; one from Connolly on November 23, 2005, requesting that 3-month LIBOR “be as high as possible”; and an August 12, 2007 email from Connolly stating, “[i]f possible, we need in NY 1mo libor as low as possible next few days. . . . tons of pays coming up overall.” As a result of this last request, King’s DB submission to LIBOR on August 13 was the lowest by any panel bank; and the DB submission on August 15 was four basis points below his estimate of what LIBOR would be.

Parietti was a DB derivatives trader supervised by Connolly. He testified that Connolly had instructed him that if “[y]ou have a big position fix into LIBOR,” you should “[s]end an email to the cash guys in London, let them know which way around and how much you have, and then just let them do whatever they do.” Curtler testified that when he and King received such requests, he would expect King to take them into account, “because that’s what we did.” They would typically adjust the LIBOR submission by half a basis point.

King described the process by which he attempted to accommodate the traders’ requests for higher or lower LIBOR submissions. In the pricer, he would focus on the relevant tenor in the LIBOR column; if the trader’s request was for a higher LIBOR submission he would “click on that cell in the spreadsheet and then put in a plus and then . . . change that rate manually to make it higher than the pricer was . . . otherwise telling [him].” King could put in an adjustment formula, which would automatically accommodate the trader’s requested alteration, regardless of whether “the market moved up or down.” However, King also testified that on days when he received a request from a derivatives trader, he “still looked at the pricer estimates,” he “still looked at the broker’s suggestions,” and he “still looked at what[wa]s going on in the market,” because “before deciding what to do,” he “had to figure out what was reasonable.”

Curtler testified that he made LIBOR submissions that benefited his own DB trading positions: “[I]f we came up with a U.S. dollar LIBOR submission for that day and my position required the rate to be higher, we’d skew it to the upside, and the opposite if we wanted it low.” By “we” Curtler included himself, King, Black, and other derivatives traders in DB’s London and New York offices. Curtler acknowledged that “there were

days where there would have been a wide range of offered rates.” He testified, however, that they were not supposed to submit self-interested LIBOR submissions because it “would give us an unfair advantage in the market.”

All three cooperators testified that they “knew” the practice of altering DB’s LIBOR submissions to benefit DB trader positions was “wrong” at the time they engaged in it. King stated that “[i]t’s intuitively wrong because we are, you know, as I say, taking advantage of the position. We are benefiting. There was a counterparty on the other side who doesn’t know what we’re doing and is being affected negatively by what we’re doing.” Parietti testified that “even if [LIBOR is] imprecise, hard to estimate, or vague, . . . it’s still wrong to base your submission on your bank’s position instead of information about the cash market.” All three cooperators testified that they never contemporaneously told anyone that they thought the practice was wrong. . . .

In the present case, in order to determine whether LIBOR submissions by King or Curtler that were affected by requests of Connolly or Black—undisputedly requests in aid of derivatives contracts held by them or by traders they supervised—constituted statements that were false, half-truths, or fraudulent omissions, we must begin by examining the BBA LIBOR Instruction with which the LIBOR submitters were to comply. We look principally to the language of the BBA LIBOR Instruction, to any accompanying elaboration or explanations of the BBA LIBOR Instruction, and to the government’s evidence as to how DB’s submitters arrived at their LIBOR submissions that were not trader-influenced. As the trial judge instructed the jury, “where, as here a[n alleged] scheme to defraud *is premised on an instruction—in this case from the BBA to the submitting bank*—the government has the burden to *negate any reasonable interpretation of the instruction* that would make Deutsche Bank’s submission responsive.”

During the period at issue in this case, the BBA LIBOR Instruction directed each panel bank to state, as to each tenor of the currency at issue,

the rate at which it *could* borrow funds, *were it to do so* by asking for *and then accepting* inter-bank offers in *reasonable market size* just prior to 1100.

As Dr. Youle testified, “rate” referred to interest rate, and “funds” referred to cash. The term “reasonable market size” was one that the BBA had not defined. Dr. Youle interpreted it as referring to the “typical amount of borrowing” the bank “would” do. The BBA stated that it had “intentional[ly]” declined to provide a definition, stating that “reasonable market size will vary according to prevailing liquidity and credit conditions as well as between currencies and even quoting banks,” and that “it would appear that reasonable market size is a concept that is understood by all market participants.”

The BBA LIBOR Instruction did not ask about an actual loan. Rather, it asked a question that was “hypothetical.” A panel bank was to “estimat[e]” the interest rate at which the bank “could” borrow an amount of cash that it would typically borrow, “were it to do so by asking for and then accepting” inter-bank offers in London just before 11 a.m. . . .

The precise hypothetical question to which the LIBOR submitters were responding was at what interest rate “could” DB borrow a typical amount of cash if it were to seek interbank offers and were to accept. If the rate submitted is one that the bank could request, be offered, and accept, the submission, irrespective of its motivation, would not be false.

Defendants, of course, had no burden to produce any evidence. The burden was on the government to provide evidence to show that the LIBOR submissions made by King or Curtler after receiving requests from Connolly or Black were untrue. At the trial of these defendants, the government’s three cooperating witnesses—King and Curtler who were LIBOR submitters, and Parietti who requested LIBOR submissions that would favor his existing derivatives trades—testified that they knew it was “wrong,” “intuitively wrong” for LIBOR submissions to take into account the DB derivatives traders’ existing positions. . . . Yet none of the witnesses testified that DB could not have borrowed a typical amount of cash at the rate stated in any of DB’s LIBOR submissions. . . . [W]hether DB “could” do so was the precise question to which the LIBOR submissions were to respond, and was thus the key to whether a given submission was false.

Instead of producing evidence that DB could not borrow at the interest rates stated in the trader-influenced LIBOR submissions, the government relied on the theory . . . (a) that on each day, for each loan tenor, there was only one true interest rate that DB could submit, (b) that that rate was generated automatically by King’s pricer, and (c) that that one true automatically generated rate was in fact what DB submitted except when King or Curtler received a request for a higher or lower number from Connolly or Black. Thus, Dr. Youle, the government’s expert, testified that “there was always an understanding that the[panel banks] would submit *the one* best estimate of *the true borrowing costs they had*.” And Curtler testified—in part—that

we set our LIBORs using a process that we used on the desk to come up with a number. That number was the Deutsche Bank’s submission, and then if we took into account requests for traders, we altered that submission.

The government emphasized its one-true-number theory in summation—“*You borrow at the lowest rate. There’s no range*”—and emphasized that DB had a “pricer” that generated the one true rate:

You . . . know, when it comes to the scheme, that *there was a pricer*. Remember that pricer . . . You heard from different witnesses about it. And there might be different versions of it. This was what was manipulated. *There was actually a rate sitting on the pricer to submit to LIBOR*. And what the defendants and their coconspirators did was that they would, *on days where they had trading positions that would benefit*, they would *take the numbers and they would change them* and they would send them. *So they took what would otherwise have been an honest submission, they changed it, and they dishonestly sent the rates that benefited the trading positions*. . . .

[I]n this case *the submitters actually had a number sitting right there on that pricer, and that's the number they would send. It was a number. And that's what they moved and changed dishonestly when they sent it to benefit the trading positions. . . .*

There are two principal respects in which the trial evidence, viewed as a whole, fails to support the foundations of the government's theory of falsity, *i.e.*, that there was (a) one true interest rate, (b) automatically generated by the pricer, (c) which was DB's LIBOR submission as generated except when there was a request from a trader. First, the testimony of the government's witnesses revealed that there were many factors other than the data automatically received by the pricer that informed DB's final LIBOR submission. Second, there were many loans available to DB, with varying interest rates; and as DB could agree to such rates, there was no one true rate that it was required to submit. . . .

It is true, as the government argues, that a scheme need not succeed in order to violate § 1343. *See, e.g., Pasquantino* (“[t]he wire fraud statute punishes the scheme, not its success” (internal quotation marks omitted)). But to come within the scope of § 1343 it must at least be a scheme to defraud. Here, the government failed to show that trader-induced LIBOR submissions did not reflect rates at which DB could have borrowed. If the submissions did reflect rates at which DB could have borrowed, they complied with the BBA LIBOR Instruction, and the LIBOR submissions were not false. . . .

The government's argument that we should uphold the convictions on the theory that trader-influenced submissions constituted statements of “opinion[s] not honestly held” suffers the same deficiency. While the government's three cooperating witnesses all testified that it was “wrong” to allow DB's LIBOR submissions to be influenced by existing derivatives trading positions because it gave them an “unfair advantage” over their counterparties, not one of the witnesses testified that the submissions that were actually made were not rates at which DB “could”—as defined by the BBA LIBOR Instruction—borrow.

Although the government states that the BBA's “instructions did not allow a panel bank, when submitting its honest estimate of its borrowing costs, to consider the submission's effect on the profitability of interest rate swaps or other derivatives positions held by the bank's traders,” in fact the BBA LIBOR Instruction contained no such prohibition. In contrast, the BBA did evince a concern about collusion between panel banks. The BBA LIBOR Instruction expressly stated that “Contributor Banks shall input their rate without reference to rates contributed by other Contributor Banks.” But there was no similar prohibition against banks' making their LIBOR submissions with consideration of the bank's own interest-rate-sensitive derivatives. Dr. Youle testified that LIBOR “was created in the '80s,” and LIBOR's use as a reference point in interest-rate-based derivatives contracts became so popular that “trillions and trillions of dollars of contracts in notional value [have come to] depend on it.” There can thus be no doubt that the BBA as an industry organization well knew that traders in interest-rate-sensitive derivatives

are intently attuned to and concerned about LIBOR. Indeed, the BBA LIBOR Instruction expressly required submitters to use maturity dates calculated in conformity with “the *ISDA* Modified Following Business Day convention.” “*ISDA* stands for International Swaps and Derivatives [A]ssociation.”

Nor could a reasonable jury infer from Dr. Youle’s testimony that the BBA LIBOR Instruction required DB to submit its “one best estimate.” While Dr. Youle testified to “an understanding that [banks] would submit the one best estimate of the true borrowing costs they had,” he did not link that understanding to the BBA LIBOR Instruction, which contains no similar qualification. . . .

Finally, we see no merit in the government’s argument that a trader-influenced LIBOR submission constituted a “half-truth[]” on the theory that it carried an “implied certification” that there had in fact been no trader influence on the submission. As discussed earlier, the BBA LIBOR Instruction as it existed during the earlier period at issue in this prosecution, while explicitly barring collaboration between panel banks, said nothing to bar a panel bank’s LIBOR submitters from receiving or considering input from that bank’s employees who were derivatives traders. There being no guidance from the BBA as to intrabank input—especially given an explicit prohibition of interbank input—a bank’s submission of a LIBOR rate did not implicitly represent that there had been no consideration of the panel bank’s existing trades. . . .

In sum, the government sought to prove falsity on the premise that the BBA LIBOR Instruction required DB to submit a particular interest rate, that such a rate was generated automatically by a DB pricer, and that LIBOR submissions that were influenced by requests from DB derivatives traders were false because those submissions were not the numbers automatically generated by the pricer. However, the government’s main fact witnesses at trial, the LIBOR submitters, testified that there were numerous ways in which the pricer did not generate such numbers automatically because those witnesses regularly altered pricer data and spreads manually; that the LIBOR submitters regularly deviated from the pricer output—even as affected by the submitters’ manual adjustments—in order to make LIBOR submissions that reflected interest rate estimates they had received from independent brokers; and that the LIBOR submitters engaged in all of these practices even on days when they had no requests from DB derivatives traders.

The government failed to produce any evidence that any DB LIBOR submissions that were influenced by the bank’s derivatives traders were not rates at which DB could request, receive offers, and accept loans in DB’s typical loan amounts; hence the government failed to show that any of the trader-influenced submissions were false, fraudulent, or misleading. . . . Accordingly, we reverse defendants’ convictions for wire fraud. Further, given that the government failed to present evidence to show falsity in the trader-influenced submissions, defendants’ convictions for conspiracy to commit wire fraud and bank fraud must also be reversed.

U.S. and British authorities brought prosecutions against some of the individuals involved in the LIBOR scandal, with mixed results. Four former Barclays bankers were sentenced in London to between thirty-three months and six and a half years for their part in the fraud after jurors rejected the defense's argument that the defendants were "just doing [their] job."¹² However, jurors appeared more sympathetic to two other Barclays traders who were acquitted of similar charges after the defense attacked one of the prosecution's experts and portrayed one of the defendants as a rookie trader who didn't get to "choose who were his tutors."¹³

Tom Hayes, a former Citigroup and UBS trader ("Trader-1" in the UBS statement of facts above), was also sentenced in the UK to 14 years in prison for his role as the ringleader of several traders responsible for the manipulation of LIBOR. A large portion of Hayes's sentence stemmed from conspiracy charges—an issue complicated by the fact that six of the former cash brokers with whom Hayes was said to have conspired were acquitted by a London jury in a separate trial. Hayes' conviction was affirmed on appeal, but his sentence was reduced from 14 to 11 years as "excessive" given his age and mental condition. He served less than six years in custody. Then, in July 2023, the UK's Criminal Case Review Commission referred Hayes' case to the Court of Appeal, in light of the U.S. ruling in *Connolly*, for reconsideration of whether the correct legal standard was applied in prosecuting Hayes. On March 27, 2024, the Court of Appeal—in an opinion too long to be readable—rejected Hayes' claims, disagreeing with the ruling in *Connolly* as a matter of UK law. Hayes is now attempting to persuade the UK Supreme Court to take up his claims.

In the U.S., twelve individuals were charged, of which four went to trial. Two former Rabobank Group traders were found guilty, but the convictions were later overturned after the Second Circuit determined that their Fifth Amendment right against compelled self-incrimination had been violated when the DOJ used testimony that the defendants were compelled to give before the British Financial Conduct Authority (a matter discussed further in Chapter 12).¹⁴ Two former Deutsche Bank traders, Matthew

¹² For more on the Barclays bankers' convictions, see Simon Bowers, *Libor-rigging trial: jury finds no defence in 'just doing my job'*, THE GUARDIAN (July 4, 2016), <https://www.theguardian.com/business/2016/jul/04/barclays-libor-convictions-a-major-victory-for-sfo>; *Libor-rigging trial: ex-Barclays traders jailed for two to six years*, THE GUARDIAN (July 7, 2016), <https://www.theguardian.com/business/2016/jul/07/libor-rigging-trial-ex-barclays-traders-jailed-merchant-pabon-mathew-johnson>.

¹³ For more on the Barclays traders' acquittals, see Jane Croft & Carol Binham, *Former Barclays Traders Acquired in SFO Libor Case*, FINANCIAL TIMES (Apr. 6, 2017), <https://www.ft.com/content/>.

¹⁴ For more on the Rabobank traders, see Chad Bray, *Convictions of 2 Former traders in Libor Scandal Are Dismissed*, N.Y. TIMES DEALBOOK (July 19, 2017), <https://www.nytimes.com/2017/07/19/business/dealbook/convictions-of-2-former-traders-in-libor-scandal-are-dismissed>.

Connolly and Gavin Black, had their convictions reversed, as discussed by the Second Circuit above. In all, between the United States and the United Kingdom, 42 individual cases were charged criminally with 19 convictions produced. The remaining 23 individual cases resulted in acquittal, dismissal, or litigation that is still pending.

4. INSIDER TRADING

Surprisingly, there is no general law against insider trading in the United States. The prohibition on insider trading developed through the common law process as a type of securities fraud—that is, an interpretation of the securities statutes you have already studied. Thus, what is important to understand—because it guides development of the doctrine—is just what the theory of *fraud* is for insider trading, and what the extensions and limitations of that theory of fraud might be.

The materials in this chapter consist mostly of case law. Because insider trading prosecutions have been front and center on Wall Street in recent years, the chapter also includes some material for talking about recent prosecutions in the area and potential law reform in the U.S. Section A provides the applicable statutes. Section B covers the “classical theory” of insider trading. Section C adds the issue of insider trading liability for “tippers” and “tippees.” Section D covers the “misappropriation theory” of insider trading. Section E includes materials illustrating a recent wave of high-profile prosecutions initiated by the U.S. Attorney in the Southern District of New York. Section F explores problems of liability involving “tipping chains” among groups and communities of individuals in the investment industry. Finally, section G briefly considers the possibility of statutory reform of insider trading law.

A. Statutes

The securities fraud statutes and rules are repeated below. Reread them. Where in the *text* do they prohibit insider trading? How have the courts situated insider trading doctrine within the text of these statutes and rules?

15 U.S.C. §78j. Manipulative and deceptive devices (“Section 10 of the ’34 Act”)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange. . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 C.F.R. § 240.10b-5. Employment of manipulative and deceptive devices (“Rule 10b-5”)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

- (a) To employ any device, scheme, or artifice to defraud,
- (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
- (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

18 U.S.C. § 1348. Securities and commodities fraud

Whoever knowingly executes, or attempts to execute, a scheme or artifice—

- (1) to defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d)); or
- (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(d));

shall be fined under this title, or imprisoned not more than 25 years, or both.

B. The “Classical” Theory of Insider Trading

This is the origin case, in which the SEC first articulated the theory of insider trading as securities fraud, albeit in a civil administrative proceeding not a federal district court case, much less a criminal prosecution. What is the theory? The question after this case was whether the federal courts would follow the SEC’s interpretive lead. As you will see, they did.

IN RE CADY, ROBERTS & CO., 40 S.E.C. 907 (1961)

CARY, Chairman:

This is a case of first impression and one of signal importance in our administration of the Federal securities acts. It involves a selling broker who executes a solicited order and sells for discretionary accounts (including that of his wife) upon an exchange. The crucial question is what are the duties of such a broker after receiving nonpublic information as to a company's dividend action from a director who is employed by the same brokerage firm.

These proceedings were instituted to determine whether Cady, Roberts & Co. ('registrant') and Robert M. Gintel, the selling broker and a partner of the registrant, willfully violated the 'anti-fraud' provisions of Section 10(b) of the Securities Exchange Act of 1934 ('Exchange Act'), Rule 10b-5 issued under that Act . . . and, if so, whether any disciplinary action is necessary or appropriate in the public interest. . . .

Rule 10b-5 appl[ies] to securities transactions by 'any person.' Misrepresentations will lie within their ambit, no matter who the speaker may be. An affirmative duty to disclose material information has been traditionally imposed on corporate 'insiders,' particularly officers, directors, or controlling stockholders. We, and the courts have consistently held that insiders must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment. Failure to make disclosure in these circumstances constitutes a violation of the anti-fraud provisions. If, on the other hand, disclosure prior to effecting a purchase or sale would be improper or unrealistic under the circumstances, we believe the alternative is to forego the transaction.

The ingredients are here and we accordingly find that Gintel willfully violated Section 10(b) and Rule 10b-5. We also find a similar violation by the registrant, since the actions of Gintel, a member of registrant, in the course of his employment are to be regarded as actions of registrant itself. It was obvious that a reduction in the quarterly dividend by the Board of Directors was a material fact which could be expected to have an adverse impact on the market price of the company's stock. The rapidity with which Gintel acted upon receipt of the information confirms his own recognition of that conclusion.

We have already noted that the anti-fraud provisions are phrased in terms of 'any person' and that a special obligation has been traditionally required of corporate insiders, e.g., officers, directors and controlling stockholders. These three groups, however, do not exhaust the classes of persons upon whom there is such an obligation. Analytically, the obligation rests on two principal elements; first, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing. In considering these elements under the broad language

of the anti-fraud provisions we are not to be circumscribed by fine distinctions and rigid classifications. Thus our task here is to identify those persons who are in a special relationship with a company and privy to its internal affairs, and thereby suffer correlative duties in trading in its securities. Intimacy demands restraint lest the uninformed be exploited.

The facts here impose on Gintel the responsibilities of those commonly referred to as 'insiders.' He received the information prior to its public release from a director of Curtiss-Wright, Cowdin, who was associated with the registrant. Cowdin's relationship to the company clearly prohibited him from selling the securities affected by the information without disclosure. By logical sequence, it should prohibit Gintel, a partner of registrant. This prohibition extends not only over his own account, but to selling for discretionary accounts and soliciting and executing other orders. In somewhat analogous circumstances, we have charged a broker-dealer who effects securities transactions for an insider and who knows that the insider possesses non-public material information with the affirmative duty to make appropriate disclosure or dissociate himself. . . .

The next case, also a civil matter, was the first time a federal appellate court fully accepted the theory of insider trading as securities fraud. In insider trading cases, you must be clear on who is doing the trading, where the information is coming from, and what the relationships are among the relevant people, including their employer-employee or, more generally, principal-agent relationships. If you get confused, draw a diagram.

SEC v. TEXAS GULF SULPHUR CO., 401 F.2d 833 (2d Cir. 1968)

WATERMAN, Circuit Judge:

[The facts of this case are dense, so the discussion has been omitted. The case involved engineering personnel for a fossil fuel company who traded in securities related to the company when they knew, before others, about promising early results of drilling cores tested from a new exploration area on the Canadian Shield in eastern Canada.]

Rule 10b-5 was promulgated pursuant to the grant of authority given the SEC by Congress in Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)). By that Act Congress purposed to prevent inequitable and unfair practices and to insure fairness in securities transactions generally, whether conducted face-to-face, over the counter, or on exchanges. The Act and the Rule apply to the transactions here, all of which were consummated on exchanges. Whether predicated on traditional fiduciary concepts or on the 'special facts' doctrine, the Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information. The essence of the Rule is that anyone who, trading for his own account in the securities of a corporation has 'access, directly or indirectly, to information intended to be available only for a corporate

purpose and not for the personal benefit of anyone' may not take 'advantage of such information knowing it is unavailable to those with whom he is dealing,' i.e., the investing public. *Matter of Cady, Roberts & Co.* Insiders, as directors or management officers are, of course, by this Rule, precluded from so unfairly dealing, but the Rule is also applicable to one possessing the information who may not be strictly termed an 'insider' within the meaning of Sec. 16(b) of the Act. *Cady, Roberts, supra*. Thus, anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed. So, it is here no justification for insider activity that disclosure was forbidden by the legitimate corporate objective of acquiring options to purchase the land surrounding the exploration site; if the information was, as the SEC contends, material, its possessors should have kept out of the market until disclosure was accomplished. *Cady, Roberts, supra*. . . .

An insider is not, of course, always foreclosed from investing in his own company merely because he may be more familiar with company operations than are outside investors. An insider's duty to disclose information or his duty to abstain from dealing in his company's securities arises only in 'those situations which are essentially extraordinary in nature and which are reasonably certain to have a substantial effect on the market price of the security if (the extraordinary situation is) disclosed.' Fleischer, *Securities Trading and Corporate Information Practices: The Implications of the Texas Gulf Sulphur Proceeding*.

Nor is an insider obligated to confer upon outside investors the benefit of his superior financial or other expert analysis by disclosing his educated guesses or predictions. The only regulatory objective is that access to material information be enjoyed equally, but this objective requires nothing more than the disclosure of basic facts so that outsiders may draw upon their own evaluative expertise in reaching their own investment decisions with knowledge equal to that of the insiders.

This is not to suggest, however, as did the trial court, that 'the test of materiality must necessarily be a conservative one, particularly since many actions under Section 10(b) are brought on the basis of hindsight,' in the sense that the materiality of facts is to be assessed solely by measuring the effect the knowledge of the facts would have upon prudent or conservative investors. As we stated in *List v. Fashion Park, Inc.*, 'The basic test of materiality . . . is whether a reasonable man would attach importance . . . in determining his choice of action in the transaction in question. Restatement, Torts § 538(2)(a); accord Prosser, Torts; I Harper & James, Torts.' This, of course, encompasses any fact ' . . . which in reasonable and objective contemplation might affect the value of the corporation's stock or securities. . . . ' *List v. Fashion Park, Inc.*, quoting from *Kohler v. Kohler Co.* Such a fact is a material fact and must be effectively disclosed to the investing public prior to the commencement of insider trading in the corporation's securities. The speculators and chartists of Wall and Bay Streets are also 'reasonable' investors entitled to the same legal protection afforded conservative traders. Thus,

material facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities. . . .

Our decision to expand the limited protection afforded outside investors by the trial court's narrow definition of materiality is not at all shaken by fears that the elimination of insider trading benefits will deplete the ranks of capable corporate managers by taking away an incentive to accept such employment. Such benefits, in essence, are forms of secret corporate compensation derived at the expense of the uninformed investing public and not at the expense of the corporation which receives the sole benefit from insider incentives. Moreover, adequate incentives for corporate officers may be provided by properly administered stock options and employee purchase plans of which there are many in existence. In any event, the normal motivation induced by stock ownership, i.e., the identification of an individual with corporate progress, is ill-promoted by condoning the sort of speculative insider activity which occurred here; for example, some of the corporation's stock was sold at market in order to purchase short-term calls upon that stock, calls which would never be exercised to increase a stockholder equity in TGS unless the market price of that stock rose sharply.

The core of Rule 10b-5 is the implementation of the Congressional purpose that all investors should have equal access to the rewards of participation in securities transactions. It was the intent of Congress that all members of the investing public should be subject to identical market risks,—which market risks include, of course the risk that one's evaluative capacity or one's capital available to put at risk may exceed another's capacity or capital. The insiders here were not trading on an equal footing with the outside investors. They alone were in a position to evaluate the probability and magnitude of what seemed from the outset to be a major ore strike; they alone could invest safely, secure in the expectation that the price of TGS stock would rise substantially in the event such a major strike should materialize, but would decline little, if at all, in the event of failure, for the public, ignorant at the outset of the favorable probabilities would likewise be unaware of the unproductive exploration, and the additional exploration costs would not significantly affect TGS market prices. Such inequities based upon unequal access to knowledge should not be shrugged off as inevitable in our way of life, or, in view of the congressional concern in the area, remain uncorrected.

We hold, therefore, that all transactions in TGS stock or calls by individuals apprised of the drilling results of K-55-1 were made in violation of Rule 10b-5. Inasmuch as the visual evaluation of that drill core (a generally reliable estimate though less accurate than a chemical assay) constituted material information, those advised of the results of the visual evaluation as well as those informed of the chemical assay traded in violation of law. The geologist Darke possessed undisclosed material information and traded in TGS securities. Therefore we reverse the dismissal of the action as to him and his personal transactions. The trial court also found that Darke, after the drilling of K-55-1 had been

completed and with detailed knowledge of the results thereof, told certain outside individuals that TGS ‘was a good buy.’ These individuals thereafter acquired TGS stock and calls. The trial court also found that later, as of March 30, 1964, Darke not only used his material knowledge for his own purchases but that the substantial amounts of TGS stock and calls purchased by these outside individuals on that day was ‘strong circumstantial evidence that Darke must have passed the word to one or more of his ‘tippees’ that drilling on the Kidd 55 segment was about to be resumed.’ Obviously if such a resumption were to have any meaning to such ‘tippees,’ they must have previously been told of K-55-1. . . .

In the next case the Supreme Court gets in the game and sort of blesses the theory. But the Court overturns the defendant’s criminal conviction, thereby also establishing limits to the classical theory. Why doesn’t the theory fit this defendant? (The Court does not yet use the word, but under present doctrine, explored later in this chapter, this defendant would be a “misappropriator.”)

CHIARELLA v. UNITED STATES, 445 U.S. 222 (1980)

Mr. Justice POWELL delivered the opinion of the Court.

The question in this case is whether a person who learns from the confidential documents of one corporation that it is planning an attempt to secure control of a second corporation violates § 10(b) of the Securities Exchange Act of 1934 if he fails to disclose the impending takeover before trading in the target company’s securities.

Petitioner is a printer by trade. In 1975 and 1976, he worked as a “markup man” in the New York composing room of Pandick Press, a financial printer. Among documents that petitioner handled were five announcements of corporate takeover bids. When these documents were delivered to the printer, the identities of the acquiring and target corporations were concealed by blank spaces or false names. The true names were sent to the printer on the night of the final printing.

The petitioner, however, was able to deduce the names of the target companies before the final printing from other information contained in the documents. Without disclosing his knowledge, petitioner purchased stock in the target companies and sold the shares immediately after the takeover attempts were made public. By this method, petitioner realized a gain of slightly more than \$30,000 in the course of 14 months. Subsequently, the Securities and Exchange Commission (Commission or SEC) began an investigation of his trading activities. In May 1977, petitioner entered into a consent decree with the Commission in which he agreed to return his profits to the sellers of the shares. On the same day, he was discharged by Pandick Press. . . .

This case concerns the legal effect of the petitioner’s silence. The District Court’s charge permitted the jury to convict the petitioner if it found that he willfully failed to inform

sellers of target company securities that he knew of a forthcoming takeover bid that would make their shares more valuable. In order to decide whether silence in such circumstances violates § 10(b), it is necessary to review the language and legislative history of that statute as well as its interpretation by the Commission and the federal courts.

Although the starting point of our inquiry is the language of the statute, § 10(b) does not state whether silence may constitute a manipulative or deceptive device. Section 10(b) was designed as a catch-all clause to prevent fraudulent practices. But neither the legislative history nor the statute itself affords specific guidance for the resolution of this case. When Rule 10b-5 was promulgated in 1942, the SEC did not discuss the possibility that failure to provide information might run afoul of § 10(b).

The SEC took an important step in the development of § 10(b) when it held that a broker-dealer and his firm violated that section by selling securities on the basis of undisclosed information obtained from a director of the issuer corporation who was also a registered representative of the brokerage firm. In *Cady, Roberts & Co.*, the Commission decided that a corporate insider must abstain from trading in the shares of his corporation unless he has first disclosed all material inside information known to him. . . .

The Commission emphasized that the duty arose from (i) the existence of a relationship affording access to inside information intended to be available only for a corporate purpose, and (ii) the unfairness of allowing a corporate insider to take advantage of that information by trading without disclosure.

That the relationship between a corporate insider and the stockholders of his corporation gives rise to a disclosure obligation is not a novel twist of the law. At common law, misrepresentation made for the purpose of inducing reliance upon the false statement is fraudulent. But one who fails to disclose material information prior to the consummation of a transaction commits fraud only when he is under a duty to do so. And the duty to disclose arises when one party has information “that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them.” In its *Cady, Roberts* decision, the Commission recognized a relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation. This relationship gives rise to a duty to disclose because of the “necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of the uninformed minority stockholders.” *Speed v. Transamerica Corp.*

The federal courts have found violations of § 10(b) where corporate insiders used undisclosed information for their own benefit. *E.g., SEC v. Texas Gulf Sulphur Co.* The cases also have emphasized, in accordance with the common-law rule, that “[t]he party charged with failing to disclose market information must be under a duty to disclose it.” *Frigitemp Corp. v. Financial Dynamics Fund, Inc.* Accordingly, a purchaser of stock

who has no duty to a prospective seller because he is neither an insider nor a fiduciary has been held to have no obligation to reveal material facts. . . .

In this case, the petitioner was convicted of violating § 10(b) although he was not a corporate insider and he received no confidential information from the target company. Moreover, the “market information” upon which he relied did not concern the earning power or operations of the target company, but only the plans of the acquiring company. Petitioner’s use of that information was not a fraud under § 10(b) unless he was subject to an affirmative duty to disclose it before trading. In this case, the jury instructions failed to specify any such duty. In effect, the trial court instructed the jury that petitioner owed a duty to everyone; to all sellers, indeed, to the market as a whole. The jury simply was told to decide whether petitioner used material, nonpublic information at a time when “he knew other people trading in the securities market did not have access to the same information.”

The Court of Appeals affirmed the conviction by holding that “[a]nyone—corporate insider or not—who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose.” Although the court said that its test would include only persons who regularly receive material, nonpublic information, its rationale for that limitation is unrelated to the existence of a duty to disclose. The Court of Appeals, like the trial court, failed to identify a relationship between petitioner and the sellers that could give rise to a duty. Its decision thus rested solely upon its belief that the federal securities laws have “created a system providing equal access to information necessary for reasoned and intelligent investment decisions.” The use by anyone of material information not generally available is fraudulent, this theory suggests, because such information gives certain buyers or sellers an unfair advantage over less informed buyers and sellers.

This reasoning suffers from two defects. First not every instance of financial unfairness constitutes fraudulent activity under § 10(b). Second, the element required to make silence fraudulent—a duty to disclose—is absent in this case. No duty could arise from petitioner’s relationship with the sellers of the target company’s securities, for petitioner had no prior dealings with them. He was not their agent, he was not a fiduciary, he was not a person in whom the sellers had placed their trust and confidence. He was, in fact, a complete stranger who dealt with the sellers only through impersonal market transactions.

We cannot affirm petitioner’s conviction without recognizing a general duty between all participants in market transactions to forgo actions based on material, nonpublic information. Formulation of such a broad duty, which departs radically from the established doctrine that duty arises from a specific relationship between two parties should not be undertaken absent some explicit evidence of congressional intent.

As we have seen, no such evidence emerges from the language or legislative history of § 10(b). Moreover, neither the Congress nor the Commission ever has adopted a parity-

of-information rule. Instead the problems caused by misuse of market information have been addressed by detailed and sophisticated regulation that recognizes when use of market information may not harm operation of the securities markets. . . .

We see no basis for applying such a new and different theory of liability in this case. As we have emphasized before, the 1934 Act cannot be read “more broadly than its language and the statutory scheme reasonably permit.” *Touche Ross & Co. v. Redington*, quoting *SEC v. Sloan*. Section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information. The contrary result is without support in the legislative history of § 10(b) and would be inconsistent with the careful plan that Congress has enacted for regulation of the securities markets. . . .

Insider trading, say the courts in interpreting 10b-5, is a form of fraud. Here is a civil enforcement case that, whether decided correctly or not, is helpful in driving home the point that insider trading actions must rest on a viable theory of fraud.

SEC v. DOROZHKO, 574 F.3d 42 (2d Cir. 2009)

JOSÉ A. CABRANES, Circuit Judge:

We are asked to consider whether, in a civil enforcement lawsuit brought by the United States Securities and Exchange Commission (“SEC”) under Section 10(b) of the Securities Exchange Act of 1934 (“Section 10(b)”), computer hacking may be “deceptive” where the hacker did not breach a fiduciary duty in fraudulently obtaining material, nonpublic information used in connection with the purchase or sale of securities. For the reasons stated herein, we answer the question in the affirmative.

In early October 2007, defendant Oleksandr Dorozhko, a Ukrainian national and resident, opened an online trading account with Interactive Brokers LLC (“Interactive Brokers”) and deposited \$42,500 into that account. At about the same time, IMS Health, Inc. (“IMS”) announced that it would release its third-quarter earnings during an analyst conference call scheduled for October 17, 2007 at 5 p.m.—that is, after the close of the securities markets in New York City. IMS had hired Thomson Financial, Inc. (“Thomson”) to provide investor relations and web-hosting services, which included managing the online release of IMS’s earnings reports.

Beginning at 8:06 a.m. on October 17, and continuing several times during the morning and early afternoon, an anonymous computer hacker attempted to gain access to the IMS earnings report by hacking into a secure server at Thomson prior to the report’s official release. At 2:15 p.m.—minutes after Thomson actually received the IMS data—that

hacker successfully located and downloaded the IMS data from Thomson's secure server.

Beginning at 2:52 p.m., defendant—who had not previously used his Interactive Brokers account to trade—purchased \$41,670.90 worth of IMS “put” options that would expire on October 25 and 30, 2007. These purchases represented approximately 90% of all purchases of “put” options for IMS stock for the six weeks prior to October 17. In purchasing these options, which the SEC describes as “extremely risky,” defendant was betting that IMS's stock price would decline precipitously (within a two-day expiration period) and significantly (by greater than 20%).

At 4:33 p.m.—slightly ahead of the analyst call—IMS announced that its earnings per share were 28% below “Street” expectations, *i.e.*, the expectations of many Wall Street analysts. When the market opened the next morning, October 18, at 9:30 a.m., IMS's stock price sank approximately 28% almost immediately—from \$29.56 to \$21.20 per share. Within six minutes of the market opening, defendant had sold all of his IMS options, realizing a net profit of \$286,456.59 overnight. . . .

[Several Supreme Court decisions] stand for the proposition that nondisclosure in breach of a fiduciary duty “satisfies § 10(b)'s requirement . . . [of] a ‘deceptive device or contrivance,’” *O'Hagan*. However, what is sufficient is not always what is necessary, and none of the Supreme Court opinions considered by the District Court *require* a fiduciary relationship as an element of an actionable securities claim under Section 10(b). . . . Even if a person does not have a fiduciary duty to “disclose or abstain from trading,” there is nonetheless an affirmative obligation in commercial dealings not to mislead. *See, e.g., Basic Inc. v. Levinson* (distinguishing “situations where insiders have traded in abrogation of their duty to disclose or abstain,” from “affirmative misrepresentations by those under no duty to disclose (but under the ever-present duty not to mislead)”).

In this case, the SEC has not alleged that defendant fraudulently remained silent in the face of a “duty to disclose or abstain” from trading. Rather, the SEC argues that defendant affirmatively misrepresented himself in order to gain access to material, nonpublic information, which he then used to trade. We are aware of no precedent of the Supreme Court or our Court that forecloses or prohibits the SEC's straightforward theory of fraud. . . . Accordingly, we adopt the SEC's proposed interpretation of *Chiarella* and its progeny: “misrepresentations are fraudulent, but . . . silence is fraudulent only if there is a duty to disclose.”. . .

In its ordinary meaning, “deceptive” covers a wide spectrum of conduct involving cheating or trading in falsehoods. *See Webster's International Dictionary* 679 (2d ed.1934) (defining “deceptive” as “tending to deceive,” and defining “deceive” as “[t]o cause to believe the false, or to disbelieve the true” or “[t]o impose upon; to deal treacherously with; cheat”). In light of this ordinary meaning, it is not at all surprising that Rule 10b-5 equates “deceit” with “fraud.” *See* 17 C.F.R. § 240.10b-5 (prohibiting

“any untrue statement of a material fact . . . or . . . any act, practice, or course of business which operates or would operate as a *fraud or deceit* upon any person, in connection with the purchase or sale of any security” (emphases added)). Indeed, we have previously observed that the conduct prohibited by Section 10(b) and Rule 10b–5 “irreducibly entails some act that gives the victim a false impression.” *United States v. Finnerty*.

The District Court—summarizing the SEC’s allegations—described the computer hacking in this case as “employ[ing] electronic means to trick, circumvent, or bypass computer security in order to gain unauthorized access to computer systems, networks, and information . . . and to steal such data.” On appeal, the SEC adds a further gloss, arguing that, in general, “[computer h]ackers either (1) ‘engage in false identification and masquerade as another user[.] . . . or (2) ‘exploit a weakness in [an electronic] code within a program to cause the program to malfunction in a way that grants the user greater privileges.’” Appellant’s Br. 22–23 (quoting Orin S. Kerr, *Cybercrime Scope: Interpreting “Access” and “Authorization” in Computer Misuse Statutes*). In our view, misrepresenting one’s identity in order to gain access to information that is otherwise off limits, and then stealing that information is plainly “deceptive” within the ordinary meaning of the word. It is unclear, however, that exploiting a weakness in an electronic code to gain unauthorized access is “deceptive,” rather than being mere theft. Accordingly, depending on how the hacker gained access, it seems to us entirely possible that computer hacking could be, by definition, a “deceptive device or contrivance” that is prohibited by Section 10(b) and Rule 10b–5.

However, we are hesitant to move from this general principle to a particular application without the benefit of the District Court’s views as to whether the computer hacking in this case—as opposed to computer hacking in general—was “deceptive.” Our caution is counseled by the considerable and careful efforts the District Court has already devoted to this case, including hearing live testimony from witnesses at a preliminary injunction hearing that covered, among other topics, how Thomson’s secure servers were infiltrated. Having established that the SEC need not demonstrate a breach of fiduciary duty, we now remand to the District Court to consider, in the first instance, whether the computer hacking in this case involved a fraudulent misrepresentation that was “deceptive.” . . .

The defendants in *United States v. Khalupsky*, 5 F.4th 279 (2d Cir. 2021), traded on the basis of information contained in pre-publication corporate press releases that they acquired from hackers based in Ukraine. Upholding the convictions, the court ruled that the hacking qualified as a “deceptive device or contrivance” under Section 10(b) of the Securities Exchange Act because it involved “SQL injection,” which allowed the hackers to identify vulnerabilities in the corporate systems and extract data, including employee login credentials that the hackers used to access further areas of the systems. Each time they used the stolen login credentials, the court said, the hackers engaged in deception by misrepresenting their identities.

Problem 4-1

Chiarella makes clear that only insiders and quasi-insiders of the firm whose securities are being traded can be liable under the classical theory. The classical theory rests on a theory of fraud through omission when the trader has a duty to disclose, but to whom does this duty run? Are there any problems with this theory?

C. Tippers and Tippees

A common insider trading fact pattern involves a tipper and one or more tippees. Tippers are insiders or quasi-insiders who give inside information to outsiders, referred to as tippees. It is not uncommon for tipper-tippee chains to exist, in which the original tippee then acts as a tipper to additional tippees farther down the chain. However, only the original tipper must be an insider or quasi-insider in order for the later tippees to be liable (with some caveats). Tippers can be liable under either the classical theory or the misappropriation theory (discussed in Part D).

The next case involves a tipper-tippee scenario, in which the Supreme Court again sort of accepts the classical theory, but does so in the process of reversing civil SEC sanctions. Why doesn't the classical theory fit this particular version of a tipper-tippee scenario?

DIRKS v. SEC, 463 U.S. 646 (1983)

Justice POWELL delivered the opinion of the Court.

Petitioner Raymond Dirks received material nonpublic information from "insiders" of a corporation with which he had no connection. He disclosed this information to investors who relied on it in trading in the shares of the corporation. The question is whether Dirks violated the antifraud provisions of the federal securities laws by this disclosure.

In 1973, Dirks was an officer of a New York broker-dealer firm who specialized in providing investment analysis of insurance company securities to institutional investors. On March 6, Dirks received information from Ronald Secrist, a former officer of Equity Funding of America. Secrist alleged that the assets of Equity Funding, a diversified corporation primarily engaged in selling life insurance and mutual funds, were vastly overstated as the result of fraudulent corporate practices. Secrist also stated that various regulatory agencies had failed to act on similar charges made by Equity Funding employees. He urged Dirks to verify the fraud and disclose it publicly.

Dirks decided to investigate the allegations. He visited Equity Funding's headquarters in Los Angeles and interviewed several officers and employees of the corporation. The senior management denied any wrongdoing, but certain corporation employees corroborated the charges of fraud. Neither Dirks nor his firm owned or traded any Equity Funding stock, but throughout his investigation he openly discussed the information he had obtained with a number of clients and investors. Some of these persons sold their

holdings of Equity Funding securities, including five investment advisers who liquidated holdings of more than \$16 million.

While Dirks was in Los Angeles, he was in touch regularly with William Blundell, the *Wall Street Journal*'s Los Angeles bureau chief. Dirks urged Blundell to write a story on the fraud allegations. Blundell did not believe, however, that such a massive fraud could go undetected and declined to write the story. He feared that publishing such damaging hearsay might be libelous.

During the two-week period in which Dirks pursued his investigation and spread word of Secrist's charges, the price of Equity Funding stock fell from \$26 per share to less than \$15 per share. This led the New York Stock Exchange to halt trading on March 27. Shortly thereafter California insurance authorities impounded Equity Funding's records and uncovered evidence of the fraud. Only then did the Securities and Exchange Commission (SEC) file a complaint against Equity Funding and only then, on April 2, did the *Wall Street Journal* publish a front-page story based largely on information assembled by Dirks. Equity Funding immediately went into receivership.

The SEC began an investigation into Dirks' role in the exposure of the fraud. After a hearing by an administrative law judge, the SEC found that Dirks had aided and abetted violations of § 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a), § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and SEC Rule 10b-5, 17 CFR § 240.10b-5 (1982), by repeating the allegations of fraud to members of the investment community who later sold their Equity Funding stock. The SEC concluded: "Where 'tippees'—regardless of their motivation or occupation—come into possession of material 'information that they know is confidential and know or should know came from a corporate insider,' they must either publicly disclose that information or refrain from trading." Recognizing, however, that Dirks "played an important role in bringing [Equity Funding's] massive fraud to light," the SEC only censured him. . . .

Not "all breaches of fiduciary duty in connection with a securities transaction," however, come within the ambit of Rule 10b-5. There must also be "manipulation or deception." In an inside-trading case this fraud derives from the "inherent unfairness involved where one takes advantage" of "information intended to be available only for a corporate purpose and not for the personal benefit of anyone." *In re Merrill Lynch, Pierce, Fenner & Smith, Inc.* Thus, an insider will be liable under Rule 10b-5 for inside trading only where he fails to disclose material nonpublic information before trading on it and thus makes "secret profits." *Cady, Roberts*. . . .

The SEC's position, as stated in its opinion in this case, is that a tippee "inherits" the *Cady, Roberts* obligation to shareholders whenever he receives inside information from an insider:

"In tipping potential traders, Dirks breached a duty which he had assumed as a result of knowingly receiving confidential information

from [Equity Funding] insiders. Tippees such as Dirks who receive non-public material information from insiders become ‘subject to the same duty as [the] insiders.’ *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (quoting *Ross v. Licht*). Such a tippee breaches the fiduciary duty which he assumes from the insider when the tippee knowingly transmits the information to someone who will probably trade on the basis thereof. . . . Presumably, Dirks’ informants were entitled to disclose the [Equity Funding] fraud in order to bring it to light and its perpetrators to justice. However, Dirks—standing in their shoes—committed a breach of the fiduciary duty which he had assumed in dealing with them, when he passed the information on to traders.”

This view differs little from the view that we rejected as inconsistent with congressional intent in *Chiarella*. In that case, the Court of Appeals agreed with the SEC and affirmed Chiarella’s conviction, holding that “[a]nyone—corporate insider or not—who regularly receives material nonpublic information may not use that information to trade in securities without incurring an affirmative duty to disclose.” Here, the SEC maintains that anyone who knowingly receives nonpublic material information from an insider has a fiduciary duty to disclose before trading.

In effect, the SEC’s theory of tippee liability in both cases appears rooted in the idea that the antifraud provisions require equal information among all traders. This conflicts with the principle set forth in *Chiarella* that only some persons, under some circumstances, will be barred from trading while in possession of material nonpublic information. Judge Wright correctly read our opinion in *Chiarella* as repudiating any notion that all traders must enjoy equal information before trading: “[T]he ‘information’ theory is rejected. Because the disclose-or-refrain duty is extraordinary, it attaches only when a party has legal obligations other than a mere duty to comply with the general antifraud proscriptions in the federal securities laws.” We reaffirm today that “[a] duty [to disclose] arises from the relationship between parties . . . and not merely from one’s ability to acquire information because of his position in the market.”

Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market. It is commonplace for analysts to “ferret out and analyze information,” and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation’s securities. The analyst’s judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation’s stockholders or the public generally.

The conclusion that recipients of inside information do not invariably acquire a duty to disclose or abstain does not mean that such tippees always are free to trade on the information. The need for a ban on some tippee trading is clear. Not only are insiders forbidden by their fiduciary relationship from personally using undisclosed corporate information to their advantage, but they may not give such information to an outsider for the same improper purpose of exploiting the information for their personal gain. See 15 U.S.C. § 78t(b) (making it unlawful to do indirectly “by means of any other person” any act made unlawful by the federal securities laws). Similarly, the transactions of those who knowingly participate with the fiduciary in such a breach are “as forbidden” as transactions “on behalf of the trustee himself.” *Mosser v. Darrow*. As the Court explained in *Mosser*, a contrary rule “would open up opportunities for devious dealings in the name of the others that the trustee could not conduct in his own.” Thus, the tippee’s duty to disclose or abstain is derivative from that of the insider’s duty. As we noted in *Chiarella*, “[t]he tippee’s obligation has been viewed as arising from his role as a participant after the fact in the insider’s breach of a fiduciary duty.”

Thus, some tippees must assume an insider’s duty to the shareholders not because they receive inside information, but rather because it has been made available to them *improperly*. And for Rule 10b–5 purposes, the insider’s disclosure is improper only where it would violate his *Cady, Roberts* duty. Thus, a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach. As Commissioner Smith perceptively observed in *Investors Management Co.*: “[T]ippee responsibility must be related back to insider responsibility by a necessary finding that the tippee knew the information was given to him in breach of a duty by a person having a special relationship to the issuer not to disclose the information. . . .” Tipping thus properly is viewed only as a means of indirectly violating the *Cady, Roberts* disclose-or-abstain rule.

In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider’s “tip” constituted a breach of the insider’s fiduciary duty. All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders. In contrast to the extraordinary facts of this case, the more typical situation in which there will be a question whether disclosure violates the insider’s *Cady, Roberts* duty is when insiders disclose information to analysts. In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear—either to the corporate insider or to the recipient analyst—whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market. Whether disclosure is a breach of duty therefore depends in large part on the purpose of the disclosure. This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate “use of inside information for personal advantage.” Thus, the test is whether the insider personally will

benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach. As Commissioner Smith stated in *Investors Management Co.*: “It is important in this type of case to focus on policing insiders and what they do . . . rather than on policing information *per se* and its possession. . . .”

The SEC argues that, if inside-trading liability does not exist when the information is transmitted for a proper purpose but is used for trading, it would be a rare situation when the parties could not fabricate some ostensibly legitimate business justification for transmitting the information. We think the SEC is unduly concerned. In determining whether the insider’s purpose in making a particular disclosure is fraudulent, the SEC and the courts are not required to read the parties’ minds. *Scienter* in some cases is relevant in determining whether the tipper has violated his *Cady, Roberts* duty. But to determine whether the disclosure itself “deceive[s], manipulate[s], or defraud[s]” shareholders, *Aaron v. SEC*, the initial inquiry is whether there has been a breach of duty by the insider. This requires courts to focus on objective criteria, *i.e.*, whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings. *Cf.* Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws* (“The theory . . . is that the insider, by giving the information out selectively, is in effect selling the information to its recipient for cash, reciprocal information, or other things of value for himself. . . .”). There are objective facts and circumstances that often justify such an inference. For example, there may be a relationship between the insider and the recipient that suggests a *quid pro quo* from the latter, or an intention to benefit the particular recipient. The elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

Determining whether an insider personally benefits from a particular disclosure, a question of fact, will not always be easy for courts. But it is essential, we think, to have a guiding principle for those whose daily activities must be limited and instructed by the SEC’s inside-trading rules, and we believe that there must be a breach of the insider’s fiduciary duty before the tippee inherits the duty to disclose or abstain. In contrast, the rule adopted by the SEC in this case would have no limiting principle.

Under the inside-trading and tipping rules set forth above, we find that there was no actionable violation by Dirks. It is undisputed that Dirks himself was a stranger to Equity Funding, with no pre-existing fiduciary duty to its shareholders. He took no action, directly or indirectly, that induced the shareholders or officers of Equity Funding to repose trust or confidence in him. There was no expectation by Dirk’s sources that he would keep their information in confidence. Nor did Dirks misappropriate or illegally obtain the information about Equity Funding. Unless the insiders breached their *Cady, Roberts* duty to shareholders in disclosing the nonpublic information to Dirks, he breached no duty when he passed it on to investors as well as to the *Wall Street Journal*.

It is clear that neither Secrist nor the other Equity Funding employees violated their *Cady, Roberts* duty to the corporation's shareholders by providing information to Dirks. The tippers received no monetary or personal benefit for revealing Equity Funding's secrets, nor was their purpose to make a gift of valuable information to Dirks. As the facts of this case clearly indicate, the tippers were motivated by a desire to expose the fraud. In the absence of a breach of duty to shareholders by the insiders, there was no derivative breach by Dirks. Dirks therefore could not have been "a participant after the fact in [an] insider's breach of a fiduciary duty." *Chiarella*. . . .

Problem 4-2

According to the Supreme Court, what is the mens rea required for tippee liability, at least in a civil action? Is this problematic?

D. Misappropriation Theory

At this point in the evolution of the case law, the Supreme Court had pretty much accepted the classical theory of insider trading as securities fraud. However, the classical theory left a fairly large gap in the types of traders who could be liable. For example, in *Chiarella*, Chiarella was a quasi-insider (independent contractor with access to confidential information) of Firm A who, through this relationship, gained inside information into Firms B and C, in whose stocks he eventually traded. Under the classical theory, Chiarella was not liable because he was not an insider or quasi-insider of Firms B and C.

In the next case, the Supreme Court not only blesses the theory of insider trading as securities fraud but also approves an expansion to include the "misappropriation" theory, which then covered future individuals like Chiarella. There is a disagreement here about how this theory can fit within the concept of fraud and the language of 10b-5. Think about the policy problem (how to get the law to cover people like Chiarella and the defendant in this next case) and how to accommodate policy goals within the text of Rule 10b-5 and a theory of fraud.

UNITED STATES v. O'HAGAN, 521 U.S. 642 (1997)

Justice GINSBURG delivered the opinion of the Court.

This case concerns the interpretation and enforcement of § 10(b) and § 14(e) of the Securities Exchange Act of 1934, and rules made by the Securities and Exchange Commission pursuant to these provisions, Rule 10b-5 and Rule 14e-3(a). . . . The first [question] relates to the misappropriation of material, nonpublic information for securities trading; the second concerns fraudulent practices in the tender offer setting. In particular, we address and resolve these issues: (1) Is a person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty to the source of the information, guilty of violating § 10(b) and Rule 10b-5? . . .

Respondent James Herman O'Hagan was a partner in the law firm of Dorsey & Whitney in Minneapolis, Minnesota. In July 1988, Grand Metropolitan PLC (Grand Met), a company based in London, England, retained Dorsey & Whitney as local counsel to represent Grand Met regarding a potential tender offer for the common stock of the Pillsbury Company, headquartered in Minneapolis. Both Grand Met and Dorsey & Whitney took precautions to protect the confidentiality of Grand Met's tender offer plans. O'Hagan did no work on the Grand Met representation. Dorsey & Whitney withdrew from representing Grand Met on September 9, 1988. Less than a month later, on October 4, 1988, Grand Met publicly announced its tender offer for Pillsbury stock.

On August 18, 1988, while Dorsey & Whitney was still representing Grand Met, O'Hagan began purchasing call options for Pillsbury stock. Each option gave him the right to purchase 100 shares of Pillsbury stock by a specified date in September 1988. Later in August and in September, O'Hagan made additional purchases of Pillsbury call options. By the end of September, he owned 2,500 unexpired Pillsbury options, apparently more than any other individual investor. O'Hagan also purchased, in September 1988, some 5,000 shares of Pillsbury common stock, at a price just under \$39 per share. When Grand Met announced its tender offer in October, the price of Pillsbury stock rose to nearly \$60 per share. O'Hagan then sold his Pillsbury call options and common stock, making a profit of more than \$4.3 million.

The Securities and Exchange Commission (SEC or Commission) initiated an investigation into O'Hagan's transactions, culminating in a 57-count indictment. The indictment alleged that O'Hagan defrauded his law firm and its client, Grand Met, by using for his own trading purposes material, nonpublic information regarding Grand Met's planned tender offer. . . .

Under the "traditional" or "classical theory" of insider trading liability, § 10(b) and Rule 10b-5 are violated when a corporate insider trades in the securities of his corporation on the basis of material, nonpublic information. Trading on such information qualifies as a "deceptive device" under § 10(b), we have affirmed, because "a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation." *Chiarella v. United States*. That relationship, we recognized, "gives rise to a duty to disclose [or to abstain from trading] because of the 'necessity of preventing a corporate insider from . . . tak[ing] unfair advantage of . . . uninformed . . . stockholders.'" The classical theory applies not only to officers, directors, and other permanent insiders of a corporation, but also to attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.

The "misappropriation theory" holds that a person commits fraud "in connection with" a securities transaction, and thereby violates § 10(b) and Rule 10b-5, when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Under this theory, a fiduciary's undisclosed, self-serving use of a principal's information to purchase or sell securities, in breach of a

duty of loyalty and confidentiality, defrauds the principal of the exclusive use of that information. In lieu of premising liability on a fiduciary relationship between company insider and purchaser or seller of the company's stock, the misappropriation theory premises liability on a fiduciary-turned-trader's deception of those who entrusted him with access to confidential information.

The two theories are complementary, each addressing efforts to capitalize on nonpublic information through the purchase or sale of securities. The classical theory targets a corporate insider's breach of duty to shareholders with whom the insider transacts; the misappropriation theory outlaws trading on the basis of nonpublic information by a corporate "outsider" in breach of a duty owed not to a trading party, but to the source of the information. The misappropriation theory is thus designed to "protec[t] the integrity of the securities markets against abuses by 'outsiders' to a corporation who have access to confidential information that will affect th[e] corporation's security price when revealed, but who owe no fiduciary or other duty to that corporation's shareholders."

In this case, the indictment alleged that O'Hagan, in breach of a duty of trust and confidence he owed to his law firm, Dorsey & Whitney, and to its client, Grand Met, traded on the basis of nonpublic information regarding Grand Met's planned tender offer for Pillsbury common stock. This conduct, the Government charged, constituted a fraudulent device in connection with the purchase and sale of securities.

We agree with the Government that misappropriation, as just defined, satisfies § 10(b)'s requirement that chargeable conduct involve a "deceptive device or contrivance" used "in connection with" the purchase or sale of securities. We observe, first, that misappropriators, as the Government describes them, deal in deception. A fiduciary who "[pretends] loyalty to the principal while secretly converting the principal's information for personal gain," Brief for United States 17, "duplicates" or defrauds the principal.

We addressed fraud of the same species in *Carpenter v. United States*, which involved the mail fraud statute's proscription of "any scheme or artifice to defraud," 18 U.S.C. § 1341. Affirming convictions under that statute, we said in *Carpenter* that an employee's undertaking not to reveal his employer's confidential information "became a sham" when the employee provided the information to his co-conspirators in a scheme to obtain trading profits. A company's confidential information, we recognized in *Carpenter*, qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information, in violation of a fiduciary duty, the Court said in *Carpenter*, constitutes fraud akin to embezzlement— "'the fraudulent appropriation to one's own use of the money or goods entrusted to one's care by another.'" *Carpenter's* discussion of the fraudulent misuse of confidential information, the Government notes, "is a particularly apt source of guidance here, because [the mail fraud statute] (like Section 10(b)) has long been held to require deception, not merely the breach of a fiduciary duty."

Deception through nondisclosure is central to the theory of liability for which the Government seeks recognition. As counsel for the Government stated in explanation of the theory at oral argument: “To satisfy the common law rule that a trustee may not use the property that [has] been entrusted [to] him, there would have to be consent. To satisfy the requirement of the Securities Act that there be no deception, there would only have to be disclosure.” . . .

We turn next to the § 10(b) requirement that the misappropriator’s deceptive use of information be “in connection with the purchase or sale of [a] security.” This element is satisfied because the fiduciary’s fraud is consummated, not when the fiduciary gains the confidential information, but when, without disclosure to his principal, he uses the information to purchase or sell securities. The securities transaction and the breach of duty thus coincide. This is so even though the person or entity defrauded is not the other party to the trade, but is, instead, the source of the nonpublic information. *See* Aldave, 13 Hofstra L. Rev. (“a fraud or deceit can be practiced on one person, with resultant harm to another person or group of persons”). A misappropriator who trades on the basis of material, nonpublic information, in short, gains his advantageous market position through deception; he deceives the source of the information and simultaneously harms members of the investing public.

The misappropriation theory targets information of a sort that misappropriators ordinarily capitalize upon to gain no-risk profits through the purchase or sale of securities. Should a misappropriator put such information to other use, the statute’s prohibition would not be implicated. The theory does not catch all conceivable forms of fraud involving confidential information; rather, it catches fraudulent means of capitalizing on such information through securities transactions.

The Government notes another limitation on the forms of fraud § 10(b) reaches: “The misappropriation theory would not . . . apply to a case in which a person defrauded a bank into giving him a loan or embezzled cash from another, and then used the proceeds of the misdeed to purchase securities.” In such a case, the Government states, “the proceeds would have value to the malefactor apart from their use in a securities transaction, and the fraud would be complete as soon as the money was obtained.” In other words, money can buy, if not anything, then at least many things; its misappropriation may thus be viewed as sufficiently detached from a subsequent securities transaction that § 10(b)’s “in connection with” requirement would not be met.

Justice THOMAS’ charge that the misappropriation theory is incoherent because information, like funds, can be put to multiple uses, *see post* (opinion concurring in judgment in part and dissenting in part), misses the point. The Exchange Act was enacted in part “to insure the maintenance of fair and honest markets,” 15 U.S.C. § 78b, and there is no question that fraudulent uses of confidential information fall within § 10(b)’s prohibition if the fraud is “in connection with” a securities transaction. It is hardly remarkable that a rule suitably applied to the fraudulent uses of certain kinds of

information would be stretched beyond reason were it applied to the fraudulent use of money.

Justice THOMAS does catch the Government in overstatement. Observing that money can be used for all manner of purposes and purchases, the Government urges that confidential information of the kind at issue derives its value *only* from its utility in securities trading. Substitute “ordinarily” for “only,” and the Government is on the mark.

Our recognition that the Government’s “only” is an overstatement has provoked the dissent to cry “new theory.” But the very case on which Justice THOMAS relies, *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, shows the extremity of that charge. In *State Farm*, we reviewed an agency’s rescission of a rule under the same “arbitrary and capricious” standard by which the promulgation of a rule under the relevant statute was to be judged; in our decision concluding that the agency had not adequately explained its regulatory action, we cautioned that a “reviewing court should not attempt itself to make up for such deficiencies.” Here, by contrast, Rule 10b–5’s promulgation has not been challenged; we consider only the Government’s charge that O’Hagan’s alleged fraudulent conduct falls within the prohibitions of the Rule and § 10(b). In this context, we acknowledge simply that, in defending the Government’s interpretation of the Rule and statute in this Court, the Government’s lawyers have pressed a solid point too far, something lawyers, occasionally even judges, are wont to do.

The misappropriation theory comports with § 10(b)’s language, which requires deception “in connection with the purchase or sale of any security,” not deception of an identifiable purchaser or seller. The theory is also well tuned to an animating purpose of the Exchange Act: to insure honest securities markets and thereby promote investor confidence. *See* 45 Fed. Reg. 60412 (1980) (trading on misappropriated information “undermines the integrity of, and investor confidence in, the securities markets”). Although informational disparity is inevitable in the securities markets, investors likely would hesitate to venture their capital in a market where trading based on misappropriated nonpublic information is unchecked by law. An investor’s informational disadvantage vis-à-vis a misappropriator with material, nonpublic information stems from contrivance, not luck; it is a disadvantage that cannot be overcome with research or skill. *See* Brudney, *Insiders, Outsiders, and Informational Advantages Under the Federal Securities Laws* (“If the market is thought to be systematically populated with . . . transactors [trading on the basis of misappropriated information] some investors will refrain from dealing altogether, and others will incur costs to avoid dealing with such transactors or corruptly to overcome their unerodable informational advantages.”).

In sum, considering the inhibiting impact on market participation of trading on misappropriated information, and the congressional purposes underlying § 10(b), it makes scant sense to hold a lawyer like O’Hagan a § 10(b) violator if he works for a law firm representing the target of a tender offer, but not if he works for a law firm

representing the bidder. The text of the statute requires no such result. The misappropriation at issue here was properly made the subject of a § 10(b) charge because it meets the statutory requirement that there be “deceptive” conduct “in connection with” securities transactions. . . .

Under the classical theory, the trader’s duty is to the firm in whose securities he trades. Under the misappropriation theory, the trader’s duty is to the source of his inside information. Note that most every individual who could be liable under the classical theory could also be liable under the misappropriation theory—because a corporate insider trading on corporate secrets will have misused information acquired from a source to which the insider owes a duty: his or her employer.

Problem 4-3

Construct a simple but original trading fact pattern, based on material nonpublic information, that includes individuals who represent each of the following types:

- (a) a classical insider who trades
- (b) a classical tipper who tips another who trades
- (c) a tippee of a classical tipper; the tippee trades
- (d) a misappropriator who trades
- (e) a misappropriating tipper who tips another who trades
- (f) a tippee of a misappropriating tipper; the tippee trades
- (g) a tippee who was tipped by another tippee who was tipped by a misappropriating tipper; the second tippee trades
- (h) a person who trades on material nonpublic information but commits no violation

Rule 10b-5-1 Trading Plans

In the late 20th century, with the dramatic rise of stock options as a form of executive compensation, the SEC heard calls for some form of safe harbor from insider trading liability for executives loaded down with options in their own companies. Executives were said to feel constrained from exercising and selling their options—and thus realizing the value of this compensation—due to fears of being accused of insider trading, given the steady stream of price-affecting developments known to senior personnel inside large companies.

In 2000, the SEC adopted Rule 10b-5-1, which provided an affirmative defense to a claim under Rule 10b-5 for trading on material nonpublic information if the person could demonstrate, among other things, that the trade was made pursuant to a written plan for the trading of securities adopted at a time when the person was unaware of any material nonpublic information. Over the ensuing two decades, concern rose that executives were establishing and canceling “10b-5-1 trading plans” manipulatively, in order to profit or avoid losses using inside information in violation of the intent of the rule. Some academic studies showed that executives using such plans profited more than those who did not employ the plans.

On February 27, 2023, the SEC adopted amendments to Rule 10b-5-1 designed to prevent manipulation of trading plans. The 2023 amendments include cooling-off periods between adoption of such a plan and the first trade under the plan; limiting plans to one per person during any 12-month period; and providing that any plan not enacted “in good faith” is not eligible for the affirmative defense.

In addition, the government has recently been willing to prosecute individuals for abusing the 10b-5-1 safe harbor by constructing trading plans to unload stock when aware of material nonpublic information. On June 21, 2024, a federal jury in Los Angeles convicted a former corporate chairman for selling tens of millions of dollars of his company’s shares under a 10b-5-1 plan at a time when he knew that an essential counter-party to his company’s business was likely to cancel its contract with the company. *See United States v. Peizer*, No. 2:23-cr-0089-DSF (C.D. Cal. 2024). The case is likely to result in an appellate decision on the viability of the government’s theory of prosecution in such circumstances.

“Shadow” Insider Trading

What if employee X who works for corporation A (1) learns that A is about to be acquired by corporation B; (2) knows that announcement of the acquisition of A by B is likely to increase the price of A’s stock; (3) accurately predicts that the announcement of B’s acquisition of A will also cause the stock price of corporation C, in the same industry, to rise; and (4) then profits by buying options in C before the announcement of B’s acquisition of A, an acquisition which does in fact lead to an increase in C’s stock price? Can this misappropriator of information from his employer (A) be liable for insider trading in securities of C?

While the SEC has not brought many such cases, the agency believes this phenomenon of “shadow trading” is growing and has begun to bring enforcement actions. The SEC brought a civil enforcement case for such conduct recently that resulted in a trial and jury verdict in favor of the SEC that will likely be the subject of an appeal to the Ninth Circuit Court of Appeals. *See SEC v. Panuwat*, No. 4:21-cv-06322 (N.D. Cal. Aug. 17, 2021).

E. Recent Prosecutions and Wall Street

The following case summarizes the facts of former McKinsey CEO Rajat Gupta's prosecution and conviction, one in a recent wave of prosecutions by the U.S. Attorney in Manhattan that targeted hedge fund traders at varying levels of seniority.

Prosecutions included the convictions (and lengthy sentence) of fund owner Raj Rajaratnam, who is discussed in the next opinion, and several traders who worked at SAC Capital for renowned hedge fund boss Steven Cohen, as well as the SAC firm itself, which settled with the government. Cohen, who was extensively investigated but never personally prosecuted and is reported to have been the inspiration for the main character in the Showtime series *Billions*, went back into the hedge fund business (with a firm called Point72) and owns the New York Mets. For very good book-length treatments of these investigations and prosecutions, see ANITA RAGHAVAN, *THE BILLIONAIRE'S APPRENTICE* (2013) (Rajaratnam and the Galleon fund), and SHEELA KOLHATKAR, *BLACK EDGE* (2017) (Cohen and SAC Capital).

As you read the materials in this part, consider the question of enforcement policy and discretion. What is DOJ trying to accomplish with these cases? Why is it doing them? Are they beneficial? In what way(s)? Leaving the doctrine aside, consider the social value, or lack thereof, of criminalizing and prosecuting insider trading.

UNITED STATES v. GUPTA, 747 F.3d 111 (2d Cir. 2014)

KEARSE, Circuit Judge:

Defendant Rajat Gupta ("Gupta") appeals from a judgment entered in the United States District Court for the Southern District of New York on November 9, 2012, following a jury trial before Jed S. Rakoff, Judge, convicting him on three counts of securities fraud, in violation of 15 U.S.C. §§ 78j(b) and 78ff, and one count of conspiracy to commit securities fraud, in violation of 18 U.S.C. § 371. . . .

At the times pertinent to this prosecution, Gupta was a member of the board of directors of The Goldman Sachs Group, Inc. ("Goldman Sachs" or "Goldman"), the global financial services firm headquartered in New York. Gupta was also involved in several financial ventures with Raj Rajaratnam (or "Raj"), founder of The Galleon Group ("Galleon"), a family of hedge funds that invested billions of dollars for its principals and clients. The present prosecution arose out of a multiyear government investigation of insider trading at Galleon which included court-authorized wiretaps of Rajaratnam's cell phone, *see United States v. Rajaratnam*. . . .

All of the government's evidence that Gupta passed confidential information about Goldman Sachs to Rajaratnam, on the basis of which Rajaratnam made purchases or sales of Goldman stock, was circumstantial. Most of the evidence described below was presented through testimony from employees of Galleon or Goldman, wiretapped telephone calls between Rajaratnam and other Galleon employees, records of calls made

to or from telephones used by Gupta or Rajaratnam, and records as to the timing of trades by Galleon in Goldman Sachs stock.

At 3:15 p.m. on September 23, 2008, Goldman Sachs held a special meeting of its board of directors. The purpose of the meeting was to approve an investment of \$5 billion in Goldman by Warren Buffett. The imminent investment was highly confidential, as it was likely to have “a meaningful impact” on Goldman’s stock price. It was to be announced to the public after the 4 p.m. close of trading on the New York Stock Exchange.

Gupta, a former managing director of the consulting firm McKinsey & Company (“McKinsey”), participated in the Goldman Sachs board meeting via telephone from a conference room at McKinsey’s New York office. Telephone records indicated that Gupta was on the Goldman Sachs conference call from 3:13 p.m. until 3:53 p.m.

At approximately 3:54 p.m., Gupta’s assistant, Renee Gomes, dialed Rajaratnam’s direct line; the McKinsey conference room telephone from which Gupta had participated in the Goldman Sachs board meeting was then connected to the call to Rajaratnam’s line. The connection between Rajaratnam’s line and the telephone Gupta used lasted approximately 30 to 35 seconds.

Caryn Eisenberg, Rajaratnam’s assistant in 2008–2009, testified that on September 23, 2008, she answered a call on his direct line at about 10 minutes before the 4:00 p.m. market close. As a general rule Eisenberg was not to put calls through to Rajaratnam near the end of the trading day, but she put the caller on hold, located Rajaratnam, and put the call through. Although at the time of trial Eisenberg no longer remembered the name of the man who was on the line, she testified that she put this call through because his name was on the short list of persons whose calls Rajaratnam would accept near the end of the trading day; she recognized his voice as that of a frequent caller; and the man said it was “urgent” that he “speak to Raj.”

Rajaratnam took the call in his office and was on the telephone only briefly. Eisenberg testified that Rajaratnam thereafter summoned Galleon cofounder Gary Rosenbach into his office and the two had a closed-door conversation. Rosenbach then “went back to his desk,” picked up his telephone, “and started saying buy Goldman Sachs.”

Galleon trader Ananth Muniyappa testified that at approximately 3:56 p.m. on September 23, Rajaratnam, as he was hanging up his telephone, instructed Muniyappa, who was at his own desk nearby, to purchase 100,000 shares of Goldman Sachs stock. When Muniyappa determined that he would probably be unable to buy as many as 100,000 shares before the market’s close (he managed to buy only a total of 67,200 shares), he quickly informed Rajaratnam, who promptly instructed Rosenbach to buy Goldman stock.

Rosenbach proceeded to buy 200,000 shares of the stock, 150,000 for Rajaratnam’s portfolio—which specialized in technology stocks—and 50,000 for Rosenbach’s own

portfolio. Rosenbach also bought 1.5 million shares (1,000,000 for Rajaratnam's portfolio and 500,000 for his own) of a financial-sector index fund made up of stocks of several institutions, including Goldman. Each of these trades was made in the final "three to four minutes" of the trading day (Tr. 401), i.e., between approximately 3:56 p.m. and 4:00 p.m. In all, the Goldman Sachs stock purchased by Muniyappa and Rosenbach at the behest of Rajaratnam in the final minutes of the trading day on September 23—excluding the shares of the index fund—cost more than \$33 million.

Warren Buffett's \$5 billion investment in Goldman Sachs was announced at approximately 6:00 p.m. on September 23. The next morning, Goldman's stock price rose to a high nearly 7% above its September 23 closing price. A government witness testified that the profits on the above Galleon purchases of Goldman stock at the end of the trading day on September 23 exceeded \$1 million.

Eisenberg testified that after Rajaratnam took the urgent call near the close of trading on September 23 he was smiling more than usual. But not everyone at Galleon was happy. Leon Shaulov was a Galleon trader and portfolio manager. Muniyappa did not buy any Goldman Sachs stock for Shaulov on September 23. Muniyappa testified that that evening, shortly after Goldman announced the Warren Buffett investment, Shaulov sent Rosenbach an email saying, "Thanks for the heads up, by the way. I'm short 170 million in financials. Not one word from anyone. Thank you very much. All I get is sick dilution. Zero help. Zero." . . .

On the morning of September 24, 2008, before the stock markets opened, Rajaratnam placed two calls from his cell phone (which was wiretapped) to Ian Horowitz, his principal trader. In the first call, at 7:09 a.m., Rajaratnam began to tell Horowitz about the events of the previous afternoon:

RAJ RAJARATNAM: . . . So, big drama yesterday, but I have to. . . .

IAN HOROWITZ: Yeah, I, I, I heard.

RAJ RAJARATNAM: Hum.

IAN HOROWITZ: I heard a little, um, you mean the last three minutes of the day?

RAJ RAJARATNAM: No, I got a call at 3:58, right?

IAN HOROWITZ: Yeah.

RAJ RAJARATNAM: Saying something good might happen to Goldman. Right?

IAN HOROWITZ: So it is what it is. Everything's, everyone's fine, I saw it cross the board. . . .

RAJ RAJARATNAM: No I saw, I, so, I told Ananth [Muniyappa] to buy some, he was fucking around, he can't, you know. So I went to Gary [Rosenbach] and said just buy me, right?

IAN HOROWITZ: Mm hmm.

RAJ RAJARATNAM: Because you were not there. It happens all the fucking time, you know you're there every day of the year, right? . . .

Rajaratnam called Horowitz again at 7:56 a.m. After asking how much Goldman Sachs stock Galleon currently owned, Rajaratnam continued his report on the previous afternoon's events:

RAJ RAJARATNAM: Okay, yeah, let me tell you what happened, honestly, right?

IAN HOROWITZ: Yeah, no, I looked at our price, I looked at our price, and I looked at what happened.

RAJ RAJARATNAM: Yeah.

IAN HOROWITZ: Someone had this before us, someone, whatever went on, something happened, someone, they . . .

RAJ RAJARATNAM: I got a call, right, saying something good's gonna happen.

IAN HOROWITZ: We'll talk about, how 'bout this, we'll talk when you come in.

RAJ RAJARATNAM: Okay.

IAN HOROWITZ: We'll talk when you come in, okay?

RAJ RAJARATNAM: But I didn't do anything, you were not there, I asked Ananth to buy some.

IAN HOROWITZ: You did nothing.

RAJ RAJARATNAM: Then I went to Gary . . . and . . .

IAN HOROWITZ: You did nothing wrong.

RAJ RAJARATNAM: Yeah at 3:58, I can't, I can't yell out in the fucking halls.

IAN HOROWITZ: No. You did nothing wrong, we'll talk about it when you come in, nothing's wrong.

RAJ RAJARATNAM: It is, I guess, Leon [Shaulov] was very upset. You know, fuck him, look, I've kept my mouth shut when he gave me WaMu, right?

IAN HOROWITZ: Get, get upset about what? You got nothing, this is at 3:58.

RAJ RAJARATNAM: Yeah, if it was, one o'clock, I always am good with him, I always call him in, I tell him everything, you know? AMD, IBM, everything, right?

IAN HOROWITZ: He's not in, so I'm, he hasn't said anything. Listen, if something comes in, I'll let you know.

On October 23, 2008, more than halfway through the fourth quarter of Goldman Sachs's fiscal year, Goldman's chairman convened an unofficial board meeting by conference call to bring the directors up-to-date on company events. At that time, Wall Street analysts were projecting that Goldman—which, since becoming a public company, had never reported a quarterly loss—would continue to report profits. In the conference call, which began at 4:15 p.m., Goldman's management informed the board that the company's fourth-quarter result would be a loss.

Records were introduced to show that Gupta, on a telephone in his home office, participated in the Goldman Sachs conference call for approximately 33 minutes and disconnected at 4:49 p.m. At 4:50 p.m., a call was placed from the telephone of Gupta's assistant Renee Gomes to the direct office line of Rajaratnam; Gupta's home office line was conferenced in to that call, and Gomes's line was disconnected. Gupta's home office telephone was connected to Rajaratnam's direct line for some 12 ½ minutes, until 5:03 p.m.

The next morning, October 24, 2008, in three transactions, Rajaratnam sold a total of 150,000 shares of Goldman Sachs stock. The first 50,000 shares were sold at 9:31 a.m., one minute after the stock market opened—the first opportunity to trade in Goldman shares since the board meeting the previous day. Another 50,000 shares were sold at 10:09 a.m.; and the final 50,000 shares were sold at 10:37 a.m. Goldman Sachs's fourth-quarter losses were not announced to the public until December 16. Based on the decline in Goldman's stock price after that announcement, the government introduced calculations showing that Rajaratnam, by selling his shares on October 24, avoided a loss of more than \$3.8 million.

At 12:12 p.m. on October 24, Rajaratnam returned a call to David Lau, a Singapore-based portfolio manager for Galleon International, one of Galleon's hedge funds. Lau had sought to reach Rajaratnam for general investment advice. Galleon International invested in non-U.S. securities primarily, but not exclusively; and it had in the past owned stock in Goldman. The conversation began with Rajaratnam advising that, as a

general matter, it would be safer to invest in United States companies than in emerging market countries. . . .

Rajaratnam then proceeded to describe to Lau the confidential negative information he had received the previous day “from somebody who’s on the Board of Goldman Sachs,” which “they don’t report until December.” Rajaratnam noted the current optimistic view of Wall Street analysts of Goldman Sachs’s likely profits, and he described the potential for selling the stock short:

RAJ RAJARATNAM: Um, now I, I heard yesterday from somebody who’s on the Board of Goldman Sachs, that they are gonna lose \$2 per share. The Street has them making \$2.50.

DAVID LAU: Really?

RAJ RAJARATNAM: You know. Yeah. Now I can get that number, you know, one, they don’t report until December, they, I think their quarter ends in November, but (UI [i.e., unintelligible]) one more, but you know they have these huge marks in ICBC and all of that stuff right. That uh is getting absolutely clobbered. You know.

DAVID LAU: Right.

RAJ RAJARATNAM: So what he was telling me was that uh, Goldman, the quarter’s pretty bad. They have zero revenues because their trading revenues are offset by asset losses, and to date they have lost \$2 per share, they just announced a 10% cut and uh you know, the basic business is ok but uh you know this is uh tough for them. I don’t think that’s built into Goldman Sachs stock price. So if it gets to \$105, I’m gonna, it’s \$99 now, it was at \$102. I was looking for \$105, I’m gonna whack it you know.

DAVID LAU: (Laughs) Okay. Okay. Okay (UI) . . .

RAJ RAJARATNAM: Okay, I don’t think it makes sense to take longer term views right now. . . .

The government also presented evidence that Gupta and Rajaratnam had a close relationship. Gupta described Rajaratnam as a “close friend[]”—indeed, “a very close friend”—and was in frequent communication with him. Rajaratnam’s address book noted Gupta as a “Good friend.” Rajaratnam had instructed Eisenberg that there were only five people she was authorized to connect with him near the end of the trading day; Gupta was one of them. (during the two years when Eisenberg was Rajaratnam’s assistant, the list was expanded to about 10 names)

Gupta and Rajaratnam were also involved in several business ventures together. In 2005, they, along with a third partner, formed Voyager Capital Partners Ltd. (“Voyager”), an

investment fund capitalized with \$50 million, \$5 million of which was contributed by Gupta and \$40 million by Rajaratnam; Gupta later borrowed \$5 million from Rajaratnam in order to buy out the third partner's share (see Tr. 1858–59), giving Gupta a \$10 million stake in Voyager. Other collaborations were discussed in a July 29, 2008 call from Gupta to Rajaratnam—the only call between these two that was captured in the wiretaps. In 2007, Gupta, Rajaratnam, and two others launched another investment fund, New Silk Route, in which Rajaratnam invested \$50 million (see *id.* at 8); Gupta was the chairman. Gupta was also heavily involved in Galleon itself. He had invested several million dollars in Galleon funds; he was involved in the planning of a new Galleon fund called Galleon Global (which ultimately was not created); he had a keycard allowing him access to Galleon's New York offices; and he regularly worked on Galleon's behalf in seeking potential investors. In early 2008, Gupta was made chairman of Galleon International, which, as of April 2008, managed assets totaling some \$1.1 billion and could earn “performance fees”. Gupta was given a 15 percent ownership stake.

In the July 2008 Gupta–Rajaratnam Call, Rajaratnam asked Gupta about a rumor that Goldman Sachs might seek to buy a commercial bank. Gupta responded that there had been “a big discussion” of that possibility, in particular with respect to “Wachovia,” as well as of the possibility of buying an insurance company, in particular “AIG.” Gupta said the Goldman board was divided and that such purchases were unlikely to be “imminent,” but that if certain banks were “a good deal . . . it's quite conceivable they'd come and say let's go buy” one. The board's discussions were confidential. Even the matter of whether or not a subject had been discussed at a Goldman board meeting was confidential.

Gupta called several witnesses in his defense. Most were character witnesses who testified that they believed Gupta to be an honest person; Gupta also sought to have them testify that he had “integrity” and thus would not have been inclined to share inside information with Rajaratnam. Gupta's daughter Geetanjali Gupta (“Geetanjali”) testified about certain conversations Gupta had with her about Rajaratnam, and sought to indicate that Gupta would not have been inclined to share inside information with Rajaratnam because Gupta believed Rajaratnam had cheated him out of money with respect to the Voyager investment. Gupta also sought to introduce documentary evidence suggesting that a different Goldman Sachs insider was giving Rajaratnam confidential information about Goldman Sachs, and that Gupta contemplated leaving a substantial portion of his wealth to charity. . . .

The jury found Gupta guilty on four of the six counts against him: Count One, conspiracy to commit securities fraud in violation of 18 U.S.C. § 371, and three substantive counts of securities fraud in violation of 15 U.S.C. §§ 78j(b) and 78ff. The substantive securities fraud convictions were on Count Three, based on Rosenbach's purchase of 150,000 shares of Goldman Sachs stock for Rajaratnam on September 23, 2008; Count Four, based on Muniyappa's purchase of 67,200 shares of Goldman Sachs stock for Rajaratnam on September 23, 2008; and Count Five, based on Rajaratnam's sale of 150,000 shares of Goldman Sachs stock on October 24, 2008. . . .

[The court rejected all of Gupta’s claims on appeal, all of which had to do with the trial court’s admission and non-admission of a variety of forms of evidence, and affirmed his conviction.]

Problem 4-4

Rajat Gupta was born in modest circumstances in Calcutta, India. His father, a journalist, was imprisoned and beaten for supporting Gandhi’s movement. Gupta worked to gain admission to the most elite schools in India and the United States, including Harvard Business School. He rose through the ranks to become the first foreign-born CEO at the vaunted McKinsey consulting firm. He donated large portions of his wealth to causes including global health and education in India, and founded several important institutions in India.

The foreperson of the jury at Gupta’s trial called him an example of the American dream, who had lived a “storybook life,” and said that the jurors “were hoping he would walk out” of the courthouse but found the evidence too overwhelming not to return a guilty verdict. See William Alden & Azam Ahmed, *A Conflicted Jury Finds Rajat Gupta Guilty*, N.Y. TIMES DEALBOOK (June 15, 2012),

<https://dealbook.nytimes.com/2012/06/15/a-conflicted-jury-finds-rajat-gupta-guilty/?mtrref=www.google.com&gwh=671D1837015A84598509BD09A193D5D1&gwt=regi&assetType=REGIWALL>.

Why did Gupta do what he did, especially in light of the fact that he did not share in the profits of the trades charged in his case? Does his case afford any insight on the general problem of insider trading?

Here is another case arising out of the government’s recent wave of insider trading prosecutions. It is a case with facts that any beginning or aspiring lawyer must never forget. It also illustrates how in some cases prosecutors might use willful blindness doctrine to assist in securing an insider trading conviction.

UNITED STATES v. GOFFER, 721 F.3d 113 (2d Cir. 2013)

WESLEY, Circuit Judge:

[Defendants Zvi] Goffer, [Michael] Kimelman, and [Craig] Drimal, along with non-party defendants, conducted a double-blind, high-volume insider trading network that led the participants to acquire over \$10 million in profits. Goffer, who worked as a proprietary trader at the Schottenfeld Group, LLC (“Schottenfeld”), spearheaded the conspiracy.

In 2007, Drimal traded from the offices of the Galleon Group (“Galleon”), a firm led by Raj Rajaratnam. Kimelman, previously an attorney at a New York law firm, traded for Quad Capital (“Quad”), a proprietary trading firm. In late 2007, Kimelman, Goffer, and Goffer’s brother Emanuel established a new trading firm, Incremental Capital

(“Incremental”), though they retained their other positions. In early 2008, Kimelman left Quad to trade with Emanuel, and Goffer began trading at Galleon. Kimelman and Goffer spoke often and shared information that led them to trade in the same stocks. In 2007 and 2008, Kimelman and Goffer traded 151 stocks within five days of each other, including 88 stocks that they both traded on the same day.

In the summer of 2007, Arthur Cutillo and Brian Santarlas, attorneys at Ropes & Gray LLP, met with Jason Goldfarb, a workers’ compensation attorney who had attended law school with Cutillo. Goldfarb indicated to the Ropes & Gray attorneys that he had a friend who traded stocks and would pay for information about corporate acquisitions. The Government showed at trial that Goffer was this friend. What followed was a series of “tips” in which Cutillo and/or Santarlas would obtain material non-public information and pass it to Goldfarb, who, in turn, would pass it to Goffer. Goffer distributed these “tips,” which frequently related to impending takeovers, to friends and partners. Based on these tips, Goffer and his co-conspirators would acquire positions in the targeted companies and profit from the takeover’s effect on the share price.

Goffer’s network used prepaid cellular telephones to avoid detection; these phones—used by the attorneys and the traders—were destroyed after each successful tip. Throughout the relevant time period, Goffer spoke with coconspirators, especially Kimelman, guardedly when on the phone. For instance, he described the P.F. Chang’s tip as “a good thing” but “nothing I’m going to talk about on the telephone.” Goffer often asked Kimelman to meet in person or “in the street” when conveying sensitive information. They also discussed countermeasures and ways to avoid detection, suspecting that high-volume trades in little-traded companies immediately prior to their acquisition could raise regulatory eyebrows. Goffer relied on Kimelman to provide him with insights into the meaning of legal documents associated with the acquisitions, including revised merger agreements, settlement agreements, signature pages, and limited guarantees, *inter alia*.

The first tip presented at trial related to Bain Capital’s bid to acquire 3Com. When Cutillo and Santarlas learned about the progress of the deal—for example, by finding documents entitled “closing agenda” or “signature papers” on Ropes & Gray’s document management system or on a communal printer—they reported this progress to Goldfarb, who passed it on to Goffer. Goffer shared information relating to the takeover bid with some of his coconspirators. Goffer frequently convened a group of co-conspirator traders (typically including Emanuel, Kimelman, and David Plate, another Schottenfeld trader) at a bar where the group would discuss the progress of the takeover bid and any new information that Goffer had received regarding the plans.

On August 7, 2007, Goffer, Drimal, Emanuel, and Plate began acquiring 3Com stock based on the material nonpublic information that Goffer received from Goldfarb. That evening, Goffer had a 25-minute phone conversation with Kimelman. The next day, Kimelman purchased 94,200 shares of 3Com stock. That week, forbidden from purchasing more 3Com stock by Quad’s risk management team, Kimelman sent an

otherwise wordless email to Goffer into which he had pasted an instant message conversation with Quad's risk management expert.

Goffer also provided details about the acquisition and the sources of his information to Drimal; Drimal passed both on to David Slaine, a cooperating witness. Drimal explained that the information came from an attorney from "Ropeson" who risked "his whole . . . career and maybe going to jail" by sharing these tips.

On September 27, 2007, Goffer told Plate and other coconspirators that the acquisition of 3Com would happen the next day. Goffer had learned that the signature papers were prepared and he confirmed with Kimelman, who verified, based on his background as an attorney, that signature papers "were what they sounded like; they were something that took place at the end of a deal." Kimelman was either present or was consulted over the phone. Bain announced its acquisition of 3Com the next day; the co-conspirators all profited. Goffer told Plate that he needed to pay his source, and identified those who were contributing (including Drimal); the co-conspirators paid Santarlas, Cutillo, and Goldfarb \$25,000 each.

In November 2007, Santarlas overheard other Ropes & Gray associates discussing a client's upcoming acquisition of Axcan. Santarlas, who did not work on mergers and acquisitions, accessed at least four documents on the Ropes & Gray document management system relating to the acquisition; he and Cutillo shared the tip with Goldfarb. Goldfarb passed the attorneys' information to Goffer, who disseminated it (at a minimum) to Drimal and Slaine. Drimal shared the information with Michael Cardillo, a Galleon trader, though he again attributed the tip to "Ropeson" attorneys. Drimal and Plate purchased Axcan stock and benefitted from the Axcan acquisition announced on November 29, 2007; Drimal gained \$1,984,867. Goffer did not trade Axcan because it was a small, rarely-traded stock and he did not want to attract regulatory attention.

In February 2008, Santarlas learned about a possible takeover of P.F. Chang's China Bistro, Inc. ("P.F.Chang's") from a colleague; he conveyed this information to Goldfarb, who shared it with Goffer. A few days later Goffer called Kimelman to seek his advice, but noted that it was "nothing I'm going to talk about on the telephone." Kimelman agreed to come into Manhattan to "figure out our plan of attack." Goffer, Emanuel, and Kimelman decided to purchase P.F. Chang's stock as part of an acquisition of a broad restaurant portfolio to disguise their use of the inside information. Goffer instructed the group that "everything's got to be printed out" to help them "go about . . . justifying a trade." No P.F. Chang's acquisition was announced in 2008.

In March 2008, Cutillo and Santarlas observed that deal documents for Bain Capital's acquisition of Clear Channel Communications, Inc. ("Clear Channel") were laid out in a "closing room" at the law firm, apparently ready for execution, and reported that closing was imminent. Unbeknownst to these tippers, neither of whom worked on the deal, the Clear Channel acquisition was staged so that the lenders could be sued for

specific performance. When the deal did not close as anticipated, Goffer, Kimelman, and Drimal all suffered losses on their Clear Channel investments.

In May, there was more Clear Channel activity at the Ropes & Gray offices. Cutillo passed the information to Goldfarb, who told Goffer. Goffer summoned Kimelman for an “urgent meeting;” immediately afterwards, he called another trader and told him to purchase Clear Channel call options for “everybody.” Over the next two business days, Clear Channel publicly announced that it was in settlement talks with the lenders and that an amended merger agreement had been reached. The market reacted favorably to this news and Goffer earned over \$1 million in profits in his Galleon account trading on this tip.

Schottenfeld trader Gautham Shankar provided several tips to Goffer, including acquisitions of Kronos, Inc. and Hilton Hotels Corp. (“Hilton”). Goffer, Kimelman, Drimal, and Emanuel benefitted from trading on this inside information. Profits from these illegal trades were included in calculating the loss amount for sentencing purposes, but the trades were not charged at trial.

In the fall of 2007, Goffer and Kimelman recruited David Slaine to join Incremental Capital. The co-conspirators hoped that Slaine, who unbeknownst to them was working as a cooperating witness after his own arrest for insider trading, would provide them with the financial backing to get their insider trading-fueled business off the ground. Kimelman urged Goffer to tell Slaine that he would “get great information” by investing with Incremental. Goffer mentioned that he had received tips about certain acquisitions before they happened, including 3Com, Axcan, and Hilton. Goffer jokingly told Slaine that the information came from a construction worker, but when pushed he elaborated “you [are] probably better off not knowing where they were coming from . . . [Y]ou don’t want to know where it’s coming from obviously.” Kimelman chimed in, asserting that the source was that “[g]uy fixing that pothole down there.” . . .

Kimelman challenges the sufficiency of the evidence supporting his substantive securities fraud conviction for his purchase of 15,000 shares of 3Com stock on August 10, 2007 and 5,000 shares of 3Com stock on September 25, 2007. Specifically, he contends that the Government did not prove that Goffer had tipped him about 3Com or that he knew or consciously avoided knowing that Goffer had material nonpublic information about 3Com that was disclosed in violation of a fiduciary duty. More specifically, he argues that the Government’s main evidence, an unrecorded phone call he had with Goffer on August 7 and an email he wrote to Goffer on August 15, does not indicate that he received a tip from Goffer or knew that any such tip was based on illegally-disclosed information. He also insists that a discussion he had with the other co-conspirators on September 27, on the eve of the deal’s announcement, cannot count as proof of his awareness of the earlier fraud. . . .

The Government did not need to prove that Kimelman knew the identity or nature of the source if he knew that the information was illegally obtained. In denying Kimelman’s

Rule 29 motion, the district court described this as “a verdict that could go either way” and “certainly a close case,” but decided that the “jury’s verdict [was not] unreasonable such that it should be overturned.” Reviewing *de novo* and “crediting ‘every inference that the jury may have drawn’ in the government’s favor,” we agree. . . .

Kimelman argues that we should exclude from our analysis evidence related to activity *after* the trades at issue. We reject this argument. Kimelman’s knowledge of the illicit nature of Goffer’s source after the trades is still probative (though not in itself sufficient to establish his knowledge before the trades).

Evidence indicating a defendant’s knowing participation in a later stock manipulation scheme is relevant to the earlier scheme where, for example, it shows that a defendant was “conversant in the language of stock manipulation.” *United States v. Rutkoske*. This analysis applies equally in the context of insider trading. “Relevancy cannot be reduced to [a] mere chronology; whether the similar act evidence occurred prior or subsequent to the crime in question is not necessarily determinative to its admissibility [and therefore its probative value].” *United States v. Ramirez*. Subsequent acts are frequently probative as to intent. *See, e.g., United States v. Germosen*. Here, Kimelman’s participation in Goffer’s ongoing scheme led to later transactions that “so closely paralleled the charged conduct that it was probative regardless of the temporal difference.” *United States v. Curley*.

If we focus on the evidence in the record from prior to the public announcement of Bain’s bid for 3Com on September 28, 2007, and credit every inference that the jury could have drawn in the Government’s favor, we find ample support for the jury to conclude that Kimelman was tipped by Goffer and knew or consciously avoided knowing that Goffer’s tip about 3Com was based on nonpublic information illegally disclosed in breach of a fiduciary duty.

The Kimelman–Goffer telephone call of August 7, though unrecorded, marked a change in Kimelman’s 3Com stock trading behavior. Prior to August 7, Kimelman day-traded 3Com stock in smaller quantities of 1,000, 2,000 and 5,000 shares, including on August 5, just two days before the call. Kimelman did not maintain those positions but sold them before the end of each trading day. On August 8, the day after the evening phone call, however, Kimelman bought 94,200 shares of 3Com, easily his largest single-day purchase, which he did not sell. In the subsequent days and weeks, he continued to add to that position—buying another 24,000 shares on August 9 and 15,000 more shares on August 10. He maintained the accumulated position until after the 3Com merger bid was announced; when the share price shot up, he sold the position and profited.

Kimelman was so aggressive in acquiring 3Com that his employer at Quad restrained him from making further purchases of 3Com stock. Despite the warning from Quad, Kimelman managed to buy 5,000 more shares of 3Com on September 25. From August 7 to 8, Kimelman’s behavior changed from being very cautious about 3Com to suddenly becoming very confident. Such a sudden change in a defendant’s stock trading pattern,

which cannot be readily explained by other reasons, could be probative of trading on insider information. *See United States v. Smith* (recognizing “situations in which unique trading patterns or unusually large trading quantities suggest that an investor had used inside information”).

His e-mail to Goffer on August 15, with news of Quad’s restraint, indicates at the very least that the two were actively discussing the trading in 3Com shares. Kimelman’s new 3Com trading behavior matched that of Goffer and of the other co-conspirators who were tipped by Goffer on August 7. And like the others, Kimelman cashed out of his 3Com positions shortly after Bain’s bid was announced. Parallel trading patterns among co-conspirators can be another indicator of insider trading. In this case, the manner in which Kimelman sold the stock is at least suggestive of the motive he had for buying it, which was not for long term investment value, but in anticipation of a particular event.

Also revealing is the discussion Kimelman had with Goffer on the eve of the 3Com deal’s announcement on September 27. Goffer asked about the significance of signature pages in a pending transaction, and Kimelman explained that the preparation of the signature pages meant that a deal signing was imminent. As a former associate at a leading corporate law firm, Kimelman had to know that Goffer, in asking such a question, was privy to the inner workings of a pending transaction to be aware of the status of signature pages. Since Goffer had no legal basis to have access to such information, Kimelman must therefore have known or been aware of a high probability that this insider information was made available to Goffer in breach of a fiduciary duty. Indeed, it was from this exchange that Plate, who testified about the conversation, became convinced that Goffer’s tip was illegally obtained.

Kimelman also argues that much of the Government’s evidence applied equally convincingly to Plate, who claimed at trial that he did not know of Goffer’s inside source until the “signature pages” conversation. However, a rational juror could readily infer from the trust that Goffer showed in Kimelman by asking him about the signature pages and the matter-of-fact manner in which Kimelman answered—without astonishment as to Goffer’s knowledge or expression of concern about the sensitivity of such information—that Kimelman shared a relationship of trust with Goffer that Plate did not. This, in turn, would support an inference that Kimelman had some degree of prior awareness of Goffer’s illegal source of information, even if the jury also concluded that Plate had no such awareness. Moreover, the jury was free not to credit Plate’s self-serving testimony that he did not know about the source of the inside information. . . .

After September 2007, evidence of his knowledge of the fraud becomes overwhelming and Kimelman does not deny the sufficiency of the showing in support of his conspiracy conviction. Goffer later described Kimelman and Emanuel as members of his “inner circle” or “tight circle.” A rational juror could find that this circle came together well before those statements were made and prior to the beginning of the 3Com trades. The government produced evidence from July 2007 showing that the trio bought and profited from shares of Hilton Hotels shortly after Goffer received an insider tip. Goffer and

Emanuel, along with co-conspirators outside the “inner circle,” bought shares of 3Com on August 7. Kimelman’s habit of feigning indifference to the source of Goffer’s information in the presence of co-conspirators not within the “inner circle” also continued in the subsequent months.

Viewed in its totality, the Government’s proof provides enough evidence for a reasonable jury to conclude that Kimelman was guilty beyond a reasonable doubt of insider trading in 3Com. The jury’s verdict is supported by sufficient evidence and is not unreasonable; we affirm Kimelman’s conviction. . . .

Over Kimelman’s objections, the district court instructed the jury on the theory of “conscious avoidance,” which permits a jury to convict a defendant for “deliberately clos[ing] his eyes to what would otherwise have been obvious to him.” *United States v. Gansman*. Kimelman appeals the issuance and the substance of jury instructions on conscious avoidance as to the illicit origins of Goffer’s tips. Finding no flaw in either, we affirm.

“A conscious avoidance instruction ‘may only be given if (1) the defendant asserts the lack of some specific aspect of knowledge required for conviction [] and (2) the appropriate factual predicate for the charge exists, i.e. the evidence is such that a rational juror may reach the conclusion beyond a reasonable doubt that the defendant was aware of a high probability of the fact in dispute and consciously avoided confirming that fact.’” *United States v. Svoboda* (quoting *United States v. Ferrarini*). In this case, the first prong is met; Kimelman claimed ignorance at trial as to the source of the 3Com tip. However, Kimelman contends that there was insufficient evidence (1) for a juror to conclude that he was aware of a high probability that the 3Com tip came from an insider and chose to avoid confirming that fact, and (2) for a juror to conclude that he *ever* knew about the illicit nature of Goffer’s information. We disagree.

For substantially the same reasons discussed above, there was ample evidence supporting the inference that if Kimelman did not know about those facts, that he had to have consciously avoided becoming aware of them. First, given the 25-minute telephone conversation he had with Goffer on the evening of August 7, the abrupt and pronounced change in his trading pattern of 3Com stock immediately thereafter, his subsequent outreach to Goffer about 3Com trading on August 15, and the fact that Goffer had shared the tip with other co-conspirators whom Kimelman knew, a rational juror was entitled to conclude that Kimelman was aware of a high probability that Goffer had insider information about 3Com. Second, the fact that Goffer asked about signature pages on the eve of the 3Com deal announcement and the routine manner in which Kimelman answered the question, again provides the basis for a juror to conclude that he was aware of a high probability that the source of Goffer’s information was illegal.

With respect to Kimelman’s conscious avoidance of knowledge of Goffer’s sources throughout the conspiracy, Kimelman’s challenge lacks any merit. While he and Kimelman were recruiting Slaine for Incremental, Goffer told Slaine that he was “better

off not knowing where [his tips] were coming from.” That way, Goffer continued, if “someone from the government ever ask[ed] you where did [that tip] come from. You [would] be like, I don’t freakin’ know where it came from.” Building on Goffer’s (facetious) assertion that his source was a construction worker, Kimelman added that it was a “[g]uy fixing that pothole down there.” His additions to this conversation about the need for plausible deniability underscore Kimelman’s conscious avoidance of knowledge as to Goffer’s source. The jury was entitled to hear the conscious avoidance instruction. . . .

And then we have, in the civil enforcement context, the battle between Mark Cuban and the SEC, which involved Rule 10b5-2 below (not to be confused with Rule 10b-5), by which the SEC has sought to further specify the scope of duties for purposes of misappropriation cases. Cuban won, as you will see.

Rule 10b5-2. Duties of trust or confidence in misappropriation insider trading cases.

This section provides a non-exclusive definition of circumstances in which a person has a duty of trust or confidence for purposes of the “misappropriation” theory of insider trading under Section 10(b) of the Act and Rule 10b-5. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-2 does not modify the scope of insider trading law in any other respect.

(a) Scope of Rule. This section shall apply to any violation of Section 10(b) of the Act (15 U.S.C. 78j(b)) and §240.10b-5 thereunder that is based on the purchase or sale of securities on the basis of, or the communication of, material nonpublic information misappropriated in breach of a duty of trust or confidence.

(b) Enumerated “duties of trust or confidence.” For purposes of this section, a “duty of trust or confidence” exists in the following circumstances, among others:

- (1) Whenever a person agrees to maintain information in confidence;
- (2) Whenever the person communicating the material nonpublic information and the person to whom it is communicated have a history, pattern, or practice of sharing confidences, such that the recipient of the information knows or reasonably should know that the person communicating the material nonpublic information expects that the recipient will maintain its confidentiality; or
- (3) Whenever a person receives or obtains material nonpublic information from his or her spouse, parent, child, or sibling; provided, however, that the person receiving or obtaining the information may demonstrate that no duty of trust or confidence existed with respect to the information, by establishing that he or she neither knew nor

reasonably should have known that the person who was the source of the information expected that the person would keep the information confidential, because of the parties' history, pattern, or practice of sharing and maintaining confidences, and because there was no agreement or understanding to maintain the confidentiality of the information.

Problem 4-5

What is the SEC's statutory authority for promulgating Rule 10b5-2? Is this problematic? (Note that on June 28, 2024, in the widely followed *Loper Bright* case, the Supreme Court overruled its *Chevron* decision, changing the longstanding standard under which courts review the validity of executive branch agencies' interpretations of statutory law.)

SEC v. CUBAN, 620 F.3d 551 (5th Cir. 2010)

PATRICK E. HIGGINBOTHAM, Circuit Judge:

This case raises questions of the scope of liability under the misappropriation theory of insider trading. Taking a different view from our able district court brother of the allegations of the complaint, we are persuaded that the case should not have been dismissed under Fed. R. Civ. P. 9(b) and 12 and must proceed to discovery.

Mark Cuban is a well known entrepreneur and current owner of the Dallas Mavericks and Landmark theaters, among other businesses. The SEC brought this suit against Cuban alleging he violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 by trading in Mamma.com stock in breach of his duty to the CEO and Mamma.com—amounting to insider trading under the misappropriation theory of liability. The core allegation is that Cuban received confidential information from the CEO of Mamma.com, a Canadian search engine company in which Cuban was a large minority stakeholder, agreed to keep the information confidential, and acknowledged he could not trade on the information. The SEC alleges that, armed with the inside information regarding a private investment of public equity (PIPE) offering, Cuban sold his stake in the company in an effort to avoid losses from the inevitable fall in Mamma.com's share price when the offering was announced.

Cuban moved to dismiss the action under Rule 9(b) and 12(b)(6). The district court found that, at most, the complaint alleged an agreement to keep the information confidential, but did not include an agreement not to trade. Finding a simple confidentiality agreement to be insufficient to create a duty to disclose or abstain from trading under the securities laws, the court granted Cuban's motion to dismiss. The SEC appeals, arguing that a confidentiality agreement creates a duty to disclose or abstain and that, regardless, the confidentiality agreement alleged in the complaint also contained an agreement not to trade on the information and that agreement would create such a duty. . . .

While O'Hagan did not set the contours of a relationship of "trust and confidence" giving rise to the duty to disclose or abstain and misappropriation liability, we are tasked to determine whether Cuban had such a relationship with Mamma.com. The SEC seeks to rely on Rule 10b5-2(b)(1), which states that a person has "a duty of trust and confidence" for purposes of misappropriation liability when that person "agrees to maintain information in confidence." In dismissing the case, the district court read the complaint to allege that Cuban agreed not to disclose any confidential information but did not agree not to trade, that such a confidentiality agreement was insufficient to create a duty to disclose or abstain from trading under the misappropriation theory, and that the SEC overstepped its authority under section 10(b) in issuing Rule 10b5-2(b)(1). We differ from the district court in reading the complaint and need not reach the latter issues.

The complaint alleges that, in March 2004, Cuban acquired 600,000 shares, a 6.3% stake, of Mamma.com. Later that spring, Mamma.com decided to raise capital through a PIPE offering on the advice of the investment bank Merriman Curhan Ford & Co. At the end of June, at Merriman's suggestion, Mamma.com decided to invite Cuban to participate in the PIPE offering. "The CEO was instructed to contact Cuban and to preface the conversation by informing Cuban that he had confidential information to convey to him in order to make sure that Cuban understood—before the information was conveyed to him—that he would have to keep the information confidential."

After getting in touch with Cuban on June 28, Mamma.com's CEO told Cuban he had confidential information for him and Cuban agreed to keep whatever information the CEO shared confidential. The CEO then told Cuban about the PIPE offering. Cuban became very upset "and said, among other things, that he did not like PIPEs because they dilute the existing shareholders." "At the end of the call, Cuban told the CEO 'Well, now I'm screwed. I can't sell.'"

The CEO told the company's executive chairman about the conversation with Cuban. The executive chairman sent an email to the other Mamma.com board members updating them on the PIPE offering. The executive chairman included:

Today, after much discussion, [the CEO] spoke to Mark Cuban about this equity raise and whether or not he would be interested in participating. As anticipated he initially "flew off the handle" and said he would sell his shares (recognizing that he was not able to do anything until we announce the equity) but then asked to see the terms and conditions which we have arranged for him to receive from one of the participating investor groups with which he has dealt in the past.

The CEO then sent Cuban a follow up email, writing "[i]f you want more details about the private placement please contact . . . [Merriman]."

Cuban called the Merriman representative and they spoke for eight minutes. "During that call, the salesman supplied Cuban with additional confidential details about the

PIPE. In response to Cuban's questions, the salesman told him that the PIPE was being sold at a discount to the market price and that the offering included other incentives for the PIPE investors." It is a plausible inference that Cuban learned the off-market prices available to him and other PIPE participants.

With that information and one minute after speaking with the Merriman representative, Cuban called his broker and instructed him to sell his entire stake in the company. Cuban sold 10,000 shares during the evening of June 28, 2004, and the remainder during regular trading the next day.

That day, the executive chairman sent another email to the board, updating them on the previous day's discussions with Cuban, stating "'we did speak to Mark Cuban ([the CEO] and, subsequently, our investment banker) to find out if he had any interest in participating to the extent of maintaining his interest. His answers were: he would not invest, he does not want the company to make acquisitions, he will sell his shares which he cannot do until after we announce.'"

After the markets closed on June 29, Mamma.com announced the PIPE offering. The next day, Mamma.com's stock price fell 8.5% and continued to decline over the next week, eventually closing down 39% from the June 29 closing price. By selling his shares when he did, Cuban avoided over \$750,000 in losses. Cuban notified the SEC that he had sold his stake in the company and publicly stated that he sold his shares because Mamma.com "was conducting a PIPE, which issued shares at a discount to the prevailing market price and also would have caused his ownership position to be diluted." . . .

In isolation, the statement "Well, now I'm screwed. I can't sell" can plausibly be read to express Cuban's view that learning the confidences regarding the PIPE forbade his selling his stock before the offering but to express no agreement not to do so. However, after Cuban expressed the view that he could not sell to the CEO, he gained access to the confidences of the PIPE offering. According to the complaint's recounting of the executive chairman's email to the board, during his short conversation with the CEO regarding the planned PIPE offering, Cuban requested the terms and conditions of the offering. Based on this request, the CEO sent Cuban a follow up email providing the contact information for Merriman. Cuban called the salesman, who told Cuban "that the PIPE was being sold at a discount to the market price and that the offering included other incentives for the PIPE investors." Only after Cuban reached out to obtain this additional information, following the statement of his understanding that he could not sell, did Cuban contact his broker and sell his stake in the company.

The allegations, taken in their entirety, provide more than a plausible basis to find that the understanding between the CEO and Cuban was that he was not to trade, that it was more than a simple confidentiality agreement. By contacting the sales representative to obtain the pricing information, Cuban was able to evaluate his potential losses or gains from his decision to either participate or refrain from participating in the PIPE offering. It is at least plausible that each of the parties understood, if only implicitly, that

Mamma.com would only provide the terms and conditions of the offering to Cuban for the purpose of evaluating whether he would participate in the offering, and that Cuban could not use the information for his own personal benefit. It would require additional facts that have not been put before us for us to conclude that the parties could not plausibly have reached this shared understanding. Under Cuban's reading, he was allowed to trade on the information but prohibited from telling others—in effect providing him an exclusive license to trade on the material nonpublic information. Perhaps this was the understanding, or perhaps Cuban misled the CEO regarding the timing of his sale in order to obtain a confidential look at the details of the PIPE. We say only that on this factually sparse record, it is at least equally plausible that all sides understood there was to be no trading before the PIPE. That both Cuban and the CEO expressed the belief that Cuban could not trade appears to reinforce the plausibility of this reading.

The *Cuban* case proceeded to a trial, after which a jury found Cuban not liable. The *Cuban* matter demonstrates how difficult it can be for the government to win even a civil enforcement case. To prevail, the SEC needed to prove to the jury that Cuban breached his duty to Mamma.com by breaking his alleged agreement to keep the company's impending offering secret. Without a confidentiality agreement, the jury was left to compare the prerecorded testimony of Guy Faure, the former Mamma.com CEO, with the live testimony of Cuban himself. In the end, the result may have turned on Cuban's charisma as much as the law.¹⁵

Compare *United States v. Chow*, 993 F.3d 125 (2d Cir. 2021), in which the Second Circuit upheld a conviction for insider trading in the face of a hedge fund executive's claim that he had no confidential relationship with the firm from which he acquired material nonpublic information. Defendant Chow's fund acquired a semiconductor company (Lattice Corp.) in the shares of which Chow and others traded. During the negotiations leading to the acquisition, Chow signed two nondisclosure agreements (NDAs) requested by Lattice. Chow argued that the misappropriation theory of insider trading does not apply if the company and the individual acquiring the information have an arm's-length relationship. The court curtly rejected Chow's claim as unsupported by the misappropriation case law. While doing so, the court cited to Rule 10b-5-2's language covering instances in which "a person agrees to maintain information in confidence."

¹⁵ For more on the Cuban trial, see Andrew Harris and Tom Korosec, *SEC Loses as Mark Cuban Triumphs in Insider-Trading Trial*, BLOOMBERG (Oct. 17, 2013), <https://www.bloomberg.com/news/articles/2013-10-16/billionaire-mark-cuban-found-not-liable-in-sec-lawsuit>.

Problem 4-6

- (a) Between 2009 and 2015, the office of Preet Bharara, U.S. Attorney for the Southern District of New York, secured 79 convictions, through trials and guilty pleas, for insider trading among players at various levels in the Wall Street fund industry (several of these convictions were later overturned on appeal). What might this wave of prosecutions have accomplished, if anything?
- (b) Is it not just illegal but also morally wrong to engage in insider trading? Why or why not?
- (c) What are some policy arguments for and against sanctioning insider trading? Some academics have argued, over the course of the last half century, that insider trading should not be illegal. Can you imagine what some of their arguments have been, as well as the responses of their critics?

F. Personal Benefit, Mens Rea, and Tipping Chains

Remember that in order for a tippee to be liable, the tipper must have breached his fiduciary duty, which requires the tipper to have received some personal benefit in exchange for providing material non-public information. Recall the following language from *Dirks*:

This standard was identified by the SEC itself in *Cady, Roberts*: a purpose of the securities laws was to eliminate “use of inside information for personal advantage.” Thus, the test is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach.

The following three cases lay out the recent sequence of important court rulings on the subject of tipper-tippee liability in insider trading law. The first case, *Newman*, out of the Second Circuit, made a splash for cutting back on the scope of liability by more narrowly defining what constitutes a personal benefit. In the second case, *Salman*, the Supreme Court partially rejected the Second Circuit’s analysis in *Newman*, pulling back from *Newman*’s narrowest definition. In the third case, *Martoma*, which is the current last word, another Second Circuit panel further rejected aspects of the court’s earlier decision in *Newman*.

The story is easiest to understand by working through these three decisions sequentially. As you will see, decades after starting down the path of theorizing insider trading as a form of fraud, the decisions have now arrived at what one could see as a kind of end point. The courts are drawing, and arguing over, some exceptionally fine lines between what sort of trading on tips counts as the crime of securities fraud and what does not.

As you read, consider whether it might be time to handle insider trading with a new statute. If so, what lines might such a statute draw?

UNITED STATES v. NEWMAN, 773 F.3d 438 (2d Cir. 2014)

BARRINGTON D. PARKER, Circuit Judge:

The Government alleged that a cohort of analysts at various hedge funds and investment firms obtained material, nonpublic information from employees of publicly traded technology companies, shared it amongst each other, and subsequently passed this information to the portfolio managers at their respective companies. The Government charged [Todd] Newman, a portfolio manager at Diamondback Capital Management, LLC (“Diamondback”), and [Anthony] Chiasson, a portfolio manager at Level Global Investors, L.P. (“Level Global”), with willfully participating in this insider trading scheme by trading in securities based on the inside information illicitly obtained by this group of analysts. On appeal, Newman and Chiasson challenge the sufficiency of the evidence as to several elements of the offense, and further argue that the district court erred in failing to instruct the jury that it must find that a tippee knew that the insider disclosed confidential information in exchange for a personal benefit.

We agree that the jury instruction was erroneous because we conclude that, in order to sustain a conviction for insider trading, the Government must prove beyond a reasonable doubt that the tippee knew that an insider disclosed confidential information and that he did so in exchange for a personal benefit. Moreover, we hold that the evidence was insufficient to sustain a guilty verdict against Newman and Chiasson for two reasons. First, the Government’s evidence of any personal benefit received by the alleged insiders was insufficient to establish the tipper liability from which defendants’ purported tippee liability would derive. Second, even assuming that the scant evidence offered on the issue of personal benefit was sufficient, which we conclude it was not, the Government presented no evidence that Newman and Chiasson knew that they were trading on information obtained from insiders in violation of those insiders’ fiduciary duties.

Accordingly, we reverse the convictions of Newman and Chiasson on all counts and remand with instructions to dismiss the indictment as it pertains to them with prejudice. . . .

At trial, the Government presented evidence that a group of financial analysts exchanged information they obtained from company insiders, both directly and more often indirectly. Specifically, the Government alleged that these analysts received information from insiders at Dell and NVIDIA disclosing those companies’ earnings numbers before they were publicly released in Dell’s May 2008 and August 2008 earnings announcements and NVIDIA’s May 2008 earnings announcement. These analysts then passed the inside information to their portfolio managers, including Newman and Chiasson, who, in turn, executed trades in Dell and NVIDIA stock, earning

approximately \$4 million and \$68 million, respectively, in profits for their respective funds.

Newman and Chiasson were several steps removed from the corporate insiders and there was no evidence that either was aware of the source of the inside information. With respect to the Dell tipping chain, the evidence established that Rob Ray of Dell's investor relations department tipped information regarding Dell's consolidated earnings numbers to Sandy Goyal, an analyst at Neuberger Berman. Goyal in turn gave the information to Diamondback analyst Jesse Tortora. Tortora in turn relayed the information to his manager Newman as well as to other analysts including Level Global analyst Spyridon "Sam" Adondakis. Adondakis then passed along the Dell information to Chiasson, making Newman and Chiasson three and four levels removed from the inside tipper, respectively.

With respect to the NVIDIA tipping chain, the evidence established that Chris Choi of NVIDIA's finance unit tipped inside information to Hyung Lim, a former executive at technology companies Broadcom Corp. and Altera Corp., whom Choi knew from church. Lim passed the information to co-defendant Danny Kuo, an analyst at Whittier Trust. Kuo circulated the information to the group of analyst friends, including Tortora and Adondakis, who in turn gave the information to Newman and Chiasson, making Newman and Chiasson four levels removed from the inside tippers.

Although Ray has yet to be charged administratively, civilly, or criminally, and Choi has yet to be charged criminally, for insider trading or any other wrongdoing, the Government charged that Newman and Chiasson were criminally liable for insider trading because, as sophisticated traders, they must have known that information was disclosed by insiders in breach of a fiduciary duty, and not for any legitimate corporate purpose. . . .

[T]he district court did not give Newman and Chiasson's proposed jury instruction. Instead, the district court gave the following instructions on the tippers' intent and the personal benefit requirement:

Now, if you find that Mr. Ray and/or Mr. Choi had a fiduciary or other relationship of trust and confidence with their employers, then you must next consider whether the [G]overnment has proven beyond a reasonable doubt that they intentionally breached that duty of trust and confidence by disclosing material[,] nonpublic information for their own benefit.

On the issue of the appellants' knowledge, the district court instructed the jury:

To meet its burden, the [G]overnment must also prove beyond a reasonable doubt that the defendant you are considering knew that the material, nonpublic information had been disclosed by the insider in

breach of a duty of trust and confidence. The mere receipt of material, nonpublic information by a defendant, and even trading on that information, is not sufficient; he must have known that it was originally disclosed by the insider in violation of a duty of confidentiality. . . .

The insider trading case law . . . is not confined to insiders or misappropriators who trade for their own accounts. Courts have expanded insider trading liability to reach situations where the insider or misappropriator in possession of material nonpublic information (the “tipper”) does not himself trade but discloses the information to an outsider (a “tippee”) who then trades on the basis of the information before it is publicly disclosed. *See Dirks*. The elements of tipping liability are the same, regardless of whether the tipper’s duty arises under the “classical” or the “misappropriation” theory. *Obus*. . . .

Liability for securities fraud . . . requires proof that the defendant acted with scienter, which is defined as “a mental state embracing intent to deceive, manipulate or defraud.” *Hochfelder*. In order to establish a criminal violation of the securities laws, the Government must show that the defendant acted “willfully.” 15 U.S.C. § 78ff(a). We have defined willfulness in this context “as a realization on the defendant’s part that he was doing a wrongful act under the securities laws.” *United States v. Cassese*; *see also United States v. Dixon* (holding that to establish willfulness, the Government must “establish a realization on the defendant’s part that he was doing a wrongful act . . . under the securities laws” and that such an act “involve[d] a significant risk of effecting the violation that occurred.”).

The Government concedes that tippee liability requires proof of a personal benefit to the insider. However, the Government argues that it was not required to prove that Newman and Chiasson knew that the insiders at Dell and NVIDIA received a personal benefit in order to be found guilty of insider trading. Instead, the Government contends, consistent with the district court’s instruction, that it merely needed to prove that the “defendants traded on material, nonpublic information they knew insiders had disclosed in breach of a duty of confidentiality. . . .”

In support of this position, the Government cites *Dirks* for the proposition that the Supreme Court only required that the “tippee know that the tipper disclosed information in breach of a duty.” In addition, the Government relies on dicta in a number of our decisions post-*Dirks*, in which we have described the elements of tippee liability without specifically stating that the Government must prove that the tippee knew that the corporate insider who disclosed confidential information did so for his own personal benefit. By selectively parsing this dictum, the Government seeks to revive the absolute bar on tippee trading that the Supreme Court explicitly rejected in *Dirks*.

Although this Court has been accused of being “somewhat Delphic” in our discussion of what is required to demonstrate tippee liability, the Supreme Court was quite clear in *Dirks*. First, the tippee’s liability derives only from the tipper’s breach of a fiduciary duty, not from trading on material, non-public information. *See Chiarella* (noting that

there is no “general duty between all participants in market transactions to forgo actions based on material, nonpublic information”). Second, the corporate insider has committed no breach of fiduciary duty unless he receives a personal benefit in exchange for the disclosure. Third, even in the presence of a tipper’s breach, a tippee is liable only if he knows or should have known of the breach.

While we have not yet been presented with the question of whether the tippee’s knowledge of a tipper’s breach requires knowledge of the tipper’s personal benefit, the answer follows naturally from *Dirks*. *Dirks* counsels us that the exchange of confidential information for personal benefit is not separate from an insider’s fiduciary breach; it is the fiduciary breach that triggers liability for securities fraud under Rule 10b–5. For purposes of insider trading liability, the insider’s disclosure of confidential information, standing alone, is not a breach. Thus, without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure, the Government cannot meet its burden of showing that the tippee knew of a breach. . . .

In light of *Dirks*, we find no support for the Government’s contention that knowledge of a breach of the duty of confidentiality without knowledge of the personal benefit is sufficient to impose criminal liability. Although the Government might like the law to be different, nothing in the law requires a symmetry of information in the nation’s securities markets. The Supreme Court explicitly repudiated this premise not only in *Dirks*, but in a predecessor case, *Chiarella v. United States*. In *Chiarella*, the Supreme Court rejected this Circuit’s conclusion that “the federal securities laws have created a system providing equal access to information necessary for reasoned and intelligent investment decisions. . . . because [material non-public] information gives certain buyers or sellers an unfair advantage over less informed buyers and sellers.” The Supreme Court emphasized that “[t]his reasoning suffers from [a] defect. . . . [because] not every instance of financial unfairness constitutes fraudulent activity under § 10(b).” *See also United States v. Chestman* (“[The policy rationale [for prohibiting insider trading] stops well short of prohibiting all trading on material nonpublic information. Efficient capital markets depend on the protection of property rights in information. However, they also require that persons who acquire and act on information about companies be able to profit from the information they generate. . . .”). Thus, in both *Chiarella* and *Dirks*, the Supreme Court affirmatively established that insider trading liability is based on breaches of fiduciary duty, not on informational asymmetries. This is a critical limitation on insider trading liability that protects a corporation’s interests in confidentiality while promoting efficiency in the nation’s securities markets.

As noted above, *Dirks* clearly defines a breach of fiduciary duty as a breach of the duty of confidentiality in exchange for a personal benefit. Accordingly, we conclude that a tippee’s knowledge of the insider’s breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit. . . .

Our conclusion also comports with well-settled principles of substantive criminal law. As the Supreme Court explained in *Staples v. United States*, under the common law,

mens rea, which requires that the defendant know the facts that make his conduct illegal, is a necessary element in every crime. Such a requirement is particularly appropriate in insider trading cases where we have acknowledged “it is easy to imagine a . . . trader who receives a tip and is unaware that his conduct was illegal and therefore wrongful.” *United States v. Kaiser*. This is also a statutory requirement, because only “willful” violations are subject to criminal provision. See *United States v. Temple* (“‘Willful’ repeatedly has been defined in the criminal context as intentional, purposeful, and voluntary, as distinguished from accidental or negligent”).

In sum, we hold that to sustain an insider trading conviction against a tippee, the Government must prove each of the following elements beyond a reasonable doubt: that (1) the corporate insider was entrusted with a fiduciary duty; (2) the corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit; (3) the tippee knew of the tipper’s breach, that is, he knew the information was confidential and divulged for personal benefit; and (4) the tippee still used that information to trade in a security or tip another individual for personal benefit. . . .

The circumstantial evidence in this case was simply too thin to warrant the inference that the corporate insiders received any personal benefit in exchange for their tips. As to the Dell tips, the Government established that Goyal and Ray were not “close” friends, but had known each other for years, having both attended business school and worked at Dell together. Further, Ray, who wanted to become a Wall Street analyst like Goyal, sought career advice and assistance from Goyal. The evidence further showed that Goyal advised Ray on a range of topics, from discussing the qualifying examination in order to become a financial analyst to editing Ray’s résumé and sending it to a Wall Street recruiter, and that some of this assistance began before Ray began to provide tips about Dell’s earnings. The evidence also established that Lim and Choi were “family friends” that had met through church and occasionally socialized together. The Government argues that these facts were sufficient to prove that the tippers derived some benefit from the tip. We disagree. If this was a “benefit,” practically anything would qualify.

We have observed that “[p]ersonal benefit is broadly defined to include not only pecuniary gain, but also, inter alia, any reputational benefit that will translate into future earnings and the benefit one would obtain from simply making a gift of confidential information to a trading relative or friend.” *Jiau*. This standard, although permissive, does not suggest that the Government may prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature. If that were true, and the Government was allowed to meet its burden by proving that two individuals were alumni of the same school or attended the same church, the personal benefit requirement would be a nullity. To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee’s trades “resemble trading by the insider himself followed by a gift of the profits to the recipient,” we hold that such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential,

and represents at least a potential gain of a pecuniary or similarly valuable nature. In other words, as Judge Walker noted in *Jiau*, this requires evidence of “a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the [latter].” . . .

Even assuming that the scant evidence described above was sufficient to permit the inference of a personal benefit, which we conclude it was not, the Government presented absolutely no testimony or any other evidence that Newman and Chiasson knew that they were trading on information obtained from insiders, or that those insiders received any benefit in exchange for such disclosures, or even that Newman and Chiasson consciously avoided learning of these facts. As discussed above, the Government is required to prove beyond a reasonable doubt that Newman and Chiasson knew that the insiders received a personal benefit in exchange for disclosing confidential information.

It is largely uncontroverted that Chiasson and Newman, and even their analysts, who testified as cooperating witnesses for the Government, knew next to nothing about the insiders and nothing about what, if any, personal benefit had been provided to them. Adondakis said that he did not know what the relationship between the insider and the first-level tippee was, nor was he aware of any personal benefits exchanged for the information, nor did he communicate any such information to Chiasson. Adondakis testified that he merely told Chiasson that Goyal “was talking to someone within Dell,” and that a friend of a friend of Tortora’s would be getting NVIDIA information. Adondakis further testified that he did not specifically tell Chiasson that the source of the NVIDIA information worked at NVIDIA. Similarly, Tortora testified that, while he was aware Goyal received information from someone at Dell who had access to “overall” financial numbers, he was not aware of the insider’s name, or position, or the circumstances of how Goyal obtained the information. Tortora further testified that he did not know whether Choi received a personal benefit for disclosing inside information regarding NVIDIA.

The Government now invites us to conclude that the jury could have found that the appellants knew the insiders disclosed the information “for some personal reason rather than for no reason at all.” But the Supreme Court affirmatively rejected the premise that a tipper who discloses confidential information necessarily does so to receive a personal benefit. *See Dirks* (“All disclosures of confidential corporate information are not inconsistent with the duty insiders owe to shareholders”). Moreover, it is inconceivable that a jury could conclude, beyond a reasonable doubt, that Newman and Chiasson were aware of a personal benefit, when Adondakis and Tortora, who were more intimately involved in the insider trading scheme as part of the “corrupt” analyst group, disavowed any such knowledge.

Alternatively, the Government contends that the specificity, timing, and frequency of the updates provided to Newman and Chiasson about Dell and NVIDIA were so “overwhelmingly suspicious” that they warranted various material inferences that could support a guilty verdict. Newman and Chiasson received four updates on Dell’s earnings

numbers in the weeks leading up to its August 2008 earnings announcement. Similarly, Newman and Chiasson received multiple updates on NVIDIA's earnings numbers between the close of the quarter and the company's earnings announcement. The Government argues that given the detailed nature and accuracy of these updates, Newman and Chiasson must have known, or deliberately avoided knowing, that the information originated with corporate insiders, and that those insiders disclosed the information in exchange for a personal benefit. We disagree.

Even viewed in the light most favorable to the Government, the evidence presented at trial undermined the inference of knowledge in several ways. The evidence established that analysts at hedge funds routinely estimate metrics such as revenue, gross margin, operating margin, and earnings per share through legitimate financial modeling using publicly available information and educated assumptions about industry and company trends. For example, on cross-examination, cooperating witness Goyal testified that under his financial model on Dell, when he ran the model in January 2008 without any inside information, he calculated May 2008 quarter results of \$16.071 billion revenue, 18.5% gross margin, and \$0.38 earnings per share. These estimates came very close to Dell's reported earnings of \$16.077 billion revenue; 18.4% gross margin, and \$0.38 earnings per share. Appellants also elicited testimony from the cooperating witnesses and investor relations associates that analysts routinely solicited information from companies in order to check assumptions in their models in advance of earnings announcements. Goyal testified that he frequently spoke to internal relations departments to run his model by them and ask whether his assumptions were "too high or too low" or in the "ball park," which suggests analysts routinely updated numbers in advance of the earnings announcements. Ray's supervisor confirmed that investor relations departments routinely assisted analysts with developing their models.

Moreover, the evidence established that NVIDIA and Dell's investor relations personnel routinely "leaked" earnings data in advance of quarterly earnings. Appellants introduced examples in which Dell insiders, including the head of Investor Relations, Lynn Tyson, selectively disclosed confidential quarterly financial information arguably similar to the inside information disclosed by Ray and Choi to establish relationships with financial firms who might be in a position to buy Dell's stock. For example, appellants introduced an email Tortora sent Newman summarizing a conversation he had with Tyson in which she suggested "low 12% opex [was] reasonable" for Dell's upcoming quarter and that she was "fairly confident on [operating margin] and [gross margin]."

No reasonable jury could have found beyond a reasonable doubt that Newman and Chiasson knew, or deliberately avoided knowing, that the information originated with corporate insiders. In general, information about a firm's finances could certainly be sufficiently detailed and proprietary to permit the inference that the tippee knew that the information came from an inside source. But in this case, where the financial information is of a nature regularly and accurately predicted by analyst modeling, and the tippees are several levels removed from the source, the inference that defendants knew, or should have known, that the information originated with a corporate insider is unwarranted.

Moreover, even if detail and specificity could support an inference as to the nature of the source, it cannot, without more, permit an inference as to that source's improper motive for disclosure. That is especially true here, where the evidence showed that corporate insiders at Dell and NVIDIA regularly engaged with analysts and routinely selectively disclosed the same type of information. Thus, in light of the testimony (much of which was adduced from the Government's own witnesses) about the accuracy of the analysts' estimates and the selective disclosures by the companies themselves, no rational jury would find that the tips were so overwhelmingly suspicious that Newman and Chiasson either knew or consciously avoided knowing that the information came from corporate insiders or that those insiders received any personal benefit in exchange for the disclosure. . . . Consequently, we reverse Newman and Chiasson's convictions and remand with instructions to dismiss the indictment as it pertains to them.

Problem 4-7

Under *Dirks* and *Newman*, what is the mens rea (or "scienter," in securities law parlance) required now for tippee liability? Does the requirement differ depending on whether the case involves civil or criminal liability?

SALMAN v. UNITED STATES, 137 S. Ct. 420 (2016)

JUSTICE ALITO delivered the opinion of the Court.

Section 10(b) of the Securities Exchange Act of 1934 and the Securities and Exchange Commission's Rule 10b–5 prohibit undisclosed trading on inside corporate information by individuals who are under a duty of trust and confidence that prohibits them from secretly using such information for their personal advantage. . . .

Petitioner Bassam Salman challenges his convictions for conspiracy and insider trading. Salman received lucrative trading tips from an extended family member, who had received the information from Salman's brother-in-law. Salman then traded on the information. He argues that he cannot be held liable as a tippee because the tipper (his brother-in-law) did not personally receive money or property in exchange for the tips and thus did not personally benefit from them. . . .

Maher Kara was an investment banker in Citigroup's healthcare investment banking group. He dealt with highly confidential information about mergers and acquisitions involving Citigroup's clients. Maher enjoyed a close relationship with his older brother, Mounir Kara (known as Michael). After Maher started at Citigroup, he began discussing aspects of his job with Michael. At first he relied on Michael's chemistry background to help him grasp scientific concepts relevant to his new job. Then, while their father was battling cancer, the brothers discussed companies that dealt with innovative cancer treatment and pain management techniques. Michael began to trade on the information Maher shared with him. At first, Maher was unaware of his brother's trading activity, but eventually he began to suspect that it was taking place.

Ultimately, Maher began to assist Michael's trading by sharing inside information with his brother about pending mergers and acquisitions. Maher sometimes used code words to communicate corporate information to his brother. Other times, he shared inside information about deals he was not working on in order to avoid detection. Without his younger brother's knowledge, Michael fed the information to others—including Salman, Michael's friend and Maher's brother-in-law. By the time the authorities caught on, Salman had made over \$1.5 million in profits that he split with another relative who executed trades via a brokerage account on Salman's behalf. . . .

The evidence at trial established that Maher and Michael enjoyed a "very close relationship." Maher "love[d] [his] brother very much," Michael was like "a second father to Maher," and Michael was the best man at Maher's wedding to Salman's sister. Maher testified that he shared inside information with his brother to benefit him and with the expectation that his brother would trade on it. While Maher explained that he disclosed the information in large part to appease Michael (who pestered him incessantly for it), he also testified that he tipped his brother to "help him" and to "fulfil[l] whatever needs he had." For instance, Michael once called Maher and told him that "he needed a favor." Maher offered his brother money but Michael asked for information instead. Maher then disclosed an upcoming acquisition. Although he instantly regretted the tip and called his brother back to implore him not to trade, Maher expected his brother to do so anyway.

For his part, Michael told the jury that his brother's tips gave him "timely information that the average person does not have access to" and "access to stocks, options, and what have you, that I can capitalize on, that the average person would never have or dream of." Michael testified that he became friends with Salman when Maher was courting Salman's sister and later began sharing Maher's tips with Salman. As he explained at trial, "any time a major deal came in, [Salman] was the first on my phone list." Michael also testified that he told Salman that the information was coming from Maher. . . .

While [Salman's] appeal was pending, the Second Circuit issued its opinion in *United States v. Newman*. There, the Second Circuit reversed the convictions of two portfolio managers who traded on inside information. The Newman defendants were "several steps removed from the corporate insiders" and the court found that "there was no evidence that either was aware of the source of the inside information." The court acknowledged that *Dirks* and Second Circuit case law allow a factfinder to infer a personal benefit to the tipper from a gift of confidential information to a trading relative or friend. But the court concluded that, "[t]o the extent" *Dirks* permits "such an inference," the inference "is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature." . . .

[In a footnote, the Supreme Court added: "The Second Circuit also reversed the Newman defendants' convictions because the Government introduced no evidence that the defendants knew the information they traded on came from insiders or that the

insiders received a personal benefit in exchange for the tips. This case does not implicate those issues.”]

In this case, Salman contends that an insider’s “gift of confidential information to a trading relative or friend,” is not enough to establish securities fraud. Instead, Salman argues, a tipper does not personally benefit unless the tipper’s goal in disclosing inside information is to obtain money, property, or something of tangible value. He claims that our insider-trading precedents, and the cases those precedents cite, involve situations in which the insider exploited confidential information for the insider’s own “tangible monetary profit.” He suggests that his position is reinforced by our criminal-fraud precedents outside of the insider-trading context, because those cases confirm that a fraudster must personally obtain money or property. More broadly, Salman urges that defining a gift as a personal benefit renders the insider-trading offense indeterminate and overbroad: indeterminate, because liability may turn on facts such as the closeness of the relationship between tipper and tippee and the tipper’s purpose for disclosure; and overbroad, because the Government may avoid having to prove a concrete personal benefit by simply arguing that the tipper meant to give a gift to the tippee. He also argues that we should interpret *Dirks*’s standard narrowly so as to avoid constitutional concerns. Finally, Salman contends that gift situations create especially troubling problems for remote tippees—that is, tippees who receive inside information from another tippee, rather than the tipper—who may have no knowledge of the relationship between the original tipper and tippee and thus may not know why the tipper made the disclosure. . . .

We adhere to *Dirks*, which easily resolves the narrow issue presented here.

In *Dirks*, we explained that a tippee is exposed to liability for trading on inside information only if the tippee participates in a breach of the tipper’s fiduciary duty. Whether the tipper breached that duty depends “in large part on the purpose of the disclosure” to the tippee. “[T]he test,” we explained, “is whether the insider personally will benefit, directly or indirectly, from his disclosure.” Thus, the disclosure of confidential information without personal benefit is not enough. In determining whether a tipper derived a personal benefit, we instructed courts to “focus on objective criteria, i.e., whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.” This personal benefit can “often” be inferred “from objective facts and circumstances,” we explained, such as “a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient.” In particular, we held that “[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend.” In such cases, “[t]he tip and trade resemble trading by the insider followed by a gift of the profits to the recipient.” We then applied this gift-giving principle to resolve *Dirks* itself, finding it dispositive that the tippers “received no monetary or personal benefit” from their tips to *Dirks*, “nor was their purpose to make a gift of valuable information to *Dirks*.”

Our discussion of gift giving resolves this case. Maher, the tipper, provided inside information to a close relative, his brother Michael. *Dirks* makes clear that a tipper breaches a fiduciary duty by making a gift of confidential information to “a trading relative,” and that rule is sufficient to resolve the case at hand. As Salman’s counsel acknowledged at oral argument, Maher would have breached his duty had he personally traded on the information here himself then given the proceeds as a gift to his brother. It is obvious that Maher would personally benefit in that situation. But Maher effectively achieved the same result by disclosing the information to Michael, and allowing him to trade on it. *Dirks* appropriately prohibits that approach, as well. *Cf.* 463 U.S., at 659 (holding that “insiders [are] forbidden” both “from personally using undisclosed corporate information to their advantage” and from “giv[ing] such information to an outsider for the same improper purpose of exploiting the information for their personal gain”). *Dirks* specifies that when a tipper gives inside information to “a trading relative or friend,” the jury can infer that the tipper meant to provide the equivalent of a cash gift. In such situations, the tipper benefits personally because giving a gift of trading information is the same thing as trading by the tipper followed by a gift of the proceeds. Here, by disclosing confidential information as a gift to his brother with the expectation that he would trade on it, Maher breached his duty of trust and confidence to Citigroup and its clients—a duty Salman acquired, and breached himself, by trading on the information with full knowledge that it had been improperly disclosed.

To the extent the Second Circuit held that the tipper must also receive something of a “pecuniary or similarly valuable nature” in exchange for a gift to family or friends, we agree with the Ninth Circuit that this requirement is inconsistent with *Dirks*. . . .

UNITED STATES v. MARTOMA, 894 F.3d 64 (2d Cir. 2018)

KATZMANN, Chief Judge:

Defendant-appellant Mathew Martoma appeals from a judgment of conviction entered on September 9, 2014 in the United States District Court for the Southern District of New York. Martoma was found guilty, after a jury trial, of one count of conspiracy to commit securities fraud in violation of 18 U.S.C. § 371 and two counts of securities fraud in violation of 15 U.S.C. §§ 78j(b) & 78ff in connection with an insider trading scheme. After Martoma was convicted, this Court issued a decision in *United States v. Newman*, which elaborated on the Supreme Court’s ruling in *Dirks v. S.E.C.*, concerning liability for a “tippee” who trades on confidential information obtained from an insider, or a “tipper.”

On appeal, Martoma argues that the jury in his case was not properly instructed and that the evidence presented at his trial was insufficient to sustain his conviction. Martoma contends that the jury instructions ran afoul of *Newman* by allowing the jury to find that a tipper receives a “personal benefit” from gifting inside information even where the tipper and tippee do not share a “meaningfully close personal relationship.” He further

argues that the evidence at trial was insufficient to sustain a conviction under any theory of personal benefit.

We conclude that the jury instructions are inconsistent with *Newman*. That decision held that a personal benefit in the form of “a gift of confidential information to a trading relative or friend” requires proof that the tipper and tippee share a “meaningfully close personal relationship.” *Newman* explained that this standard “requires evidence of ‘a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the [latter].’” Thus, Martoma’s jury instructions were erroneous, not because they omitted the term “meaningfully close personal relationship,” but because they allowed the jury to convict based solely on evidence of friendship without also requiring either that the tipper and tippee shared a quid pro quo-like relationship or that the tipper intended to benefit the tippee.

We nonetheless conclude that this instructional error did not affect Martoma’s substantial rights. At trial, the government presented compelling evidence that at least one tipper shared a relationship suggesting a quid pro quo with Martoma. For the same reason, Martoma’s challenge to the sufficiency of the personal-benefit evidence fails. The government also presented sufficient evidence for a rational trier of fact to conclude that at least one tipper received a personal benefit by disclosing inside information with the intention to benefit Martoma. Accordingly, the judgment of the district court is AFFIRMED. . . .

We agree that the jury instructions are inconsistent with *Newman*, though not for the reasons Martoma advances. *Newman* held that a personal benefit in the form of “a gift of confidential information to a trading relative or friend,” *see Dirks*, requires proof that the tipper and tippee shared what the decision called a “meaningfully close personal relationship.” The Court explained that this standard “requires evidence of ‘a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the [latter].’” Thus, Martoma’s jury instructions were erroneous, not because they omitted the term “meaningfully close personal relationship,” but because they allowed the jury to find a personal benefit in the form of a “gift of confidential information to a trading relative or friend” without requiring the jury to find either that tipper and tippee shared a relationship suggesting a quid pro quo or that the tipper gifted confidential information with the intention to benefit the tippee.

We nonetheless conclude that this instructional error did not affect Martoma’s substantial rights. At trial, the government presented compelling evidence that at least one tipper received a different type of personal benefit from disclosing inside information: \$70,000 in “consulting fees.” This evidence establishes the existence of a relationship suggesting a quid pro quo between the tipper and tippee. For this reason, Martoma’s challenge to the sufficiency of the personal-benefit evidence fails. Moreover, the government presented sufficient evidence for a rational trier of fact to conclude that at least one tipper received a personal benefit by disclosing inside information with the

intention to benefit Martoma. Accordingly, we AFFIRM the judgment of the district court.

Martoma's convictions stem from an insider trading scheme involving securities of two pharmaceutical companies, Elan Corporation, plc ("Elan") and Wyeth, that were jointly developing an experimental drug called bapineuzumab to treat Alzheimer's disease. Martoma worked as a portfolio manager at S.A.C. Capital Advisors ("SAC"), a hedge fund owned and managed by Steven A. Cohen. In that capacity, Martoma managed an investment portfolio with buying power of between \$400 and \$500 million that was focused on pharmaceutical and healthcare companies. He also recommended investments to Cohen, who managed SAC's largest portfolio. While at SAC, Martoma began to acquire shares in Elan and Wyeth in his portfolio and recommended that Cohen acquire shares in the companies as well.

In order to obtain information about bapineuzumab, Martoma contacted expert networking firms and arranged paid consultations with doctors knowledgeable about Alzheimer's disease, including two who were working on the bapineuzumab clinical trial. Dr. Sidney Gilman, chair of the safety monitoring committee for the bapineuzumab clinical trial, participated in approximately 43 consultations with Martoma at the rate of around \$1,000 per hour. As a member of the safety monitoring committee, Dr. Gilman had an obligation to keep the results of the clinical trial confidential. His consulting contract reiterated that he was not to disclose any confidential information in a consultation. He nevertheless provided Martoma, whom he knew to be an investment manager seeking information to help make securities trading decisions, with confidential updates on the drug's safety that he received during meetings of the safety monitoring committee. Dr. Gilman also shared with Martoma the dates of upcoming safety monitoring committee meetings, which allowed Martoma to schedule consultations with Dr. Gilman shortly after each one. Another consultant, Dr. Joel Ross, one of the principal investigators on the clinical trial, met with Martoma on many occasions between 2006 and July 2008 and charged approximately \$1,500 per hour. Like Dr. Gilman, Dr. Ross had an obligation to maintain the confidentiality of information about the bapineuzumab clinical trial. Nevertheless, during their consultations, Dr. Ross provided Martoma with information about the clinical trial, including information about his patients' responses to the drug and the total number of participants in the study, that Dr. Ross recognized was not public.

On June 17, 2008, Elan and Wyeth issued a press release regarding the results of "Phase II" of the bapineuzumab clinical trial. The press release described the preliminary results as "encouraging," with "clinically meaningful benefits in important subgroups" of Alzheimer's patients with certain genetic characteristics, but indicated that the drug had not proven effective in the general population of Alzheimer's patients. The press release further stated that the results of the trials would be presented in greater detail at the International Conference on Alzheimer's Disease to be held on July 29, 2008. Elan's share price increased following the press release.

In mid-July of 2008, the sponsors of the bapineuzumab trial selected Dr. Gilman to present the results at the July 29 conference. It was only at this point that Dr. Gilman was unblinded as to the final efficacy results of the trial. Dr. Gilman was “initially euphoric” about the results, but identified “two major weaknesses in the data” that called into question the efficacy of the drug as compared to the placebo. On July 17, 2008, the day after being unblinded to the results, Dr. Gilman spoke with Martoma for about 90 minutes by telephone about what he had learned. That same day, Martoma purchased a plane ticket to see Dr. Gilman in person at his office in Ann Arbor, Michigan. That meeting occurred two days later, on July 19, 2008. At that meeting, Dr. Gilman showed Martoma a PowerPoint presentation containing the efficacy results and discussed the data with him in detail.

The next morning, Sunday, July 20, Martoma sent Cohen, the owner of SAC, an email with “It’s important” in the subject line and asked to speak with him by telephone. The two had a telephone conversation lasting about twenty minutes, after which Martoma emailed Cohen a summary of SAC’s Elan and Wyeth holdings. The day after Martoma spoke to Cohen, on July 21, 2008, SAC began to reduce its position in Elan and Wyeth securities and entered into short-sale and options trades that would be profitable if Elan’s and Wyeth’s stock fell.

Dr. Gilman publicly presented the final results from the bapineuzumab trial at the International Conference on Alzheimer’s Disease in the afternoon of July 29, 2008. Elan’s share price began to decline during Dr. Gilman’s presentation and at the close of trading the next day, the share prices of Elan’s and Wyeth had declined by about 42% and 12%, respectively. The trades that Martoma and Cohen made in advance of the announcement resulted in approximately \$80.3 million in gains and \$194.6 million in averted losses for SAC. Martoma personally received a \$9 million bonus based in large part on his trading activity in Elan and Wyeth.

At Martoma’s trial, the district court instructed the jury on the personal benefit element of insider trading law as follows:

If you find that Dr. Gilman or Dr. Ross disclosed material, non-public information to Mr. Martoma, you must then determine whether the government proved beyond a reasonable doubt that Dr. Gilman and Dr. Ross received or anticipated receiving some personal benefit, direct or indirect, from disclosing the material, non-public information at issue.

The benefit may, but need not be, financial or tangible in nature; it could include obtaining some future advantage, developing or maintaining a business contact or a friendship, or enhancing the tipper’s reputation.

A finding as to benefit should be based on all the objective facts and inferences presented in the case. You may find that Dr. Gilman or Dr. Ross received a direct or indirect personal benefit from providing inside

information to Mr. Martoma if you find that Dr. Gilman or Dr. Ross gave the information to Mr. Martoma with the intention of benefiting themselves in some manner, or with the intention of conferring a benefit on Mr. Martoma, or as a gift with the goal of maintaining or developing a personal friendship or a useful networking contact. . . .

The government now takes the position that *Salman* fully abrogated *Newman*'s interpretation of the personal benefit element, whereas Martoma argues that *Newman*'s "meaningfully close personal relationship" standard survived *Salman*. However, because there are many ways to establish a personal benefit, we conclude that we need not decide whether *Newman*'s gloss on the gift theory is inconsistent with *Salman*. At trial, the government presented compelling evidence that Dr. Gilman received a different type of personal benefit: \$70,000 in consulting fees, which can be seen either as evidence of a quid pro quo-like relationship, or simply advance payments for the tips of inside information that Dr. Gilman went on to supply. The government also introduced sufficient evidence to prove Dr. Gilman received a personal benefit by disclosing inside information with the intention to benefit Martoma. We accordingly conclude that Martoma has provided no basis for his judgment of conviction to be vacated or reversed. . . .

As we understand the dissent, our core disagreement is over whether intent to benefit is a standalone personal benefit under *Dirks*. The dissent argues that it is not, claiming instead that the correct formulation is a "relationship . . . that suggests . . . an intention to benefit" the tippee. The key sentence of *Dirks* is admittedly ambiguous, and we acknowledge that the dissent has offered a plausible reading. *See* 463 U.S. ("For example, there may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient."). But that is not the only reading. The comma separating the "intention to benefit" and "relationship . . . suggesting a quid pro quo" phrases can be read to sever any connection between them. The sentence, so understood, effectively reads, "there may be a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or there may be an intention to benefit the particular recipient." And that is the reading this Court adopted in *Warde*, where we read the "intention to benefit" language independently of the language of relationships: "The 'benefit' element of § 10(b) is satisfied when the tipper 'intend[s] to benefit the . . . recipient' or 'makes a gift of confidential information to a trading relative or friend.'" We adhere to *Warde*.

Our understanding is also more consonant with *Dirks* as a whole. Because the existence of a breach "depends in large part on the purpose of the disclosure," it makes perfect sense to permit the government to prove a personal benefit with objective evidence of the tipper's intent, without requiring in every case some additional evidence of the tipper-tippee relationship. *Cf. United States v. Falcone* (Sotomayor, J.) (explaining that "the key factor" in proving a personal benefit is "the tipper's intent in providing the information"). For example, suppose a tipper discloses inside information to a perfect stranger and says, in effect, you can make a lot of money by trading on this. Under the

dissent's approach, this plain evidence that the tipper intended to benefit the tippee would be insufficient to show a breach of the tipper's fiduciary duty to the firm due to the lack of a personal relationship. *Dirks* and *Warde* do not demand such a result. Rather, the statement "you can make a lot of money by trading on this," following the disclosure of material non-public information, suggests an intention to benefit the tippee in breach of the insider's fiduciary duty.

We are not persuaded by our dissenting colleague's arguments to the contrary. The dissent contends that proof that the tipper had an intent to benefit the tippee does not prove that the tipper truly "received" a personal benefit. The dissent would evidently have there be proof of something more concrete. However, as we have explained, it is settled law that personal benefits may be indirect and intangible and need not be pecuniary at all. The tipper's intention to benefit the tippee proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose. That is precisely what, under *Dirks*, the personal benefit element is designed to test. Is evidence that an insider intended to benefit an outsider with valuable confidential information any less probative of the absence of a legitimate corporate purpose than evidence that the tippee gave the tipper trivialities like shellfish and a gift card?

The dissent argues that its formulation is more faithful to the personal benefit standard because evidence of a relationship suggesting an intent to benefit the tippee "provides reason to believe that the tipper benefits by benefitting, since the tipper is understood as contributing to a relationship from which both tipper and tippee benefit," a rationale that does not apply where there has been no proof of a relationship. We disagree. That rationale would justify a personal benefit in the form of a relationship suggesting an intention to benefit both tipper and tippee, from which it is straightforward to infer that the tipper personally benefited from the tip. But what *Dirks* in fact refers to is an intention to benefit the tippee alone. Whichever way *Dirks* is read, it recognizes that purposely benefitting the tippee with inside information proves that the tipper has received a personal benefit in breach of a fiduciary duty. The question is whether *Dirks* requires that to be proved with evidence of a relationship or not. We think it clear that the answer is no. And although few reported decisions have relied on the intent to benefit theory, its legitimacy has until today been uncontroversial. To take an example close to home, it featured in the jury instructions in this very case and no objection was raised, nor was any challenge to this language pressed on appeal. . . .

It is against that background that we must assess how *Newman* affected this Court's insider trading law. The central question in *Newman* was an issue of scienter on which our district courts had been split: whether a tippee must be aware, not only that the tipper breached a fiduciary duty in disclosing inside information, but also that the tipper received a personal benefit. The Court persuasively explained that both were required. ("[A] tippee's knowledge of the insider's breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit."). This important teaching of *Newman* is not before us. We observe that, unlike the defendants

in *Newman*, Martoma received confidential information directly from the tipper, and he does not claim that he was unaware of any personal benefit Dr. Gilman received. *Cf. id.* at 448 (“In *Jiau*, the defendant knew about the benefit because she provided it.”).

Newman’s second holding is the focus of this appeal. After resolving the scienter question, *Newman* considered the sufficiency of the personal benefit evidence for two tippers, where the government relied chiefly on evidence that they were friendly with their tippees. The first tipper and tippee were not “close” friends but “had known each other for years, having both attended business school and worked at Dell together,” and the tippee had provided modest “career advice and assistance” to the tipper. The second tipper and tippee were “family friends” that “had met through church and occasionally socialized together.” The government argued that these relationships were “sufficient to prove that the tippers derived some benefit from the tip.”

The *Newman* panel rejected the government’s argument, holding that the personal benefit “standard, although permissive, does not suggest that the Government may prove the receipt of a personal benefit by the mere fact of a friendship, particularly of a casual or social nature.” As the *Newman* Court reasoned, if that were enough, then “practically anything would qualify,” and “the personal benefit requirement would be a nullity.” And in the sentence that forms the basis of Martoma’s argument on appeal, *Newman* stated as follows:

To the extent *Dirks* suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee, where the tippee’s trades ‘resemble trading by the insider himself followed by a gift of the profits to the recipient,’ we hold that such an inference is impermissible in the absence of proof of a meaningfully close personal relationship . . .

On the facts before it, the *Newman* Court found that standard had not been satisfied.

Martoma focuses on this single sentence of *Newman* to argue that a jury may not infer that a tipper received a personal benefit from gifting confidential information in the absence of a “meaningfully close personal relationship.” The term “meaningfully close personal relationship” is new to our insider trading jurisprudence, and, viewed in isolation, it might admit multiple interpretations. But *Newman* provided substantial guidance. Immediately after introducing the “meaningfully close personal relationship” concept, *Newman* held that it “requires evidence of ‘a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the [latter].’” As explained above, each of these is an independently sufficient basis to infer a personal benefit under *Dirks* and its progeny. *See, e.g., Jiau* (quid pro quo-like relationship). In other words, *Newman* cabined the gift theory using two other freestanding personal benefits that have long been recognized by our case law. And although the dissent urges in strong terms that this reading is mistaken or even improper, its dispute is in truth with the plain language of *Dirks*, as construed by *Warde*. We do no

more than read literally *Newman*'s own explanation of its novel standard in light of these decisions, thereby fulfilling our legitimate function to construe and give effect to prior panel decisions.

With that understanding of *Newman*, we conclude that the personal benefit jury instructions in Martoma's trial, issued prior to that decision, were erroneous. The instructions allowed the jury to find a personal benefit based solely on the conclusion that Dr. Gilman tipped Martoma in order to "develop[] or maintain[] . . . a friendship." Under *Newman*, this articulation of the gift theory is incomplete. A properly instructed jury would have been informed that it could find a personal benefit based on a "gift of confidential information to a trading relative or friend" only if it also found that Dr. Gilman and Martoma shared a relationship suggesting a quid pro quo or that Dr. Gilman intended to benefit Martoma with the inside information. But, of course, there was no error in the district court's instructions that the jury could also find a personal benefit based on either of those two factors alone, i.e., if it concluded that Dr. Gilman disclosed confidential information "with the intention of conferring a benefit on Mr. Martoma," or "with the intention of benefiting [himself] in some manner." Each of these personal benefits is unaffected by *Newman*'s interpretation of the gift theory, and neither requires proof that Dr. Gilman and Martoma share any type of "personal relationship."

Although the jury instructions were inaccurate, we conclude that the error did not affect Martoma's substantial rights. The government produced compelling evidence that Dr. Gilman, the tipper, "entered into a relationship of quid pro quo" with Martoma. Dr. Gilman, over the course of approximately 18 months and 43 paid consultation sessions for which he billed \$1,000 an hour, regularly and intentionally provided Martoma with confidential information from the bapineuzumab clinical trial. Martoma kept coming back, specifically scheduling consultation sessions so that they would occur shortly after the safety monitoring committee meetings, when Dr. Gilman would have new information to pass along. Starting at least in August 2007, Dr. Gilman would reschedule his conversations with Martoma if he had no new information to reveal at the time they were scheduled to meet. By that point, the consulting relationship between Dr. Gilman and Martoma involved no legitimate service; as Dr. Gilman testified at trial, "the purpose of those consultations was for [him] to disclose to [Martoma] confidential information about the results . . . of the last Safety Monitoring Committee [meeting]." And because Martoma continued to see Dr. Gilman to receive confidential information, Dr. Gilman continued to receive consulting fees. The fact that Dr. Gilman did not specifically bill for his July 17 and 19, 2008 conversations with Martoma in which Dr. Gilman divulged the final drug efficacy data is also of no moment because, as he admitted at trial, doing so "would [have been] tantamount to confessing that [he] was . . . giving [Martoma] inside information." In the context of their ongoing "relationship of quid pro quo," Dr. Gilman's disclosures of confidential information were designed to "make good on the substantial pecuniary benefit he had already earned," *Dirks* and as a result, "it is clear beyond a reasonable doubt that a rational jury would have found [Martoma] guilty absent [any] error." *Mahaffy*

The dissent argues that under our analysis, a fact-finder must always find that tipper and tippee had a quid pro quo-like relationship whenever a tip is exchanged within a paid consulting relationship. Not so. We merely hold that on the compelling facts of this case, it is clear beyond a reasonable doubt that a properly instructed jury would have found Martoma guilty. Nor does our decision mean that a tipper who accidentally or unknowingly reveals inside information can be found guilty. Such a tipper would be protected by the requirement that the tipper know (or is reckless in not knowing) that the information is material and non-public, or by the requirement that the tipper expect the tippee to trade. . . .

Moreover, even if a jury were inclined to accept Martoma's argument that there was no quid pro quo-like relationship because Dr. Gilman did not bill Martoma for two key sessions, a rational jury could nonetheless find that Dr. Gilman personally benefited by disclosing inside information with the "intention to benefit" Martoma. We think a jury can often infer that a corporate insider receives a personal benefit (i.e., breaches his fiduciary duty) from deliberately disclosing valuable, confidential information without a corporate purpose and with the expectation that the tippee will trade on it. Here, as previously noted, Dr. Gilman knew that Martoma was an investment manager who was seeking information on which to base securities trading decisions. And Dr. Gilman plainly understood the valuable nature of the information about the bapineuzumab clinical trial, as Martoma had previously paid him \$1,000 per hour over the course of 43 consultations to convey his knowledge on the subject, and had visited Dr. Gilman in his Ann Arbor office to receive the key drug efficacy results firsthand. From these facts, a reasonable jury could infer that Dr. Gilman personally benefited by conveying inside information about the trial with the purpose of benefiting Martoma, even if it was not persuaded that the two had a relationship suggesting a quid pro quo (or a personal relationship, for that matter).

POOLER, Circuit Judge:

I respectfully dissent. . . .

The only time *Dirks* refers to an "intention to benefit" is when it discusses the need to prove "a relationship between the insider and the recipient that suggests . . . an intention to benefit the particular recipient." Reading "intention to benefit" out of context, my colleagues assert that, under *Dirks*, an intention can be inferred without any objective evidence about relationships. But *Dirks* does not say that, and it has never been applied to allow such a freestanding inference of intent in this Circuit or elsewhere. . . .

None of these puzzles is presented if one reads the relevant sentence in *Dirks* the way I have suggested. It is easy to understand why the *Dirks* court would have mentioned a relationship suggesting an intention to benefit, an objective circumstance, when it was providing examples of objective facts and circumstances. Unlike a standalone intention to benefit, a relationship suggesting an intention to benefit provides reason to believe that the tipper benefits by benefitting, since the tipper is understood as contributing to a

relationship from which both tipper and tippee benefit. And the focus on relationships rather than bare intentions fits neatly with *Dirks*'s cabining of the gift theory to disclosures to "trading relative[s] or friend[s]."

This cannot be so, my colleagues protest. They ask us to imagine a situation where a tipper "discloses inside information to a perfect stranger and says, in effect, you can make a lot of money by trading on this." Wouldn't it be absurd if this perfect stranger could not be held liable for insider trading if he went ahead and traded on this information? No, it would not be. At least, not if one takes the personal benefit rule seriously. Ex hypothesi, the fictional tipper in their scenario receives absolutely nothing in return for his disclosure, except, I suppose, the warmth that comes with knowing that somebody else might have made some money because of his actions (or perhaps the schadenfreude that comes with knowing that shareholders were defrauded). But if those sorts of "benefits" were enough, then every disclosure of inside information without affirmative indication of a pure heart would be presumptively beneficial to the tipper. *Dirks* rejected that possibility, and every appellate court to have considered the issue, including us, has consistently done the same. That is the law whether we like or not, but, for what it's worth, I see no reason to worry that truly random acts of enrichment can go unpunished. . . .

What about Rajat Gupta after these recent Supreme Court and Second Circuit rulings? None of the turmoil in insider trading law turned out to help him. See the following opinion rejecting a second challenge to Gupta's conviction.

GUPTA v. UNITED STATES, 913 F.3d 81 (2d Cir. 2019)

Per Curiam opinion.

[Rajat] Gupta's convictions of engaging in and conspiring to engage in an insider trading scheme were based on evidence that on several occasions Gupta, while serving on boards of directors of various companies, disclosed material nonpublic information about those companies to his friend and business associate Raj Rajaratnam, founder of the Galleon Group ("Galleon"), a family of hedge funds that invested billions of dollars for its principals and clients, *see Gupta I*. In his direct appeal from the judgment of conviction, Gupta principally challenged the admission in evidence of certain wiretap evidence and challenged the exclusion of certain evidence he sought to introduce. We rejected all of Gupta's contentions and affirmed the judgment. Gupta did not challenge the sufficiency of the evidence to convict him or any of the instructions to the jury.

After Gupta's appeal had been decided, this Court decided [*United States v.*] *Newman*, in which we reversed the insider trading convictions of two tippees.

In his present § 2255 motion, Gupta quotes the following parts of the trial court's instructions to the jury at his trial:

First, [the government must prove that] on or about the date alleged, Mr. Gupta engaged in an insider trading scheme, in that, in anticipation of receiving at least some modest benefit in return, he provided to Mr. Rajaratnam the material non-public information specified in the count you are considering. . . .

[A]s to the benefit that the defendant anticipated receiving, the benefit does not need to be financial or to be tangible in nature. It could include, for example, maintaining a good relationship with a frequent business partner, or obtaining future financial benefits.

He contends that

[t]he instruction thus began by emphasizing, in a formulation plainly invalid following *Newman*, that “the benefit does not need to be financial or to be tangible in nature.” By way of example, the district court continued, “maintaining a good relationship” with Rajaratnam would suffice. The instruction thus permitted, consistent with the government’s theory, proof and arguments in the case, a guilty verdict based on the relationship, alone, as the benefit.

Gupta contends that his convictions should be vacated on the ground that *Newman*, “[b]y contrast, . . . held that a personal benefit must take the form of an ‘exchange’—a quid pro quo—in which the alleged tipper receives an ‘objective, consequential . . . gain of a pecuniary or similarly valuable nature,’ or at least the opportunity for such gain.” (quoting *Newman*). We disagree. . . .

[T]he trial court’s reference to a good relationship with a frequent business partner was consistent with the Supreme Court’s discussion in *Dirks v. SEC* as to what may properly be considered a tipper’s anticipated personal benefit sufficient to warrant his conviction of insider trading. In *Dirks*, noting that “a purpose of the securities laws was to eliminate use of inside information for personal advantage,” (internal quotation marks omitted), the Court stated that the test for whether that purpose has been contravened is “whether the insider receives a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.” The Court also stated that an inference of such a benefit may be warranted by the circumstance of “a relationship between the insider and the recipient that suggests a quid pro quo from the latter, or an intention to benefit the particular recipient.” Where the recipient of the tip is the tipper’s “frequent” “business” partner, the tipper’s anticipation of a quid pro quo is easily inferable. . . .

Indeed, the lack of need for proof of the tipper’s financial or tangible gain was highlighted as well by the *Dirks* Court’s illustration that

[t]he elements of fiduciary duty and exploitation of nonpublic information also exist when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.

see also United States v. Martoma (“The tipper’s intention to benefit the tippee proves a breach of fiduciary duty because it demonstrates that the tipper improperly used inside information for personal ends and thus lacked a legitimate corporate purpose.”).

Finally, the trial court’s instruction that the benefit to Gupta need not have been financial or tangible, although contrary to the formulation given in *Newman*, could not have constituted prejudice to Gupta because it was correct. The *Newman* formulation was expressly rejected by the Supreme Court in *Salman v. United States*, as that Court noted that

[t]o the extent the Second Circuit held that the tipper must also receive something of a “pecuniary or similarly valuable nature” in exchange for a gift to family or friends, *Newman*, . . . this requirement is inconsistent with *Dirks*.

Thus, in the wake of *Salman*, we have stated that “it is settled law that personal benefits may be indirect and intangible and need not be pecuniary at all.” *United States v. Martoma*. . . .

[T]he record as a whole, viewed in the light most favorable to the government, contained ample evidence that Gupta and Rajaratnam were business associates. . . .

There was ample evidence to permit the jury to find that Gupta intended Rajaratnam to trade on the basis of the confidential information Gupta passed to him and that Gupta personally benefitted in one of the ways envisioned in *Dirks*. . . .

Problem 4-8

You are an attorney at a major New York law firm. In light of <i>Newman</i> , <i>Salman</i> , and <i>Martoma</i> , advise Sally—a client who runs a hedge fund—when she can and cannot trade on the basis of nonpublic information she learns about publicly traded companies. The first task in preparing this advice, of course, is to distill where these cases have left the law of insider trading with regard to the elements of proof needed to establish tippee liability.

The theme by which theories of fraud, pursued under various statutes, can tend to overlap in the issues they raised continues in the next case, where insider trading law and the question of “property fraud” both become relevant.

UNITED STATES v. BLASZCZAK, 56 F.4th 230 (2d Cir 2022)

KEARSE, Circuit Judge:

This appeal returns to us on remand from the United States Supreme Court for further consideration, in light of *Kelly v. United States*, , of this Court’s prior affirmance of judgments of the United States District Court for the Southern District of New York convicting defendants David Blaszcak, Theodore Huber, Robert Olan, and Christopher Worrall of conversion of government property in violation of 18 U.S.C. § 641 and wire fraud in violation of 18 U.S.C. § 1343; and convicting Blaszcak, Huber, and Olan of securities fraud in violation of 18 U.S.C. § 1348 (“Title 18 securities fraud”), conspiracy to commit wire fraud and Title 18 securities fraud in violation of 18 U.S.C. § 1349, and conspiracies in violation of 18 U.S.C. § 371 to, *inter alia*, convert government property and defraud the United States, all originating from misappropriation of confidential information from the Centers for Medicare & Medicaid Services (“CMS”). On this remand: (A) defendants contend that their argument that the CMS information at issue does not constitute “property” or a “thing of value” within the meaning of the above statutes is supported by the Supreme Court’s decision in *Kelly*; (B) the government, concurring in that contention, confesses error as to those substantive counts and as to a conspiracy count premised only on crimes concerning “property” (Count Two); and it agrees that either the defendants’ convictions on those counts should be reversed, or the cases should be remanded to the district court so that the government can dismiss those counts pursuant to Fed. R. Crim. P. 48(a); and (C) the government seeks affirmance on the remaining conspiracy counts on which one or more defendants were convicted (Counts One and Seventeen).

For the reasons that follow, given the Supreme Court’s decision in *Kelly* and the prosecutorial discretion to which the Executive Branch of the government is entitled, we grant the government’s request to remand the cases to the district court for dismissal of the substantive counts and the conspiracy charged in Count Two. As to Counts One and Seventeen, the verdicts do not reveal whether the jury found that the charged defendants conspired to engage in alleged conduct other than that which the government no longer contends was criminal. Accordingly, we vacate the convictions on these two counts and remand for such further proceedings as may be appropriate. . . .

CMS is an agency within the United States Department of Health and Human Services. CMS administers Medicare and Medicaid, including *inter alia*, issuing rules setting reimbursement rates for healthcare providers. The rules may impact the stock prices of companies that offer products and services covered by the rates.

Worrall was an employee at CMS; Blaszcak, a consultant for hedge funds, was a former CMS employee. Huber and Olan were partners in a hedge fund (“Deerfield”). At various times between 2009 and 2014, Worrall gave Blaszcak nonpublic information about the timing and substance of proposed CMS rule changes that would change reimbursement rates for certain types of medical care for various health conditions. Blaszcak gave that

information to Huber, Olan, or another Deerfield partner, following which Deerfield engaged in profitable short sales of shares of companies that would be negatively affected by reimbursement rate reductions when they became effective. Between 2010 and 2013, Blaszcak also gave such information to another hedge fund client, following which that fund profitably maintained its short positions and purchased put-options in shares of such companies. . . .

The jury acquitted all of the defendants on all substantive counts of Title 15 securities fraud. [Ed: we don't know why the jury acquitted on the securities fraud counts, of course, but this is why the "property" question under the wire fraud charges became dispositive.] On the other substantive charges, all four defendants were convicted on at least one count of § 641 property conversion and at least one count of § 1343 wire fraud: Blaszcak was convicted on a total of three counts of § 641 property conversion, two counts of § 1343 wire fraud, and two counts of Title 18 securities fraud. Huber and Olan were each convicted on one count of § 641 property conversion, one count of § 1343 wire fraud, and one count of Title 18 securities fraud. Worrall was convicted only on one count of § 641 property conversion and one count of § 1343 wire fraud. As to the conspiracy counts, Blaszcak, Huber, and Olan were convicted on Counts One and Two; Blaszcak was convicted on Count Seventeen.

On appeal, defendants challenged their convictions on the principal ground that §§ 1343 and 1348 apply to fraudulent schemes to obtain "money or property" and that § 641 applies to conversion of "money[] or [a] thing of value" of the government, and that CMS's confidential information as to its plans for announcing changes in medical service reimbursement rates was not government "property" or a "thing of value" within the meaning of those statutes. . . .

Defendants on this remand renew their principal contention that the CMS information at issue does not constitute "property" or a "thing of value" within the meaning of the fraud and conversion statutes, and they contend that that conclusion is supported by the Supreme Court's decision in *Kelly*. Their opening brief on remand urges that all of their convictions be reversed.

The government on remand, insofar as the substantive counts of conviction are concerned, agrees with defendants that those counts cannot stand. It states that,

[i]n light of the Supreme Court's holding in *Kelly*, it is now the position of the Department of Justice that in a case involving confidential government information, that information typically must have economic value in the hands of the relevant government entity to constitute "property" for purposes of 18 U.S.C. §§ 1343 and 1348. . . . A related, though not necessarily identical, analysis applies when determining what confidential information is a "thing of value" under 18 U.S.C. § 641. The Department has determined that the confidential information at issue in this case does not constitute "property" or a "thing of value" under the relevant statutes after *Kelly*. To be sure, this Court

recognized that “CMS *does* have an economic interest in its confidential predecisional information” because the agency “invests time and resources into generating and maintaining the confidentiality of” that information, and leaks affect the “efficient use of its limited time and resources.” *Blaszczak* [I]. But in the Department’s view, shaped by *Kelly*, the CMS employee time at issue in this case did not constitute “an object of the fraud,” and thus the associated “labor costs could not sustain the conviction[s]” here. *Kelly*. . . .

The government argues, however, that the conspiracy convictions on Counts One and Seventeen should be affirmed. Count One, on which *Blaszczak*, *Huber*, and *Olan* were convicted, alleged that defendants’ objectives were not only to convert government property in violation of § 641, but also to commit Title 15 securities fraud and to defraud the United States in violation of 18 U.S.C. § 371. And Count Seventeen, alleged only against *Blaszczak*, alleged that his objectives were both conversion of government property and defrauding the United States. The government acknowledges that “[i]n light of [its] confession of error, . . . the Government is constrained to concede that the § 641 objects are legally invalid,” but it argues that “the § 371 defraud-clause objects were not affected by *Kelly* and remain legally valid.” (Government brief on remand at 10.) The government also concedes that the jury’s “general verdict[s]” on Counts One and Seventeen, and “the presence of both legally invalid and legally valid objects gives rise to error” (citing *Yates v. United States*). However, it argues that the error is harmless in light of the “overwhelming evidence” that *Blaszczak* conspired with *Huber* and *Olan* (the *Deerfield* partners) to defraud the United States in connection with *Deerfield*’s stock trading (Count One), and that *Blaszczak* conspired with another client to defraud the United States in connection with that client’s stock trading (Count Seventeen). . . .

As indicated in Part I.B. above, the *Kelly* Court noted that the relevant federal fraud statutes such as § 1343 are “limited in scope to the protection of property rights” and do not “criminaliz[e] all acts of dishonesty,” and that the government therefore was required to prove, *inter alia*, that the object of the defendants’ fraudulent scheme was money or property, *Kelly* (internal quotation marks omitted). . . .

In the present case the same is true with respect to the counts charging various defendants with fraud in violation of §§ 1343 and 1348 or with conversion of government property in violation of § 641. In contrast, as to the counts of the indictment that charged violations of the Title 15 securities laws, the actual and intended victims of the alleged frauds would have been investors in the market for securities of the companies whose fortunes would be affected by the regulations promulgated by CMS. Indeed, as noted by the Court-appointed amicus curiae, “[a]t its core, this was a case about insider trading—an act already understood to be wrongful under [Title 15].” But the jury acquitted defendants on all of those Title 15 substantive counts; and in the remaining substantive counts at issue here, on which the jury convicted—the fraud sections, §§ 1343 and 1348, and the section prohibiting “conver[sion]” of “money,” or a “thing of value” from “the United States or any department or agency thereof,” 18 U.S.C. § 641—the purported victim would have been the government agency CMS. Thus, defendants could not

properly be convicted of violating §§ 1343, 1348, or 641 unless the objective of their schemes and conduct was money or property of CMS. . . .

While confidential information may constitute property of a commercial entity such as the publisher victim in *Carpenter v. United States*—for which confidential information was its “stock in trade, to be gathered at the cost of enterprise, organization, skill, labor, and money, and *to be distributed and sold to those who [would] pay money for it,*” (internal quotation marks omitted; emphasis ours)—the same is not true with respect to a regulatory agency such as CMS. CMS is not a commercial entity; it does not sell, or offer for sale, a service or a product.

CMS adopts regulations that affect, *inter alia*, business organizations or health industry entities, whether the affected persons or entities favor the regulations or not. And while CMS seeks to maintain confidentiality as to its planned regulations—and the regulations can plainly have either a favorable or an adverse effect on certain business entities’ fortunes—a planned CMS regulation, even if disclosed to outsiders prematurely, remains within the exclusive control of CMS. And if it is prematurely disclosed to others, the disclosure has no direct impact on the government’s fisc, although it might well impact CMS’s subsequent regulatory choices. CMS can adhere to its planned regulation, or it can alter or abandon it; it can publish the regulation at the time it had planned, or it can postpone or advance the announcement or the regulation’s effective date. As the Supreme Court recognized in *Cleveland* and emphasized in *Kelly*, the government’s right to determine “who should get a benefit and who should not . . . do[es] ‘not create a property interest.’” *Kelly* (quoting *Cleveland*). The information reflecting such a decision and the timing of that disclosure are regulatory in character and do not constitute money or property of the victim; and they are not a “thing of value” to CMS that is susceptible to being “convert[ed],” 18 U.S.C. § 641. . . .

The only remaining counts of the indictment are Count One, on which Blaszcak, Huber, and Olan were convicted of conspiring, in violation of 18 U.S.C. § 371, to convert property belonging to the United States in violation of 18 U.S.C. § 641, to commit Title 15 securities fraud, and to defraud the United States in violation of § 371; and Count Seventeen, on which Blaszcak was convicted of conspiring, in violation of 18 U.S.C. § 371, to violate § 641 and to defraud the United States.

As to these counts, the jury was not given questions to answer that would reveal which one or more of the alleged conspiratorial goals it found proven. And since the government has confessed error as to charges that defendants’ conduct was within the scope of § 641, and it no longer seeks to sustain these conspiracy convictions on the basis of § 641 property-conversion goals, the government acknowledges that the verdicts on these counts are “‘flawed.’”

The government contends, however, that the convictions on Counts One and Seventeen can be affirmed on the ground that the error was harmless. We disagree. . . . Given the emphasis the government placed on theft in its rebuttal summation to the jury, and the

fact that the only substantive crimes on which the jury returned verdicts of guilty were the alleged property crimes under § 641, § 1343, and § 1348, we cannot conclude that the government has carried its burden. Despite the fact that a plurality of the indictment's counts alleged substantive counts of Title 15 securities fraud—and “[a]t its core,” that is what this case was about—the jury acquitted each defendant on every such count in which he was charged. We see no basis on which to infer that if there had been no charges of property crimes or conspiratorial goals to commit property crimes, the jury would necessarily have found that any of the defendants conspired to commit Title 15 securities fraud or to defraud the United States. We cannot conclude that the inclusion of § 641 conversion as a goal of the conspiracies alleged in Counts One and Seventeen was an error that was harmless. . . .

JOHN M. WALKER, Jr., Circuit Judge, joined by JUDGE KEARSE, concurring:

I join Judge Kearse's opinion in full. I write separately to highlight an anomaly in a separate ruling in *Blaszczak I* that, while not discussed by today's majority opinion because it is no longer outcome determinative, nevertheless deserves attention. In *Blaszczak I*, the panel held that a criminal conviction for tipper-tippee insider trading securities fraud prosecuted under 18 U.S.C. § 1348 does not require proof that the tipper received a “personal benefit.” This holding stands in contrast to the requirement of proof of a tipper's personal benefit when the government seeks criminal or civil penalties for insider trading under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5 promulgated thereunder.

If that strikes one as odd, it should. Reasonable minds can certainly differ on how the law can best prevent insider trading without unduly impairing the normal functioning of security analysts as informational intermediaries between companies and the market. But traditional notions of fair play are offended by the present incongruence in this circuit between civil and criminal deterrence. It should not require fewer elements to prove a criminal conviction than to impose civil penalties for the same conduct. This asymmetry deserves the further attention of our court, the Supreme Court, and Congress.

The government can punish insider trading in two ways: through civil penalties under Rule 10b-5 or criminal prosecution under either Rule 10b-5 or 18 U.S.C. § 1348. These laws broadly prohibit schemes or artifices to defraud in connection with the securities market. Neither provision expressly mentions insider trading, but both can be used to police it, although under different standards and elements. . . .

Courts have tethered § 10(b) and Rule 10b-5 liability to a breach of a fiduciary duty in connection with the purchase or sale of a security. Under the “classical” theory, liability for insider trading is predicated on an insider's breach of the duty of trust and confidence that he owes, as an insider, to purchasers and sellers of his company's stock. An insider violates § 10(b) and Rule 10b-5 when he trades based on material, non-public

information. The insider can also be liable as a “tipper” when he divulges—or tips—that inside information to outsiders.

For an outsider, mere possession of an issuer’s nonpublic market information does not create a duty. But an outsider who acquires a company’s inside information (a “tippee”) may still be prohibited from trading on that information if he received it from a tipper who has breached her fiduciary duties and the tippee knows of the tipper’s breach. It is the tipper’s predicate breach that allows a tippee who trades with knowledge of the tipper’s breach to be held derivatively liable. The touchstone for whether the tipper has breached those duties is whether the tipper received a “personal benefit” in exchange for providing the inside information.

Again, nothing in the text of § 10(b) or Rule 10b-5 requires that the tipper receive a “personal benefit.” But the Supreme Court, since *Dirks v. SEC*, has imposed such a requirement. In a civil enforcement action against a tipper for a violation of § 10(b) and Rule 10b-5, the government must prove that a tipper “(1) tip[ped] (2) material nonpublic information (3) in breach of a fiduciary duty of confidentiality owed to shareholders . . . or to the source of the information . . . (4) for personal benefit to the tipper.”

Likewise, a tippee may be civilly liable when: 1) he knew or had reason to know that the tipper disclosed that information in breach of a duty and received a personal benefit in the process and 2) the tippee used that information by trading or tipping for his own benefit in disregard of that knowledge. The precise nature of the “personal benefit” in a particular case “will not always be easy for courts” to determine. But at least in theory, the *Dirks* test provides a “simple and clear ‘guiding principle’ for determining tippee liability.”

Now we turn to the text of 18 U.S.C. § 1348, which provides a broad criminal prohibition against securities fraud and thus insider trading. For the government to secure a criminal conviction for violations of 18 U.S.C. § 1348, it must prove that a defendant knowingly engaged in a “scheme or artifice to defraud any person in connection with” a registered security or commodity of a publicly traded company. Like § 10(b) and Rule 10b-5, nothing in the text of 18 U.S.C. § 1348 requires proof of a personal benefit.

The judicial accretion to § 10(b) and Rule 10b-5 requiring a personal benefit to the tipper and knowledge of such by the tippee is absent from our interpretation of § 1348. In *Blaszczak I* the panel declined to “graft the *Dirks* personal-benefit test onto the elements of Title 18 securities fraud” in a tipper-tippee insider trading prosecution. Because 18 U.S.C. § 1348 requires no proof of a personal benefit, the panel observed that the statute gives the government “a different—and broader—enforcement mechanism” than is available under § 10(b) and Rule 10b-5.

Consider some of the potential consequences of a legal scheme that requires fewer elements to convict someone criminally than to penalize someone civilly for the same

conduct. The risk of overdeterrence looms large: The government has expressly acknowledged that securities analysts, who routinely “ferret out and analyze information” from corporate insiders to price accurately a security, are critical to a functioning market. But when the bounds of permissible conduct are not clearly delineated, parties are prevented “from ordering their actions in accord with legal requirements.” The personal benefit test creates at least some legal distinction between those who gave and obtained tips fraudulently and those who appropriately engaged in the honest disclosure and collection of corporate information. In this way, the element provides corporate insiders and analysts (and their attorneys) with notice of “when the line is crossed.” Without it, corporate insiders may be more reticent to share information with analysts in the ordinary course of business and analysts who do receive company information may be less likely to act on it for fear of running afoul of § 1348.

Beyond the problem that lawful market analyst activity may be inhibited in the wake of the *Blaszczak I* decision, 18 U.S.C. § 1348(1)’s criminal prohibition stands to capture more instances of tipper-tippee insider trading than would be civilly sanctionable. In the *Blaszczak* trial it was no accident that the jury convicted the defendants of insider trading fraud by violating 18 U.S.C. § 1348 but acquitted them of the same conduct under § 10(b) and Rule 10b-5. Under *Blaszczak I*, the government may prosecute someone as a tippee when he trades on company information that he knows to be material and nonpublic, without proving that the source of that information was engaged in self-dealing.

To be sure, the higher standard of proof to secure a criminal conviction may mitigate this incongruence to a degree. But the threat of criminal exposure (or a referral from the SEC to a United States Attorney’s office) is a weighty cudgel in plea bargaining and in extracting civil settlements. It also poses a challenge to the lawyer advising the security analyst who has no desire to run afoul of the law but wants to be able to do his job effectively.

We are taught that judges must “take the statute as we find it” and that we should “assume that Congress is aware of existing law when it passes legislation,” including statutes and judicial “gloss”—such as *Dirks*’s personal benefit test. Thus I understand the *Blaszczak I* panel’s decision, in the absence of Supreme Court guidance, not to import a personal benefit element to securities fraud prosecutions under 18 U.S.C. § 1348. I write separately, however, to highlight a glaring anomaly that the panel’s decision creates and that warrants further attention by Congress and the courts. . . .

Leaving aside the issues about what counts as “property,” the opinion in *Blaszczak I*, as the concurring opinion in *Blaszczak II* suggests, created a stir by ruling that the government could prosecute tipper-tippee cases *without having to prove personal benefit* (as long as it proceeded under the Title 18 securities fraud statute rather than under Title 15 and Rule 10b-5). Because that issue was not before the Second Circuit on remand from the Supreme Court, the concurrence criticizing this theory remains dicta for now.

Whether this issue receives further attention from the Second Circuit will depend on whether the government chooses the perhaps risky strategy in a future tipper-tippee case of proceeding under the Title 18 statute and, citing *Blaszczak I* as authority, requesting a jury instruction explaining that no intent to convey personal benefit is necessary for tipper-tippee liability. This is a frustratingly unclear state of the law for practitioners and students, at least within the Second Circuit, but it will remain so unless the government brings an insider trading prosecution that necessarily forces the courts to revisit the issue of insider trading liability under 18 U.S.C. § 1348.

As a final note on recent developments, consider the following indictment—which recently produced a guilty verdict after a trial—in which the government applied an insider trading-type theory to a form of tradeable asset that is not a security.

Indictment

United States v. Nathaniel Chastain

No. 1:22-cr-00305 (S.D.N.Y. May 31, 2022)

1. This case concerns insider trading in Non-Fungible Tokens or “NFTs” on OpenSea, the largest online marketplace for the purchase and sale of NFTs. In violation of the duties of trust and confidence he owed to his employer, OpenSea, NATHANIEL CHASTAIN, the defendant, exploited his advanced knowledge of what NFTs would be featured on OpenSea’s homepage for his personal financial gain.

2. As part of his employment, NATHANIEL CHASTAIN, the defendant, was responsible for selecting NFTs to be featured on OpenSea’s homepage. OpenSea kept confidential the identity of featured NFTs until they appeared on its homepage. After an NFT was featured on OpenSea’s homepage, the price buyers were willing to pay for that NFT, and for other NFTs made by the same NFT creator, typically increased substantially.

3. From at least in or about June 2021 to at least in or about September 2021, NATHANIEL CHASTAIN, the defendant, misappropriated OpenSea’s confidential business information about what NFTs were going to be featured on its homepage and used that information to secretly purchase dozens of NFTs shortly before they were featured. CHASTAIN then sold the NFTs he had purchased at a profit shortly after the NFTs were featured. To conceal the fraud, CHASTAIN conducted these purchases and sales using anonymous digital currency wallets and anonymous accounts on OpenSea.

4. At all times relevant to this Indictment, NATHANIEL CHASTAIN, the defendant, was a product manager at Ozone Networks, Inc. d/b/a OpenSea (“OpenSea”), the largest online marketplace for the purchase and sale of NFTs.

5. NFTs are a type of digital asset stored on a blockchain, which is a digital, decentralized ledger that stores information, including information about transactions. Each NFT is typically associated with a digital object, such as a piece of digital artwork,

and the NFT provides proof of ownership of that digital object and a license to use the object for specific purposes.

6. Many NFTs are on a particular blockchain called the Ethereum blockchain. To buy and sell NFTs on the Ethereum blockchain, a person needs to have an Ethereum account. Each Ethereum account has an “address,” which is a unique public identifier for the Ethereum account, much like an email address. A person with an Ethereum account can send and receive the cryptocurrency used on the Ethereum blockchain, called Ether (abbreviated “ETH”), as well as other assets, including NFTs. Transfers to and from the account are recorded on the blockchain, using the account’s address. To use an Ethereum account, a person needs a “wallet,” which is software that allows a user to access an Ethereum account and interact with the Ethereum blockchain.

7. OpenSea is an NFT marketplace, where users can create, sell, and buy NFTs. Beginning in or about May 2021, the top of the homepage of OpenSea’s website started displaying featured NFTs. OpenSea changed the featured NFT multiple times per week. Information about what NFT and was going to be a featured NFT was OpenSea’s confidential business information because it was not publicly available until the featured NFT appeared on the OpenSea website homepage. The value of featured NFTs, as well as other NFTs made by the same NFT creator, typically appreciated once they appeared on the OpenSea homepage due to the increase in publicity and resulting demand for the NFT.

8. From in or about May 2021 to in or about September 2021, NATHANIEL CHASTAIN, the defendant, was responsible for selecting the NFTs that would be featured on OpenSea’s homepage. Because of his role at OpenSea, CHASTAIN knew what NFTs were going to be featured before members of the public. CHASTAIN also knew that the value of an NFT typically rose after it became a featured NFT, as did other NFTs made by the same NFT creator.

9. At all times relevant to this Indictment, employees of OpenSea, including NATHANIEL CHASTAIN, the defendant, had an obligation to maintain the confidentiality of confidential business information received in connection with their work for OpenSea, and an obligation to refrain from using such information, except for the benefit of OpenSea or to the extent necessary to perform work for OpenSea. Confidential information included any information not generally known or available outside of OpenSea. Indeed, upon joining OpenSea, Chastain signed a written agreement in which he acknowledged these obligations.

10. From at least in or about June 2021 to at least in or about September 2021, NATHANIEL CHASTAIN, the defendant, used OpenSea’s confidential business information about what NFTs would be featured to buy dozens of NFTs shortly before those NFTs, or NFTs by the same NFT creator, were featured on OpenSea’s homepage. CHASTAIN then sold those NFTs at a profit shortly after the NFTs were featured. For instance:

- a. On August 2, 2021, minutes before the NFT named “The Brawl 2” was featured on OpenSea’s homepage, CHASTAIN purchased four of the NFT, only to sell them within hours after the NFT was featured at prices double of what he paid.
- b. Again, on August 9, 2021, CHASTAIN purchased ten of the NFT “Flipping and spinning” before it was featured on OpenSea’s homepage, and then sold them at prices 250% to 300% higher than where they were before the NFT was featured.
- c. On September 14, 2021, CHASTAIN purchased the NFT “Spectrum of a Ramenfication Theory,” as well as three other NFTs by the same creator, shortly before the NFT was featured on OpenSea’s homepage. CHASTAIN made over four times the amount of money when he sold “Spectrum of a Ramenfication Theory” early the next morning.

11. To conceal his purchase of featured NFTs before they appeared on OpenSea’s homepage, NATHANIEL CHASTAIN, the defendant, used anonymous OpenSea accounts, instead of his publicly-known account in his own name, to make the purchases and sales. He also transferred funds through multiple anonymous Ethereum accounts in order to conceal his involvement in purchasing and selling the featured NFTs. CHASTAIN used new Ethereum accounts without any prior transaction history in order to further conceal his involvement in the scheme.

12. Over the course of his scheme to profit by misappropriating OpenSea’s confidential business information about the featured NFTs, NATHANIEL CHASTAIN, the defendant, purchased a total of approximately 45 NFTs on approximately eleven separate occasions. CHASTAIN typically sold those NFTs for between two and five times his purchase price.

13. From at least in or about June 2021 to at least in or about September 2021, in the Southern District of New York and elsewhere, NATHANIEL CHASTAIN, the defendant, knowingly having devised and intending to devise a scheme and artifice to defraud, and for obtaining money and property by means of false and fraudulent pretenses, representations, and promises, transmitted and caused to be transmitted by means of wire, radio, and television communication in interstate and foreign commerce, writings, signs, signals, pictures, and sounds, for the purpose of executing such scheme and artifice, to wit, in violation of the duties he owed to OpenSea, CHASTAIN misappropriated OpenSea’s confidential business information by purchasing NFTs that he knew were going to featured on OpenSea’s homepage, and then profited by reselling the NFTs after they had been featured and appreciated in value [in violation of 18 U.S.C. § 1343].

[In May 2023, a jury convicted Chastain after a trial on these charges].

G. Statutory Reform of Insider Trading Law?

The debate about insider trading law following decisions in *Newman*, *Salman*, and related cases has reinvigorated a longstanding conversation about whether U.S. law would be better off with a statutory prohibition on insider trading in place of judicial

construction of Rule 10b-5. To think about that question, consider the following examples: a recent House Bill and an existing statute in another jurisdiction (Hong Kong).

H. R. 2534

IN THE SENATE OF THE UNITED STATES

DECEMBER 9, 2019

Received; read twice and referred to the Committee on Banking, Housing, and Urban
Affairs

AN ACT

To amend the Securities Exchange Act of 1934 to prohibit certain securities trading and related communications by those who possess material, nonpublic information.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1 SHORT TITLE.

This Act may be cited as the “Insider Trading Prohibition Act”.

SEC. 2. PROHIBITION ON INSIDER TRADING.

(a) **IN GENERAL.**—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 16 the following new section:

“SEC. 16A. PROHIBITION ON INSIDER TRADING.

“(a) PROHIBITION AGAINST TRADING SECURITIES WHILE AWARE OF MATERIAL, NONPUBLIC INFORMATION.—It shall be unlawful for any person, directly or indirectly, to purchase, sell, or enter into, or cause the purchase or sale of or entry into, any security, security-based swap, or security-based swap agreement, while aware of material, nonpublic information relating to such security, security-based swap, or security-based swap agreement, or any nonpublic information, from whatever source, that has, or would reasonably be expected to have, a material effect on the market price of any such security, security-based swap, or security-based swap agreement, if such person knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information.

“(b) PROHIBITION AGAINST THE WRONGFUL COMMUNICATION OF CERTAIN MATERIAL, NONPUBLIC INFORMATION.—It shall be unlawful for any person whose own purchase or sale of a security, security-based swap, or entry into a security-based swap agreement would violate subsection (a), wrongfully to communicate material, nonpublic information relating to such security, security-based swap, or security-based swap agreement, or any nonpublic information, from whatever source, that has, or would reasonably be expected to have, a material effect on the market price of any such security, security-based swap, or security-based swap agreement, to any other person if—

“(1) the other person—

“(A) purchases, sells, or causes the purchase or sale of, any security or security-based swap or enters into or causes the entry into any security-based swap agreement, to which such communication relates; or

“(B) communicates the information to another person who makes or causes such a purchase, sale, or entry while aware of such information; and

“(2) such a purchase, sale, or entry while aware of such information is reasonably foreseeable.

“(c) STANDARD AND KNOWLEDGE REQUIREMENT.—

“(1) STANDARD.—For purposes of this section, trading while aware of material, nonpublic information under subsection (a) or communicating material nonpublic information under subsection (b) is wrongful only if the information has been obtained by, or its communication or use would constitute, directly or indirectly—

“(A) theft, bribery, misrepresentation, or espionage (through electronic or other means);

“(B) a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users;

“(C) conversion, misappropriation, or other unauthorized and deceptive taking of such information; or

“(D) a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, a breach of any code of conduct or ethics policy, or a breach of any other personal or other relationship of trust and confidence for a direct or indirect personal benefit (including pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend).

“(2) KNOWLEDGE REQUIREMENT.—It shall not be necessary that the person trading while aware of such information (as proscribed by subsection (a)), or making the

communication (as proscribed by subsection (b)), knows the specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain of communication, so long as the person trading while aware of such information or making the communication, as the case may be, was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained, improperly used, or wrongfully communicated.

“(d) DERIVATIVE LIABILITY.—Except as provided in section 20(a), no person shall be liable under this section solely by reason of the fact that such person controls or employs a person who has violated this section, if such controlling person or employer did not participate in, or directly or indirectly induce the acts constituting a violation of this section.

“(e) AFFIRMATIVE DEFENSES.—

“(1) IN GENERAL.—The Commission may, by rule or by order, exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any or all of the provisions of this section, upon such terms and conditions as it considers necessary or appropriate in furtherance of the purposes of this title.

“(2) DIRECTED TRADING.—The prohibitions of this section shall not apply to any person who acts at the specific direction of, and solely for the account of another person whose own securities trading, or communications of material, nonpublic information, would be lawful under this section. . . .

Hong Kong Ordinance CAP 571, section 270. Insider Dealing.

(1) Insider dealing in relation to a listed corporation takes place

- (a) when a person connected with the corporation and having information which he knows is inside information in relation to the corporation
 - (i) deals in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives; or
 - (ii) counsels or procures another person to deal in such listed securities or derivatives, knowing or having reasonable cause to believe that the other person will deal in them;
- (b) when a person who is contemplating or has contemplated making, whether with or without another person, a take-over offer for the corporation and who knows that the information that the offer is contemplated or is no longer contemplated is inside information in relation to the corporation

- (i) deals in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives, otherwise than for the purpose of the take-over; or
 - (ii) counsels or procures another person to deal in such listed securities or derivatives, otherwise than for the purpose of the take-over;
- (c) when a person connected with the corporation and knowing that any information is inside information in relation to the corporation, discloses the information, directly or indirectly, to another person, knowing or having reasonable cause to believe that the other person will make use of the information for the purpose of dealing, or of counselling or procuring another person to deal, in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives;
- (d) when a person who is contemplating or has contemplated making, whether with or without another person, a take-over offer for the corporation and who knows that the information that the offer is contemplated or is no longer contemplated is inside information in relation to the corporation, discloses the information, directly or indirectly, to another person, knowing or having reasonable cause to believe that the other person will make use of the information for the purpose of dealing, or of counselling or procuring another person to deal, in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives;
- (e) when a person who has information which he knows is inside information in relation to the corporation and which he received, directly or indirectly, from a person whom he knows is connected with the corporation and whom he knows or has reasonable cause to believe held the information as a result of being connected with the corporation
- (i) deals in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives; or
 - (ii) counsels or procures another person to deal in such listed securities or derivatives; or
- (f) when a person having received, directly or indirectly, from a person whom he knows or has reasonable cause to believe is contemplating or is no longer contemplating making a take-over offer for the corporation, information to that effect which he knows is inside information in relation to the corporation
- (i) deals in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives; or

- (ii) counsels or procures another person to deal in such listed securities or derivatives.
- (2) Insider dealing in relation to a listed corporation also takes place when a person who knowingly has inside information in relation to the corporation in any of the circumstances described in subsection (1)
 - (a) counsels or procures another person to deal in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives, knowing or having reasonable cause to believe that the other person will deal in such listed securities or derivatives outside Hong Kong on a stock market other than a recognized stock market; or
 - (b) discloses the inside information to another person knowing or having reasonable cause to believe that the other person or some other person will make use of the inside information for the purpose of dealing, or of counselling or procuring any other person to deal, in the listed securities of the corporation or their derivatives, or in the listed securities of a related corporation of the corporation or their derivatives, outside Hong Kong on a stock market other than a recognized stock market.

5. INTERNATIONAL BRIBERY

A. The Policy Context

A major campaign is underway within the United States, and globally, to combat bribery in the conduct of international business. For nearly two decades, this effort has been producing vast amounts of work for law firms.

The primary legal locus of this activity, and the primary focus of our study, is the Foreign Corrupt Practices Act—“the FCPA.” The statute is long and complex and the case law is relatively slim because corporations have not generally been keen to litigate these cases. This chapter will develop a framework for what the major legal issues are in this area, though students should understand that the law is both rapidly evolving and underdeveloped and there are plenty of opportunities for policy discussion.

Because international corruption enforcement is such a fast-developing area, it makes sense to start with a portion of a law review piece that gives something of an overview and poses some questions about what might be at stake from a policy perspective.

THE MARKET FOR GLOBAL ANTICORRUPTION ENFORCEMENT

Rachel Brewster and Samuel W. Buell, 80 *LAW & CONTEMP. PROBS.* 193 (2017)¹⁶

In a brief couple of decades, America’s enforcement of its Foreign Corrupt Practices Act (FCPA)—civilly by the Securities and Exchange Commission (SEC) and criminally by the Department of Justice (DOJ)—has gone from practically nonexistent to one of the largest and busiest fields of corporate crime practice in the world. Corporate enforcement has been a growth area in American law throughout that period. No other area has expanded so rapidly nor so expensively for corporate defendants as enforcement under the umbrella of the FCPA. The expansive statute prohibits covered corporations and their employees from offering bribes to foreign officials and political leaders for the purpose of advancing business interests.

A question that has naturally arisen is what precisely created a lively market for anti-corruption enforcement. The FCPA rested mostly dormant for over two decades before American prosecutors and securities enforcers eagerly embraced the statute at the beginning of the twenty-first century. In the nearly quarter century from the statute’s enactment in 1977 through the year 2000, the federal government pursued only fifty-two FCPA enforcement actions. No more than five such actions were brought in a single year, and in four of those years, zero actions were commenced. Then, from 2001 through 2015, the government initiated 379 FCPA cases, reaching an annual high of 56 cases in 2010.

¹⁶ Copyright © 2017 by Rachel Brewster and Samuel W. Buell.

This explosion in FCPA practice, as some have called it, is not limited to numbers of cases and settlements. FCPA prosecutions and enforcement actions include some of the biggest-ticket matters the government brings in the corporate sector. From 1977 through 2000, the government collected approximately \$129 million in FCPA sanctions. Since 2000, over \$8 billion has flowed into government coffers from FCPA enforcement actions, most of which has been dictated by terms of settlements between SEC or DOJ with corporate defendants.

What has created this surge in FCPA cases? This article explores both supply channels for cases—the international cooperation between law enforcement officials that made more rigorous enforcement of the FCPA politically possible—as well as the demand pressures that generate cases—the incentives and behaviors of U.S. prosecutors and enforcement attorneys. . . .

Congress passed the FCPA in the late 1970s after the Watergate hearings and the subsequent SEC investigation of corporations' political activities revealed that U.S. companies were bribing foreign government officials. Perhaps most notable was the case of Lockheed: the defense contractor received a \$250 million government loan to avoid bankruptcy and spent over \$100 million of those funds on bribes to various government officials. Though the FCPA is often described in terms of post-Watergate moralism (and it certainly was partly that), the statute was predominately a response to a national security concern. In the Cold War of the late 1970s, the success of the capitalist model as the ultimate winner of the global competition for economic and social ordering did not appear assured. National security interests were bound up in supporting a particular model of capitalism in which large transnational corporations were the major actors in global markets. As a result, revelations of corporate bribes to foreign government officials concerned members of Congress because they played into Soviet narratives of how markets were corrupted by corporations, controlled by capital-holding elites, and hopelessly rigged against labor.

The Lockheed case was particularly maddening because Lockheed was viewed overseas as an arm of the U.S. Department of Defense—thus tying corrupt corporate actions to the American government in foreign reporting. In passing the FCPA, legislators were responding to a future threat as well as realized losses. Friendly right-of-center administrations in Japan and Italy had lost elections to left-of-center and communist parties after revelations that those administrations had accepted bribes from U.S. companies.

But the security concerns that led to the passage of the FCPA did not support robust enforcement of the law. The statute represented one state's unilateral policy regulating foreign markets. While the FCPA provided prosecutors with significant extraterritorial jurisdiction, prosecutors' law enforcement powers were still territorially limited. International cooperation is essential to effective enforcement. The ability of a state to prosecute a foreign corporation is limited—particularly if cases depend upon internal corporate records—if neither foreign law enforcement officials, nor the company, are

helpful. And, at the time, foreign governments were not generally helpful. Most Western governments failed to see the problem with foreign bribery and refused to impose civil or criminal rules against it. Indeed, most European governments subsidized foreign bribery by making it a tax-deductible business expense.

The lack of foreign support for the FCPA created a domestic enforcement problem as well. If the statute could only effectively be enforced against U.S. corporations, then American businesses faced a significant disadvantage in foreign markets. A robust enforcement policy would arguably decrease U.S. exports, particularly for large government procurement sales contracts—a market in which bribes were commonly offered with bids—because only U.S. corporations would fear FCPA enforcement. The expanding U.S. trade deficit in the early 1980s and the concurrent fear of the loss of American economic hegemony to European and Japanese companies further raised the economic costs and the political stakes of prosecuting FCPA cases.

To develop a robust FCPA enforcement program, the U.S. government needed international cooperation. Acting alone, Congress could give the statute a broad jurisdictional scope, including coverage over all companies who list on a U.S. exchange and commit bribery anywhere, but the lack of international cooperation made foreign cases difficult to maintain. Without the foreign company component of the enforcement portfolio, strong FCPA enforcement arguably lacked political support.

From the original passage of the FCPA in 1977, and again in 1988 amendments to the statute, Congress recognized the need for international coordination of anti-corruption rules. In 1975 and 1988, Congress called for the State Department to engage in state-to-state negotiations to establish an international anti-bribery standard that would be enforced in multiple jurisdictions. The State Department sought to form anti-bribery agreements with other states in multiple fora in the 1970s and early 1980s, but with little success. Within the United Nations, the United States pushed for an anti-corruption treaty under the auspices of the UN's Economic and Social Council, but it failed to win support among developing states. Within the General Agreement on Tariffs and Trade's Tokyo Round, the United States attempted to bring anti-corruption principles into international trade negotiations. This similarly failed when the United States was unwilling to offer greater access to the American market in return.

The State Department finally decided that the best forum was the OECD, which had a smaller membership but included almost all developed states. The OECD generally only passed non-binding resolutions, so it was not the obvious choice if the United States wanted a binding treaty, but it appeared to hold the greatest potential for cooperation. Yet even in the OECD, other developed governments were unwilling to reconsider their lax approach to foreign bribery or even its tax-deductible status. Foreign bribery was simply not an issue that other governments saw a need to regulate.

In the 1990s, however, elite views of the need to address foreign corruption, particularly the cost of bribery to development, started to shift. In the 1970s, a prevalent view was that corruption could be “market enhancing,” meaning that markets would function

better if governments, and particularly developing state governments, could be pushed out of the marketplace through bribes.

That corruption could be market enhancing was not simply an academic view. Many Western governments and international institutions concurred. World Bank policymakers labeled corruption a political issue, rather than an economic one. Under World Bank decisionmaking procedures, policymakers were supposed to avoid “political” issues within the host governments. Labeling corruption as political allowed the World Bank to implicitly endorse bribery by their contractors and ignore the economic effects of corruption on host countries. Major Western governments similarly viewed corruption as a constructive means of concluding contracts with developing governments and, on the whole, understood these relationships to be development promoting, or at least not particularly harmful to development goals. As a result, American lobbying for programs to curtail the corporate supply of bribes was not particularly persuasive.

The 1990s brought change in this consensus regarding the relationship between bribery and the market. Economists and policymakers in international institutions such as the World Bank and the International Monetary Fund started to re-evaluate the effects of corruption on development. Instead of trying to push the government out of the marketplace, more policymakers discussed the constructive role of governments in establishing markets, regulating markets, and moderating their effects.

Many World Bank policymakers became convinced that corruption was one of the greatest obstacles to development rather than market grease. Corruption incentivized governments to become more engaged in markets (as sources of personal monetary gain), biased government spending to projects where large bribes were possible, and decreased government accountability. In 1996, the World Bank reclassified corruption as an economic issue, and adopted a robust anti-bribery program that monitored the Bank’s contractors and subcontractors for any illicit payments to governments.

This shift in thinking also took place outside of governance institutions. A number of economists focusing on Africa left the World Bank to form Transparency International (TI), an NGO focused on increasing government transparency as a means of decreasing corruption. TI raised the salience of corruption as a political issue, particularly in Western Europe. Similarly, scholars such as Susan Rose-Ackerman built a stronger case that bribery was not economically efficient and harmed developing states. These different sources of changing political and economic views combined to challenge the older consensus and re-conceptualize the role of corruption in the functioning of markets.

This conceptual change started to gain traction in national governments’ policies when a series of corruption scandals erupted in European capitals between 1995 and 1996. In Germany, France, and the United Kingdom, domestic corruption allegations dominated national politics and became major electoral issues in all three countries. Political candidates promised to change their governments’ approach to corruption, both

nationally and internationally. One outlet to make good on these promises was the OECD, and U.S. efforts to establish an anti-corruption agreement there accelerated. OECD members agreed to a binding legal instrument (an oddity for the OECD), the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, which required each state to adopt its own foreign anti-bribery law. The Convention, signed in 1997 and entered into force in 1999, also required governments to provide each other with legal assistance in prosecuting foreign bribery cases.

The OECD Convention changed the political economy of bringing anti-bribery cases within the United States. The treaty did not meaningfully change the extraterritorial scope of the FCPA, but it provided the necessary international support for a much wider range of cases. In particular, it allowed prosecutors to bring cases against American corporations and their overseas competitors. U.S. prosecutors did not face diplomatic and political resistance from these cases in which the activity had previously been legal and tolerated abroad. Further, the DOJ and SEC could seek foreign investigative and other legal assistance on anti-bribery cases—assistance they have received even from OECD states that have failed to prosecute firms themselves. This change allowed the DOJ and the SEC to bring more FCPA cases without steeply raising competitive costs for American-based corporations.

The DOJ has not been shy about advertising its enforcement strategy as “fair” to American industry. Former Assistant Attorney General Lanny A. Breuer explicitly argued that the FCPA did not hurt U.S. business because of the scale of foreign prosecutions, noting, “[W]e do not only prosecute U.S. companies and individuals under the FCPA. Indeed, over the last five years, more than half of our corporate FCPA resolutions have involved foreign companies or U.S. subsidiaries of foreign companies.” Other DOJ officials have similarly stated that FCPA prosecutions are aimed at establishing equal liability for foreign and domestic firms for foreign bribery. Former Assistant Attorney General Alice Fisher argued that targeting foreign firms as well as domestic ones was part of the Department’s effort to address corruption’s long-term harm in emerging markets.

The OECD treaty was an essential part of opening the door to greater American enforcement of the FCPA. U.S. prosecutors needed more than the broad extraterritorial jurisdiction provided by the statute. They also needed foreign support. Other governments had to lend political support to the idea that corruption should be prosecuted. In addition, foreign prosecutors and police had to help gather evidence and provide other legal assistance. After the passage of the OECD Convention, extraterritorial prosecutions for violations of the FCPA were more viable. OECD governments were adopting, if not also enforcing, their own domestic legislation prohibiting foreign bribery and had formally committed themselves to mutual legal assistance. And U.S. prosecutors had further incentives, particular to their political and professional environments, for entering this new legal arena.

The OECD Anti-Bribery Convention was critical, not because other OECD countries began prosecuting cases themselves but because they started supporting U.S. cases. Although the FCPA offered prosecutors extraterritorial jurisdiction to pursue these cases before the OECD Convention, prosecutors had generally adopted a restrained approach. The treaty invigorated the FCPA by giving American prosecutors the means to take a much more aggressive position towards domestic and foreign firms without being seen as disproportionately harming American industry. . . .

For at least the last two administrations, the executive branch has pursued an express policy to prioritize and increase prosecutions of FCPA violations by large corporations. Both White House staffs and the political appointee suites in the DOJ have described this policy initiative as an effort to root out corruption and bribery in global commerce. The effort has included more FCPA prosecutions, almost all of which concluded in settlements; hiring of more FCPA prosecutors; and increased efforts to use civil legal mechanisms to freeze and seize the assets of corrupt foreign officials (the Department's so-called "kleptocracy" initiative). This impetus from policy levels has been important, perhaps even essential, to growth of the field. Prosecutors' interests, left unchanneled, could have led them to prioritize other forms of corporate misconduct than bribery of foreign officials.

A longstanding and atypical coordinating device has empowered this top-down initiative. The United States Attorneys' Manual is an ostensibly binding set of rules concerning the conduct of federal prosecutors that is nonetheless unenforceable in court. In relevant part, it prohibits instituting a criminal investigation or prosecution for violation of the FCPA without the "express authorization" of DOJ's Criminal Division in Washington, wherein an office called the Fraud Section supervises FCPA prosecutions as well as initiates many of them. The Manual contains this sort of control provision for only a few federal criminal statutes, which are otherwise enforced at the pleasure of United States Attorneys and other supervisory federal prosecutors without Washington interference. The Manual explains that centralized control and monitoring are needed in this instance because "violations of the FCPA will raise complex enforcement problems abroad as well as difficult issues of jurisdiction and statutory construction" and may involve "high-level foreign government officials."

The rationale for DOJ's control rule for FCPA cases may be outdated. Many federal prosecutions, from business crime to drugs to terrorism to piracy, now routinely implicate the same concerns about interaction with other nations. Prosecutors are free to wield many statutes abroad without DOJ Criminal Division supervision, as for example with the use of the wire fraud statute to prosecute the FIFA corruption cases in the Eastern District of New York. Prosecutors could evade the Manual's requirements, in some corruption cases at least, simply by choosing a different legal theory. But now, as a result of DOJ's longstanding FCPA policy, bureaucratic institutions are firmly in place: a fully staffed Fraud Section in Washington understands its mandate to include robust FCPA enforcement. Consequently, FCPA enforcement does not depend on the perhaps changing priorities of United States Attorneys and their staffs over time.

But one can take Washington's FCPA initiative at face value without having to take it entirely seriously. That is to say, it is possible that officials in the Clinton, Bush, and Obama Administrations have believed that the U.S. legal system can make corruption less endemic in large commercial transactions in the developing world. That might seem quixotic, a bit like using a hand pump to drain Lake Michigan. The scale of global corruption plainly overwhelms the Department's thirty or forty lawyers bringing their dozen or two prosecutions per year. But perhaps there is some logic, or at least sincerity, in the DOJ's effort. If enough large corporations sufficiently fear even one potentially devastating FCPA prosecution—and their managers certainly have been complaining incessantly about that legal risk—they might start to refuse to play the corruption game in enough important markets that some of those markets will begin to change.

Critics might say that DOJ's political appointees have become enamored with the FCPA because of its prosecution friendliness, jurisdictional breadth, and relatively low bar for liability. The SEC's power to gather evidence of the same violations in parallel civil enforcement proceedings has further made FCPA cases the low-hanging fruit of corporate crime. If one wants to look like one is prosecuting major corporate crimes, the FCPA provides a much easier path than, for example, deploying the laws governing securities fraud against large banks for marketing failed mortgage-backed securities. In addition, DOJ appointees in Washington have unusually direct control over the Fraud Section, a unit that has a specialized charter and expertise in FCPA cases, which can be used by DOJ to initiate corporate prosecutions.

A similar dynamic could affect the SEC's priorities, perhaps even more. The SEC has jurisdiction only over the securities laws, which include the FCPA but also, most importantly, the laws against securities fraud. Without diverting into the doctrinal details, FCPA violations are generally far easier to prove than securities fraud. This is especially true in SEC actions because the FCPA includes a provision—frequently invoked by the SEC but rarely by the DOJ—that makes it a violation of the statute simply to fail to maintain “books and records” that are accurate in all material respects. The SEC commonly invokes this provision, which is nearly impossible for defendants to contest, as a fallback or settlement option when it initiates FCPA cases.

Finally, there is the most cynical view. There are some abroad, especially in Europe, who believe that the United States may be using global corporate enforcement, especially FCPA enforcement, as a means of assisting U.S. firms in the competition for dominance among multi-nationals. Some have maintained that the U.S. policy of prosecuting foreign firms is discriminatory and violates general international legal principles of equal treatment before the law.

One study involving a large original data set found that foreign firms tended to suffer higher penalties than U.S. firms in DOJ resolutions. However, as the author was careful to discuss, potential selection effects complicate inferences from this data. Foreign firms represented only eighteen percent of the corporate defendants in the study, and it is

plausible that American prosecutors tend to prosecute only larger cases against foreign firms while prosecuting a more diverse set of domestic firms.

Another study of FCPA settlements found that the DOJ assessed greater penalties against foreign firms than domestic ones, even accounting for the size of the bribe and whether the firm voluntarily disclosed the illegal activity. These authors also wondered about some of the many questions such findings raise. For instance, do U.S. regulators make stronger cases against foreign firms due to coordination with foreign regulators? Are U.S. firms more successful than foreign ones at lowering their sanctions in settlement because of greater sophistication in dealing with U.S. regulators?

For a brute capture story to be convincing, one would need to point to a path through which U.S. firms influence the decisions of line prosecutors about which firms to choose as targets for FCPA actions. The structure and professional culture of DOJ divisions and U.S. Attorney's Offices, as well as the civil service protections enjoyed by career prosecutors, are not amenable to this kind of influence. As a matter of course, these offices do not provide opportunities for advocates of U.S. firms, such as the Chamber of Commerce, an opportunity to be heard in matters of prosecutorial discretion. The SEC gives its potential defendants the opportunity to formally argue against enforcement action in a written document to the Commissioners themselves called a Wells submission. But these are litigation documents—briefs on the legal merits—not lobbying submissions designed to exploit interest group pressures.

In respect to their enforcement arms, the DOJ and SEC differ significantly from other executive branch institutions like the Departments of Agriculture or Commerce in which industry groups routinely enjoy transparent access to decisionmaking and, by law, to the rulemaking process. Conventional political discourse in Washington, at least in its rhetoric, condemns efforts to “politicize” the government's prosecution of criminal offenses. Accordingly, the White House routinely and vocally disavows any influence over Justice Department investigations and prosecutions. Any skew of FCPA case selection towards foreign firms would thus have to result from subtler and perhaps unconscious effects on the decisions of line prosecutors and enforcers.

The U.S. corporate crime prosecutor operates within the context of a particular political economy. The prosecutor also works within an influential professional economy. In investigations of why the government has so quickly increased the volume of FCPA enforcement matters, the forces of this economy have been underemphasized if not unnoticed. For several reasons, the legal professional economy has been directing the federal prosecutor's attentions overseas in recent years.

The typical, though not mandatory, career path of the white collar prosecutor in Main Justice or a major U.S. Attorney's Office is as follows: graduation with a strong academic record from a top law school, often followed by a federal judicial clerkship; several years as an associate at a global or at least national law firm with a corporate practice, often including junior work on the defense of corporations and their managers in civil and criminal government enforcement actions; a stint of somewhere between

four and ten years as a federal prosecutor; and then, for most, a partner or of-counsel position at the same sort of large law firm. More recently, others have taken up senior in-house counsel or compliance positions at major corporations as companies have discovered the benefits of having the advice and experience of former prosecutors and enforcement lawyers readily at hand.

This is the so-called “revolving door” of corporate white collar practice. This door has come to spin faster as the practice of defending corporations in internal investigations and enforcement matters has mushroomed over the last two decades, now constituting a major slice of the revenues of America’s 100 largest law firms.

There is a familiar capture story told about this career arc. In her first period of law firm service, the young lawyer becomes inculcated with the views of the corporate sector towards criminal enforcement. She thus begins government service with an ideological slant in favor of the plight of the white collar target over others in the criminal justice system. Then, as she advances through the Justice Department ranks and begins to meet corporate adversaries across the table and on the rare occasion in court, she inevitably begins to think about the implications of her relationships with those adversaries for her exit from the government. Wishing to curry favor with future employers, she cultivates a reputation for “reasonableness” by crediting arguments she hears from opposing counsel and settling most or all of her cases with corporate defendants and their managers on lenient terms.

This facially plausible story omits important facts, principally on two dimensions: the psychology of this cohort of lawyers and the actual market for former Justice Department prosecutors. First, as to psychology, this lawyer tends to be ambitious and interested in government practice for the opportunity it affords to impact some corner of social policy. These are people who went to law school “to make a difference” and who eventually realize that, given their material and familial goals in life, their relatively short stint in government may end up being their one chance to do something big and important. This is a powerful drive and it directs the lawyer into big cases and towards trials and punitive sentences, not away from them. If these highly credentialed lawyers only care about material rewards, they have easier and more lucrative paths readily available to them in the private sector without enduring the more Spartan conditions of government service.

Federal law is highly amenable to these motivations. The American prosecutor is famously the king or queen of discretion: discretion to decide whom to prosecute for what offenses and whom to leave unmolested by legal action. Though the SEC’s processes are more bureaucratized than those of the DOJ, initial discretion also rests with the securities enforcement attorney. The discretionary authority to charge is both initial—in the sense that the prosecutor starts the case and the case does not start without the prosecutor—and nearly absolute—in the sense that judicial review of the charging or declination decision is available only for invidious discrimination and never for qualitative judgment.

No prosecutor is vested with more of this discretion than the federal prosecutor charged with handling corporate crime. That prosecutor, whether she works in one of the Justice Department's ninety-three U.S. Attorney's Offices spread across the land or in one of the offices at "Main Justice" in Washington that deal exclusively with business crime, has no conventional lawyer's caseload that is brought to her for prosecution by agents of a roving police force. Instead, in consultation with investigative agents, civil enforcement agencies, and her colleagues and supervisors, she chooses the few cases she wishes to expend her time and energies pursuing. Indeed, she enjoys not just the discretion to prosecute but also the discretion to investigate in the first instance.

In the sphere of international business, the jurisdictional provisions of the relevant statutes allow the federal prosecutor to consider extending her reach to a great deal of conduct that occurs abroad. American criminal law treats most complex white collar crimes, especially if conspiracy charges are involved, as "continuing offenses" that are committed at all places and times when and where acts occur during the period of the offense. Often all the prosecutor needs to file her indictment in a U.S. district court is a wiring through that district, or a company's incorporation or headquartering in the United States, or in the case of the FCPA, some material part of the bribery offense that was "within the territory of the United States."

As for principles of international law regarding states' assertions of extraterritorial jurisdiction, United States law affords them a very limited role in this area—using them at most as tie-breakers on close questions of statutory interpretation. Congress is free to legislate extraterritorially; there is no Constitutional prohibition against it. However, Congress must clearly state its intention to legislate extraterritorially to overcome a judicially enforced presumption against extraterritorial application of statutes. As a body of legislation expressly designed to reach overseas, the FCPA easily fits this bill.

In criminal law, possession of the body is nine-tenths of the law when it comes to jurisdiction to adjudicate. Only the individual defendant who manages to position himself beyond successful extradition proceedings will end up in a winning posture. A recent study found only one case in which a federal court rewarded a defendant's due process challenge to the assertion of U.S. criminal jurisdiction over him. Even kidnaped defendants have been denied jurisdictional relief once the government has, by brute force, successfully positioned them before U.S. courts. Extraterritorial prosecution—or, perhaps better, prosecution with minimal territorial contact—is, as a matter of law, readily available to American prosecutors deploying the FCPA.

Like many bureaucratic actors who exercise substantial discretion, the federal business crime prosecutor acts for a combination of reasons, some that are direct and purposeful and others that arise indirectly. The sum total of the enforcement decisions of "line" attorneys is an essential aspect of government policy. Enforcement, it bears emphasis, is a type of law or at least a lawmaking practice. . . .

It is widely believed that FCPA defense may be the most expensive and thus lucrative service that law firms sell in the field of internal investigations and defense against

government enforcement. For example, Siemens spent at least \$1 billion on professional services, mostly provided by the law firm Debevoise & Plimpton and the accounting firm Deloitte, in dealing with its massive bribery scandal. Walmart has spent at least \$400 million so far managing its FCPA problem relating to bribery in Mexico, and the meter is still running on that unresolved case.

In winning these rewarding representations from corporate clients, firms will want to demonstrate that their stable of partners includes former DOJ lawyers who handled the largest, most complicated, and most global FCPA matters. The senior prosecutor naturally will understand that grabbing some of those cases in the prime of her prosecutorial career will position her well for a secure career following government service.

In the case of FCPA enforcement, the relationship between the private and public sectors is more complex than, and perhaps just as powerful as, the metaphorical revolving door by which the private captures the public. This symbiotic relationship characterizes the enforcement of corporate criminal offenses, and their civil analogues, in general. It arises from a kind of organic process over the last several decades by which the government, through incremental moves by enforcement lawyers and their defense counterparts, has come to cope with the massive problem of detecting and investigating corporate wrongdoing.

In short, the government uses corporate criminal liability as a lever to compel firms to monitor their own employees, discover wrongdoing, and report it to the government. In turn, the government allows firms to settle criminal matters short of indictment and prosecution and on somewhat more lenient terms. Firms trade self-policing and self-reporting for lower sanctions. . . .

The United States remains the most important enforcer of foreign anti-corruption laws by a significant margin. The United States has brought more cases both total and relative to its world exports, and has imposed greater penalties than any other state. Though success in establishing a global enforcement market was made possible by the OECD treaty's requirement for mutual legal assistance and cooperation, the treaty has not been equally effective in convincing other OECD members to enforce their own foreign anti-corruption laws. The majority of OECD states still have little to no enforcement of their own foreign anti-bribery laws. Both the OECD Anti-Bribery Working Group and Transparency International have documented how most members of the treaty have failed to provide any political support or material resources to foreign anti-bribery prosecutions.

Within the last decade, however, a few countries have begun to prioritize anti-corruption law. Germany, Switzerland, and the United Kingdom have all significantly revised their laws and started investing political capital in investigations and prosecutions. Some of these cases have been brought in active coordination with U.S. authorities but others involve independent investigations and sanctions. Notably, several states have amended their laws to permit increased flexibility for prosecutors to settle cases. For instance, the

United Kingdom revised its Foreign Anti-Bribery Act in 2011 to permit deferred prosecution agreements as seen in the United States. The French government is also attempting to revise its anti-bribery laws, the so-called Loi Sapin II. The French proposal would establish a foreign anti-bribery agency with power to enter into non-prosecution agreements and U.S.-style corporate monitoring.

It remains uncertain whether greater foreign prosecution efforts will complement or challenge the current U.S. dominance in anti-bribery enforcement. So far, other OECD states' efforts seem to be complementary. Many early European bribery prosecutions were brought in conjunction with U.S. investigations and prosecutions—for instance, the Siemens case with the German government and the BAE case with the UK government. In addition, one empirical study of foreign government behavior found that coordination with the United States on a bribery case was the best predictor that a state would later bring its own independent prosecutions. . . .

Recent U.S. administrations have emphasized or deemphasized “the fight against corruption” in various ways. Consider the following statement of the Biden Administration on these matters.

UNITED STATES STRATEGY ON COUNTERING CORRUPTION

December 2021 White House Report

When government officials abuse public power for private gain, they do more than simply appropriate illicit wealth. Corruption robs citizens of equal access to vital services, denying the right to quality healthcare, public safety, and education. It degrades the business environment, subverts economic opportunity, and exacerbates inequality. It often contributes to human rights violations and abuses and can drive migration. As a fundamental threat to the rule of law, corruption hollows out institutions, corrodes public trust, and fuels popular cynicism toward effective, accountable governance.

Moreover, the impacts of corruption frequently reverberate far beyond the immediate environment in which the acts take place. In today's globalized world, corrupt actors bribe across borders, harness the international financial system to stash illicit wealth abroad, and abuse democratic institutions to advance anti-democratic aims. Emerging research and major journalistic exposés have documented the extent to which legal and regulatory deficiencies in the developed world offer corrupt actors the means to offshore and launder illicit wealth. This dynamic in turn strengthens the hand of those autocratic leaders whose rule is predicated on the ability to co-opt and reward elites.

On June 3, 2021, President Biden established the fight against corruption as a core national security interest of the United States. As he wrote in National Security Study Memorandum-1 (NSSM-1), “corruption threatens United States national security, economic equity, global anti-poverty and development efforts, and democracy itself. . . . [B]y effectively preventing and countering corruption and demonstrating the

advantages of transparent and accountable governance, we can secure a critical advantage for the United States and other democracies.”

Pursuant to NSSM-1, Federal departments and agencies have conducted an interagency review to take stock of existing U.S. Government anti-corruption efforts and to identify and seek to rectify persistent gaps in the fight against corruption. In parallel with this review, departments and agencies have begun to accelerate and amplify their efforts to prevent and combat corruption at home and abroad; bring transparency to the United States’ and international financial systems; and make it increasingly difficult for corrupt actors to shield their activities.

This first United States Strategy on Countering Corruption builds on the findings of the review and lays out a comprehensive approach for how the United States will work domestically and internationally, with governmental and non-governmental partners, to prevent, limit, and respond to corruption and related crimes. The Strategy places special emphasis on the transnational dimensions of the challenges posed by corruption, including by recognizing the ways in which corrupt actors have used the U.S. financial system and other rule-of-law based systems to launder their ill-gotten gains. To curb corruption and its deleterious effects, the U.S. Government will organize its efforts around five mutually reinforcing pillars of work:

- a. Modernizing, coordinating, and resourcing U.S. Government efforts to fight corruption;
- b. Curbing illicit finance;
- c. Holding corrupt actors accountable;
- d. Preserving and strengthening the multilateral anti-corruption architecture; and,
- e. Improving diplomatic engagement and leveraging foreign assistance resources to advance policy goals

By pursuing concrete lines of effort that advance strategic objectives under each of these pillars, and integrating anti-corruption efforts into relevant policy-making processes, the United States intends to lead in promoting prosperity and security for the American people and people around the world.

From the small-town hospital administrator who demands bribes in exchange for life-saving services, to the globe-trotting kleptocrat who offshores an embezzled fortune, corruption harms both individuals and societies. The effects of corrupt acts are frequently both direct and indirect. When government officials steal from public coffers or fix a contract to reward a political crony, these actors directly transfer funding from essential services to private interests. Corruption also indirectly contributes to reduced public trust in state institutions, which in turn can add to the appeal of illiberal actors who exploit popular grievances for political advantage.

Whether grand corruption perpetrated by powerful elites, or administrative corruption carried out by lower-level officials interacting directly with the public, corrupt acts harm the public interest, hamper countries’ development, and diminish state capacity.

Corruption has been shown to significantly curtail the ability of states to respond effectively to public health crises and to address climate change, migration, and inequities of all forms, while contributing to state fragility. Countries with high levels of corruption are more likely to have populations that suffer from human rights abuses, and are less likely to address those abuses. And states with endemic corruption are more vulnerable to terrorist networks, transnational organized and gang-related criminals, and human traffickers.

Corruption's increasingly globalized nature—fueled in part by transnational illicit finance and criminal networks, as well as exploitation of the licit financial system—imposes steep costs on ordinary citizens and good governance alike. In particular, transnational corruption driven by political and economic elites with the aid of complicit financial and legal service providers undermines lower income countries' ability to advance the welfare of their citizens and perpetuates aid dependency. According to the United Nations Conference on Trade and Development's *Economic Development in Africa Report 2020*, for example, every year an estimated \$88.6 billion—equivalent to 3.7 percent of Africa's GDP—leaves the continent in the form of illicit capital flight.

Corrupt actors exploit deficiencies in anti-money laundering and countering the financing of terrorism (AML/CFT) systems and processes—as well as in other critical transparency, reporting, business, real estate, and tax regimes—to use public contracting, concessions, and procurement processes for personal enrichment. Corrupt elites and non-state armed groups enrich themselves through illicit proceeds and trade of high-value commodities, including gold, wildlife, timber, petroleum, and other natural resources. Across an ever-more connected and digital world, corrupt actors exploit oversight and regulator weaknesses in jurisdictions around the world to divert and hide the proceeds of their acts. And by leaving their financial systems vulnerable to illicit assets—through anonymous shell companies, opaque transactions, and under-regulated professional service providers—rule-of-law-based societies continue to provide entry points for corrupt actors to launder their funds and their reputations. Such activity negatively impacts average citizens in the United States, tilting the economic playing field against working Americans, enabling criminals to flourish and foreign adversaries to subversively peddle their influence, perpetuating growth-dampening inequality, and contributing to pricing out families from home ownership through real estate purchases.

In parallel, authoritarian regimes and their proxies have been shown to engage in bribery and other corrupt acts as a means to advance their strategic goals, while exploiting the international financial system to offshore illicit gains, and influence elections and policies in democratic states. Corruption in the form of state-directed cross-border investments from authoritarian states, for example, has had a corrosive effect on institutions in developing countries. Such practices harm the competitive landscape of financial markets, and often have long-term corrosive impacts on governance and human rights standards. The U.S. Government will continue to study the weaponization of corruption to understand its use and impacts on the United States, other democracies, and countries around the world, as well as how to thwart and build resilience against this evolving threat.

While the U.S. Government has long recognized countering corruption as an important foreign policy goal, a growing understanding of corruption's strategic impact and the increasing interconnectedness of the global economy underscores the need for a new approach. For the U.S. Government to effectively counter contemporary corruption, we must recognize the transnational dimensions of the challenge, and respond in a manner that is both systemic and tailored to local conditions. Doing so will require addressing vulnerabilities in the U.S. and international financial systems; bolstering international best practices, regulations, and enforcement efforts; supporting the role of non-governmental actors; building political will and recognizing when it is absent; and consistently pursuing accountability through a combination of diplomatic engagement, foreign assistance, and enforcement actions.

The United States will continue to evaluate and implement measures as needed to further safeguard our financial system, and will work with likeminded partners and relevant multilateral institutions to do the same. We will make it harder to hide the proceeds of ill-gotten wealth in opaque corporate structures, reduce the ability of individuals involved in corrupt acts to launder funds through anonymous purchases of U.S. real estate, and bolster asset recovery and seizure activities. We will innovate, adapt, partner, and learn, so as to maximize the potential for diplomatic tools, including foreign assistance and targeted sanctions, to stem corruption and to hold corrupt actors accountable, while expanding efforts to ensure that foreign assistance and engagement do not inadvertently contribute to corrupt practices. And we will continue to vigorously enforce the Foreign Corrupt Practices Act (FCPA) and other statutory and regulatory regimes via criminal and civil enforcement actions. . . .

As the largest economy in the international financial system, the United States bears particular responsibility to address our own regulatory deficiencies, including in our AML/CFT regime, in order to strengthen global efforts to limit the proceeds of corruption and other illicit financial activity. We will therefore address deficiencies in the U.S. anti-money laundering regime, including by effectively collecting beneficial ownership information on those who control anonymous shell companies, and by increasing transparency in real estate transactions. Recognizing how quickly money and other commodities move across borders, we will also work with allies and partners to address governance weaknesses and other deficiencies, tighten global regimes, increase information sharing and law enforcement cooperation, and prevent the establishment of safe havens as we work to close old ones. . . .

The FCPA, and many other countries' anti-bribery statutes, have been enacted in whole or in part to fulfill obligations under the following international convention.

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions

Adopted by the Negotiating Conference on 21 November 1997

Preamble

The Parties,

Considering that bribery is a widespread phenomenon in international business transactions, including trade and investment, which raises serious moral and political concerns, undermines good governance and economic development, and distorts international competitive conditions;

Considering that all countries share a responsibility to combat bribery in international business transactions;

Having regard to the Revised Recommendation on Combating Bribery in International Business Transactions, adopted by the Council of the Organisation for Economic Co-operation and Development (OECD) on 23 May 1997, C(97)123/FINAL, which, *inter alia*, called for effective measures to deter, prevent and combat the bribery of foreign public officials in connection with international business transactions, in particular the prompt criminalisation of such bribery in an effective and co-ordinated manner and in conformity with the agreed common elements set out in that Recommendation and with the jurisdictional and other basic legal principles of each country;

Welcoming other recent developments which further advance international understanding and co-operation in combating bribery of public officials, including actions of the United Nations, the World Bank, the International Monetary Fund, the World Trade Organisation, the Organisation of American States, the Council of Europe and the European Union;

Welcoming the efforts of companies, business organisations and trade unions as well as other non-governmental organisations to combat bribery;

Recognising the role of governments in the prevention of solicitation of bribes from individuals and enterprises in international business transactions;

Recognising that achieving progress in this field requires not only efforts on a national level but also multilateral co-operation, monitoring and follow-up;

Recognising that achieving equivalence among the measures to be taken by the Parties is an essential object and purpose of the Convention, which requires that the Convention be ratified without derogations affecting this equivalence;

Article 1

The Offence of Bribery of Foreign Public Officials

1. Each Party shall take such measures as may be necessary to establish that it is a criminal offence under its law for any person intentionally to offer, promise or give any undue pecuniary or other advantage, whether directly or through intermediaries, to a foreign public official, for that official or for a third party, in order that the official act or refrain from acting in relation to the performance of official duties, in order to obtain or retain business or other improper advantage in the conduct of international business.
2. Each Party shall take any measures necessary to establish that complicity in, including incitement, aiding and abetting, or authorisation of an act of bribery of a foreign public official shall be a criminal offence. Attempt and conspiracy to bribe a foreign public official shall be criminal offences to the same extent as attempt and conspiracy to bribe a public official of that Party.
3. The offences set out in paragraphs 1 and 2 above are hereinafter referred to as “bribery of a foreign public official”.
4. For the purpose of this Convention:
 - a) “foreign public official” means any person holding a legislative, administrative or judicial office of a foreign country, whether appointed or elected; any person exercising a public function for a foreign country, including for a public agency or public enterprise; and any official or agent of a public international organisation;
 - b) “foreign country” includes all levels and subdivisions of government, from national to local;
 - c) “act or refrain from acting in relation to the performance of official duties” includes any use of the public official’s position, whether or not within the official’s authorised competence.

Article 2

Responsibility of Legal Persons

Each Party shall take such measures as may be necessary, in accordance with its legal principles, to establish the liability of legal persons for the bribery of a foreign public official.

Article 3

Sanctions

1. The bribery of a foreign public official shall be punishable by effective, proportionate and dissuasive criminal penalties. The range of penalties shall be comparable to that applicable to the bribery of the Party’s own public officials and shall, in the case of

natural persons, include deprivation of liberty sufficient to enable effective mutual legal assistance and extradition.

2. In the event that, under the legal system of a Party, criminal responsibility is not applicable to legal persons, that Party shall ensure that legal persons shall be subject to effective, proportionate and dissuasive non-criminal sanctions, including monetary sanctions, for bribery of foreign public officials.

3. Each Party shall take such measures as may be necessary to provide that the bribe and the proceeds of the bribery of a foreign public official, or property the value of which corresponds to that of such proceeds, are subject to seizure and confiscation or that monetary sanctions of comparable effect are applicable.

4. Each Party shall consider the imposition of additional civil or administrative sanctions upon a person subject to sanctions for the bribery of a foreign public official.

Article 4

Jurisdiction

1. Each Party shall take such measures as may be necessary to establish its jurisdiction over the bribery of a foreign public official when the offence is committed in whole or in part in its territory.

2. Each Party which has jurisdiction to prosecute its nationals for offences committed abroad shall take such measures as may be necessary to establish its jurisdiction to do so in respect of the bribery of a foreign public official, according to the same principles.

3. When more than one Party has jurisdiction over an alleged offence described in this Convention, the Parties involved shall, at the request of one of them, consult with a view to determining the most appropriate jurisdiction for prosecution.

4. Each Party shall review whether its current basis for jurisdiction is effective in the fight against the bribery of foreign public officials and, if it is not, shall take remedial steps.

Article 5

Enforcement

Investigation and prosecution of the bribery of a foreign public official shall be subject to the applicable rules and principles of each Party. They shall not be influenced by considerations of national economic interest, the potential effect upon relations with another State or the identity of the natural or legal persons involved.

Article 6**Statute of Limitations**

Any statute of limitations applicable to the offence of bribery of a foreign public official shall allow an adequate period of time for the investigation and prosecution of this offence.

Article 7**Money Laundering**

Each Party which has made bribery of its own public official a predicate offence for the purpose of the application of its money laundering legislation shall do so on the same terms for the bribery of a foreign public official, without regard to the place where the bribery occurred.

Article 8**Accounting**

1. In order to combat bribery of foreign public officials effectively, each Party shall take such measures as may be necessary, within the framework of its laws and regulations regarding the maintenance of books and records, financial statement disclosures, and accounting and auditing standards, to prohibit the establishment of off-the-books accounts, the making of off-the-books or inadequately identified transactions, the recording of non-existent expenditures, the entry of liabilities with incorrect identification of their object, as well as the use of false documents, by companies subject to those laws and regulations, for the purpose of bribing foreign public officials or of hiding such bribery.
2. Each Party shall provide effective, proportionate and dissuasive civil, administrative or criminal penalties for such omissions and falsifications in respect of the books, records, accounts and financial statements of such companies. . . .

**OECD Convention on Combating Bribery of Foreign Public Officials in
International Business Transactions
Ratification Status as of May 2018**

Country	Deposit of Instrument of Acceptance/Approval/ Ratification/Accession	Entry into Force of the Convention	Entry into Force of Implementing Legislation
Argentina	8 February 2001	9 April 2001	10 November 1999
Australia	19 October 1999	18 December 1999	17 December 1999
Austria	20 May 1999	19 July 1999	1 October 1998

Belgium	27 July 1999	25 September 1999	3 April 1999
Brazil	24 August 2000	23 October 2000	11 June 2002
Bulgaria	22 December 1998	15 February 1999	29 January 1999
Canada	17 December 1998	15 February 1999	14 February 1999
Chile	18 April 2001	17 June 2001	8 October 2002
Colombia	20 November 2012	19 January 2013	14 November 2012
Costa Rica	24 May 2017	23 July 2017	15 May 2017
Czech Republic	21 January 2000	21 March 2000	9 June 1999
Denmark	5 September 2000	4 November 2000	1 May 2000
Estonia	14 December 2004	12 February 2005	1 July 2004
Finland	10 December 1998	15 February 1999	1 January 1999
France	31 July 2000	29 September 2000	29 September 2000
Germany	10 November 1998	15 February 1999	15 February 1999
Greece	5 February 1999	15 February 1999	1 December 1998
Hungary	4 December 1998	15 February 1999	1 March 1999
Iceland	17 August 1998	15 February 1999	30 December 1998
Ireland	22 September 2003	21 November 2003	26 November 2001
Israel	11 March 2009	10 May 2009	21 July 2008
Italy	15 December 2000	13 February 2001	26 October 2000
Japan	13 October 1998	15 February 1999	15 February 1999
Korea	4 January 1999	15 February 1999	15 February 1999
Latvia	31 March 2014	30 May 2014	21 March 2014
Lithuania	16 May 2017	15 July 2017	3 May 2017
Luxembourg	21 March 2001	20 May 2001	11 February 2001
Mexico	27 May 1999	26 July 1999	18 May 1999
Netherlands	12 January 2001	13 March 2001	1 February 2001
New Zealand	25 June 2001	24 August 2001	3 May 2001
Norway	18 December 1998	15 February 1999	1 January 1999
Peru	28 May 2018	27 July 2018	1 January 2018
Poland	8 September 2000	7 November 2000	4 February 2001
Portugal	23 November 2000	22 January 2001	9 June 2001
Russian Federation	17 February 2012	17 April 2012	16 May 2011
Slovak Republic	24 September 1999	23 November 1999	1 November 1999
Slovenia	6 September 2001	5 November 2001	23 January 1999

South Africa	19 June 2007	18 August 2007	27 April 2004
Spain	14 January 2000	14 March 2000	2 February 2000
Sweden	8 June 1999	7 August 1999	1 July 1999
Switzerland	31 May 2000	30 July 2000	1 May 2000
Turkey	26 July 2000	24 September 2000	11 January 2003
United Kingdom	14 December 1998	15 February 1999	14 February 2002
United States	8 December 1998	15 February 1999	10 November 1998

Problem 5-1

Should the United States use its criminal courts to attempt to deter corruption in other countries, particularly in the developing world? Are there other legitimate purposes for the US to bring prosecutions related to bribery in the conduct of international business? If so, what factors should prosecutors look for in choosing these cases?

The ultimate policy question, of course, is whether the FCPA and the government's enforcement campaign have been beneficial. This is an extremely difficult question to answer empirically, in addition to being normatively controversial given disagreement about optimal policy goals. For one recent take with updated enforcement data, see Mike Koehler, *Has the FCPA Been Successful in Achieving its Objectives?*, 2019 U. ILL. L. REV. 1267 (2019). For the most thoughtful and extended treatment to date, see KEVIN E. DAVIS, *BETWEEN IMPUNITY AND IMPERIALISM: THE REGULATION OF TRANSNATIONAL BRIBERY* (2019). Meanwhile, the popularity of such efforts among enforcers in developed nations continues to grow rapidly. See generally Jennifer Arlen and Samuel W. Buell, *The Law of Corporate Investigations and the Global Expansion of Corporate Criminal Enforcement*, 93 S. CAL. L. REV. 697 (2020).

B. The FCPA Statutory Scheme and UK Bribery Act

Before taking up the text of the statutes themselves, the following article gives an overview of the FCPA's structure and key provisions.

FOREIGN CORRUPT PRACTICES ACT

Dannette Blain, Alyssa Domino, Robert Bickford, Carmen Grisaffi & Kaylee Otterbacher, 59 AM. CRIM. REV 909 (2022).

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In 1977, Congress amended the Securities Exchange Act of 1934 ("Exchange Act") and enacted the Foreign Corrupt Practices Act ("FCPA" or "the Act"). The FCPA's passage followed an extensive Securities and Exchange Commission ("SEC") investigation and

voluntary disclosure program in the 1970s, which revealed that U.S. companies had paid hundreds of millions of dollars in bribes to secure business from foreign officials. Corporate bribery both hindered the markets from operating efficiently and eroded public confidence in U.S. companies' financial integrity. Seeking to restore public confidence in the business community, Congress passed the FCPA, which regulates international corruption through two sets of provisions: the accounting provisions and the anti-bribery provisions.

First, the accounting provisions require regular reports to the SEC, maintenance of accurate records, and the establishment of internal compliance controls. These provisions apply to both domestic and foreign companies traded on U.S. stock exchanges. Second, the FCPA's anti-bribery provisions criminalize the transfer of money or other gifts to foreign officials and political actors with the intent to influence the obtainment or retainment of business. The anti-bribery prohibitions apply to conduct by securities issuers, U.S. citizens and entities, and certain foreign nationals and entities. Both the SEC and the United States Department of Justice ("DOJ") have jurisdiction to enforce the FCPA's anti-bribery provisions with civil or criminal enforcement actions, respectively.

Increased enforcement and severe fines have made understanding the FCPA imperative for businesses across the world. While the SEC and the DOJ jointly averaged only three prosecutions annually between 1978 and 2000, the number of enforcement actions per year has since drastically increased. Notably, 2019 was considered "the most significant year ever" in FCPA enforcement; the year saw record-breaking penalties of \$2.6 billion—topped only by \$2.8 billion in penalties in 2020—and had four FCPA-related trials, the most ever conducted in one year. There were also seventy-three actions taken in 2019, second only to 2010. Although the years between 2010 and 2019 did not exceed the 2010 peak, both the DOJ and SEC remained committed to FCPA enforcement. For example, the agencies brought fifty-three actions in 2016, wherein the twenty-seven corporations charged with FCPA violations paid an average of \$223.4 million in criminal penalties—the highest average in history. Additionally, the number of DOJ enforcement actions per year reached its third-highest peak in 2017, making up twenty-nine of the combined thirty-nine actions. In 2018, there were thirty-eight enforcement actions, resulting in \$1 billion in corporate fines.

The past decade's uptick in the number of actions and average penalties paid is a result of federal efforts to further strengthen the FCPA, including the SEC's creation of the FCPA Unit in 2010, the DOJ's implementation of a cooperation policy prioritizing individual accountability ("The Yates Memorandum") in 2015, the DOJ's development of a pilot cooperation program in 2016, the institution of the DOJ's formal "FCPA Corporate Enforcement Policy" in 2017, and the DOJ's "Updated Guidance on Evaluation of Corporate Compliance Programs" in 2020. These measures aim to incentivize individuals and companies to voluntarily self-disclose FCPA-related misconduct and otherwise cooperate with DOJ investigations.

In addition, developments in the substantive law have aided enforcement efforts and promoted increased compliance. Among these developments is a broad interpretation of FCPA jurisdiction that encompasses conduct outside U.S. territory, including foreigners' conduct with an attenuated territorial nexus to the United States.

Finally, increased enforcement and compliance also stems from more robust international cooperation.

The FCPA amended the Exchange Act to impose record-keeping and internal control requirements on securities issuers, as codified in 15 U.S.C. § 78m(b)(2) and (b)(5) (collectively referred to as the "accounting provisions"). This marked a major shift in securities law by treating inaccurately recorded payments as potential accounting violations regardless of their materiality to investor decisions. The DOJ has equal authority with the SEC to pursue violations of the record-keeping and internal controls provisions of the FCPA. The SEC, however, has taken the lead in pursuing civil liability for violations of these provisions, given its expertise in accounting matters and primary role in protecting the integrity of the financial markets as well as the provisions' exclusive applicability to "issuers" under the FCPA.

Elements of the accounting provisions include (1) the covered parties, (2) the recordkeeping, or "books and records," provision, and (3) the internal controls provision.

The FCPA accounting provisions apply to "issuers" under the Exchange Act, which includes publicly-held companies and companies that hold American Depositary Receipts. An "issuer" either has securities registered with the SEC under § 12 of the Exchange Act or is required to file periodic reports with the SEC pursuant to § 15(d) of the Exchange Act. Additionally, issuers owning more than fifty percent of foreign subsidiary stock are also required to ensure that the subsidiary complies with the accounting provisions. A corporation classified as an issuer, therefore, must satisfy the accounting provisions whether or not it directly engages in foreign operations.

The record-keeping provisions require all issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." The requirement applies to records in a wide variety of forms, regardless of their materiality to investors. The FCPA defines "reasonable detail" as a "level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs."

These provisions serve three goals: (i) ensuring that businesses accurately report transactions, (ii) preventing the falsification of records to conceal illegal transactions, and (iii) promoting the correct characterization of all transactions so that financial statements conform to accounting principles. Overall, by creating affirmative record-keeping duties for all issuer transactions, the regulations facilitate the SEC's detection of business improprieties. By requiring accurate recording and disclosure of payments, the books and records provisions have the collateral effect of deterring foreign bribe payments.

The FCPA accounting provisions also require issuers to create and maintain internal controls to reasonably ensure that transactions are properly authorized. Congress intended these provisions to ensure that issuers use accepted accounting methods when recording economic transactions.

Compliance depends on the overall reasonableness of the internal controls. The SEC considers several factors in evaluating such systems: (1) the role of the board of directors; (2) communication to employees of corporate procedures and policies; (3) assignment of authority and responsibility; (4) competence and integrity of personnel; (5) accountability for performance and compliance; and (6) objectivity and effectiveness of the internal audit function. If a company's board of directors creates an internal audit committee, this committee must use internal accounting oversight to reasonably assure that the company follows FCPA provisions.

Individuals designated as "control persons" may be liable for accounting violations that occur even without their knowledge or participation. Under the "control person" theory, codified in § 20(a) of the Exchange Act, individuals who directly or indirectly "control [] any person liable" under the chapter are themselves liable to the same extent unless the controlling person "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." The courts of appeals are divided as to whether culpable participation is a necessary element of control person liability. Those courts requiring culpable participation look for proof "that the controlling person knew or should have known that the primary violator, over whom that person had control, was engaging in fraudulent conduct."

Under either accounting provision, an individual must "knowingly" circumvent or fail to "implement a system of internal accounting controls" or falsify "any book, record, or account." Although the Act was not intended for the prosecution of inadvertent accounting violations, the DOJ has found that willful blindness—or conscious avoidance—satisfies the intent requirement.

There are two exceptions to criminal liability under the FCPA accounting provisions. First, § 78m(b)(4) does not impose criminal liability for technical or insignificant accounting errors. Second, a good faith exception applies to issuers who hold fifty percent or less of a corporation's voting power. Accordingly, a parent corporation that owns fifty percent or less of a subsidiary or affiliate need only exercise good-faith efforts to influence the minority-owned subsidiary or affiliate's decision to comply with FCPA accounting practices.

The anti-bribery provisions of the FCPA prohibit (1) covered parties from (2) performing the qualifying jurisdictional act—either (a) taking any action within or outside the territory of the United States, depending on the covered party or (b) utilizing "the mails or any means or instrumentality of interstate commerce"—(3) in furtherance of an offer, payment, promise to pay, or authorization to pay anything of value, (4) knowingly, corruptly, or willfully, (5) directly or indirectly to a foreign official, foreign political party or official, or a candidate for foreign political office (6) to influence any

official act or decision, or to secure any improper advantage in order to obtain or retain business.

“Covered parties” currently include: (1) issuers, and their officers, directors, employees, agents, and shareholders; (2) domestic concerns, and their officers, directors, employees, agents, and shareholders; and (3) certain persons and entities, other than issuers and domestic concerns, acting in the territory of the United States. An “issuer” is a company that has securities listed on a national securities exchange in the United States or that is required to file periodic reports with the SEC. “Domestic concerns” include “any individual who is a citizen, national, or resident of the United States [or] any corporation . . . which has its principal place of business in the United States, or which is organized under the laws of a State of the United States.” “United States persons” is a sub-category within the category of “domestic concerns.” Finally, the FCPA also applies to “any natural person other than a national of the United States . . . or any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship organized under the law of a foreign nation or a political subdivision thereof” while acting in the territory of the United States. For ease of reference, this third category of covered persons is often referred to by its statutory enumeration: “78dd-3” parties.

The qualifying jurisdictional acts under the FCPA do not neatly correspond to the three categories of covered parties discussed above. Rather, the persons and entities included within each category of “covered parties” may satisfy the jurisdictional element of the statute either by developing a nexus with United States interstate commerce or by acting in a specific covered location.

For certain covered parties, the government may prove a nexus with U.S. interstate commerce—or the “use of . . . any means or instrumentality of interstate commerce”—in order to establish jurisdiction under the FCPA. For U.S. issuers and “U.S. persons,” proving a nexus with U.S. interstate commerce is one of two ways to satisfy the FCPA’s jurisdictional requirement. Alternatively, for foreign issuers and foreign nationals permanently residing in the United States, proving a nexus with U.S. interstate commerce is the exclusive means of establishing jurisdiction.

Violators have a nexus with interstate commerce when, in making prohibited bribe(s), they make use of the instrumentalities of interstate commerce. “Interstate commerce” is defined by the FCPA as “trade, commerce, transportation, or communication among the several States, or between any foreign country and any State or between any State and any place or ship outside thereof.” Use of the instrumentalities of interstate commerce can be proven with minimal contact with the United States; the conduct must touch the United States at some point, but it does not have to occur within the territorial United States.

Storing or routing emails through U.S. servers, using U.S. mail or wires, using U.S.-licensed cell phones while outside the United States, or using money denominated in U.S. dollars all constitute use of the instrumentalities of interstate commerce.

Three changes in the 1998 Amendments to the FCPA expanded the reach of the anti-bribery provisions beyond the jurisdictional grounds discussed above. These amendments brought the FCPA into conformity with the Organization for Economic Cooperation and Development (“OECD”) Anti-Bribery Convention’s requirement that parties exercise “territorial” and “nationality” jurisdiction. First, the amendments extended anti-bribery jurisdiction over “any person,” including foreign persons or entities unaffiliated with issuers and domestic concerns, acting inside U.S. territory (“territorial jurisdiction” or “78dd-3 jurisdiction”). Second, the amendments embraced “nationality jurisdiction” over certain U.S. entities. Nationality jurisdiction subjects U.S. issuers and “United States person [s]” (whether acting alone or on behalf of a U.S. issuer) to FCPA liability when, assuming all other elements of the offense are met, they take any action while outside the United States. Third, the amendments expanded the statute to reach foreign nationals employed by or acting as agents of U.S. issuers or engaged in work involving domestic concerns wherever they act.

The DOJ has interpreted the provision “in the territory of the United States” broadly for the purposes of establishing § 78dd-3 jurisdiction over foreign persons. The DOJ “interprets [Section 78dd-3(a)] as conferring jurisdiction whenever a foreign company or national *causes* an act to be done within the territory of the United States by any person acting as that company’s or national’s agent.”

The SEC and DOJ have attempted to expand the jurisdictional reach of the FCPA further by developing the concept of “accessory liability.” Under this theory of liability, a foreign national or company that does not directly act in the United States may still be liable “for aiding and abetting an FCPA violation or for conspiring to violate the FCPA.” After the Second Circuit’s decision in *United States v. Hoskins*, however, it is unclear how successful the government will be if it continues to pursue charges against foreign nationals and corporations under this theory.

Currently, the FCPA’s reach only touches the payor—the receiving foreign official is immune. The exclusion of bribe recipients from criminal liability reflects “an affirmative legislative policy to leave unpunished a well-defined group of persons who were necessary parties to the acts constituting a violation of the substantive law” and “reinforce[s] the proposition that Congress had absolutely no intention of prosecuting the foreign officials involved.” This decision was motivated by diplomatic, enforcement, and jurisdictional considerations.

On any of the jurisdictional grounds, prosecutors may charge employees without filing charges against their corporate employer. The DOJ’s recent emphasis on prosecuting individuals and its formalized cooperation credit policy strongly incentivize corporations to expose employee wrongdoing.

Although the phrase “anything of value” is not defined in the FCPA or in its legislative history, the phrase is interpreted expansively. Any item of potential present or future benefit may be “of value” if either the payor or recipient subjectively values it. Thus, items “of value” include money, gifts, discounts, charitable donations, use of resources

(e.g., materials, facilities, and equipment), entertainment luxuries (e.g., food, travel, meals, and lodging), and promises of future employment or internships. An FCPA violation may also arise out of “payments or gifts to third parties, such as [a foreign] official’s family members. This broad interpretation of the phrase “anything of value” comports with the interpretation of the same phrase in the domestic anti-bribery statute.

The FCPA imposes three distinct scienter requirements dependent upon the specific unlawful conduct alleged: all defendants, individual or corporate, must have “corruptly” committed the alleged act; individual defendants facing criminal penalties must also have “willfully” committed the alleged act; and defendants facing charges based on payments to a third party must also have made such payments “while knowing” that the payment would be directed to a foreign official.

Although the FCPA does not define “corruptly,” the statute’s legislative history suggests that “[t]he word ‘corruptly’ connotes an evil motive or purpose, an intent to wrongfully influence the recipient.” Specifically, “the offer, payment, promise, or gift, must be intended to induce the recipient to misuse his official position in order to wrongfully direct business to the payor or his client, or to obtain preferential legislation or a favorable regulation.” That is, there must be the intention to produce a quid pro quo where the illegal payment is intentionally made, offered, or promised in exchange for some unlawful act, although completion of the exchange is not required. Additionally, a defendant can have the requisite corrupt intent even if he “[does] not know the identity of the recipient.”

The FCPA also does not define the term “willfully,” but the term has been interpreted to apply to acts “committed voluntarily and purposefully, and with a bad purpose.” In proving that a defendant acted “willfully,” the government need only prove that an act was undertaken with knowledge of its general unlawfulness, rather than with knowledge that the act would specifically violate the FCPA.

The FCPA asserts that a person acts “knowing[ly]” when he is (1) aware that he is “engaging in such conduct,” or (2) aware that or “has a firm belief that such circumstance exists or that such result is substantially certain to occur.” The knowledge requirement may be satisfied through willful blindness, or conscious avoidance, i.e., when the defendant intentionally avoids confirming his suspicions about the culpability of his conduct. For example, corporate officials may be found liable where they have a reasonable indication that an FCPA violation has occurred, but they fail to act. Thus, both those with actual knowledge and “those who purposefully avoid actual knowledge” are liable under the FCPA.

The anti-bribery provisions define “foreign official” as:

[A]ny officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such

government or department, agency, or instrumentality, or for or on behalf of any such public international organization.

Entities need not be state-owned or state-controlled to qualify as an “instrumentality” of a foreign government. Rather, in *United States v. Esquenazi*, the Eleventh Circuit set forth a two-part test for determining which entities constitute “instrumentalities” of foreign governments under the FCPA. The *Esquenazi* court interpreted a government “instrumentality” as an organization that both: (i) is “controlled by the government of a foreign country” and (ii) “performs a function the controlling government treats as its own.” . . .

Once a foreign entity is considered a government instrumentality, all of the entity’s employees are considered foreign officials regardless of their status or responsibilities within the organization. U.S. businesses that regularly engage in commercial relationships with state-controlled companies, such as those traditionally common in China, should take into account this increased risk for an FCPA violation when developing compliance programs.

The FCPA prohibits payments to foreign officials for a wide variety of purposes related to obtaining or retaining business. Thus, in addition to payments made for the clear purpose of obtaining or retaining government contracts, the FCPA prohibits payments made to increase sales, to secure special tax or customs treatment, “to obtain government action to prevent competitors from entering a market, or to circumvent a licensing or permit requirement.”

As demonstrated above, determination of prohibited payments under the FCPA rests on whether the payment would *assist in* obtaining or retaining business. Because the Act and courts alike have failed to specify just how direct the nexus between payments and business sought must be, businesses and individuals continue to grapple with the legality of payments that simply permit the company to operate more efficiently or effectively, otherwise known as “facilitating” or “grease” payments.

The FCPA creates an exception for “facilitating” payments, also known as “grease” payments, as well as two affirmative defenses to potential anti-bribery violations: the “local law” defense and the “reasonable and bona fide business expenditure” defense.

The FCPA expressly permits “facilitating” payments (also known as “grease payments”) to foreign officials “to expedite or to secure the performance of a routine governmental action.” Grease payments are an exception, rather than an affirmative defense, because such payments are, by definition, “routine” and thus not made with the corrupt intent of prompting the foreign official to *misuse* their official position.

“Routine governmental actions” are non-discretionary actions that a foreign official ordinarily performs in the course of daily business. Examples include obtaining permits and licenses, processing governmental paperwork, scheduling inspections, and providing utilities or governmental services such as police protection. Permissible

payments are usually of low value, but the purpose is more important than the value. Notably, payments that would otherwise fall under the exception are prohibited under the FCPA if they encourage a foreign official “to award new business or to continue business with a particular party.”

Three caveats accompany the grease payments exception. First, courts agree with regulators that the exception is “very limited.” For example, the SEC has fined companies for payments arguably within the exception. And while there is no official maximum amount for grease payments, \$1,000 appears to have emerged as the acceptable limit. Second, issuers must identify and record grease payments as such, since there is no parallel exception under the accounting provisions. Third, grease payments allowed under the FCPA may still violate foreign anti-bribery laws, such as the UK Bribery Act. Accordingly, most U.S. companies ban or severely limit facilitation payments to avoid liability under foreign laws.

The reasonable and bona fide business expenditure defense applies when expenses “incurred by or on behalf of a foreign official,” or other covered person and/or entity, are “directly related to the promotion, demonstration, or explanation of [a company’s] products or services,” or are related to a company’s “execution or performance of a contract with a foreign government or agency thereof.” Although no court has interpreted this affirmative defense, the statute expressly mentions the cost of travel and lodging, and the DOJ has issued guidance describing expenses allowed and prohibited under this provision. Nominal payments for items such as cab fares, refreshments, company promotional items, small tokens of courtesy, and reasonable meals and entertainment expenses are highly unlikely to trigger enforcement action unless they are part of a pattern of behavior evincing corrupt intent. Expenditures that might otherwise satisfy this affirmative defense may also signal a corrupt intent and/or violate the FCPA’s accounting provisions when they are mischaracterized in a company’s books and records or occur due to a failure to implement adequate controls.

The FCPA is part of the securities laws (the ‘34 Act). It includes a violation for simply failing to record payments (see how the first statute below does that), known as the “books and records” provision. The main statutory scheme, however, prohibits certain forms of corrupt payments.

The anti-bribery part of the legislation has three statutory provisions that run parallel to each other. Much of the key language is the same in all three provisions—in terms of the bribery-related conduct necessary to violate the FCPA. The three statutes differ primarily in terms of *who* they cover rather than *what conduct* they prohibit. Set out below are: (1) the bookkeeping provision, (2) the bulk of the first of the three anti-bribery provisions, and (3) only the differing jurisdictional language in the other two anti-bribery provisions.

Do the usual drill here of figuring out the elements of the crime, but you should spend even more time than usual on the statutory language because it is detailed and there is

not abundant case law interpreting it. To whom do the statutes apply? What acts are prohibited? What are the required mental states for a criminal violation? What is the jurisdictional scope or requirements of each provision?

Foreign Corrupt Practices Act (FCPA) (Selected Provisions)

15 U.S.C. § 78m - Periodical and other reports . . . (“books and records”)

(b)(2) Every issuer which has a class of securities registered pursuant to section 78l of this title and every issuer which is required to file reports pursuant to section 78o(d) of this title shall—

(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer;

(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—

(i) transactions are executed in accordance with management’s general or specific authorization;

(ii) transactions are recorded as necessary

(I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and

(II) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management’s general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. . . .

(b)(4) No criminal liability shall be imposed for failing to comply with the requirements of paragraph (2) of this subsection except as provided in paragraph (5) of this subsection.

(b)(5) No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2). . . .

(b)(7) For the purpose of paragraph (2) of this subsection, the terms “reasonable assurances” and “reasonable detail” mean such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs.

15 U.S.C. § 78dd–1 - Prohibited foreign trade practices by issuers

(a) Prohibition

It shall be unlawful for any issuer which has a class of securities registered pursuant to section 78l of this title or which is required to file reports under section 78o(d) of this title, or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to—

(1) any foreign official for purposes of—

(A)

(i) influencing any act or decision of such foreign official in his official capacity,

(ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or

(iii) securing any improper advantage; or

(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person;

(2) any foreign political party or official thereof or any candidate for foreign political office for purposes of—

(A)

(i) influencing any act or decision of such party, official, or candidate in its or his official capacity,

(ii) inducing such party, official, or candidate to do or omit to do an act in violation of the lawful duty of such party, official, or candidate, or

(iii) securing any improper advantage; or

(B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; or

(3) any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of—

(A)

(i) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity,

(ii) inducing such foreign official, political party, party official, or candidate to do or omit to do any act in violation of the lawful duty of such foreign official, political party, party official, or candidate, or

(iii) securing any improper advantage; or

(B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

(b) Exception for routine governmental action

Subsections (a) and (g) of this section shall not apply to any facilitating or expediting payment to a foreign official, political party, or party official the purpose of which is to expedite or to secure the performance of a routine governmental action by a foreign official, political party, or party official.

(c) Affirmative defenses

It shall be an affirmative defense to actions under subsection (a) or (g) of this section that—

(1) the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations of the foreign official's, political party's, party official's, or candidate's country; or

(2) the payment, gift, offer, or promise of anything of value that was made, was a reasonable and bona fide expenditure, such as travel and lodging expenses, incurred by or on behalf of a foreign official, party, party official, or candidate and was directly related to—

(A) the promotion, demonstration, or explanation of products or services; or

(B) the execution or performance of a contract with a foreign government or agency thereof. . . .

(f) Definitions

For purposes of this section:

(1)

(A) The term “foreign official” means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization.

(B) For purposes of subparagraph (A), the term “public international organization” means—

(i) an organization that is designated by Executive order pursuant to section 288 of title 22; or

(ii) any other international organization that is designated by the President by Executive order for the purposes of this section, effective as of the date of publication of such order in the Federal Register.

(2)

(A) A person’s state of mind is “knowing” with respect to conduct, a circumstance, or a result if—

(i) such person is aware that such person is engaging in such conduct, that such circumstance exists, or that such result is substantially certain to occur; or

(ii) such person has a firm belief that such circumstance exists or that such result is substantially certain to occur.

(B) When knowledge of the existence of a particular circumstance is required for an offense, such knowledge is established if a person is aware of a high probability of the existence of such circumstance, unless the person actually believes that such circumstance does not exist.

(3)

(A) The term “routine governmental action” means only an action which is ordinarily and commonly performed by a foreign official in—

(i) obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country;

(ii) processing governmental papers, such as visas and work orders;

(iii) providing police protection, mail pick-up and delivery, or scheduling inspections associated with contract performance or inspections related to transit of goods across country;

(iv) providing phone service, power and water supply, loading and unloading cargo, or protecting perishable products or commodities from deterioration; or

(v) actions of a similar nature.

(B) The term “routine governmental action” does not include any decision by a foreign official whether, or on what terms, to award new business to or to continue business with a particular party, or any action taken by a foreign official involved in the decision-making process to encourage a decision to award new business to or continue business with a particular party.

(g) Alternative jurisdiction

(1) It shall also be unlawful for any issuer organized under the laws of the United States, or a State, territory, possession, or commonwealth of the United States or a political subdivision thereof and which has a class of securities registered pursuant to section 781 of this title or which is required to file reports under section 780 (d) of this title, or for any United States person that is an officer, director, employee, or agent of such issuer or a stockholder thereof acting on behalf of such issuer, to corruptly do any act outside the United States in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to any of the persons or entities set forth in paragraphs (1), (2), and (3) of subsection (a) of this section for the purposes set forth therein, irrespective of whether such issuer or such officer, director, employee, agent, or stockholder makes use of the mails or any means or instrumentality of interstate commerce in furtherance of such offer, gift, payment, promise, or authorization.

(2) As used in this subsection, the term “United States person” means a national of the United States (as defined in section 1101 of title 8) or any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship organized under the laws of the United States or any State, territory, possession, or commonwealth of the United States, or any political subdivision thereof.

15 U.S.C. § 78ff - Penalties

(c) Violations by issuers, officers, directors, stockholders, employees, or agents of issuers

(1)

(A) Any issuer that violates subsection (a) or (g) of section 78dd–1 of this title shall be fined not more than \$2,000,000.

(B) Any issuer that violates subsection (a) or (g) of section 78dd–1 of this title shall be subject to a civil penalty of not more than \$10,000 imposed in an action brought by the Commission.

(2)

(A) Any officer, director, employee, or agent of an issuer, or stockholder acting on behalf of such issuer, who willfully violates subsection (a) or (g) of section 78dd–1 of this title shall be fined not more than \$100,000, or imprisoned not more than 5 years, or both.

(B) Any officer, director, employee, or agent of an issuer, or stockholder acting on behalf of such issuer, who violates subsection (a) or (g) of section 78dd–1 of this title shall be subject to a civil penalty of not more than \$10,000 imposed in an action brought by the Commission.

(3) Whenever a fine is imposed under paragraph (2) upon any officer, director, employee, agent, or stockholder of an issuer, such fine may not be paid, directly or indirectly, by such issuer.

15 U.S.C. § 78dd–2 - Prohibited foreign trade practices by domestic concerns [this is the second of the three anti-bribery provisions; it prohibits essentially the same substantive conduct but differs jurisdictionally, applying to “domestic concerns” instead of “issuers”]

(a) Prohibition

It shall be unlawful for any domestic concern, other than an issuer which is subject to section 78dd–1 of this title, or for any officer, director, employee, or agent of such domestic concern or any stockholder thereof acting on behalf of such domestic concern, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to . . . [defining essentially the same acts as 15 U.S.C. § 78dd–1] . . .

(g) Penalties

(1)

(A) Any domestic concern that is not a natural person and that violates subsection (a) or (i) of this section shall be fined not more than \$2,000,000.

(B) Any domestic concern that is not a natural person and that violates subsection (a) or (i) of this section shall be subject to a civil penalty of not more than \$10,000 imposed in an action brought by the Attorney General.

(2)

(A) Any natural person that is an officer, director, employee, or agent of a domestic concern, or stockholder acting on behalf of such domestic concern, who willfully violates subsection (a) or (i) of this section shall be fined not more than \$100,000 or imprisoned not more than 5 years, or both.

(B) Any natural person that is an officer, director, employee, or agent of a domestic concern, or stockholder acting on behalf of such domestic concern, who violates subsection (a) or (i) of this section shall be subject to a civil penalty of not more than \$10,000 imposed in an action brought by the Attorney General.

(3) Whenever a fine is imposed under paragraph (2) upon any officer, director, employee, agent, or stockholder of a domestic concern, such fine may not be paid, directly or indirectly, by such domestic concern.

(h) Definitions

For purposes of this section:

(1) The term “domestic concern” means—

(A) any individual who is a citizen, national, or resident of the United States; and

(B) any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or a territory, possession, or commonwealth of the United States. . . .

(i) Alternative jurisdiction

(1) It shall also be unlawful for any United States person to corruptly do any act outside the United States in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to any of the persons or entities set forth in paragraphs (1), (2), and (3) of subsection (a) of this section, for the purposes set forth therein, irrespective of whether such United States person makes use of the mails or any means or instrumentality of interstate commerce in furtherance of such offer, gift, payment, promise, or authorization.

(2) As used in this subsection, the term “United States person” means a national of the United States (as defined in section 1101 of title 8) or any corporation,

partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship organized under the laws of the United States or any State, territory, possession, or commonwealth of the United States, or any political subdivision thereof.

15 U.S.C. § 78dd–3 - Prohibited foreign trade practices by persons other than issuers or domestic concerns [this is the third of the three anti-bribery provisions; it prohibits essentially the same substantive conduct but differs jurisdictionally, applying to anyone who acts “while in the territory of the United States” instead of to “issuers” or “domestic concerns”]

(a) Prohibition

It shall be unlawful for any person other than an issuer that is subject to section 78dd–1 of this title or a domestic concern (as defined in section 78dd–2 of this title), or for any officer, director, employee, or agent of such person or any stockholder thereof acting on behalf of such person, while in the territory of the United States, corruptly to make use of the mails or any means or instrumentality of interstate commerce or to do any other act in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to— . . . [defining essentially the same acts as 15 U.S.C. §§ 78dd–1 and 78dd–2] . . .

(e) Penalties

(1)

(A) Any juridical person that violates subsection (a) of this section shall be fined not more than \$2,000,000.

(B) Any juridical person that violates subsection (a) of this section shall be subject to a civil penalty of not more than \$10,000 imposed in an action brought by the Attorney General.

(2)

(A) Any natural person who willfully violates subsection (a) of this section shall be fined not more than \$100,000 or imprisoned not more than 5 years, or both.

(B) Any natural person who violates subsection (a) of this section shall be subject to a civil penalty of not more than \$10,000 imposed in an action brought by the Attorney General.

(3) Whenever a fine is imposed under paragraph (2) upon any officer, director, employee, agent, or stockholder of a person, such fine may not be paid, directly or indirectly, by such person.

Alternative Fines Act. Note that the “alternative fines act,” 18 U.S.C. § 3571, applies to the issue of corporate penalties for FCPA violations. The statute provides that, for *all* federal criminal cases, a court may impose a fine on an organization that is “not more than the greater of *twice the gross gain* or *twice the gross loss*” resulting from the offense (emphasis added). This provision, of course, has far more impact than most of the penalty provisions in specific offense definitions on the size of a potential corporate fine in a federal criminal case involving major conduct in a large business. To use a quick example, a company convicted of violating the FCPA in order to secure a contract with a foreign government earning the company \$500 million could be fined \$1 billion.

A VERY ROUGH STATUTORY SUMMARY

Statute (15 U.S.C.)	Who covered?	How violate?	With what mens rea?	Jurisdictional reach?
§ 78m (“books and records”)	All “issuers” of registered securities (as defined by ’34 Act) and any “person” of an issuer	Fail to keep accurate accounting records; or Fail to maintain adequate accounting controls	“Knowingly” circumvent or fail to implement controls (criminal)	All “issuers” of registered securities (as defined by ’34 Act)
§ 78dd-1 (FCPA anti-bribery #1)	All “issuers” of registered securities (as defined by ’34 Act) and their agents	Through mail or interstate commerce; Offer (etc.) anything of value; To “foreign official” or “foreign political party or official” (defined terms), or same through intermediary	“Corruptly” in furtherance of offer; and Purpose to influence; and Business purpose Willfully (criminal)	Use of mail or interstate commerce, or “Issuer” doing act outside U.S., in furtherance of offer
§ 78dd-2 (FCPA anti-bribery #2)	All “domestic concerns” (that are not “issuers”) and their agents	Through mail or interstate commerce; Offer (etc.) anything of value; To “foreign official” or “foreign political party or official,” or same through intermediary	“Corruptly” in furtherance of offer; and Purpose to influence; and Business purpose Willfully (criminal)	Use of mail or interstate commerce, or Any “United States person” doing act outside U.S., in furtherance of offer
§ 78dd-3 (FCPA anti-bribery #3)	Any person (that is not an “issuer”) while in U.S. territory	Through mail or interstate commerce; Offer (etc.) anything of value; To “foreign official” or “foreign political party or official,” or same through intermediary	“Corruptly” in furtherance of offer; and Purpose to influence; and Business purpose Willfully (criminal)	Use of mail or interstate commerce, in furtherance of offer

For many decades after enactment of the FCPA, it was understood from the plain statutory text and other materials that Congress had no intent to authorize prosecution of foreign officials who solicit, receive, or are offered business-related bribes—choosing

to leave such cases to foreign domestic law. In 2023, Congress shifted course, enacting the following new provisions (placed within the major existing federal bribery statute) that give U.S. prosecutors authority to charge foreign officials who seek or accept business bribes.

18 U.S.C. § 201

(a) For the purpose of this section—. . .

(4) the term “foreign official” means—

(A)(i) any official or employee of a foreign government or any department, agency, or instrumentality thereof; or

(ii) any senior foreign political figure, as defined in section 1010.605 of title 31, Code of Federal Regulations, or any successor regulation;

(B) any official or employee of a public international organization;

(C) any person acting in an official capacity for or on behalf of—

(i) a government, department, agency, or instrumentality described in subparagraph (A)(i); or

(ii) a public international organization; or

(D) any person acting in an unofficial capacity for or on behalf of—

(i) a government, department, agency, or instrumentality described in subparagraph (A)(i); or

(ii) a public international organization; and

(5) the term “public international organization” means—

(A) an organization that is designated by Executive order pursuant to section 1 of the International Organizations Immunities Act (22 U.S.C. 288); or

(B) any other international organization that is designated by the President by Executive order for the purposes of this section, effective as of the date of publication of such order in the Federal Register. . .

(f) Prohibition of demand for a bribe.—

(1) Offense.—It shall be unlawful for any foreign official or person selected to be a foreign official to corruptly demand, seek, receive, accept, or agree to receive or accept, directly or indirectly, anything of value personally or for any other person or nongovernmental entity, by making use of the mails or any means or instrumentality of interstate commerce, from any person (as defined in section 104A of the Foreign

Corrupt Practices Act of 1977 (15 U.S.C. 78dd-3), except that that definition shall be applied without regard to whether the person is an offender) while in the territory of the United States, from an issuer (as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a))), or from a domestic concern (as defined in section 104 of the Foreign Corrupt Practices Act of 1977 (15 U.S.C. 78dd-2)), in return for—

- (A) being influenced in the performance of any official act;
 - (B) being induced to do or omit to do any act in violation of the official duty of such foreign official or person; or
 - (C) conferring any improper advantage,
- in connection with obtaining or retaining business for or with, or directing business to, any person.

(2) Penalties.—Any person who violates paragraph (1) shall be fined not more than \$250,000 or 3 times the monetary equivalent of the thing of value, imprisoned for not more than 15 years, or both.

(3) Jurisdiction.—An offense under paragraph (1) shall be subject to extraterritorial Federal jurisdiction.

With the following statute, the UK became an important player in the field of international anti-corruption enforcement. Many cases of bribery involving large corporations will be covered by both U.S. and UK jurisdiction. Again, look at the covered persons and entities, covered acts, the required mental states, and the jurisdictional reach. Is the UK Act broader or narrower than the FCPA, or both broader and narrower? In which ways?

United Kingdom, Bribery Act of 2010

Section 6. Bribery of foreign public officials

(1) A person (“P”) who bribes a foreign public official (“F”) is guilty of an offence if P’s intention is to influence F in F’s capacity as a foreign public official.

(2) P must also intend to obtain or retain—

- (a) business, or
- (b) an advantage in the conduct of business.

(3) P bribes F if, and only if—

- (a) directly or through a third party, P offers, promises or gives any financial or other advantage—

- (i) to F, or
 - (ii) to another person at F's request or with F's assent or acquiescence, and
 - (b) F is neither permitted nor required by the written law applicable to F to be influenced in F's capacity as a foreign public official by the offer, promise or gift.
- (4) References in this section to influencing F in F's capacity as a foreign public official mean influencing F in the performance of F's functions as such an official, which includes—
- (a) any omission to exercise those functions, and
 - (b) any use of F's position as such an official, even if not within F's authority.
- (5) "Foreign public official" means an individual who—
- (a) holds a legislative, administrative or judicial position of any kind, whether appointed or elected, of a country or territory outside the United Kingdom (or any subdivision of such a country or territory),
 - (b) exercises a public function—
 - (i) for or on behalf of a country or territory outside the United Kingdom (or any subdivision of such a country or territory), or
 - (ii) for any public agency or public enterprise of that country or territory (or subdivision), or
 - (c) is an official or agent of a public international organisation.
- (6) "Public international organisation" means an organisation whose members are any of the following—
- (a) countries or territories,
 - (b) governments of countries or territories,
 - (c) other public international organisations,
 - (d) a mixture of any of the above.
- (7) For the purposes of subsection (3)(b), the written law applicable to F is—
- (a) where the performance of the functions of F which P intends to influence would be subject to the law of any part of the United Kingdom, the law of that part of the United Kingdom,
 - (b) where paragraph (a) does not apply and F is an official or agent of a public international organisation, the applicable written rules of that organisation,

(c) where paragraphs (a) and (b) do not apply, the law of the country or territory in relation to which F is a foreign public official so far as that law is contained in—

(i) any written constitution, or provision made by or under legislation, applicable to the country or territory concerned, or

(ii) any judicial decision which is so applicable and is evidenced in published written sources.

(8) For the purposes of this section, a trade or profession is a business.

Section 7. Failure of commercial organisations to prevent bribery

(1) A relevant commercial organisation (“C”) is guilty of an offence under this section if a person (“A”) associated with C bribes another person intending—

(a) to obtain or retain business for C, or

(b) to obtain or retain an advantage in the conduct of business for C.

(2) But it is a defence for C to prove that C had in place adequate procedures designed to prevent persons associated with C from undertaking such conduct.

(3) For the purposes of this section, A bribes another person if, and only if, A—

(a) is, or would be, guilty of an offence under section 1 or 6 (whether or not A has been prosecuted for such an offence), or

(b) would be guilty of such an offence if section 12(2)(c) and (4) were omitted. . . .

Section 8. Meaning of associated person

(1) For the purposes of section 7, a person (“A”) is associated with C if (disregarding any bribe under consideration) A is a person who performs services for or on behalf of C.

(2) The capacity in which A performs services for or on behalf of C does not matter.

(3) Accordingly A may (for example) be C’s employee, agent or subsidiary.

(4) Whether or not A is a person who performs services for or on behalf of C is to be determined by reference to all the relevant circumstances and not merely by reference to the nature of the relationship between A and C.

(5) But if A is an employee of C, it is to be presumed unless the contrary is shown that A is a person who performs services for or on behalf of C. . . .

Section 11. Penalties

(1) An individual guilty of an offence under section . . . 6 is liable—

(a) on summary conviction, to imprisonment for a term not exceeding 12 months, or to a fine not exceeding the statutory maximum, or to both,

(b) on conviction on indictment, to imprisonment for a term not exceeding 10 years, or to a fine, or to both.

(2) Any other person guilty of an offence under section . . . 6 is liable—

(a) on summary conviction, to a fine not exceeding the statutory maximum,

(b) on conviction on indictment, to a fine. . . .

Section 12. Offences under this Act: territorial application

(1) An offence is committed under section . . . 6 in England and Wales, Scotland or Northern Ireland if any act or omission which forms part of the offence takes place in that part of the United Kingdom.

(2) Subsection (3) applies if—

(a) no act or omission which forms part of an offence under section . . . 6 takes place in the United Kingdom,

(b) a person's acts or omissions done or made outside the United Kingdom would form part of such an offence if done or made in the United Kingdom, and

(c) that person has a close connection with the United Kingdom.

(3) In such a case—

(a) the acts or omissions form part of the offence referred to in subsection (2)(a), and

(b) proceedings for the offence may be taken at any place in the United Kingdom.

(4) For the purposes of subsection (2)(c) a person has a close connection with the United Kingdom if, and only if, the person was one of the following at the time the acts or omissions concerned were done or made—

(a) a British citizen,

(b) a British overseas territories citizen,

(c) a British National (Overseas),

(d) a British Overseas citizen,

(e) a person who under the British Nationality Act 1981 was a British subject,

(f) a British protected person within the meaning of that Act,

(g) an individual ordinarily resident in the United Kingdom,

- (h) a body incorporated under the law of any part of the United Kingdom,
- (i) a Scottish partnership.

(5) An offence is committed under section 7 irrespective of whether the acts or omissions which form part of the offence take place in the United Kingdom or elsewhere. . . .

Section 14. Offences under sections 1, 2 and 6 by bodies corporate etc.

(1) This section applies if an offence under section 1, 2 or 6 is committed by a body corporate or a Scottish partnership.

(2) If the offence is proved to have been committed with the consent or connivance of—

- (a) a senior officer of the body corporate or Scottish partnership, or
- (b) a person purporting to act in such a capacity,

the senior officer or person (as well as the body corporate or partnership) is guilty of the offence and liable to be proceeded against and punished accordingly. . . .

C. Recent Foreign Bribery Examples

Problem 5-2

- (a) Suppose you are an in-house lawyer at a global pharmaceutical company. You learn that the company's deputy chief of sales in India arranged prostitutes for doctors who heavily prescribed one of the company's leading drugs. What is the company's potential exposure under U.S. and UK law, what more would you most need to know, and what arguments if any might be available to the company if confronted about these incidents by prosecutors and regulators?
- (b) Recall your thoughts under Problem 5-1 of factors that should or should not counsel in favor of FCPA prosecutions (or the equivalent for UK prosecutors). Do such factors exist in the matters described in the following two settlement documents, concerning JP Morgan's hiring practices related to China and Goldman Sachs' dealings with a Malaysian sovereign wealth fund?

ATTACHMENT A

STATEMENT OF FACTS

1. The following Statement of Facts is incorporated by reference as part of the Non-Prosecution Agreement (the "Agreement") between the United States Department of Justice, Criminal Division, Fraud Section, the United States Attorney's Office for the Eastern District of New York (collectively, the "Offices"), and the defendant JPMorgan Securities (Asia Pacific) Limited ("JPMorgan-APAC" or the "Company"). Certain of the facts herein are based on information obtained from third parties by the Offices through their investigation and provided to the Company. JPMorgan-APAC hereby

agrees and stipulates that the following facts and conclusions of law are true and accurate. JPMorgan-APAC admits, accepts, and acknowledges that it is responsible for the acts of its officers, directors, employees, and agents as set forth below.

Relevant Entities and Individuals

2. JPMorgan Chase & Co., a Delaware incorporated and New York headquartered financial services firm, and its subsidiaries and affiliated companies (collectively, “JPMorgan”) provided numerous types of financial services, including investment banking, globally. JPMorgan Chase & Co.’s shares were publicly traded on the New York Stock Exchange and it was an “issuer” within the meaning of the Foreign Corrupt Practices Act (“FCPA”), Title 15, United States Code, Section 78dd-1(a).

3. JPMorgan-APAC was a Hong Kong registered company and wholly owned subsidiary of JPMorgan Chase & Co. JPMorgan-APAC, which was headquartered in Hong Kong, principally carried out investment banking under the “JPMorgan” brand for the Asia- Pacific region. JPMorgan-APAC was an “agent” of an issuer within the meaning of the FCPA, Title 15, United States Code, Section 78dd-1(a), and a number of its employees and agents were each a “person” within the meaning of the FCPA, Title 15, United States Code, Section 78dd- 3(a) and (f)(1). Many of JPMorgan-APAC’s clients in China were state-owned enterprises (“SOEs”), which were owned and controlled by the government of China and performed a function that the government treated as its own, and thus were each an “instrumentality” within the meaning of the FCPA, Title 15, United States Code, Sections 78dd-1(f)(1) and 78dd-3(f)(2). Employees of these customers and clients were therefore “foreign officials” within the meaning of the FCPA, Title 15, United States Code, Sections 78dd-1(f)(1) and 78dd-3(f)(2).

Relevant JPMorgan-APAC Clients and Government Officials

4. “Client 1,” an entity whose identity is known to the United States and the Company, was a state-owned and controlled Chinese financial services firm and an instrumentality within the meaning of the FCPA, Title 15, United States Code, Sections 78dd- 1(f)(1) and 78dd-3(f)(2) (“instrumentality”).

5. “Client 2,” an entity whose identity is known to the United States and the Company, was a private Chinese manufacturing company.

6. “Client 3,” an entity whose identity is known to the United States and the Company, was a Taiwanese private financial holding company.

7. “Client 4,” an entity whose identity is known to the United States and the Company, was a state-owned and controlled Chinese bank and financial services firm and an instrumentality.

8. “Chinese Official 1,” an individual whose identity is known to the United States and the Company, was the Deputy Minister of a Chinese government agency and a

foreign official within the meaning of the FCPA, Title 15, United States Code, Sections 78dd-1(f)(1) and 78dd-3(f)(2) (“foreign official”).

9. “Chinese Official 2,” an individual whose identity is known to the United States and the Company, was an Executive Vice President of Client 4 and a foreign official.

Overview of the Scheme

10. In or about and between 2006 and 2013, JPMorgan-APAC had a compliance review process to screen candidates for employment who had been referred to the Company by its clients, potential clients, and government officials. This process was supposed to ensure compliance with JPMorgan’s anti-corruption policies including that referred candidates were not hired as part of *quid pro quo* arrangements, whereby the Company would win business from the referral source in exchange for hiring the applicant.

11. Beginning in or about 2006 and continuing until at least in or about 2012, however, JPMorgan-APAC bankers set up and used a program (the “Client Referral Program”) to hire referred candidates specifically for the purpose of influencing senior officials at clients to award business to the Company and, in certain instances, to achieve the very *quid pro quo* arrangements the compliance review process and JPMorgan’s policies sought to prevent. Company employees sometimes referred to the Client Referral Program as the “Sons and Daughters Program.”

12. Although such *quid pro quo* hiring arrangements initially occurred in certain instances, in or about November 2009, JPMorgan-APAC executives and senior bankers institutionalized the practice of making hires for the purpose of winning specific business mandates, and revamped the Client Referral Program to improve its efficacy by prioritizing those hires linked to upcoming client transactions. The changes to the Client Referral Program were made by senior JPMorgan-APAC investment bankers. Under the revamped Client Referral Program, referred candidates for employment needed, to quote a presentation prepared by JPMorgan-APAC employees responsible for implementing the program, a “[d]irectly attributable linkage to business opportunity” to be considered for a job.

13. As a result of the scheme to corruptly influence senior officials at clients and potential clients through the Client Referral Program, the Company received investment banking mandates from Chinese SOEs whose executives referred candidates to the Company. The Company earned at least \$35 million in profits from those mandates.

Relevant JPMorgan-APAC Policies and Hiring Procedures

14. In or about 2001, JPMorgan established a policy that applied to, among other entities, JPMorgan-APAC and which prohibited the hiring of children or relatives of clients and potential clients in order to obtain business. On or about March 31, 2006, a JPMorgan-APAC managing director sent an e-mail to all JPMorgan-APAC investment bankers reiterating that policy and stating, in part:

As you know, the firm does not condone the hiring of the children or other relatives of clients or potential clients of the Firm . . . for the purpose of securing or potentially securing business for the Firm. In fact, the firm's policies expressly forbid this. There are no exceptions. . . . [T]he Firm recognizes that from time to time we want to make offers to people who may raise the appearance of a conflict of interest or even a regulatory issue, with respect to their parents or relatives holding senior ownership or management positions in companies that the Firm may have or wish to have as its clients, or other regulatory or governmental or quasi- governmental positions. In light of that, the firm has developed a "Sons & Daughters" program that sets out clear parameters within which we are prepared to analyze and potentially make such offers.

15. Thereafter, JPMorgan-APAC's Legal and Compliance Department circulated a "Questionnaire for Potential Hire Under the 'Sons & Daughters Program'" (the "Compliance Questionnaire") to be used as part of the compliance screening process. The Compliance Questionnaire focused on FCPA and other risks and required the bankers who wanted to hire applicants who had been referred by both private and SOE clients and potential clients and government officials, to disclose, among other things: (1) whether the applicant was qualified for the position; (2) whether the applicant had gone through the normal interviewing process; (3) whether the referring client/potential client was government-related; (4) whether the firm was actively pitching for any business from the client/potential client; and (5) whether there was an "expected benefit to JPMorgan" for hiring the referred candidate.

16. In or about September 2007, JPMorgan broadened its FCPA policy into a global anti-corruption policy, which applied to JPMorgan-APAC and provided that "the offer of internships or training for relatives of a public official" required legal and compliance pre-clearance and that hiring to win business was prohibited. At or around the same time, in connection with the new policy, JPMorgan-APAC compliance employees trained bankers that pre-clearance was required from the legal and compliance department because "[a]n offer of internship to a relative of a non-U.S. public official suggests an advantage by causing the official to misuse his or her position."

17. In or about June 2011, JPMorgan implemented an updated global Anti-Corruption Policy, which applied to JPMorgan-APAC. A training presentation on this policy advised that "almost anything can meet the definition of a 'bribe,' including internships [and] employment." The updated policy further advised that "[n]o employee may directly or indirectly offer, promise, grant or authorize the giving of money or anything else of value to a government official to influence official action or obtain an improper advantage."

The Corrupt Use of the Client Referral Program

18. Beginning no later than in or about late 2007, JPMorgan-APAC investment bankers used the hiring of client-referred candidates in certain instances as a tool to influence senior officials at clients and prospective clients to obtain banking business. During this period, the Compliance Questionnaire was routinely used by both JPMorgan-APAC investment bankers and personnel responsible for compliance matters. To obtain approval to make these hires, JPMorgan-APAC bankers and supporting personnel provided incorrect, misleading, and untruthful responses to the Compliance Questionnaire. Rather than using the Compliance Questionnaire to determine if a referral hire was done for the purpose of obtaining or retaining business, JPMorgan-APAC employees, including support personnel, falsely used the forms to justify and paper over corrupt business arrangements. In addition, JPMorgan-APAC compliance personnel drafted and modified Compliance Questionnaires that failed to state the true purpose for hiring some referred candidates. For instance, in or about January 2007, JPMorgan-APAC employees, including compliance employees, began using a template for the Compliance Questionnaire with certain answers pre-filled in, including the answer “No expected benefit” in response to a question requiring an explanation for what was the intended benefit to the firm from the referral hire.

JPMorgan-APAC Management Refocused the Client Referral Program to Corruptly Obtain Business Mandates

19. In or about September 2009, JPMorgan-APAC bankers sought to expand and further capitalize on the use of improper referral hiring. On or about September 5, 2009, a JPMorgan-APAC managing director (“JPMorgan-APAC Employee 1”) wrote an e-mail to his JPMorgan supervisor that stated:

One specific item that we may need your help is how to run a better sons and daughters program, which has an almost linear relationship with mandates in China. People believe [other investment banks] are doing a much better job. On the other hand, we J.P.Morgan have had a few disas[t]rous cases which I can share with you later. We have more LoBs [lines of business] in China therefore in theory we can accommodate more ‘powerful’ sons and daughters that could benefit the entire platform.

20. Following this e-mail, various senior members of JPMorgan-APAC management met on repeated occasions to discuss revamping the Client Referral Program to improve JPMorgan-APAC’s ability to obtain specific client business mandates. Among other matters, it was agreed that the Client Referral Program would be used to prioritize referral requests that JPMorgan-APAC received from “decision-makers” or those who had the ability to influence an upcoming banking mandate, preferably in the near term. Thus, for example, on or about September 22, 2009, a JPMorgan-APAC executive who was responsible for supervising Client Referral Program hires (“JPMorgan-APAC Employee 2”) wrote in an e-mail that he wanted to

revisit the Client Referral Program “to plan [for] better . . . deal conversion or revenue attribution and relationship.”

21. Referred candidates hired under the revamped Client Referral Program typically were less qualified for the position of associate, analyst, or summer intern when compared with the regular pool of such candidates hired through JPMorgan-APAC’s standard hiring programs. Referred candidates who met JPMorgan-APAC’s hiring standards typically were directed to apply for jobs through the normal hiring channels. Referred candidates who did not meet JPMorgan-APAC’s hiring criteria for its standard hiring programs were hired through the Client Referral Program. Despite the fact that the Client Referral Program hires typically lacked the record of academic achievement and finance background that JPMorgan required under its standard hiring programs, Compliance Questionnaires submitted for Client Referral Program hires routinely stated that the Client Referral Program candidates were as qualified as other applicants for positions as associates, analysts, and summer interns.

22. In or about November 2009, a JPMorgan-APAC employee whose responsibilities included supervising employees hired under the Client Referral Program prepared a presentation, at the direction of JPMorgan-APAC Employee 2, that described how Client Referral Program hiring was “designed to hire employees referred by [] key clients who may not meet [] regular hiring standard[s],” and that the program “could be further improved to optimize control/management and enhance contribution to business generation.”

23. Under the revamped Client Referral Program, the “selection criteria” included a “[d]irectly attributable linkage to business opportunity.” The authority to sponsor referral hires was further restricted to senior managing directors. The November 2009 presentation also stated that the cost of the program would be “[f]ully allocated to the sponsor’s team as a marketing expense.” In or about December 2010 and March 2011, to keep the Client Referral Program focused on generating near term revenue, a JPMorgan-APAC employee, whose responsibilities included supervising employees hired under the Client Referral Program, created and then updated a spreadsheet that tracked hires to specific clients, while also tracking revenue attributable to those hires. The spreadsheet included columns for each hire, the referring client, the relationship of the candidate, and the amount of revenue generated attributable to the hire in U.S. dollars. One of the purposes of the spreadsheet was to track deals that resulted from the hires and measure revenue associated with Client Referral Program hires.

24. As with the earlier *ad hoc quid pro quo* hires made prior to 2009, JPMorgan-APAC continued to use the existing Compliance Questionnaire to obtain pre-clearance to hire candidates selected under the revamped Client Referral Program. Both investment bankers and support personnel routinely provided inaccurate, misleading, and untruthful answers to the Compliance Questionnaire.

25. Referred candidates hired under the Client Referral Program were typically given the same titles and paid the same amount as entry-level investment bankers,

despite the fact that many Client Referral Program hires performed ancillary work such as proof reading and provided little real value to any deliverable product. On or about July 13, 2011, JPMorgan- APAC Employee 2 sent an e-mail that asked the JPMorgan-APAC employee then overseeing the management of junior-level employees whether “we get real IB [investment banking] productivity from [the referral hire] or is she a photocopier[?]” The employee responded: “Photocopier” and noted that full-time, regular hires referred to these special hires as “‘contractors’ - peripheral.”

26. Client Referral Program hires were also given special treatment in certain instances. For example, on or about April 28, 2011, JPMorgan-APAC Employee 2 requested that a Client Referral Program hire be shifted into a permanent position but noted an issue given the referral’s “undeniable underperformance.” Nevertheless, the hiring was permitted on the grounds that the “deal is large enough [and] we are pregnant enough with this person, that we’d be crazy not to accommodate her father’s wants.”

27. JPMorgan-APAC, through its employees or agents, took acts in furtherance of the corrupt scheme while in the territory of the United States, including sending e-mails while in the United States in furtherance of hiring the referred candidates in order to assist in obtaining and retaining business, and placing certain of the referred candidates in New York in order to assist in obtaining and retaining business. A banker who was based in New York and who reported into JPMorgan-APAC (the “New York Banker”) was directly responsible together with JPMorgan-APAC bankers for placing at least two of the referred candidates in New York, and JPMorgan ultimately profited from the illegal scheme.

Examples of JPMorgan-APAC Quid Pro Quo Hiring

JPMorgan-APAC’s Use of the Referral Program to Secure Business from Client 1

28. In or around 2007, a senior official from Client 1 referred another senior official’s son to a JPMorgan-APAC investment banker in Hong Kong. On or about November 15, 2007, a JPMorgan executive sent an e-mail to an employee in the JPMorgan Human Resources Department for the APAC region, copying a JPMorgan-APAC executive, asking if prior to hiring this candidate they had “validate[d] this kid’s parental status.” On or about the same date, the JPMorgan-APAC executive responded in an e-mail that the referral was “[c]onfirmed as son of [] mayor” and “[c]lose to [Client 1] ceo.”

29. In or about December 2007, JPMorgan-APAC Human Resources and Legal and Compliance employees received responses to the Compliance Questionnaire for this referral. The JPMorgan-APAC banker who completed the form initially disclosed that there was an “expected benefit” to JPMorgan by hiring the job applicant, writing, among other things, “[t]he hiring of this candidate will place JPMorgan in a more favorable position for securing future business from the client.” Shortly thereafter, a JPMorgan-APAC employee changed the response to this question to read: “The candidate will be trained by JPMorgan for couple of years and then go to local bank. Thus, will bring more

business[.]” Rather than rejecting the hire, Human Resources and Compliance instead instructed the JPMorgan-APAC employee to remove the offending language, writing, “[h]iring of the candidate should not be for the purposes of securing future business of the firm. Please remove.”

30. The following week, a JPMorgan-APAC employee changed the Compliance Questionnaire answer to read: “1. Maintain long term good relationship with the client. 2. If the candidate can work out within the firm and demonstrates his capability that will be a win-win situation for JPMorgan, particularly from finding a capable employee point of view.” On or about March 10, 2008, the candidate started work at JPMorgan-APAC.

31. Thereafter, in or about mid-2008, JPMorgan-APAC became the exclusive financial advisor to Client 1 on a transaction yielding profits to the Company of approximately \$4.82 million.

JPMorgan-APAC’s Use of Referral Hiring to Secure Business from Client 2

32. On or about May 29, 2008, a JPMorgan-APAC investment banker received a referral hiring request from a senior executive of Client 2. At the time of the referral, JPMorgan-APAC was actively pitching to be a “joint bookrunner” (*i.e.*, a lead underwriter in a securities issuance) in the initial public offering (“IPO”) for Client 2.

33. On or about July 1, 2008, the sponsoring banker who received the hiring request wrote an e-mail to the JPMorgan-APAC banker responsible for overseeing hiring under the Client Referral Program to inquire whether the referral candidate had been hired. The banker sought guidance about whether it was worth hiring the person, since the IPO had been postponed. A JPMorgan-APAC executive responded: “I am supportive of bringing her on board given what’s at stake. . . . A couple of points . . . to discuss and agree prior to any offer being made to her: how do you get the best quid pro quo from the relationship upon confirmation of the offer?”

34. On or about the same date, the sponsoring banker responded to the e-mail, copying three other JPMorgan-APAC executives, stating, “The client has communicated clearly the quid pro quo on this hire and the team should start working on the [upcoming] IPO asap.” JPMorgan-APAC was selected along with another investment bank as a bookrunner on the IPO. The internal Compliance Questionnaire did not include the information concerning the *quid pro quo* arrangement with Client 2, and in response to the question “What is the expected benefit to JPMorgan in employing the candidate,” the answer provided was “[n]o expected benefit” from the hire.

JPMorgan-APAC’s Use of Referral Hiring to Secure Business from Client 3

35. In or about February 2009, JPMorgan-APAC received a request to hire the son of the Vice-Chairman of Client 3, who also held a senior position at another JPMorgan-APAC client. On or about February 16, 2009, the sponsoring JPMorgan-APAC banker sent an e-mail to a JPMorgan-APAC executive and other investment bankers noting that

both entities “are very important JPM clients” and that “we are in active discussion with [Client 3] on a potential equity raising.”

36. On or about February 17, 2009, the JPMorgan-APAC banker responsible for overseeing junior-level employee staffing sent an e-mail to JPMorgan-APAC Employee 2 seeking approval for the son’s hire, noting that “[t]here seem to be strong business reasons for this referral hire and he is also a Wharton, but not very impressive, poor GPA.” On the same day, JPMorgan-APAC Employee 2 responded, “I know how important this relationship is and yes I support its being processed now.”

37. JPMorgan-APAC Employee 2 kept the Vice-Chairman of Client 3 informed of the son’s status. On or about February 17, 2009, JPMorgan-APAC Employee 2 e-mailed a colleague: “I will be seeing the candidate’s father next week . . . and I can relay the good news to him in person . . . lets get internal approvals underway.” Within several weeks, the son was made an offer and then began working at JPMorgan-APAC in or about July 2009.

38. On or about July 23, 2009, a banker who supervised the work of the son described the son’s performance as not satisfactory:

Clearly, I think [the referral] has attitude issue. Every research analyst/assistant and intern . . . comes to office for morning meeting-morning meeting participation is compulsory for entire research department globally. We have told [the son] to attend but apparently he doesn’t seem to care In this case, I think he can stay in other department and doesn’t need to “sit” in research for the sake of it. If having [the son] sit in every department for 2 weeks is a business need to maintain relations with [Client 3], I can understand and am happy to accommodate. But next time, we really don’t need to have an intern doing nothing and not following very basic rule.

39. In spite of the son’s performance issues, JPMorgan-APAC continued to employ him and to accommodate additional demands concerning him described below. On or about August 27, 2010, JPMorgan-APAC Employee 2 wrote an e-mail to another JPMorgan-APAC banker, which read, in part: “So we picked up a new mandate in [our office] today - all we have to do is get [the son] a full time analyst job at JPM in NY. Mission impossible?” On or about the same date, the JPMorgan-APAC banker responded by referencing the difficulties given the son’s performance: “Can try his napping habit will be an eye-opening experience for our NY colleagues if he gets a job. Does it have to be [investment banking]? He’s not really built for it.”

40. On or about September 3, 2010, JPMorgan-APAC Employee 2 sent an e-mail to several JPMorgan investment bankers stating:

We have a very good client in Taiwan who has asked that we find an IB analyst role for his son in NY. We are being offered now a sellside on a

800mm [transaction] and the quid pro quo, is an analyst IB job for his son.

41. On or about October 29, 2010, the son of the Vice-Chairman of Client 3 was offered a full-time position as an analyst at JPMorgan in New York. A JPMorgan banker noted in an October 29, 2010 e-mail sent to a JPMorgan-APAC banker based in Asia and other JPMorgan bankers that because of the job offer the son was a “happy young man! And his dad will also be very pleased.”

42. On or about January 27, 2011, JPMorgan received a mandate for an equity offering from Client 3. On or about the same date, a high-level JPMorgan executive sent an e-mail to another high-level executive, stating, “[Vice Chairman of Client 3] certainly followed through on his unspoken promises. We must make absolutely sure we keep a close eye on his son whom I continue to mentor on a regular basis.” The JPMorgan executive then sent an e-mail to a JPMorgan-APAC banker stating, “This win is really down to you. We would never have got a chance without your help and guidance and your relationships.”

JPMorgan-APAC’s Use of Referral Hiring to Secure Business

Generally by Hiring the Son of Chinese Official 1

43. JPMorgan-APAC hired the son of Chinese Official 1, who was then a deputy minister at a Chinese government agency. On or about July 21, 2006, a JPMorgan-APAC investment banker attempted to place a candidate referred by Chinese Official 1 in an investment banking position in JPMorgan’s New York office. Several days later, in describing the importance of Chinese Official 1, the JPMorgan-APAC investment banker e-mailed a high-level executive at JPMorgan describing the influence of Chinese Official 1:

Although he is now promoted to be a government official, his influence remains strong both personally as well as in an official capacity [at the Chinese Ministry] . . . [and] a good in[-]depth relationship with the Ministry will pave the ground for us in many large and important industries in China as well as large cap companies, despite the fact some of them are ‘independent’ commercial entities, a unique feature of the Chinese/government business alliance.

44. In or about December 2006, the son of Chinese Official 1 completed interviews for a position in New York. A New York employee e-mailed a JPMorgan-APAC banker that the referral “did very very poorly in interviews—some [managing directors] said he was the worst BA [business analyst] candidate they had ever see[n]—and we obviously had to extend him an offer . . . [o]bviously, we will need to accommodate due to client pressure, but we’re going to have to handle this very carefully.”

45. In or about mid-2007, JPMorgan-APAC created a position in New York to place the son into a one-year term position.

46. In May 2008, during the first year of the son's work at JPMorgan in New York, Chinese Official 1 requested that JPMorgan-APAC Employee 1 provide the son with another job after his one-year term position expired. On or about June 8, 2008, JPMorgan-APAC Employee 1 sent an e-mail discussing the business case for finding the referral candidate another position, which stated, in part:

The father indicated to me repeatedly that he is willing to go extra miles to help JPM in whatever way we think he can. And I do have a few cases where I think we can leverage the father's connection. [G]iven the above, I'd like to discuss with you and seek your advice/support on how to handle the son in NY and leverage the father in China. Many thanks.

47. In or about July 2008, the New York Banker offered a position in his group to the referral candidate. On or about August 11, 2008, the New York Banker informed JPMorgan-APAC Employee 1: "I don't have the details of the incident but apparently last Friday when I was out of the office, [the referral] sent out an e-mail (which he inadvertently copied to an HR person), where he made some inappropriate sexual remarks."

48. After learning of the e-mail, various JPMorgan-APAC executives undertook to keep Chinese Official 1's son in the position. On or about August 12, 2008, the New York Banker sent a follow up e-mail stating:

[T]here is general consensus among the seniors in our group as well reports from people in his previous group that [the referral] is immature, irresponsible and unreliable. [A banker in the] European Clients Group with whom we share the analyst pool where [the referral] sits, is no longer willing to have [the referral] as part of the pool. That means that our Asia Group must take him on exclusively and in addition to all else, there is also concern about his reliability on confidentiality of client records/documents which means that we may not be able to let him have access to sensitive transactional records/documents.

49. The next day, the New York Banker e-mailed a colleague: "[A]s I suspected, we will need to manage this situation in our group for which I will need your input/support." Despite the referral's performance, he was kept on until his position was eliminated as part of a reduction in force exercise ten months later.

JPMorgan-APAC's Use of Referral Hiring to Secure a Major Hong Kong IPO

50. Beginning no later than in or about early 2009, Client 4 commenced the process for an IPO. JPMorgan-APAC was actively competing with other investment banks for a lead role on that IPO and had been informally pitching for such a role since 2007. When Client 4 went public in 2010, the IPO raised billions of dollars.

51. As part of pitching for a role in the Client 4 IPO, JPMorgan-APAC identified several key decision-makers at Client 4 who were understood to have significant

influence over awarding roles in the IPO to the competing investment banks. One of these key decision-makers was Chinese Official 2.

52. On or about November 13, 2009, several months before JPMorgan-APAC submitted a formal proposal for the IPO, Chinese Official 2 e-mailed a letter to a JPMorgan- APAC Employee 1 and attached the resume of a referred candidate. This referred candidate wanted a position in JPMorgan's New York office. In e-mails, JPMorgan-APAC Employee 1 repeatedly described the referred candidate as Chinese Official 2's nephew, although in reality there was no blood relation between the referred candidate and Chinese Official 2. The referred candidate's father was an executive at a Chinese state-owned energy company, from which JPMorgan-APAC was also seeking business.

53. In or about late 2009, Chinese Official 2 communicated to JPMorgan-APAC Employee 1 that hiring the referred candidate would significantly influence the role JPMorgan-APAC would receive in Client 4's upcoming IPO. JPMorgan-APAC Employee 1 communicated this message to several senior colleagues, who understood that JPMorgan-APAC would receive a more significant and lucrative role in the IPO if JPMorgan-APAC hired the candidate referred by Chinese Official 2, and would risk losing the mandate if it did not make the hire.

54. On or about December 4, 2009, a JPMorgan-APAC executive e-mailed a colleague, who had received the November 12 letter from Chinese Official 2: "Spoke[n] with a few people who know [the referred candidate]. Unlikely to pass th[ro]ugh regular process." Indeed, in subsequent months, as the candidate referred by Chinese Official 2 pursued various jobs at JPMorgan, it became clear that he was not qualified for an investment banking job at JPMorgan. On or about December 9, 2009, one recruiter, for example, stated in an e-mail that "[relative] to other candidates, [the referral candidate's] technological and quantitative skills were light (this is an extremely quantitative position)."

55. On or about December 16, 2009, a JPMorgan-APAC banker e-mailed the New York Banker. The JPMorgan-APAC banker asked for assistance with hiring the referred candidate and stated that JPMorgan-APAC would "agree to fund [the referral] if necessary." Thereafter, the New York Banker arranged for multiple interviews for positions in New York for the candidate referred by Chinese Official 2.

56. In or about December 2009 and January 2010, JPMorgan-APAC executives received multiple inquiries and repeated pressure from Chinese Official 2 and another official to hire the candidate referred by Chinese Official 2. On or about December 22, 2009, JPMorgan-APAC Employee 1 e-mailed the New York Banker to offer his appreciation for the New York Banker's assistance and stated that the candidate's "father and his uncle have separately approached so many different people at J.P. Morgan."

57. On or about December 28, 2009, Chinese Official 2 sent a follow up e-mail to JPMorgan-APAC Employee 1 pushing for the hire of the referred candidate. On or about January 14, 2010, JPMorgan-APAC Employee 1 e-mailed his supervisor referring to a letter from “[Chinese Official 2] at [Client 4] pushing for a NY-based job position for his nephew.” JPMorgan-APAC Employee 1 stated that:

[T]o avoid any “complication”, [Chinese Official 2] has asked to keep this confidential and particularly away from the ‘[Client 4] pitch team’ But I have kept [a senior banker on the pitch team] in the loop . . . Would be great if you could give this a push in NY [Financial Institutions Group].

58. In a separate e-mail sent on or about January 14, 2010, JPMorgan-APAC Employee 1 forwarded the December 28th e-mail from Chinese Official 2 and stated: “Another letter from [Chinese Official 2] pushing for the same candidate. In between there have been several phone calls and sms from him.” JPMorgan-APAC Employee 1 later e-mailed the New York Banker and told him, “I spoke with [the supervisor] last week about [the referred candidate] after his meeting with [Chinese Official 2]. He agreed to take this case to [another high-level banker] in NY himself. FYI only.”

59. By the end of January 2010, JPMorgan-APAC employees attempting to find a job for the candidate referred by Chinese Official 2 had been unsuccessful. On or about January 21, 2010, a New York-based JPMorgan employee who had interviewed the referred candidate reported that the candidate’s “communication skills and his interest in Investment Banking lagged that of his peers. Based on the feedback, the FIG [Financial Institutions Group] New York team is not comfortable moving forward with an offer.” After receiving pushback from the New York Banker to reconsider, the interviewer wrote:

[T]he recruitment process for our analyst program in the Investment Bank is highly competitive. I have personally interviewed and interacted with dozens of highly talented analyst candidates that have had a more well-rounded skill-set than [the referred candidate] that we’ve also chosen not to pursue. In summary, [the referred candidate’s] current skill-set falls short in some of the categories I mentioned above and I would recommend he pursue a different career track.

60. On or about January 22, 2010, the New York Banker received a follow up e-mail from a human-resources employee recommending that he “be honest with the individual (and the client) and let him know that we don’t want to place him in a situation where it will be difficult to succeed and advise (and help) him pursue other opportunities that might be better ‘fits’ for his skill set and will provide a better opportunity to be successful.”

61. The New York Banker did not deliver this message to the referred candidate or Chinese Official 2. Instead, JPMorgan-APAC bankers created a position for the referred

candidate in the New York office funded out of JPMorgan-APAC's budget. On or about February 2, 2010, a JPMorgan-APAC banker leading the pitch for Client 4's IPO e-mailed three senior colleagues about the referral candidate:

[W]e have now reached consensus among us to offer [the referred candidate] a one year fixed term position at [the New York Banker's] team in our new york office. We understand that you have been always supportive of this hire. it is time to ask your approval to proceed on that basis. [Chinese Official 2] called and sent sms to [JPMorgan-APAC Employee 1] and me several times to ask the status. If we can get this hire done soon, that will be very helpful.

62. On or about February 10, 2010, the firm hired the candidate referred by Chinese Official 2 and attributed the headcount to JPMorgan-APAC; no Compliance Questionnaire was submitted for this hire to Legal and Compliance.

63. Thereafter, in the second quarter of 2010, JPMorgan-APAC was selected as a joint bookrunner for Client 4's IPO. On or about June 7, 2010, JPMorgan-APAC Employee 1 sent an e-mail to the New York Banker: "I understand from his father that [the referred hire] will start today in office. His uncle [Chinese Official 2] did deliver [the Client 4] IPO and his father is helping us on a [different] ipo."

64. In or about mid-2010, a senior official at Client 4 informed a banker at one of JPMorgan-APAC's competitors that the selection criteria for investment banks to underwrite the Client 4 IPO had included whether the investment bank had hired candidates referred by Client 4 officials.

65. On or about November 9, 2010, JPMorgan-APAC Employee 1 wrote in an e-mail to several JPMorgan-APAC executives that "[the referred hire] has been extremely helpful in our relationship with [Client 4]."

66. On or about January 26, 2011, JPMorgan-APAC Employee 1 wrote to a JPMorgan-APAC executive about the referred hire: "[t]his is the young analyst you met briefly. . . . He (and his family) has been instrumental in helping us on both the [Client 4] IPO and [an energy company] IPO. His father is also helping us on [other energy companies] at the moment as well."

67. JPMorgan-APAC received profits of at least \$23.8 million as a result of the Client 4 IPO.

Corporate crime problems can tend towards contagion within industries. That seems to particularly be a tendency in the financial services industry. For example, in October of 2019, investigative journalists reported a scheme by Deutsche Bank to win business

through mass bribery of Chinese political elites.¹⁷ Beyond million-dollar payouts to Chinese consultants, Deutsche Bank also gave Chinese officials luxury goods such as a \$15,000 crystal horse, a \$4,000 bottle of French wine, and Louis Vuitton products totaling \$22,000. The Deutsche Bank affair led to a civil enforcement settlement with the SEC somewhat similar to the DOJ settlement in the JP Morgan matter.¹⁸

The following is another high-profile FCPA matter involving perhaps the world's most familiar name in financial institutions, Goldman Sachs. The example provides a paradigmatic picture of bribery in the conduct of business in a developing economy. The matter was resolved through settlements with various enforcers, including a settlement with DOJ that included a guilty plea by a regional subsidiary and a deferred prosecution agreement with the parent company, Goldman Sachs. To see the nature of the FCPA violations, here is a portion of the agreed statement of facts that was appended to the settlement agreements.

ATTACHMENT A

STATEMENT OF FACTS

The following Statement of Facts is incorporated by reference as part of the Deferred Prosecution Agreement (the "Agreement") between the United States Department of Justice, Criminal Division, Fraud Section (the "Fraud Section") and Money Laundering and Asset Recovery Section ("MLARS"), and the United States Attorney's Office for the Eastern District of New York (the "Office") (collectively, the "United States"), and the defendant, The Goldman Sachs Group, Inc. (together with its wholly-owned subsidiaries and affiliated entities, "Goldman" or the "Company"). Goldman hereby agrees and stipulates that the following facts and conclusions of law are true and accurate. Certain of the facts herein are based on information obtained from third parties by the United States through its investigation and described to Goldman. Goldman admits, accepts, and acknowledges that it is responsible for the acts of its officers, directors, employees and agents as set forth below. Should the United States pursue the prosecution that is deferred by this Agreement, Goldman agrees that it will neither contest the admissibility of, nor contradict, this Statement of Facts in any such proceeding. The following facts took place during the relevant time period, unless otherwise noted, and establish beyond a reasonable doubt the charges set forth in the criminal Information attached to the Agreement.

1. From in or about and between 2009 and at least 2014 (the "relevant time period"), Goldman was a global investment banking, securities and investment management firm incorporated in Delaware and headquartered in New York, New York. Accordingly, during the relevant time period, Goldman was a "United States person" as

¹⁷ For the details, see Michael Forsythe, David Enrich, & Alexandra Stevenson, *Inside a Brazen Scheme to Woo China: Gifts, Golf and a \$4,254 Wine*, N.Y. TIMES (Oct. 14, 2019), <https://www.nytimes.com/2019/10/14/business/deutsche-bank-china.html>.

¹⁸ For the details, see <https://www.sec.gov/litigation/admin/2019/34-86740.pdf>.

that term is used in the Foreign Corrupt Practices Act (“FCPA”), Title 15, United States Code, Section 78dd-1(g). Goldman had a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934 (Title 15, United States Code, Section 78l) and was required to file periodic reports with the U.S. Securities and Exchange Commission (“SEC”). Accordingly, during the relevant time period, Goldman was an “issuer” as that term is used in the FCPA, Title 15, United States Code, Section 78dd-1. Goldman operated worldwide primarily through wholly-owned subsidiaries and affiliated entities. Goldman and its subsidiaries and affiliated entities, combined, had approximately 38,000 employees.

2. Goldman Sachs (Malaysia) Sdn. Bhd. (“Goldman Malaysia”) was a wholly-owned subsidiary and agent of Goldman. Goldman Malaysia was incorporated in Malaysia and had offices in Kuala Lumpur. Goldman Malaysia’s records and accounts were included in Goldman’s consolidated financial statements to the SEC. Goldman Malaysia also received revenue related to the relevant transactions described more fully below. During the relevant time period, Goldman Malaysia and its employees and directors were agents of an “issuer” as that term is used in the FCPA, Title 15, United States Code, Section 78dd-1.

3. Goldman Sachs (Singapore) Pte., Goldman Sachs International, Goldman Sachs Bank USA, Goldman Sachs & Co. L.L.C. and Goldman Sachs (Asia) L.L.C. are each Goldman subsidiaries, and they and their employees were agents of Goldman that assisted in carrying out business around the world, including the relevant transactions and conduct set forth herein. During the relevant time period, Goldman Sachs (Asia) L.L.C. was incorporated in Delaware, had offices in Hong Kong and was a “domestic concern” as that term is used in the FCPA, Title 15, United States Code, Section 78dd-2, and a “United States person” as that term is used in the FCPA, Title 15, United States Code, Section 78dd-2(i).

4. Tim Leissner (“Leissner”) was employed by various Goldman subsidiaries and acted as an agent and employee of Goldman with respect to the transactions and conduct set forth herein. Leissner was employed by Goldman from in or about and between 1998 and 2016, and was a Participating Managing Director (“PMD”) from in or about and between November 2006 and February 2016. Additionally, he held various senior positions in Goldman’s Investment Banking Division in Asia from in or about and between 2011 and 2016, including Chairman of Southeast Asia, a region that included Malaysia, from in or about and between July 2014 and February 2016, and he served on the Board of Directors for Goldman Malaysia. Leissner’s job included obtaining and executing business for Goldman. During the relevant time period, with respect to the transactions and conduct set forth herein, Leissner was an employee and agent of an “issuer” and a “domestic concern” as those terms are used in the FCPA, Title 15, United States Code, Sections 78dd-1(a) and 78dd-2(a).

5. Ng Chong Hwa, also known as “Roger Ng” (“Ng”), was employed by various Goldman subsidiaries from in or about and between 2005 and 2014, including Goldman

Malaysia, and acted as an agent and employee of Goldman with respect to the transactions and conduct set forth herein. In or about and between April 2010 and May 2014, Ng was a Managing Director (“MD”) of Goldman. For part of that time, Ng served as Head of Investment Banking and on the Board of Directors for Goldman Malaysia, and was then employed by another Goldman subsidiary in Malaysia. Ng worked with Leissner on the relevant transactions, and his job included obtaining and executing business for Goldman. During the relevant time period, Ng was an employee and agent of an “issuer” as that term is used in the FCPA, Title 15, United States Code, Section 78dd-1(a).

6. “Employee 1,” an individual whose identity is known to the United States and the Company, was employed by at least one Goldman subsidiary, and acted as an agent and employee of Goldman. In or about and between October 2007 and November 2018, Employee 1 served as a PMD and, during the relevant time period, held various leadership positions in Goldman’s Asia operations. Employee 1 worked with Leissner and Ng on the relevant transactions. During the relevant time period, Employee 1 was an employee and agent of an “issuer” as that term is used in the FCPA, Title 15, United States Code, Section 78dd-1(a).

7. 1Malaysia Development Berhad (“1MDB”) was a strategic investment and development company wholly owned by the Government of Malaysia through its Ministry of Finance (“MOF”). It was formed in or about 2009 to pursue investment and development projects for the economic benefit of Malaysia and its people, primarily relying on debt to fund these projects. 1MDB was overseen by senior Malaysian government officials, was controlled by the Government of Malaysia and performed a function on behalf of Malaysia. During the relevant time period, 1MDB was an “instrumentality” of a foreign government, as that term is used in the FCPA, Title 15, United States Code, Sections 78dd-1(f)(1), 78dd-2(h)(2), 78dd- 3(f)(2).

8. International Petroleum Investment Company (“IPIC”) was an investment fund wholly owned by the Government of Abu Dhabi. It was established by the Government of Abu Dhabi and was overseen by senior Abu Dhabi government officials, was controlled by the Government of Abu Dhabi and performed a government function on behalf of Abu Dhabi. During the relevant time period, IPIC was an “instrumentality” of a foreign government, as that term is used in the FCPA, Title 15, United States Code, Sections 78dd-1(f)(1), 78dd-2(h)(2), 78dd-3(f)(2).

9. Aabar Investments PJS (“Aabar”) was a private joint stock company incorporated under the laws of Abu Dhabi, and a subsidiary of IPIC. During the relevant time period, Aabar was an “instrumentality” of a foreign government, as that term is used in the FCPA, Title 15, United States Code, Sections 78dd-1(f)(1), 78dd-2(h)(2), 78dd-3(f)(2). . .

10. During the relevant time period, Low Taek Jho, also known as “Jho Low” (“Low”), was a Malaysian national who worked as an intermediary in relation to 1MDB

and other foreign government officials on numerous financial transactions and projects involving Goldman and others. . . .

11. In or about and between 2009 and 2014, Goldman, through certain of its agents and employees, together with others, knowingly and willfully conspired and agreed with others to corruptly provide payments and things of value to, or for the benefit of, foreign officials and their relatives to induce those foreign officials to influence the decisions of 1MDB, IPIC and Aabar to obtain and retain business for Goldman, including positions as an advisor to 1MDB on the acquisitions of Malaysian energy assets, underwriter of the 1MDB bonds, and underwriter of certain other 1MDB business, including the contemplated initial public offering (“IPO”) of 1MDB’s Malaysian energy assets. Leissner, Ng and Employee 1 used Low’s connections within the Governments of Malaysia and Abu Dhabi to obtain and retain this and other business for Goldman and, in turn, concealed Low’s involvement in the deals from certain employees and agents of Goldman. In total, Goldman conspired to provide approximately \$1.6077 billion to, or for the benefit of, foreign officials and their relatives, of which approximately \$18.1 million was paid from accounts controlled by Leissner.

12. The bribes resulted in Goldman being engaged on, among other projects, three bond offerings that were related to 1MDB’s energy acquisitions and that raised a total of approximately \$6.5 billion for 1MDB in 2012 and 2013. The bribes were also intended to help Goldman secure a role on the anticipated IPO of those energy assets. These three bond offerings and a related acquisition, along with a transaction involving Low and IPIC, ultimately earned Goldman in excess of \$600 million in fees and revenue across its divisions, and increased Goldman’s stature in Southeast Asia. In the course of this scheme, payments and communications made in furtherance of the scheme were made via wires that passed through the Eastern District of New York.

13. Pursuant to Goldman’s internal accounting controls, each 1MDB bond transaction required Goldman management’s general and specific authorization. Moreover, because Goldman initially purchased the full value of each bond from 1MDB using Goldman’s assets, the transactions needed to be appropriately authorized and properly recorded. Among other things, Goldman’s internal accounting controls included the Firmwide Capital Committee (“FWCC”), which was authorized by Goldman’s Chief Executive Officer to provide global oversight and approval of bond transactions, including those transactions in which Goldman used its own assets to purchase the financial instruments, like the 1MDB bonds. Goldman’s internal accounting controls also included approval of the bonds by Goldman’s Business Intelligence Group (“BIG”) and compliance, both of which were represented on the FWCC. While certain of Goldman’s employees and agents, including Leissner, Ng and Employee 1, circumvented these and other controls, other Goldman employees and agents who were responsible for implementing its internal accounting controls failed to do so in connection with the 1MDB bond deals. Specifically, although employees serving as part of Goldman’s control functions knew that any transaction involving Low posed a significant risk, and although they were on notice that he was involved in the

transactions, they did not take reasonable steps to ensure that Low was not involved. Additionally, there were significant red flags raised during the due diligence process and afterward, including, but not limited to, Low's involvement in the deals, that were either ignored or only nominally addressed so that the transactions would be approved and Goldman could continue to do business with 1MDB.

14. In or about 2009, Leissner and Ng were introduced to Low, who was known to be close to various high-ranking officials in Malaysia and Abu Dhabi, and through Low began cultivating relationships with Malaysian Official 1 and others to secure business for Goldman.

15. In or about January 2009, Leissner and Ng discussed with Low and others a role for Goldman in the creation of and potential fundraising for Terengganu Investment Authority ("TIA"), 1MDB's predecessor entity.

16. Leissner and Ng also attempted to onboard Low as a Goldman client, or otherwise work with Low, on numerous occasions in or about and between 2009 and 2013. For example, in or about September 2009, Ng referred Low for a private wealth management account ("PWM") through a Goldman European subsidiary. Ng described Low as "our partner in a lot of transactions in [M]alaysia. Largely the mid-east and [M]alaysia rationship [sic]." As part of the onboarding process, Goldman's control functions, including BIG, vetted Low's finances and raised questions about his source of wealth. As control functions personnel worked to diligence those questions about Low, the business side continued to pressure them to approve Low as a client. In a March 13, 2010 email, a Goldman regional head of compliance wrote to a high-level BIG executive and others, expressing frustration with the pressure to approve Low and underscoring the red flags Low raised as a client:

This has been an exceptionally trying experience I have to admit, and I believe that no matter what we do [Goldman PWM representative] is not willing to accept that we are not in a position to onboard this prospect . . . I do not believe we will ever be able to get comfortable with this matter. I'd like to shut this down once and for all . . . It is seldom that one sees a vendor report, which has been backed up verbally by them, that so clearly states that we should exercise extreme caution.

17. Ultimately, BIG personnel rejected Low as a Goldman client because of his inability to satisfactorily answer questions raised by Goldman's control functions, as well as negative news coverage about Low's lavish spending. Notwithstanding this rejection, there were additional attempts to onboard Low and his companies as a Goldman client.

18. For example, in early 2011, Leissner tried to onboard two of Low's companies as clients of Goldman but was unable to do so due to compliance's continued objections to Low.

19. Around the same time, Leissner made an additional attempt to bring Low on as a PWM client through Goldman's Singapore office, without referencing the prior attempt. Low was again denied due to, among other things, his questionable source of wealth. In a March 11, 2011 email chain discussing the attempt, a high-ranking employee in compliance and MD noted, "To be clear, we have pretty much zero appetite for a relationship with this individual," and a high-ranking employee in BIG and MD expressed, "this is a name to be avoided."

20. Even after the control functions had rejected Low as a client, Leissner, Ng and others at Goldman continued their relationship with Low and used him to obtain and retain business for Goldman from 1MDB and others. In or about and between 2012 and 2013, Leissner, Ng, Employee 1 and other Goldman employees worked with Low to help 1MDB raise more than \$6.5 billion via three separate bond offering transactions, referred to internally at Goldman as "Project Magnolia," "Project Maximus" and "Project Catalyze," respectively.

21. In or about February 2012, 1MDB engaged Goldman as its financial advisor for its anticipated purchase of a Malaysian energy company ("Malaysian Energy Company A"). Low helped secure Goldman's role in that transaction.

22. On or about January 23, 2012, Low arranged a meeting between Leissner, Ng and a high-ranking 1MDB official. In making the arrangements, Low emailed all three at their personal email addresses, and stated "Making an introduction to [Leissner] and [Ng]'s private e-mail accounts [. . .] Please exclude me from the e-mail list going forward." Thereafter, Leissner and Ng worked with the high-ranking 1MDB official on the potential purchase of Malaysian Energy Company A.

23. 1MDB was also interested in raising funds to acquire Malaysian Energy Company A, including through a bond transaction. In or about early 2012, Leissner, Ng, 1MDB Official 1, 1MDB Official 3, Low and others met in Malaysia to discuss the necessity of a guarantee from IPIC to make the bond transaction feasible for Goldman, which would purchase all of the bonds initially, and then sell the bonds to other investors.

24. In or about February 2012, Leissner and Ng traveled to London to meet with Low and others to discuss the proposed bond transaction. Leissner and Ng utilized Goldman resources to fund their travel to London.

25. At that meeting, Low explained that government officials from Abu Dhabi and Malaysia needed to be bribed to both obtain the guarantee from IPIC and get the necessary approvals from Malaysia and 1MDB. Low advised that a high-ranking official of IPIC ("IPIC Official 1") and Malaysian Official 1 needed to be paid the largest bribes out of all the government officials to approve the transaction, and that other lower-level officials would need to be bribed as well.

26. Subsequently, Leissner and Ng each separately informed Employee 1 about the information they had learned at the London meeting regarding the need to bribe foreign officials.

27. Low also promised remuneration to various 1MDB officials to facilitate the deals and to ensure Goldman's role in those deals. For example, on or about March 8, 2012, 1MDB Official 1 emailed himself a copy of an online chat he had with Low on or about March 8, 2012, in which they discussed, among other things, Malaysian Energy Company A. In that chat, Low told 1MDB Official 1 that he would give 1MDB Official 1 a "big present" when the Malaysian Energy Company A transaction was completed and then directed 1MDB Official 1 to "delete from email and destroy once done."

28. On or about March 5, 2012, Leissner, Ng, Employee 1, Low and others traveled to Abu Dhabi to meet with IPIC and Aabar representatives regarding the potential debt financing that would assist 1MDB in raising funds for the acquisition of Malaysian Energy Company A. During the same trip, Low arranged a meeting between Leissner and IPIC Official 1, during which Leissner delivered a letter from Malaysian Official 1 addressed to IPIC Official 1.

29. On or about March 19, 2012, 1MDB formally chose Goldman as the "sole bookrunner and arranger" for the \$1.75 billion debt financing transaction designed, in part, to pay \$822 million towards Malaysian Energy Company A's acquisition. IPIC was chosen to serve as guarantor on the bond and Aabar was granted certain options by the 1MDB issuer for assistance in securing the guarantee.

30. One of Goldman's goals in pursuing this transaction was to secure more business for itself, including a role in the potential IPO of 1MDB's energy assets, as explicitly stated in Goldman's FWCC memorandum circulated during the approval process for Project Magnolia: "Post closing, we expect significant follow on business from 1MDB and 1MDB Energy[,] including the IPO of 1MDB Energy."

31. As work progressed on Project Magnolia, between on or about March 25, 2012 and on or about March 29, 2012, Leissner and Ng traveled to Los Angeles, California and New York, New York to discuss matters related to Project Magnolia with Low and others. Leissner and Ng traveled using Goldman resources.

32. Meanwhile, although employees within Goldman's control functions suspected that Low may be involved in the deal, the only step taken by the control functions to investigate that suspicion was to ask members of the deal team whether Low was involved and to accept their denials without reasonable confirmation.

33. For example, during a telephone call in or about March 2012, a high-ranking employee in BIG and MD voiced suspicions that Low was involved in Project Magnolia. Leissner denied that Low was involved. Similarly, on or about April 3, 2012, the day before a FWCC meeting to discuss Project Magnolia, a high-ranking executive in BIG, who was also an advisor to the FWCC ("Employee 2"), emailed other members of BIG

that “Leissner said Jho Low not involved at all in deal as far as he [is] aware but that Low was present when Leissner met [IPIC Official 1] in Abu Dhabi.”

34. On or about April 4, 2012, the FWCC meeting was held, which was attended telephonically by Goldman executives in New York, New York. During this meeting, Leissner was asked whether Low was involved in Project Magnolia and Leissner said that, other than arranging a meeting between Leissner and IPIC Official 1, Low was not involved. Ng was also present during this meeting and did not correct Leissner’s false statement about Low’s involvement. Later that same day, after the FWCC meeting, Employee 2 emailed Leissner, stating “I was told Jho Low attended the meeting you had with [IPIC Official 1] . . . that was wrong.” Leissner responded that he “hand delivered a letter by the Prime Minister of Malaysia to [IPIC Official 1] and the Crown Prince.” Employee 2 replied, “I guess Low will have had a hand in fixing that you were able to carry the letter from the Malaysian PM . . . Important we have no role on our side for Low and we should ask that any payments from any of [the] participants to any intermediaries are declared and transparent.” Leissner agreed with Employee 2’s admonishment.

35. Goldman’s control functions accepted the statements of the deal team members about Low’s involvement at face value, rather than taking additional steps that Goldman’s control functions took in other deals, such as reviewing the electronic communications of members of the deal team to look for evidence of Low’s involvement (e.g., searching for references to Low). For example, had Goldman conducted a review of Leissner’s electronic communications at this time, it would have discovered multiple messages linking Low to, among others, the bond deal, 1MDB officials, Malaysian Official 1 and Abu Dhabi Official 1, as well as the use of personal email addresses by Leissner and Ng to discuss Goldman business.

36. During this time period, Low, Leissner and Ng continued to structure the bribery scheme. Leissner and Ng ultimately understood that Low intended to use the funds raised through Project Magnolia to pay bribes, and cause bribes to be paid, to foreign officials in Malaysia and Abu Dhabi to influence those officials to obtain the necessary approvals and assistance for Goldman to execute Project Magnolia.

37. On or about May 16, 2012, Goldman’s committees approved Project Magnolia, and on or about May 21, 2012, the \$1.75 billion bond issuance closed. Goldman purchased the entire bond issuance from 1MDB.

38. On or about May 22, 2012, Goldman caused approximately \$907,500,000 in proceeds from Project Magnolia to be wired to a 1MDB subsidiary (“1MDB Subsidiary 1”), through a correspondent bank account in New York, New York. Goldman booked approximately \$192,500,000 in fees for this bond transaction and an additional approximately \$16,800,000 in fees for advising on the acquisition of Malaysian Energy Company A. . . .

39. Within weeks of closing Project Magnolia, in or about May 2012, 1MDB sought assistance from Goldman to purchase a second Malaysian energy company (“Malaysian Energy Company B”) and to issue a bond to raise funds for the acquisition. In or about August 2012, 1MDB agreed to purchase Malaysian Energy Company B for approximately \$814 million and planned to finance the purchase with another \$1.75 billion bond guaranteed indirectly by IPIC.

40. Once again, Goldman’s control functions simply accepted at face value the representations of the deal team members and failed to further investigate Low’s suspected involvement in this bond deal. For example, on or about June 20, 2012, a member of Goldman’s control functions asked members of the deal team, “Is Jho Low involve[d] in this transaction? Please also keep us posted if there are any other politically exposed person involve[d] in this transaction in a non-official capacity.” A deal team member responded “no.”

41. Additionally, on or about October 10, 2012, in response to committee questions, Leissner told a firmwide committee that neither Low nor any intermediary was involved in Project Maximus. Despite their continued concern, as evidenced by their repeated questions, Goldman’s control functions did not engage in electronic surveillance of Leissner’s correspondence or activities to determine whether Low was involved in the deal.

42. Goldman’s continued control failures were further compounded when Goldman ignored additional red flags raised by Project Maximus, including that 1MDB was seeking to raise additional funds within a few months of raising \$1.75 billion via Project Magnolia without having utilized the full amount from that deal, and was also seeking to raise far more than was needed to acquire Malaysian Energy Company B. Goldman’s control functions also failed to verify how Project Magnolia’s proceeds were used.

43. On or about October 19, 2012, Project Maximus closed. Goldman purchased the entire bond issuance from 1MDB. On or about October 19, 2012, Goldman caused approximately \$1.64 billion to be transferred via wire through correspondent accounts in the United States to another 1MDB subsidiary (“1MDB Subsidiary 2”). Goldman booked approximately \$110,000,000 in fees for Project Maximus. . . .

44. Leissner then directed follow-on transfers from Holding Company 2 Account to government officials and others. For example, on or about December 4, 2012, Leissner emailed his close relative from his personal account with bank account details and amounts to be wired from Holding Company 2 Account to Malaysian Official 2, 1MDB Official 4 and 1MDB Official 5. On or about January 15, 2013, Leissner again emailed his close relative from his personal account, correcting some banking information and adding a transfer to 1MDB Official 2. . . .

45. In or about November 2012, almost immediately after Project Maximus closed, Leissner and Low began working on another bond issuance. Ultimately, Goldman underwrote a third bond issuance that raised an additional \$3 billion for 1MDB with

Goldman acting as arranger and underwriter. This bond issuance was purportedly intended to fund 1MDB's portion of a joint venture with Aabar.

46. Goldman's control functions had continued suspicions that Low was working on the third bond deal. Once again, however, the control functions relied solely on the deal team members' denials of Low's involvement without any further scrutiny.

47. On or about April 24, 2013, a senior Goldman executive who was a member of Goldman's approval committee located in New York, New York, emailed Leissner about "1MDB," asking: "Is there a story circulating about an intermediary on the Magnolia trades?" Leissner responded, "Not that I am aware of . . . There definitely was no intermediary on any of the trades. The blogs in Malaysia always try to link a young Chinese business man [sic], Jho Low, to 1MDB. That is not the case other than he was an advisor alongside other prominent figures to the King of Malaysia at the time of the creation of 1MDB." There was no follow-up by Goldman's control functions about Low.

48. Goldman also failed to address the other red flags that were raised by the proposed \$3 billion transaction, including, once again, 1MDB raising large sums of money with no identified use of proceeds within months of Project Magnolia and Project Maximus, and Goldman's failure to verify use of past bond proceeds. Adding to the transaction's risks was the upcoming Malaysian general election, which directly affected the political future of Malaysian Official 1.

49. Goldman's committees nevertheless approved Project Catalyze on or about March 13, 2013, and the proceeds from Project Catalyze were issued on or about March 19, 2013. Goldman purchased the entire bond issuance from 1MDB and booked approximately \$279,000,000 in fees on Project Catalyze.

50. Low and Leissner continued to pay bribes to government officials from the bond proceeds. On or about March 19, 2013, Goldman transferred via wire from and through the United States approximately \$2.7 billion from Project Catalyze to an account for another 1MDB subsidiary ("1MDB Subsidiary 3") at Foreign Financial Institution A. Subsequently, Low caused approximately \$1,440,188,045 to be transferred through a series of pass-through accounts to accounts beneficially owned or controlled by Low and Individual 1. Low then directed multiple transfers to various government officials. . . .

51. After the bond deals were complete, Goldman continued to pursue 1MDB business, including a role in the anticipated 1MDB Energy IPO. In the pursuit of that additional business, in or about September 2013, Goldman hosted a roundtable in New York for Malaysian Official 1. Several senior Goldman executives, Leissner, Low, 1MDB Official 3 and others were scheduled to attend this meeting, though Low did not ultimately attend. However, during that trip, a New York jeweler ("Jeweler 1") met with Low and the wife of Malaysian Official 1 in a hotel suite at the Mandarin Oriental Hotel in New York, New York, to show the wife of Malaysian Official 1 a piece of expensive jewelry that Jeweler 1 had designed for her at Low's request.

52. On or about January 13, 2014, 1MDB invited Goldman to submit a proposal to provide services to 1MDB in connection with the IPO. Goldman worked on the proposed IPO through 2014, during which time Low and Leissner continued to make or promise corrupt payments to government officials, including from Project Catalyze's misappropriated proceeds.

53. On or about June 2, 2014, Leissner sent an email to himself at his personal email account containing a chat between himself and Low in which the two discussed 1MDB business opportunities that Goldman was trying to win at the time, including the IPO. Specifically, they discussed how to manage officials at 1MDB to steer additional business to Goldman, including getting Goldman to serve as a Joint Global Coordinator for the IPO.

a. For example, Low stated that 1MDB Official 2 and another high-ranking 1MDB official were unhappy with Goldman for not "deliver[ing]" a loan to 1MDB in 2013, which was ultimately provided by Foreign Financial Institution F. As a result, according to Low, 1MDB would only give Goldman a more limited role in the IPO. Leissner responded that he "would have delivered" the loan, and expressed frustration that Goldman was concerned about issues related to 1MDB's delayed financial reporting at the time, declaring "Committee is stupid!!!"

b. Low and Leissner then agreed that Leissner would "babysit" 1MDB Official 2 and the high-ranking 1MDB official, and Low would "manage via [1MDB Board of Directors]." Leissner also noted that neither named official provided "much of value" but that they "need[ed] to suck up to them."

c. Low and Leissner also discussed sending "cakes" to "madam boss" and Low asked if he could transfer money to Management Company 1 Account so that Leissner could "settle madam cakes 2." Low asked Leissner, "Do u mind if funds go [from] [Shell Company 1] to u [sic] direct at [Management Company 1]? Or u [sic] think too sensitive?" Leissner responded, "[Shell Company 1] is ok too. But need to get it out asap. Best today. Because I am seriously in trouble."

d. Low and Leissner further discussed Leissner's continued efforts to onboard Low as a formal Goldman client. Leissner explained he would "push harder" for Low once Leissner was confirmed as Goldman's Southeast Asia Chairman of the Investment Banking Division.

54. On or about June 2, 2014, approximately \$1.215 million was transferred from Shell Company Account 8 to Management Company 1 Account.

55. On or about October 10, 2014, Leissner caused approximately \$4.1 million to be transferred from Management Company 1 Account to Jeweler 1 in New York, New York, in part to pay for approximately \$1.3 million in jewelry that had been purchased on or about January 3, 2014 by the wife of Malaysian Official 3 while she, Malaysian Official 1 and Low were in the United States.

56. On or about October 14, 2014, Leissner transferred approximately \$600,000 from Holding Company 2 Account to an account beneficially owned and controlled by Abu Dhabi Official 2 and his close relative.

57. Also on or about October 14, 2014, Leissner transferred approximately \$3.5 million from Holding Company 2 Account to the business account of an associate of Malaysian Official 1's relative.

58. After the bond deals were completed, in or about and between March 2013 and February 2016, additional red flags were raised in the press and on internal phone calls among Goldman's employees and executives about Low's involvement in the deals and the possible payment of bribes in connection with the deals. Goldman failed to investigate these red flags or to perform an internal review of its role in the bond deals despite the clear implication that the deals had involved criminal wrongdoing. Further, high ranking employees of Goldman failed to escalate concerns about bribery and other criminal conduct related to the bond deals pursuant to Goldman's escalation policy, which required that any Goldman employee who became aware of any conduct that could raise, among others, "a legal, compliance, reputational, ethical, accounting, [or] internal accounting control" issue to report such conduct immediately to a supervisor and Goldman's control functions.

59. Specifically, in or about May 2013, a Goldman PMD ("Employee 3") who had been involved in the 1MDB deals, discussed the deals in a series of phone calls with Goldman senior executives that were recorded on Goldman phone lines. For example, on or about May 8, 2013, Employee 3 called a senior Goldman executive about, among other things, Project Catalyze. Employee 3 stated, "the main reason for the delay for [IPIC] not having funded their three billion into the JV with 1MDB is [Abu Dhabi Official 1] is trying to get something on the side in his pocket." He continued later, "I think it's quite disturbing to have come across this piece of information" The senior Goldman executive replied, "What's disturbing about that? It's nothing new, is it?" In response, Employee 3 agreed that the situation was nothing new. Employee 3 had at least one substantially similar phone conversation with at least one other senior Goldman executive.

60. Subsequently, in May 2015 and again in October 2015, amid negative media reporting linking Low with the 1MDB bond deals and Malaysian Official 1, Goldman executives and employees discussed Low's involvement in the 1MDB deals. For example, on a recorded call on or about October 13, 2015, Employee 3 told the senior Goldman executive that a senior IPIC officer had informed his subordinate that "there are a number of key people who are involved in, let's call it the situation. [Abu Dhabi Official 1] is one. Jho Low for sure. He thinks Jho Low is the leader of the pack. And he has a very strong view that [Leissner] is involved." The control functions never took steps to address these red flags.

61. There were also subsequent emails and recorded phone calls between Employee 3 and senior Goldman executives in the control functions about the disparity between

how due diligence and risk issues were handled on various deals. In particular, they discussed the unusual latitude granted to certain employees, such as Leissner and Employee 1.

62. For example, in or about January 2016, on a recorded call between Employee 2, who had been involved in BIG's review of each of the relevant transactions, and Employee 3, they discussed, among other things, Leissner's conduct, including Leissner's false statements that Low was not involved in the 1MDB deals. Employee 2 then noted that there were several similarly "problematic" people from a compliance perspective at Goldman, and Employee 3 agreed, immediately mentioning Employee 1 as an example of a "problematic" person. Employee 3 also noted the "double standard" between the minor repercussions meted out to favored employees like Leissner and Employee 1 when they got caught trying to circumvent the control functions, and the more serious repercussions to other, less favored employees who engaged in similar behavior. Employee 2 agreed, stating, "Yes, double standard, and it looks stupid." In the course of the call, Employee 2 also noted that Leissner's email communications had been searched as part of an internal investigation into a separate incident involving the use of an intermediary that occurred subsequent to the 1MDB deals, which Employee 2 stated "seems to me should have been done ages ago." Employee 3 similarly discussed on a recorded call in or about February 2016 with a high-ranking employee in compliance and MD how repercussions for control functions violations varied radically between deals. . . .

In the Goldman 1MDB affair, Timothy Leissner pled guilty and agreed to testify for the government. In the spring of 2022, the government proceeded to trial against former Goldman employee Roger Ng. Leissner's days of testimony at Ng's trial were jaw-dropping in their details—recounting one of the most dishonest and craven courses of conduct ever disclosed from within the walls of a large financial institution. Leissner even lied to women to get them to marry him while he was already married, supporting his story with photoshopped divorce papers! For some reading for the curious, start with these: <https://www.ft.com/content/829f619d-7a9c-4c4b-9e1d-82ee8706e085> (Financial Times); <https://www.nytimes.com/2022/03/01/business/goldman-sachs-1mdb-leissner.html> (New York Times). The jury appeared not to hesitate in convicting Ng.

D. FCPA Jurisdiction

Although case law on the FCPA is scant, the following decision from the Second Circuit provides some clarity on who falls under the jurisdiction of the FCPA. As you read, ask yourself what are the key doctrinal takeaways regarding extraterritoriality and conspiracy liability? What kinds of actors are beyond the FCPA's reach?

UNITED STATES v. HOSKINS, 44 F.4th 140 (2d Cir. 2022)

POOLER, Circuit Judge:

The American subsidiary of Alstom Power, Inc. (“API”), a global power and transportation services company, hired two consultants to bribe Indonesian officials to help secure a \$118 million power contract. Lawrence Hoskins, who worked in Paris for API’s United Kingdom subsidiary, was allegedly responsible for approving the selection of the consultants and authorizing payments to them. For his role in the alleged bribery scheme, Hoskins was charged in an American court with (among other things) violating the Foreign Corrupt Practices Act (“FCPA”), which makes it unlawful for officers, directors, and agents “of a domestic concern” to use interstate commerce corruptly to bribe or attempt to bribe foreign officials. 15 U.S.C. § 78dd *et seq.*

Because Hoskins is not an American citizen, was not employed by the American subsidiary, and did not enter the United States while allegedly working on the scheme, he falls outside the category of persons directly covered by the FCPA. The government nevertheless contended that Hoskins was liable under the FCPA as a co-conspirator or accomplice to the American subsidiary’s FCPA violation. Earlier in this litigation, we rejected that theory and held that a person could not be “guilty as an accomplice or a co-conspirator for an FCPA crime that he or she is incapable of committing as a principal[.]” *United States v. Hoskins* (“*Hoskins I*”). The government then revised its prosecutorial theory, arguing Hoskins’s work for API’s American subsidiary rendered him an “an agent” of “a domestic concern”—a category of persons squarely within the FCPA’s terms. *See* 15 U.S.C. § 78dd-2. The jury convicted Hoskins of eleven counts, seven of which were FCPA violations, and four of which were money laundering charges, and acquitted him on one count of money laundering. Hoskins then moved for acquittal, arguing he was not an agent within the meaning of the FCPA. . . .

Alstom S.A. is a global corporation headquartered in France that provides power and transportation services. Alstom has a United States-based subsidiary, API, located in Connecticut. As detailed in *Hoskins I*, the government alleged that API and other affiliates of Alstom retained two “consultants” who bribed Indonesian officials in order to secure a \$118 million power contract with the Indonesian government for API and certain other partners, referred to as the “Tarahan Project.” Between November 2001 and August 2004, Hoskins was employed by Alstom’s UK subsidiary, but was assigned to work in its French subsidiary, Alstom Resources Management S.A. Specifically, Hoskins worked in the subsidiary’s International Network (“IN”) department, which was an internal-facing “support organization” that provided operational business units with support “on an as-needed basis.”

During the relevant time, Hoskins was the Area Senior Vice President for the Asia region in the IN. He performed various functions for and on behalf of Alstom subsidiaries, including API. One project in which Hoskins was involved was the Tarahan Project, which sought to secure a \$118 million contract with the Indonesian government to build

a coal-fired power plant. The bidding for the project was being conducted by Indonesia's state-owned and controlled electricity company, Perusahaan Listrik Negara ("PLN"). At the time, API was looking for a way to bribe PLN and other officials to ensure that PLN would give the contract to a consortium led by API. The other members of the consortium were a Japanese trading company, Marubeni Corporation, and Alstom's Indonesian subsidiary, Alstom Power Energy Systems Indonesia ("PTESI").

In 2002, Hoskins and his alleged API co-conspirators discussed hiring a consultant named Harsono, who had connections with Emir Moeis, a high-ranking member of the Indonesian Parliament. During these early stages of the project, Fred Pierucci, the head of boiler sales worldwide for Alstom, asked Hoskins to check in with two Alstom Indonesia leaders—Reza Moenaf, the Alstom "country president" for its Indonesia business who reported to Hoskins, and Eko Sulianto, who reported to Moenaf—regarding the "latest position on Tarahan." Moenaf sent an email to Frederic Pierucci and David Rothschild, the regional sales manager for API who worked on the Tarahan Project, stating: "According to [Hoskins], [Pierucci] has already given his 'go-ahead' to proceed with the proposed consultant[.]" In response to another of Moenaf's emails, Pierucci responded, "Please go ahead and finalise the consultancy agreement. Please send me the key data so that I can approve it officially."

Before finalizing this arrangement, Rothschild expressed concern that Harsono was too close to Moeis, which would make the bribery too obvious, and instead suggested hiring another consultant named Pirooz Sharafi, who was based in Maryland, and his company, Pacific Resources, Inc. Sharafi had a close personal relationship with Moeis. Pierucci agreed with Rothschild's recommendation. Moenaf pushed back because he did not think that Sharafi had the requisite connections with PLN's Tarahan Project team. Nevertheless, API hired Sharafi and Pacific Resources, and Moenaf facilitated the execution of the consultancy agreement, committing 3 percent of the ultimate contract price to Sharafi if API won the bid.

By 2003, Moenaf's concerns came to fruition, when the PLN evaluation committee expressed dissatisfaction with Sharafi and questioned his commitment to bribing them. Larry Puckett, another API sales representative, told Pierucci via email that PLN's president was dissatisfied. Puckett explained that API's consortium partner, Marubeni, wanted API, "particularly . . . Pierucci to agree to take . . . immediate action" on finding a new consultant.

Subsequently, Pierucci, Hoskins, William Pomponi, an API employee, and Marubeni representatives, among others, met in Jakarta, where Sharafi was informed that API needed to switch to a different arrangement with a different consultant who was in better standing with PLN: Azmin Aulia and his consulting company, PT Gajendra. They informed Sharafi that his commission would be cut to 1 percent, while Aulia would be retained at a 2 percent commission. On another occasion, Hoskins, Sharafi, and Thiessen met with Aulia to confirm his commitment to a 2 percent commission on his consulting agreement. Communications and testimony about this friction identified Pierucci as the

ultimate decision-maker regarding the switch. Pierucci directed Hoskins to issue the revised consulting agreements, and Hoskins directed people in his department to execute them.

The plan encountered troubles when Aulia complained to Moenaf (who reported to Hoskins) that Aulia was concerned about paying bribes up front and not receiving any compensation for years. Hoskins proposed offering Aulia a better payment schedule and asked Pierucci for the “all clear” before communicating the new terms to the consultants. Once the agreements were finally in place, Pierucci thanked the team, commending Pomponi for “leading this negotiation” and Hoskins for “the local support.” API paid its consultants, who, in accordance with the consulting agreements, bribed the Indonesian officials. Hoskins resigned from Alstom effective August 31, 2004. . . .

Hoskins moved to dismiss Count One of the indictment, arguing that the FCPA statute “prescribes liability only for narrowly-circumscribed groups of people—American companies and citizens, and their agents, employees, officers, directors, and shareholders, as well as foreign persons acting on American soil” and that the government could not circumvent that limitation by charging Hoskins on aiding and abetting or conspiracy theories. . . .

The issues raised by the district court’s decision were the subject of an interlocutory appeal. We held “that Congress did not intend for persons outside of the statute’s carefully delimited categories to be subject to conspiracy or complicity liability.” *Hoskins I*. Therefore, while the statute articulated multiple categories of individuals subject to the FCPA, it did not provide “jurisdiction over a foreign national who acts outside the United States, but not on behalf of an American person or company as an officer, director, employee, agent, or stockholder.” . . .

The crux of this appeal is whether there was an agency relationship between Hoskins and API. “At common law, agency is the fiduciary relationship that arises when one person (a ‘principal’) manifests assent to another person (an ‘agent’) that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests or otherwise consents so to act.” *In re Trib. Co. Fraudulent Conv. Litig.* (brackets and some internal quotation marks omitted). “The three elements necessary to an agency relationship are (1) a manifestation by the principal that the agent will act for him; (2) acceptance by the agent of the undertaking; and (3) an understanding between the parties that the principal will be in control of the undertaking.” *Johnson v. Priceline.com, Inc.* (internal quotation marks omitted). The agent has the authority—express or implied—to “act or to conduct a transaction on account of the principal which . . . he is privileged to do because of the principal’s manifestations to him.” *Minskoff v. Am. Express Travel Related Servs. Co., Inc.* (internal quotation marks omitted); *see also Bank of New York v. Yugoimport* (“A principal-agent relationship is created by express or implied contract or by law, in which one party (the agent) may act on behalf of another party (the principal) and bind that other party by words or actions.” (internal quotation marks omitted)).

Some factors a court considers in deciding whether an agency relationship exists include: “the situation of the parties, their relations to one another, and the business in which they are engaged; the general usages of the business in question and the purported principal’s business methods; the nature of the subject matters and the circumstances under which the business is done.” *Cleveland v. Caplaw Enters.* (quoting *Columbia Broad. Sys., Inc. v. Stokely–Van Camp, Inc.*).

The parties agree that the common law meaning of agency we apply here is the correct one. There was no explicit or implied agency or employee relationship between Hoskins and API such that the elements of an agency relationship were proven beyond a reasonable doubt. Hoskins was employed by a different subsidiary, within the IN department, which provides global support to all sales and operational subsidiaries. The record demonstrates that Hoskins’s actions in furtherance of securing consultants for the Tarahan Project were all subject to the decision-making of Pierucci and other executives of API.

Conspicuously missing from the evidence is anything indicating that Pierucci or other API representatives actually controlled Hoskins’s actions as Hoskins and his API counterparts operated under separate, parallel employment structures. Pierucci did not hire Hoskins, lacked the ability to fire Hoskins, and lacked any say in Hoskins’s compensation. This lack of control over Hoskins is fundamental to the question of whether Hoskins was an agent because the “chief justifications for the principal’s accountability for the agent’s acts are the principal’s ability to select and control the agent and to terminate the agency relationship, together with the fact that the agent has agreed expressly or implicitly to act on the principal’s behalf.” Restatement (Third) of Agency § 1.01 cmt. c.

There is, of course, some evidence of direction from Pierucci and API to Hoskins. Pierucci asked Hoskins to execute certain tasks, such as revising agreements and sending them to API. Hoskins asked for approval from API before moving forward with Aulia, indicating that he looked to API for instruction. App’x at 934-37. And the record shows Hoskins located and hired consultants at the behest of API and that these consultant contracts required Hoskins’s approval.

Yet the fact that Hoskins collaborated with and supported API and Pierucci does not mean he was under their control within the meaning of the FCPA. Identifying consultants to become agents of API does not make Hoskins himself an agent of API. Nor does reviewing contracts for API to make sure they complied with API standards make Hoskins an agent. The government argues that because Hoskins provided API with support, he is an agent. But the government cites to no authority that supports such a broad definition of “agent” within the meaning of FCPA.

At bottom, the government failed to present sufficient evidence to allow the jury to find an agency relationship. Indeed, the record demonstrates Hoskins and API’s relationship lacks key elements of agency, such as any indication that Hoskins had any authority to

act on API's behalf, and whether API could "revoke" any authority it purportedly gave to Hoskins, or even do anything to control Hoskins's actions. *See* 12 Williston on Contracts § 35:30 (explaining that a principal has the authority to revoke an agent's power orally or otherwise); Restatement (Third) of Agency § 1.01 cmt. c. The government argues that API revoked Hoskins's authority when it declined to go with Harsono, whom Hoskins and Moenaf suggested as a consultant, instead going with Sharafi. This can hardly be said to be a revocation of authority, but rather a collaboration between multiple corporate employees and subsidiaries to obtain the desired result: finding an effective but not incriminating consultant.

There is no evidence that Hoskins was authorized to enter into any agreements on API's behalf. The government itself notes that "Hoskins could not hire a consultant without API's instruction." Yet a hallmark of a principal-agent relationship is that an agent can bind principals to certain legal commitments. *See* Restatement (Third) of Agency § 1.01 cmt. c (explaining that agents have "power to affect the principal's legal relations through the operation of apparent authority"). While Hoskins may have supported API by attending meetings with consultants in Jakarta, it was ultimately API that did the negotiating and contracting. For example, one of the government's key pieces of evidence was a meeting at a hotel in Jakarta where Sharafi agreed to reduce his commission from 3 to 1 percent, with Aulia receiving the 2 percent difference. Yet there is no indication that Hoskins had any authority to negotiate these percentages nor that he served as anything more than a messenger for API at this meeting. *Minskoff* (describing how an agent has the authority to conduct a transaction for the principal because of the principal's manifestations). The fact that Hoskins supported the Tarahan Project, which API had control over, does not support a finding of a principal-agent relationship. Hoskins supported API's endeavors because of his role within the IN department of Alstom, not because API granted him agency authority.

Likewise, the facts the dissent points to do nothing more than illustrate why there was no agency relationship. The dissent writes that the government had to prove "only that API could terminate his involvement—and thus revoke his authority—at least in part." Yet the dissent, like the government at trial, fails to specify any facts showing that API could terminate its relationship with Hoskins or otherwise exerted control over Hoskins. As discussed above, there is no doubt that Hoskins supported API and identified consultants, but the dissent's argument requires extrapolating facts that do not appear in the record, instead of the appropriate course of drawing permissible inferences in the government's favor. "[I]t is not enough that inferences in the government's favor are permissible. We must also be satisfied that the inferences are sufficiently supported to permit a rational juror to find that element, like all elements, beyond a reasonable doubt." *Pauling*. Here, such inferences are not supported by any facts in the record. . . .

E. FCPA Mens Rea

The following case is a legal malpractice claim that turns on the proper construction of the FCPA's mens rea requirement. Notice the interesting procedural history here that

requires the court, in the context of a civil legal malpractice claim, to determine what proof is required to satisfy the FCPA's mens rea requirements for purposes of criminal liability. How does the court define "corruptly" within the meaning of the FCPA?

STICHTING v. SCHREIBER, 327 F.3d 173 (2d Cir. 2003)

SACK, Circuit Judge:

The plaintiff, Stichting ter behartiging van de belangen van oudaandeelhouders in het kapitaal van Saybolt International B.V. (Foundation of the Shareholders' Committee Representing the Former Shareholders of Saybolt International B.V.),¹⁹ appeals from a decision of the United States District Court for the Southern District of New York (Jed S. Rakoff, *Judge*) granting the defendants' motion for summary judgment. *See Stichting Ter behartiging Van de Belangen Van Oudaandeelhouders in Het Kapitaal Van Saybolt International B.V. v. Schreiber* ("Stichting"). The plaintiff claims that the erroneous legal advice given by defendant Philippe E. Schreiber caused a United States-based corporation that was a subsidiary of a Dutch company to violate the Foreign Corrupt Practices Act, 15 U.S.C. §§ 78dd–1, *et seq.* ("FCPA"). The corporation pleaded guilty in a Massachusetts federal district court to violating the FCPA, and its former chief executive officer ("CEO") was convicted of violating the FCPA by a New Jersey federal district court jury.

In the case at bar, the district court concluded that the guilty plea and the conviction collaterally estop the plaintiff, as the corporation's assignee, from claiming that Schreiber caused the corporation to think that its acts would not violate the FCPA. We disagree with the district court's conclusion that the corporation's guilty plea is inconsistent with the plaintiff's theory of how Schreiber misled the corporation. We also disagree with the district court's conclusion that the corporation was in privity with its former CEO at the time of his trial and therefore is bound by the trial's outcome. We vacate the judgment and remand for further proceedings consistent with this opinion. In so doing, we do not question the validity of either the plea or the conviction.

This appeal is from the district court's grant of the defendants' motion for summary judgment. The facts we adduce here are undisputed except as otherwise noted.

In 1995, Saybolt International was a private Dutch limited-liability company whose various worldwide subsidiaries were engaged in "the business of performing quantitative and qualitative testing of bulk commodities such as oil, gasoline, and other petrochemicals, as well as grains [and] vegetable oils." Saybolt International owned Saybolt North America, Inc., a Delaware corporation with principal offices in Parsippany, New Jersey. All directors and officers of Saybolt North America were also directors or officers of Saybolt International. One such person was David H. Mead, who served as chief executive officer of Saybolt North America and as an officer and director

¹⁹ [Ed: the case caption has been edited to "Stichting" to make this party name easier to read and recall].

of Saybolt International. Mead also served as the *de facto* head of all operations under the control of Saybolt International in the Western Hemisphere.

Beginning in late 1994 or early 1995, Saybolt de Panama S.A. (“Saybolt de Panama”), a subsidiary of Saybolt International under Mead’s supervision, sought to acquire property in Panama for the construction of a laboratory and office complex. Sometime in 1995, Mead was told that Saybolt de Panama had identified suitable property in the Panama Canal Zone but that the lease could be acquired only if the company would first pay a \$50,000 bribe to a Panamanian government official.

Mead raised the issue of the bribe in a Saybolt North America board meeting held in New Jersey on November 9, 1995. Schreiber, a lawyer admitted to practice in New York State, was present at the meeting. In addition to serving as a director of Saybolt North America, Schreiber occasionally provided legal services to the corporation. At the meeting, Schreiber advised those present that Saybolt North America could not pay the proposed bribe to the Panamanian official without subjecting the corporation and its officers and directors to potential liability. Then and in the weeks that followed, however, Schreiber allegedly led Mead and others to believe that “the bribe payment could legally be made under U.S. law by [their] Dutch affiliate.”

Allegedly on this basis, on December 17, 1995, an employee of Saybolt North America traveled by commercial airline from New Jersey to Panama for purposes of arranging the bribe. On December 21, 1995, Saybolt International wired \$50,000 from the Netherlands to a bank account controlled by Saybolt de Panama. The Saybolt North America employee then directed an employee of Saybolt de Panama to deliver the \$50,000 to an individual acting as an intermediary for the Panamanian official.

On November 20, 1996, United States officials investigating possible environmental crimes by Saybolt North America executed a search warrant at its offices in New Jersey. The search uncovered evidence of the Panama bribe.

Shortly thereafter, on May 12, 1997, Core Laboratories, N.V. (“Core”) purchased Saybolt International and its controlling interest in Saybolt North America. Pursuant to the purchase agreement, Saybolt International’s former shareholders placed \$6 million in escrow to cover any criminal liability that might arise from the company’s activities in Panama. In exchange, Core assigned the former shareholders all causes of action for any legal malpractice related to the Panama incident.

United States prosecutors decided to bring separate criminal proceedings against Saybolt North America and its officers. Mead was arrested in January 1998, at which point he stopped actively working for the various Saybolt entities, which were by then part of Core. On April 20, 1998, a federal grand jury in the District of New Jersey returned an indictment charging Mead with, *inter alia*, violating the FCPA, 15 U.S.C. § 78dd–2(a)(3), and conspiring to violate the FCPA, 18 U.S.C. § 371.

At about that time, the United States Attorney for the District of Massachusetts and the United States Attorney for the District of New Jersey jointly issued an information charging Saybolt North America with substantially the same offenses charged in Mead's indictment: violating, and conspiring to violate, the FCPA. On August 18, 1998, officers of Core caused Saybolt North America to enter into a plea agreement in which Saybolt North America promised to "cooperate truthfully and completely with the United States . . . in any trial or other proceedings arising out of this investigation of [Saybolt North America] and any of [its] present and former officers and employees." On December 3, 1998, Saybolt North America pleaded guilty to the charges in the information before the United States District Court for the District of Massachusetts (William G. Young, *Judge*). In the plea colloquy, the court instructed John D. Denson, the Core officer representing Saybolt North America, as follows:

You understand that before the corporation or corporations can be found guilty of [violating the FCPA], the government would have to prove beyond a reasonable doubt that an agent of the corporation, acting for the corporation and so situated with respect to the management of the corporation[] that the act or acts can properly be considered the acts of the corporation itself, has to have entered into a corrupt, that is, a bribe-like transaction in the international commerce of the United States. It has to be not just that there was a mistake, that this agent or agents of the corporations knew what they were doing. Do you understand that?

Denson answered "Yes, sir." The court then entered judgment against the corporation.

Unlike his former employer, Mead decided to fight the charges against him. His case went to trial before the United States District Court for the District of New Jersey (Anne E. Thompson, *Judge*) in early October 1998. At trial, Mead presented evidence that, Mead contended, suggested that Schreiber led Mead to believe that "the bribe payment could legally be made" if the bribe of the Panamanian official were paid by a non-United States entity. The court instructed the jury that "[i]f the evidence shows you that the defendant actually believed that the transaction was legal, he cannot be convicted." The jury convicted Mead on both charges, and the district court sentenced him to four months' imprisonment and a \$20,000 fine.

Saybolt International's former shareholders assigned their legal malpractice causes of action to the plaintiff, which brought this diversity action in the United States District Court for the Southern District of New York on November 18, 1999. In its amended complaint, the plaintiff alleged that Schreiber, and through him Walter, Conston, Alexander & Green, P.C., defendant-third-party-plaintiff, a law firm with which Schreiber was affiliated, committed legal malpractice by failing to advise Saybolt North America that "the bribe payment as proposed to be paid by a Dutch company to Panamanian officials would violate the FCPA." Without Schreiber's malpractice, the amended complaint alleged, "the bribe payment would not have been made, even at the cost of the entire Panama deal." The plaintiff further alleged that by committing such

malpractice, Schreiber also breached his lawyer's fiduciary duty to Saybolt North America and breached his contract to provide competent professional services. Finally, the plaintiff alleged that Schreiber's malpractice cost the former Saybolt International shareholders \$4.2 million, mostly in criminal fines.

In a June 12, 2001, Memorandum Order, the district court granted the defendants' motion for summary judgment on all claims. The court noted that the plaintiff alleged that Schreiber's erroneous advice led Saybolt North America to act without the knowledge that its conduct violated United States law. The court then held that this allegation necessarily contradicts Saybolt North America's guilty plea to the charges that it violated the FCPA:

To enter such a plea Saybolt [North America] had to affirm, as it did, that it undertook the misconduct in question with knowledge of the corruptness of its acts. Since, if it had in fact relied on Schreiber's allegedly erroneous and misleading advice, Saybolt [North America] would not have believed at the time that its misconduct was unlawful or corrupt, it could never have made this admission at its allocution or, indeed, entered its guilty plea at all.

On this basis, the district court concluded that under the doctrine of collateral estoppel, Saybolt North America's guilty plea forecloses the plaintiff's theory of causation. "[S]ince Saybolt did . . . plead guilty and admit its criminal intent, it is bound by those admissions, and therefore cannot now contend either that it relied on Schreiber's alleged advice or that that advice, even if erroneous, . . . proximately caused whatever damages . . . were incurred by Saybolt." . . .

As the district court described it, the plaintiff's claim in its civil suit is that its lawyer, Schreiber, "advised Saybolt [North America] that a bribe payment by a foreign affiliate might be legal but also failed to advise Saybolt [North America] that any involvement by Saybolt [North America] or its officers in arranging the affiliate's payment could result in criminal liability." "[I]f Saybolt [North America] had in good faith relied on Schreiber's advice, Saybolt [North America] would have believed that its arranging the bribe through a foreign affiliate was permissible."

By pleading guilty, Saybolt North America admitted the six elements of the FCPA crime: that (1) it was a domestic concern, (2) that it made use of a means or instrumentality of interstate commerce, (3) corruptly, (4) in furtherance of an offer or payment of something of value to a person, (5) while knowing that the money would be offered or given directly or indirectly to a foreign official, (6) for purposes of influencing an act or decision of that foreign official in his official capacity. But by pleading guilty, Saybolt North America did not admit that at the time of the criminal act it knew that the act of arranging, rather than paying, such a bribe was criminal. Knowledge by a defendant that it is violating the FCPA—that it is committing all the elements of an FCPA violation—is not itself an element of the FCPA crime. Federal statutes in which the defendant's knowledge that he or she is violating the statute is an element of the violation are rare;

the FCPA is plainly not such a statute. Saybolt North America did not, therefore, by pleading guilty, preclude an assertion in a subsequent civil action—the case at bar—that it did not know it was violating the FCPA at the time of the violation.

The plaintiff is thus not collaterally estopped by Saybolt North America’s criminal plea from arguing in this civil suit that, even though Saybolt North America admittedly did *commit* a violation of the FCPA, it did not *know* that it was committing a violation of the FCPA at the time; that it did not know it was committing such a violation because Schreiber negligently told it that it was not committing a violation by causing a foreign entity to pay the bribe; and that it suffered damages as a result of the negligent advice. . . .

To be sure, by pleading guilty, Saybolt North America admitted that it acted “corruptly”—the element of the crime that we numbered “3” in the discussion above—in its actions related to the Panamanian bribe. The defendants see in this admission a collateral bar to the plaintiff’s assertion that Saybolt North America did not know that it was violating the FCPA at the relevant time and, indeed, was misled into believing that it was acting legally. The district court apparently agreed. We do not. We conclude that an admission that an act was done “corruptly” in this context is not equivalent to an admission that the person committing it knew that it violated the particular law at the time the act was performed.

It is difficult to determine the meaning of the word “corruptly” simply by reading it in context. We therefore look outside the text of the statute to determine its intended meaning. *See In re Venture Mortgage Fund, L.P.* (“Legislative history and other tools of interpretation may be relied upon only if the terms of the statute are ambiguous.” (citation and internal quotation marks omitted)).

The Senate Report for the FCPA explains the statute’s use of the term “corruptly” as follows:

The word “corruptly” is used [in the FCPA] in order to make clear that the offer, payment, promise, or gift, must be intended to induce the recipient to misuse his official position in order to wrongfully direct business to the payor or his client, or to obtain preferential legislation or a favorable regulation. The word “corruptly” connotes an evil motive or purpose, an intent to wrongfully influence the recipient.

The 1977 House Report uses a similar description, adding that the word “corruptly” in the FCPA is intended to have the same meaning as in 18 U.S.C. § 201, the federal statute criminalizing the bribing of a federal official.

The Senate’s explanation of the term “corruptly” tracks closely our interpretation of that term in 18 U.S.C. § 201(b). We have repeatedly held in that context that “a fundamental component of a ‘corrupt’ act is a breach of some official duty owed to the government or the public at large.” *United States v. Rooney*; *accord United States v. Zacher* (“The common thread that runs through common law and statutory formulations of the crime

of bribery is the element of corruption, breach of trust, or violation of duty.”). We have also, in the context of the federal statute criminalizing the bribing of agents of financial institutions, approved jury instructions providing that a person acts “corruptly” if he or she acts with a “bad purpose.” *United States v. McElroy*. Our case law defining the term “corruptly” in federal bribery statutes thus parallels the Senate Report’s explanation of the term as denoting an evil motive or purpose and an intent to induce an official to misuse his position. . . .

We thus conclude that the word “corruptly” in the FCPA signifies, in addition to the element of “general intent” present in most criminal statutes, a bad or wrongful purpose and an intent to influence a foreign official to misuse his official position. But there is nothing in that word or anything else in the FCPA that indicates that the government must establish that the defendant in fact knew that his or her conduct violated the FCPA to be guilty of such a violation.

Finally in this connection, we note that had Saybolt North America gone to trial, it would have been allowed to present evidence that it relied on Schreiber’s advice that the benefit sought from the Panamanian official would not require the official to misuse his position or breach his duties—i.e., that it did not act corruptly—precisely because “corruptly” is an element of the offense. Saybolt North America also would have been allowed a jury instruction on this allegation. *See United States v. Carr* (“[R]eliance on advice of counsel . . . is the basis for a jury instruction on whether or not the defendant possessed the requisite specific intent.”). By pleading guilty, Saybolt North America effectively admitted that it could not factually support such a theory of reliance.

But Saybolt North America would not properly have been entitled to a jury instruction on an allegation that Schreiber led it to believe that its acts did not violate the FCPA. A defense of reliance on advice of counsel is available only to the extent that it might show that a defendant lacked the requisite specific intent, and specific intent to violate the FCPA is not an element of an FCPA violation. Thus, Saybolt North America’s guilty plea does not constitute an admission that it could not factually support the theory of reliance on counsel that is the basis of the plaintiff’s malpractice action.

We conclude that the question whether Saybolt North America acted with knowledge that its conduct violated the FCPA was not answered by its guilty plea, and thus that the plea does not collaterally estop the plaintiff from litigating the issue in its claim against Schreiber and the law firm with which he was affiliated. . . .

F. Foreign Officials and Instrumentalities

The following case addresses the question of what an “instrumentality” is in the context of the FCPA’s definition of “foreign official.” The answer to this question is key for understanding the extent to which the FCPA can be used to deal with bribery in connection with state-owned enterprises, which are of course major corporate entities in many developed and developing economies.

UNITED STATES v. ESQUENAZI, 752 F.3d 912 (11th Cir. 2014)

MARTIN, Circuit Judge:

Joel Esquenazi and Carlos Rodriguez appeal their convictions and sentences imposed after a jury convicted them of conspiracy, violating the Foreign Corrupt Practices Act, and money-laundering. After careful review, and with the benefit of oral argument, we affirm. . . .

Messrs. Esquenazi and Rodriguez co-owned Terra Telecommunications Corp. (Terra), a Florida company that purchased phone time from foreign vendors and resold the minutes to customers in the United States. Mr. Esquenazi, Terra's majority owner, served as President and Chief Executive Officer. Mr. Rodriguez, the company's minority owner, served as Executive Vice President of Operations. James Dickey served as Terra's general counsel and Antonio Perez as the company's comptroller.

One of Terra's main vendors was Telecommunications D'Haiti, S.A.M. (Teleco). Because the relationship of Teleco to the Haitian government was, and remains, at issue in this case, the government presented evidence of Teleco's ties to Haiti. Former Teleco Director of International Relations Robert Antoine testified that Teleco was owned by Haiti. An insurance broker, John Marsha, testified that, when Messrs. Rodriguez and Esquenazi were involved in previous contract negotiations with Teleco, they sought political-risk insurance, a type of coverage that applies only when a foreign government is party to an agreement. In emails with Mr. Marsha copied to Messrs. Esquenazi and Rodríguez, Mr. Dickey called Teleco an "instrumentality" of the Haitian government.

An expert witness, Luis Gary Lissade, testified regarding Teleco's history. At Teleco's formation in 1968, the Haitian government gave the company a monopoly on telecommunication services. Teleco had significant tax advantages and, at its inception, the government appointed two members of Teleco's board of directors. Haiti's President appointed Teleco's Director General, its top position, by an executive order that was also signed by the Haitian Prime Minister, the minister of public works, and the minister of economy and finance. In the early 1970s, the National Bank of Haiti gained 97 percent ownership of Teleco. From that time forward, the Haitian President appointed all of Teleco's board members. Sometime later, the National Bank of Haiti split into two separate entities, one of which was the Banque de la Republique d'Haiti (BRH). BRH, the central bank of Haiti, is roughly equivalent to the United States Federal Reserve. BRH retained ownership of Teleco. In Mr. Lissade's expert opinion, for the years relevant to this case, Teleco belonged "totally to the state" and "was considered . . . a public entity."

Mr. Lissade also testified that Teleco's business entity suffix, S.A.M., indicates "associate anonymous mixed," which means the "Government put money in the corporation." Teleco's suffix was attached not by statute, but "de facto" because "the government consider[ed] Teleco as its . . . entity." In 1996, Haiti passed a "modernization" law, seeking to privatize many public institutions. As a result, Haiti

privatized Teleco sometime between 2009 and 2010. Ultimately, Mr. Lissade opined that, during the years relevant to this case, “Teleco was part of the public administration.” He explained: “There was no specific law that . . . decided that at the beginning that Teleco is a public entity but government, officials, everyone consider[ed] Teleco as a public administration.” And, he said, “if there was a doubt whatsoever, the [anti-corruption] law [that] came in 2008 vanish[ed] completely this doubt . . . by citing Teleco as a public administration” and by requiring its agents—whom Mr. Lissade said were public agents—to declare all assets to avoid secret bribes.

In 2001 Terra contracted to buy minutes from Teleco directly. At that time, Teleco’s Director General was Patrick Joseph (appointed by then-President Jean-Bertrand Aristide), and the Director of International Relations was Robert Antoine. Mr. Antoine had two friends and business associates who played a role in this case: Jean Fourcand, a grocery-store owner, and Juan Diaz.

By October 2001, Terra owed Teleco over \$400,000. So Mr. Perez testified, Mr. Esquenazi asked him to contact Mr. Antoine and negotiate an amortization deal or, alternatively, to offer a side payment. Mr. Perez met with Mr. Antoine, who rejected the idea of amortization but agreed to a side payment to ease Terra’s debt. The deal, according to Mr. Perez, was that Mr. Antoine would shave minutes from Terra’s bills to Teleco in exchange for receiving from Terra fifty percent of what the company saved. Mr. Antoine suggested that Terra disguise the payments by making them to sham companies, which Terra ultimately did. Mr. Perez returned to Mr. Esquenazi and told him the news and later shared details of the deal in a meeting with Messrs. Esquenazi, Rodriguez, and Dickey. The four discussed “the fact that Robert Antoine had accepted an arrangement to accept . . . payments to him in exchange for reducing [Terra’s] bills.” Mr. Perez testified: “[Mr. Esquenazi] was happy, and both James Dickey and Carlos Rodriguez also congratulated me on a job well done.”

The following month, in November 2001, Terra began funneling personal payments to Mr. Antoine using the following subterfuge. Mr. Dickey, on Terra’s behalf, drafted a “consulting agreement” between Terra and a company Mr. Antoine had suggested called J.D. Locator. J.D. Locator, an otherwise insolvent company, was owned by Mr. Antoine’s friend Juan Diaz. During the course of the next several months, Messrs. Rodriguez and Esquenazi authorized payments to J.D. Locator via “check requests,” forms Terra used to write checks without invoices. Mr. Diaz testified that he knew the payments Terra made were not for legitimate consulting services and that he never intended to provide such services. Instead, Mr. Diaz retained ten percent of the funds Terra paid J.D. Locator and disbursed the remainder, usually either to Mr. Antoine or his business associate Mr. Fourcand. Mr. Fourcand testified that he knew he was receiving money from Terra (through J.D. Locator) that would ultimately go to Mr. Antoine and that Mr. Antoine asked him to be part of that deal. All told, while Mr. Antoine remained at Teleco, Terra paid him and his associates approximately \$822,000. And, during that time, Terra’s bills were reduced by over \$2 million.

In April 2003, President Aristide removed Mr. Antoine and named Alphonse Inevil as his replacement. Mr. Inevil soon replaced Mr. Joseph as Director General, and Jean Rene Duperval replaced Inevil. Later that year, with Terra still behind on its bills, Mr. Esquenazi helped Mr. Duperval form a shell company, Telecom Consulting Services Corporation (TCSC), through which Esquenazi ultimately would make side payments to Mr. Duperval. TCSC's president was Margurite Grandison, Mr. Duperval's sister; its incorporator and registered agent was Mr. Dickey; and the company's principal business address was a post office box that named Mr. Duperval as the person empowered to receive mail through it. Ms. Grandison executed a "commission agreement" with Terra, which Mr. Esquenazi signed. And on November 20, Mr. Rodriguez authorized the first transfer, \$15,000, to TCSC. Over the next five months, although Terra received no invoices to reflect money owed TCSC, Terra made six additional transfers to TCSC totaling \$60,000. Each of these seven transfers is the subject of the substantive FCPA counts. Ms. Grandison then disbursed money from TCSC's account to Mr. Duperval and his associates. She made a number of transfers, twelve of which constitute the substantive money-laundering counts.

During the Internal Revenue Service's investigation of the case, Mr. Esquenazi admitted he had bribed Mr. Duperval and other Teleco officials. He and Mr. Rodriguez nonetheless pleaded not guilty, proceeded to trial, and were found guilty on all counts.

Five days after the jury convicted Messrs. Esquenazi and Rodriguez, the government received from an attorney involved in Patrick Joseph's defense a declaration by the Haitian Prime Minister, Jean Max Bellerive. The declaration, marked with a date that fell in the middle of the jury trial, stated: "Teleco has never been and until now is not a State enterprise." In a second declaration, made later and provided by the government to defense counsel, Prime Minister Bellerive confirmed that "the facts mentioned in the [first] statement are truthful," but clarified: "The only legal point that should stand out in this statement is that there exists no law specifically designating Teleco as a public institution." In this second declaration, Prime Minister Bellerive also stated, "this does not mean that Haiti's public laws do not apply to Teleco even if no public law designates it as such." The second declaration detailed the public aspects of Teleco, many of which the government's expert had discussed at trial. Messrs. Esquenazi and Rodriguez moved for a judgment of acquittal and a new trial on the basis of the declarations, which the district court denied. . . .

The FCPA prohibits "any domestic concern" from "mak[ing] use of the mails or any means . . . of interstate commerce corruptly in furtherance of" a bribe to "any foreign official," or to "any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official," for the purpose of "influencing any act or decision of such foreign official . . . in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person." 15 U.S.C. §§ 78dd-2(a)(1), (3). A "foreign official" is "any officer or employee of a foreign government or any department, agency, or *instrumentality* thereof." *Id.* § 78dd-2(h)(2)(A). The central question before

us, and the principal source of disagreement between the parties, is what “instrumentality” means (and whether Teleco qualifies as one).

The FCPA does not define the term “instrumentality,” and this Court has not either. For that matter, we know of no other court of appeals who has. The definition matters in this case, in light of the challenges to the district court’s jury instructions on “instrumentality”; to the sufficiency of the evidence that Teleco qualified as an instrumentality of the Haitian government; and to Mr. Esquenazi’s contention that the statute is unconstitutionally vague. Before we address these challenges, however, we must define “instrumentality” for purposes of the FCPA.

We begin, as we always do when construing statutory text, with the plain meaning of the word at issue. *See Harris v. Garner*. According to Black’s Law Dictionary, an instrumentality is “[a] means or agency through which a function of another entity is accomplished, such as a branch of a governing body.” Webster’s Third New International Dictionary says the word means “something that serves as an intermediary or agent through which one or more functions of a controlling force are carried out: a part, organ, or subsidiary branch esp. of a governing body.” These dictionary definitions foreclose Mr. Rodriguez’s contention that only an actual *part* of the government would qualify as an instrumentality—that contention is too cramped and would impede the “wide net over foreign bribery” Congress sought to cast in enacting the FCPA. *United States v. Kay*. Beyond that argument, the parties do not quibble over the phrasing of these definitions, and they agree an instrumentality must perform a government function at the government’s behest. The parties also agree, however, and we have noted in other cases interpreting similar provisions, that the dictionary definitions get us only part of the way there. *See Edison v. Doublerly* (recognizing the Second Circuit’s conclusion that “instrumentality” is “a word susceptible of more than one meaning” (citing *Green v. New York*)). Thus, we turn to other tools to decide what “instrumentality” means in the FCPA.

To interpret “instrumentality” as used in the Americans with Disabilities Act, we relied upon what the Supreme Court has called the “commonsense canon of *noscitur a sociis*,” *United States v. Williams* (—that is, “a word is known by the company it keeps.” *Edison* (quoting *Green*, (quoting, in turn, *Jarecki v. G.D. Searle & Co.*)). In the FCPA, the company “instrumentality” keeps is “agency” and “department,” entities through which the government performs its functions and that are controlled by the government. We therefore glean from that context that an entity must be under the control or dominion of the government to qualify as an “instrumentality” within the FCPA’s meaning. And we can also surmise from the other words in the series along with “instrumentality” that an instrumentality must be doing the business of the government. What the defendants and the government disagree about, however, is what functions count as the government’s business.

To answer that question, we examine the broader statutory context in which the word is used. *See Edison* (“We have affirmed many times that we do not look at one word or

term in isolation but rather look to the entire statute and its context.”). In this respect, we find one other provision of the FCPA and Congress’s relatively recent amendment of the statute particularly illustrative. First, the so-called “grease payment” provision establishes an “exception” to FCPA liability for “any facilitating or expediting payment to a foreign official . . . the purpose of which is to expedite or to secure the performance of a *routine governmental action* by a foreign official.” 15 U.S.C. § 78dd–2(b). “Routine governmental action” is defined as “an action . . . ordinarily and commonly performed by a foreign official in,” among other things, “providing phone service.” *Id.* § 78dd–2(h)(4)(A). If an entity involved in providing phone service could never be a foreign official so as to fall under the FCPA’s substantive prohibition, there would be no need to provide an express exclusion for payments to such an entity. In other words, if we read “instrumentality,” as the defendants urge, to categorically exclude government-controlled entities that provide telephone service, like Teleco, then we would render meaningless a portion of the definition of “routine governmental action” in section 78dd–2(b). “It is a cardinal rule of statutory construction that significance and effect shall, if possible, be accorded to every word.” *Regions Hosp. v. Shalala* (citation omitted). Thus, that a government-controlled entity provides a commercial service does not automatically mean it is not an instrumentality. In fact, the statute expressly contemplates that in some instances it would.

Next, we turn to Congress’s 1998 amendment of the FCPA, enacted to ensure the United States was in compliance with its treaty obligations. That year, the United States ratified the Organization for Economic Cooperation and Development’s Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention), Dec. 17, 1997, S. Treaty Doc. No. 105–43, 37 I.L.M. 1 (ratified Dec. 8, 1998, entered into force Feb. 15, 1999). . . .

To implement the Convention’s mandates, Congress amended the FCPA in 1998. *See* Pub. L. No. 105–366, 112 Stat. 3302. The only change to the definition of “foreign official” in the FCPA that Congress thought necessary was the addition of “public international organization.” 15 U.S.C. 78dd–2(h)(2)(A). This seems to demonstrate that Congress considered its preexisting definition *already to cover* a “foreign public official” of an “enterprise . . . over which a government . . . exercise[s] a dominant influence” that performs a “public function” because it does not “operate[] on a normal commercial basis . . . substantially equivalent to that of . . . private enterprise[s]” in the relevant market “without preferential subsidies or other privileges.” OECD Convention art. 1.4(a) & cmt. 14, 15. Although we generally are wary of relying too much on later legislative developments to decide a prior Congress’ legislative intent, the circumstances in this case cause us less concern in that regard. This is not an instance in which Congress merely discussed previously enacted legislation and possible changes to it. Rather, Congress *did* make a change to the FCPA, and it did so specifically to ensure that the FCPA fulfilled the promise the United States made to other nations when it joined the Convention. The FCPA after those amendments is a different law, and we may consider Congress’s intent in passing those amendments as strongly suggestive of the meaning of “instrumentality” as it exists today. . . .

Although we believe Teleco would qualify as a Haitian instrumentality under almost any definition we could craft, we are mindful of the needs of both corporations and the government for *ex ante* direction about what an instrumentality is. With this guidance, we define instrumentality as follows. An “instrumentality” under section 78dd–2(h)(2)(A) of the FCPA is an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own. Certainly, what constitutes control and what constitutes a function the government treats as its own are fact-bound questions. It would be unwise and likely impossible to exhaustively answer them in the abstract. Because we only have this case before us, we do not purport to list all of the factors that might prove relevant to deciding whether an entity is an instrumentality of a foreign government. For today, we provide a list of some factors that may be relevant to deciding the issue.

To decide if the government “controls” an entity, courts and juries should look to the foreign government’s formal designation of that entity; whether the government has a majority interest in the entity; the government’s ability to hire and fire the entity’s principals; the extent to which the entity’s profits, if any, go directly into the governmental fisc, and, by the same token, the extent to which the government funds the entity if it fails to break even; and the length of time these indicia have existed. We do not cut these factors from whole cloth. Rather, they are informed by the commentary to the OECD Convention the United States ratified. *See* OECD Convention, art. 1.4, cmt. 14 (stating that an entity is “deemed” to be under governmental control “*inter alia*, when the government or governments hold the majority of the enterprise’s subscribed capital, control the majority of votes attaching to shares issued by the enterprise or can appoint a majority of the members of the enterprise’s administrative or managerial body or supervisory board”). They are also consistent with the approach the Supreme Court has taken to decide if an entity is an agent or instrumentality of the government in analogous contexts. . . .

We then turn to the second element relevant to deciding if an entity is an instrumentality of a foreign government under the FCPA—deciding if the entity performs a function the government treats as its own. Courts and juries should examine whether the entity has a monopoly over the function it exists to carry out; whether the government subsidizes the costs associated with the entity providing services; whether the entity provides services to the public at large in the foreign country; and whether the public and the government of that foreign country generally perceive the entity to be performing a governmental function. Just as with the factors indicating control, we draw these in part from the OECD Convention. . . .

In addition to challenging the “instrumentality” jury instruction, Messrs. Esquenazi and Rodriguez also argue the evidence was insufficient to demonstrate that Teleco was an instrumentality of the Haitian government. We review the sufficiency of the evidence *de novo*, “viewing the evidence and taking all reasonable inferences in favor of the jury’s verdict.” *United States v. Fries*. In light of our construction of the term, we have little

difficulty concluding sufficient evidence supported the jury's necessary finding that Teleco was a Haitian instrumentality.

From Teleco's creation, Haiti granted the company a monopoly over telecommunications service and gave it various tax advantages. Beginning in early 1970s, and through the years Messrs. Esquenazi and Rodriguez were involved, Haiti's national bank owned 97 percent of Teleco. The company's Director General was chosen by the Haitian President with the consent of the Haitian Prime Minister and the ministers of public works and economic finance. And the Haitian President appointed all of Teleco's board members. The government's expert testified that Teleco belonged "totally to the state" and "was considered . . . a public entity." Although the expert also testified that "[t]here was no specific law that . . . decided that at the beginning that Teleco is a public entity," he maintained that "government, officials, everyone consider[ed] Teleco as a public administration." Construed in the light most favorable to the jury's verdict, that evidence was sufficient to show Teleco was controlled by the Haitian government and performed a function Haiti treated as its own, namely, nationalized telecommunication services.

G. Addressing International Corruption Beyond the FCPA

Can the United States prosecute corruption in international business transactions if such corruption *doesn't* involve foreign public officials? Yes. To see how, one must become familiar with a few more complicated but important statutes: the "Travel Act," federal money laundering prohibitions, and "RICO."

In addition, this part includes some materials for considering the role of U.S. law and American lawyers in the process by which the proceeds of corruption abroad are often patriated into the U.S. and other attractive jurisdictions for investment and wealth-building. Recall what the Biden Administration statement earlier in the chapter had to say about that subject.

The "Travel Act"

18 U.S.C. § 1952 - Interstate and foreign travel or transportation in aid of racketeering enterprises

(a) Whoever travels in interstate or foreign commerce or uses the mail or any facility in interstate or foreign commerce, with intent to—

- (1) distribute the proceeds of any unlawful activity; or
 - (2) commit any crime of violence to further any unlawful activity; or
 - (3) otherwise promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity,
- and thereafter performs or attempts to perform—

(A) an act described in paragraph (1) or (3) shall be fined under this title, imprisoned not more than 5 years, or both; or

(B) an act described in paragraph (2) shall be fined under this title, imprisoned for not more than 20 years, or both, and if death results shall be imprisoned for any term of years or for life.

(b) As used in this section (i) “unlawful activity” means (1) any business enterprise involving gambling, liquor on which the Federal excise tax has not been paid, narcotics or controlled substances (as defined in section 102(6) of the Controlled Substances Act), or prostitution offenses in violation of the laws of the State in which they are committed or of the United States, (2) extortion, bribery, or arson in violation of the laws of the State in which committed or of the United States, or (3) any act which is indictable under subchapter II of chapter 53 of title 31, United States Code, or under section 1956 or 1957 of this title and (ii) the term “State” includes a State of the United States, the District of Columbia, and any commonwealth, territory, or possession of the United States. . . .

With organized crime in mind, Congress designed the Travel Act, somewhat like RICO (which the Travel Act predates), to allow federal prosecutors to “pull” some traditional state crimes into federal court when committed across state (and international) lines. In the context of bribery in business matters, the relevant state laws are so-called “commercial bribery” statutes, which are prevalent in American criminal codes. The following example is from New York:

N.Y. Penal Law § 180.03. Commercial bribing in the first degree.

A person is guilty of commercial bribing in the first degree when he confers, or offers or agrees to confer, any benefit upon any employee, agent or fiduciary without the consent of the latter’s employer or principal, with intent to influence his conduct in relation to his employer’s or principal’s affairs, and when the value of the benefit conferred or offered or agreed to be conferred exceeds one thousand dollars and causes economic harm to the employer or principal in an amount exceeding two hundred fifty dollars.

“Promotion” and “concealment” money laundering

18 U.S.C. § 1956 - Laundering of monetary instruments

(a)

(1) Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity—

(A)

- (i) with the intent to promote the carrying on of specified unlawful activity; or
- (ii) with intent to engage in conduct constituting a violation of section 7201 or 7206 of the Internal Revenue Code of 1986; or

(B) knowing that the transaction is designed in whole or in part—

- (i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity; or
- (ii) to avoid a transaction reporting requirement under State or Federal law,

shall be sentenced to a fine of not more than \$500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than twenty years, or both. . . .

(c) As used in this section—

(1) the term “knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity” means that the person knew the property involved in the transaction represented proceeds from some form, though not necessarily which form, of activity that constitutes a felony under State, Federal, or foreign law, regardless of whether or not such activity is specified in paragraph (7);

(2) the term “conducts” includes initiating, concluding, or participating in initiating, or concluding a transaction;

(3) the term “transaction” includes a purchase, sale, loan, pledge, gift, transfer, delivery, or other disposition, and with respect to a financial institution includes a deposit, withdrawal, transfer between accounts, exchange of currency, loan, extension of credit, purchase or sale of any stock, bond, certificate of deposit, or other monetary instrument, use of a safe deposit box, or any other payment, transfer, or delivery by, through, or to a financial institution, by whatever means effected;

(4) the term “financial transaction” means (A) a transaction which in any way or degree affects interstate or foreign commerce (i) involving the movement of funds by wire or other means or (ii) involving one or more monetary instruments, or (iii) involving the transfer of title to any real property, vehicle, vessel, or aircraft, or (B) a transaction involving the use of a financial institution which is engaged in, or the activities of which affect, interstate or foreign commerce in any way or degree;

(5) the term “monetary instruments” means (i) coin or currency of the United States or of any other country, travelers’ checks, personal checks, bank checks, and money orders, or (ii) investment securities or negotiable instruments, in bearer form or otherwise in such form that title thereto passes upon delivery;

(6) the term “financial institution” includes—

(A) any financial institution, as defined in section 5312(a)(2) of title 31, United States Code, or the regulations promulgated thereunder; and

(B) any foreign bank, as defined in section 1 of the International Banking Act of 1978 (12 U.S.C. 3101);

(7) the term “specified unlawful activity” means—

[a long list of criminal offenses including] . . .

(A) any act or activity constituting an offense listed in section 1961(1) of this title except an act which is indictable under subchapter II of chapter 53 of title 31;

(B) with respect to a financial transaction occurring in whole or in part in the United States, an offense against a foreign nation involving— . . .

(iv) bribery of a public official, or the misappropriation, theft, or embezzlement of public funds by or for the benefit of a public official; . . .

(vi) an offense with respect to which the United States would be obligated by a multilateral treaty, either to extradite the alleged offender or to submit the case for prosecution, if the offender were found within the territory of the United States . . .

(D) . . . any felony violation of the Foreign Corrupt Practices Act . . .

(8) the term “State” includes a State of the United States, the District of Columbia, and any commonwealth, territory, or possession of the United States; and

(9) the term “proceeds” means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, including the gross receipts of such activity. . . .

(f) There is extraterritorial jurisdiction over the conduct prohibited by this section if—

(1) the conduct is by a United States citizen or, in the case of a non-United States citizen, the conduct occurs in part in the United States; and

(2) the transaction or series of related transactions involves funds or monetary instruments of a value exceeding \$10,000. . . .

(h) Any person who conspires to commit any offense defined in this section or section 1957 shall be subject to the same penalties as those prescribed for the offense the commission of which was the object of the conspiracy. . . .

RICO

18 U.S.C. § 1961 –Definitions

As used in this chapter—

(1) “racketeering activity” means (A) any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, or dealing in a controlled substance or listed chemical (as defined in section 102 of the Controlled Substances Act), which is chargeable under State law and punishable by imprisonment for more than one year . . .

(2) “State” means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, any political subdivision, or any department, agency, or instrumentality thereof;

(3) “person” includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) “enterprise” includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) “pattern of racketeering activity” requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

(6) “unlawful debt” means a debt (A) incurred or contracted in gambling activity which was in violation of the law of the United States, a State or political subdivision thereof, or which is unenforceable under State or Federal law in whole or in part as to principal or interest because of the laws relating to usury, and (B) which was incurred in connection with the business of gambling in violation of the law of the United States, a State or political subdivision thereof, or the business of lending money or a thing of value at a rate usurious under State or Federal law, where the usurious rate is at least twice the enforceable rate; . . .

18 U.S.C. § 1962 – Prohibited activities

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise’s affairs through a pattern of racketeering activity or collection of unlawful debt.

(d) It shall be unlawful for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section.

[RICO's criminal penalties include fines, up to 20 years' imprisonment, and extensive forfeiture provisions.]

The next case, involving the bribery scandal relating to the Salt Lake City Olympics, was prosecuted as a Travel Act violation. As you read, consider the following questions: Why wasn't this an FCPA case? What is the underlying state statute with which the Travel Act was being used to bring this case in federal court? What issues with the state statute do the defendants raise and why does the court reject these arguments? Do you agree with the court's reasoning?

UNITED STATES v. WELCH, 327 F.3d 1081 (10th Cir. 2003)

BALDOCK, Circuit Judge:

Defendants Thomas K. Welch and David R. Johnson were the President and Senior Vice President, respectively, of the Salt Lake City Bid Committee for the 2002 Olympic Winter Games (SLBC). Community leaders organized the SLBC in the late 1980's as an I.R.C. § 501(c)(3) not-for-profit corporation under the direction of a board of trustees. The SLBC's primary purpose was to secure, in cooperation with the United States Olympic Committee (USOC), the right from the International Olympic Committee (IOC) to host the quadrennial Winter Games in Utah. The IOC is an "international non-governmental non-profit organization" based in Lausanne, Switzerland. One of the primary duties of individual IOC members from participating countries is to cast votes to elect the host city for the Olympic Games. In June 1995, the IOC awarded the 2002 Olympic Winter Games to Salt Lake City, Utah.

In July 2000, a federal grand jury indicted Defendants Welch and Johnson on fifteen bribery-related counts of criminal misconduct in connection with the SLBC's activities in procuring the 2002 Games. . . . Counts II through V charged Defendants with use of communications in interstate and foreign commerce to facilitate unlawful activity in violation of 18 U.S.C. § 1952(a)(3). . . .

According to the indictment, Salt Lake City began competing for the Olympic Winter Games around 1988. In 1994, the SLBC and USOC jointly executed and filed with the IOC an "Undertaking" in which they agreed to abide by the provisions of the International Olympic Charter and to act in accord with the IOC's instructions to candidate cities bidding on the 2002 Winter Games. As part of the 2002 bidding process, the IOC distributed a series of instructions to candidate cities and IOC members. IOC members similarly are bound by the Charter and take an oath to remain free from commercial influence. As stated in the indictment, the instructions "limited certain expenditures by candidate cities, created rules concerning visits by IOC members to candidate cities, and placed limitations on the value of gifts and other benefits which could be given to IOC members by and on behalf of candidate cities."

Meanwhile, between February 1988 and July 1999, Defendants purportedly utilized interstate facilities, contrary to federal law, to engage in a bribery scheme to “misappropriate and misapply the monies and funds of the SLBC[] by diverting SLBC income and by giving . . . money and other material benefits to influence IOC members to vote for Salt Lake City to host the Olympic Winter Games[.]” Among other things, the indictment alleges Defendants instructed an SLBC “sponsor” “to make a series of payments to the defendants in cash so that the payments would not appear on the SLBC’s books and records and could be diverted by the defendants for their own personal purposes.”

The indictment alleges Defendants (1) made direct and indirect payments of money and other things of substantial value to IOC members; (2) paid for tuition, living expenses, and spending money for the children and relatives of IOC members; (3) paid for medical expenses of IOC members and their relatives; and (4) paid for personal and vacation travel expenses of IOC members and their relatives. Defendants also purportedly obtained lawful permanent resident alien status for an IOC member’s son through submission of false and misleading documents to immigration authorities. Defendants allegedly conferred valuable benefits upon amenable IOC members totaling approximately \$1,000,000 in value.

According to the indictment, neither the SLBC, its board of trustees, nor its contributors were aware of Defendants’ scheme. Similarly, neither the USOC, IOC, Salt Lake City, State of Utah, nor the United States had any knowledge of Defendants’ activities. The indictment alleges Defendants secretly retained and paid Alfredo La Mont, the USOC’s Director of International Relations, to assist them “in influencing the conduct of IOC members in connection with the IOC’s election” of Salt Lake City to host the Winter Games. To further conceal their illicit activities, Defendants allegedly (1) made payments to IOC members in cash; (2) created and funded a sham program known as the National Olympic Committee Program ostensibly to provide athletes in underprivileged countries with training and equipment; (3) entered into sham contracts and consulting agreements on behalf of the SLBC; (4) recorded payments and benefits which the SLBC provided to IOC members inaccurately in corporate books and records; (5) placed false, fraudulent, and misleading information in SLBC financial records and statements, and (6) failed to disclose material information in public documents. . . .

Commonly referred to as the Travel Act, 18 U.S.C. § 1952 provides in relevant part:

(a) Whoever . . . uses the mail or any facility in interstate or foreign commerce, with intent to— . . .

(3) . . . promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity,

and thereafter performs or attempts to perform—

(A) an act described in paragraph . . . (3) shall be fined under this title, imprisoned not more than 5 years, or both[.]

§ 1952(a)(3)(A). Subsection (b) defines “unlawful activity” as, among other things, “bribery . . . in violation of the laws of the State in which committed[.]” *Id.* § 1952(b)(i)(2). In this case, the “unlawful activity” on which the Travel Act counts rely is bribery as defined by Utah Code Ann. § 76-6-508(1)(a). Entitled “Bribery of or receiving bribe by person in the business of selection, appraisal, or criticism of goods or services,” § 76-6-508(1)(a) provides in relevant part:

(1) A person is guilty of a class A misdemeanor when, without the consent of the . . . principal, contrary to the interests of the . . . principal:

(a) he confers, offers, or agrees to confer upon the . . . agent, or fiduciary of . . . [the] principal any benefit with the purpose of influencing the conduct of the . . . agent, or fiduciary in relating to his . . . principal’s affairs[.] . . .

Concerned with state and local governments’ inability to cope with the interstate nature of complex criminal enterprises, Congress enacted the Travel Act as part of the Attorney General’s 1961 legislative program directed against “organized crime.” *See Perrin v. United States*. The Travel Act “impose[s] criminal sanctions upon the person whose work takes him across State or National boundaries in aid of certain ‘unlawful activities.’” H.R. Rep. No. 966 (1961), reprinted in 1961 U.S.C.C.A.N. 2664, 2666 (letter from Attorney General Robert F. Kennedy to the Speaker of the House of Representatives). The Travel Act is, “in short, an effort to deny individuals who act [with the requisite] criminal purpose access to the channels of commerce.” *Erlenbaugh v. United States*.

As set forth by the Act’s plain language, the elements necessary to sustain a Travel Act conviction are (1) travel in interstate or foreign commerce or use of the mail or any facility in interstate or foreign commerce, (2) with the intent to promote, manage, establish, carry on, or facilitate the promotion, management, establishment, or carrying on, of any unlawful activity, and (3) performance of or an attempt to perform an act of promotion, management, establishment, or carrying on of the enumerated unlawful activity. 18 U.S.C. § 1952(a)(3). The district court never suggested the Travel Act counts fail to allege the foregoing elements, and neither have Defendants. Instead, the concern focuses largely on whether the Utah Commercial Bribery Statute legitimately defines the “unlawful activity” required for this Travel Act prosecution. . . .

Utah Code Ann. § 76-6-508(1)(a) is unconstitutionally vague as applied to Defendants only if its language “fails to provide people of ordinary intelligence a reasonable opportunity to understand” that Defendants’ conduct, as alleged in the indictment, was proscribed. *Hill v. Colorado*. In making that determination, we interpret the statute consistent with Utah state law. *See United States v. Gaudreau*. Unfortunately, the Utah Supreme Court has not addressed the constitutionality of § 76-6-508. The court has, however, provided useful principles to assist us in addressing that question:

When interpreting statutes our primary goal is to evince the true intent and purpose of the legislature. We discern legislative intent and purpose by first looking to the “best evidence” of its meaning, which is the plain language of the statute itself. When examining the statutory language, we assume the legislature used each term advisedly and in accordance with its ordinary meaning.

State v. Martinez (internal quotations and citations omitted). Where the words of a statute are unambiguous, the Utah Supreme Court “has a long history of relying on dictionary definitions to determine plain meaning.” *State v. Redd* (relying on dictionary definition of “remove” as used in a penal statute).

The district court concluded the words “any benefit” were “inherently ambiguous because the breadth of the language encompasses all gifts including expressions of courtesy such as good will gifts.” We agree with the district court that “it . . . broaches absurdity to believe the [Utah] legislature intended to criminalize good will gifts and gestures, especially in the context of promoting Salt Lake City and the State of Utah on the world stage to host the Olympic Winter Games.” Neither § 76-6-508(1)(a), nor the indictment, however, in any way seek to criminalize “good will gifts and gestures.” Webster’s Third New Int’l Dictionary 979 (1981) (hereinafter “Webster’s”) defines “good will” as “a will acting freely from pure disinterested motives.” Utah Code Ann. § 76-6-508(1)(a), in clear contrast, requires a defendant confer or agree to confer a “benefit” upon the agent or fiduciary of a principal “with the purpose of influencing the conduct of the . . . agent, or fiduciary in relating to his . . . principal’s affairs[.]” The district court failed to appreciate the limiting effect of § 76-6-508(1)(a)’s mens rea requirement on the phrase “any benefit” and on the statute as a whole.

To establish Defendants’ violation of the Travel Act, the Government must prove, among other things, that Defendants acted with a culpable state of mind. The Travel Act requires an act “with intent to . . . promote . . . or facilitate the promotion . . . of any unlawful activity[.]” The “unlawful activity” in this case, bribery under § 76-6-508(1)(a), requires an act “with the purpose of influencing . . . conduct[.]” Both statutes require the Government prove Defendants acted with a higher level of culpability than mere knowledge. The Travel Act requires a specific “intent to . . . promote[.]” *See United States v. James* (Travel Act violation is a specific intent crime); *see also United States v. Hall* (approving a specific intent instruction on a Travel Act charge). In other words, the Travel Act requires a defendant act not only with knowledge of what he is doing, but also with the objective of promoting some unlawful activity. *See United States v. Blair* (“A specific intent crime is one in which an act was committed voluntarily and purposely with the specific intent to do something the law forbids.”) (internal quotations omitted). Meanwhile, § 76-6-508(1)(a) requires a purposeful act. A person acts purposely if he consciously desires his conduct bring about a particular result, whatever the actual likelihood of that result. *See United States v. Bailey*. As the Court explained in *Bailey*, acting with a purpose and with a specific intent are much the same.

A vagueness challenge to a penal statute based on insufficient notice rarely succeeds where the requisite mental state is one of purpose or specific intent. The Supreme Court “has long recognized that the constitutionality of a vague statutory standard is closely related to whether that standard incorporates a requirement of mens rea.” *Colautti v. Franklin*, limited on other grounds by *Webster v. Reproductive Health Servs.* The Court explained nearly sixty years ago that “where the punishment imposed is only for an act knowingly done with the purpose of doing that which the statute prohibits, the accused cannot be said to suffer from lack of warning or knowledge that the act which he does is a violation of law.” *Screws v. United States*; accord *United States v. Stewart*. This is so because to meet the statute’s mens rea requirement, a defendant must consciously behave in a way the law prohibits, “and such conduct is a fitting object of criminal punishment.” *United States v. United States Gypsum Co.*

Contrary to the district court’s conclusion, no construction of § 76-6-508(1)(a) as applied to the allegations of the Travel Act counts could encompass those who confer or attempt to confer “benefits” upon an agent or fiduciary without unlawful purpose. The district court expressed concern that the words “any benefit” “leaves defendants to guess whether such gestures as transporting IOC members to and from the airport is sanctioned by § 76-6-508, but providing dinner for them is not; whether providing dinner is legal under the statute, but providing lodging is not; and so on and so forth.” In doing so, the court went well beyond the four corners of the indictment to hypothetical “benefits” which § 76-6-508(1)(a) may or may not proscribe. *See Hill* (rejecting “hypertechnical theories” as to what a penal statute covered).

Counts II, III, and IV of the indictment allege Defendants made or caused to be made international wire transfers in the amounts of \$12,000, \$1,000, and \$15,000 respectively. Those counts further allege Defendants made those transfers to three IOC members with the “intent to . . . promote . . . or facilitate the promotion” of the crime of bribery as defined by § 76-6-508(a)(1). Count V alleges Defendants received an interstate fax from Alfredo La Mont, the USOC representative Defendants allegedly retained to assist them in their bribery scheme. That count further alleges Defendants received the fax with the “intent to . . . promote . . . or facilitate the promotion” of the crime of bribery as defined by § 76-6-508(1)(a).

At trial, Defendants will be free to argue before the jury that they facilitated these transfers and correspondence, if proven, absent the requisite intent to promote bribery. Absent proof of an intent to influence conduct, Defendants’ use of interstate and international channels of commerce would not promote the designated “unlawful activity” as required by 18 U.S.C. § 1952(a). *See Jones* (proper Travel Act instruction “fully incorporates the elements of the relevant state law offense into the definition of the Travel Act violation”). That argument, however, is premature because at this stage we accept the indictment’s allegations as true.

Employing much the same rationale as the district court, Defendants suggest “most gifts given to persons in a position to make decisions have, at some level, an intent to

influence those persons, but not all of those gifts are unlawful.” Defendants add the Government does not “suggest that all benefits given with the intent to influence IOC members were bribes.” Neither § 76-6-508(1)(a) nor the indictment, however, concerns itself with “most gifts” and “all benefits.” The indictment plainly states that certain expenditures, gifts, and other benefits tendered to IOC members were within IOC guidelines and permissible. The indictment does not oppose Defendants’ undertaking on behalf of the SLBC to persuade IOC members, within the bounds of the law, as to the merits of their cause.

Instead, the indictment alleges Defendants clandestinely employed interstate and international channels of commerce to assist them in conferring direct and indirect cash payments and other benefits on IOC members “with the purpose of influencing” those members to cast their votes for Salt Lake City—not on the basis of the city’s merits as mandated by the IOC, but on the basis of the members’ personal gain. In other words, the indictment alleges Defendants used the channels of commerce to promote bribery, “a concept well-understood by the ordinary person.” *Gaudreau* (rejecting a constitutional challenge to Colorado’s commercial bribery statute when used as a predicate for a RICO prosecution). Defendants, like the district court, improperly wander beyond the four corners of the indictment to argue their case. Speculation about the vagueness of § 76-6-508(1)(a) in hypothetical situations is inadequate to sustain an attack on a Utah statute which surely applies to the conduct alleged in the indictment. *See Saffo* (“One to whose conduct a statute clearly applies may not successfully challenge it for vagueness.”). . . .

The district court next reasoned the phrase “in relating to his . . . principal’s affairs” was unduly vague because it left one to guess whether the principal need suffer some detriment and was thus “susceptible to two distinct interpretations.” . . .

Despite the district court’s concern, § 76-6-508(1)(a)’s language does not require the principal actually “suffer some detriment.” *Cf. Parise* (refusing to read into Pennsylvania’s commercial bribery statute a requirement that the agent acted against the principal’s interest). Such a reading of the statute might attribute to the Utah legislature the unexpressed intent to limit § 76-6-508(1)(a)’s reach to instances where the ultimate outcome harmed the principal. *See Bailey* (recognizing the criminal justice system “could easily fall of its own weight if courts . . . become obsessed with hair-splitting distinctions that [the legislature] neither stated nor implied when it made the conduct criminal”). Certainly the selection of Salt Lake City to host the 2002 Olympic Winter Games, in itself, was not detrimental to the IOC. The Games, by all accounts, were a success. Section 76-6-508(1)(a), however, proscribes conduct spawned by a corrupt intent to compromise an agent’s duty of loyalty to the principal. Purposeful conduct designed to compromise this duty of loyalty is the harm at which the statute is aimed. We conclude that whatever the exact contours of § 76-6-508(1)(a)’s “in relating to” language, the conduct which Defendants allegedly sought to influence in this case, i.e., IOC members’ votes, undoubtedly “relates to” the IOC’s “affairs.”

The court further reasoned the phrase “contrary to the interests of the . . . principal” was unduly vague because “[a] subjective evaluation by the defendants . . . is required to determine what is ‘contrary to the interests’ of the IOC and its members.” Consistent with the statute’s aim to protect the duty of loyalty, § 76-6-508(1)(a) does not require that the principal suffer some detriment. Rather, the statute requires only that the proscribed conduct be “contrary to the interests of” the principal, or in other words, opposed to the principal’s concerns. *See Webster’s* (defining the terms “contrary” and “interest” respectively).

The IOC’s interest is not limited to the desirability of the chosen site as the district court suggested. The IOC clearly has an interest in the fairness of the bidding process as evidenced by, among other things, the Olympic Charter. As stated in the indictment: “The Olympic Charter prohibited IOC members from accepting from governments, organizations, or other legal entities or natural persons, any mandate liable to bind them or interfere with their freedom of action and vote.” Fairness in the site selection process depends on the undivided loyalty of IOC members to the IOC—a loyalty critical to the IOC’s mission. *See Report of the IOC ad hoc Commission to Investigate the Conduct of Certain IOC Members and to Consider Possible Changes in the Procedures for the Allocation of the Games of the Olympiad and Olympic Winter Games* (1999). We believe a person of ordinary intelligence would understand that Defendants’ alleged conduct was “contrary to the interest of” the IOC.

To the extent, if any, the phrase “contrary to the interest of” requires “subjective evaluation by the defendants,” it is like the myriad of other phrases appearing in § 76-6-508(1)(a) with which the district court found fault. “[T]he law is full of instances where a man’s fate depends on his estimating rightly, that is, as the jury subsequently estimates it, some matter of degree.” *United States v. Villano* (quoting *Nash v. United States*). What the district court failed to recognize in analyzing the phrase “contrary to the interest of,” as well as § 76-6-508(1)(a)’s other phrases, is that-

[L]aws cannot define the boundaries of impermissible conduct with mathematical certainty. . . . “The precise course of the [boundary] may be uncertain, but no one can come near it without knowing that he does so, if he thinks, and if he does so it is familiar to the criminal law to make him take the risk.”

Gaudreau (quoting *United States v. Wurzbach*). “Nor is it unfair to require that one who deliberately goes perilously close to an area of proscribed conduct shall take the risk that he may cross the line.” *Boyce Motor Lines*

We do not suggest Defendants have violated the Travel Act or even come “perilously close” to violating it, although the indictment plainly supports the former view. That ultimately is for a jury to decide. What we decide is that the statutory definition of “unlawful activity,” i.e., Utah Code Ann. § 76-6-508(1)(a), on which the indictment’s Travel Act counts rely, conveyed sufficiently clear warning to Defendants as to the criminal nature of their alleged conduct when measured by common understanding and

practices. *See Villano*; *see also Gaudreau* (noting that state “commercial bribery statutes have been uniformly upheld in the face of vagueness challenges”). The possibility Defendants, sophisticated businessmen, would misunderstand the unremarkable proposition that their use of the channels of commerce in the manner alleged might promote, in violation of the Travel Act, the “unlawful activity” of bribery as defined by § 76-6-508(1)(a) seems remote. *See Hill*. That possibility becomes still more remote when considering the indictment’s allegations as to Defendants’ concerted efforts to conceal their conduct. *See supra* at 1086; *see also United States v. Rybicki* (noting that a mail fraud defendant’s efforts to avoid detection by omitting information from financial records was “indicative of consciousness of guilt”). . . .

A jury in Salt Lake City acquitted all defendants of all charges in the *Welch* prosecution. How might you speculate on the basis for the jury’s acquittals?

As a way of considering the huge money laundering and tax evasion problems involved in international corruption (consider the scandals revealed by the leaks known as *The Panama Papers*, *The Paradise Papers*, and *The FinCEN files*) and the role of the U.S. in those problems, it is highly recommended to watch a *60 Minutes* television news report, “Anonymous, Inc.,” which includes secret video recordings of reputable New York lawyers discussing a potential money laundering scheme with a prospective foreign client. (At last check, a CBS News subscription was required but may be available for free on a trial basis, or through your institution’s library; the author has typically used class time to show the report, which is stunning.) Consider the following ethics opinions in connection with the conduct of attorneys in that *60 Minutes* story.

ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

COMMITTEE ON PROFESSIONAL ETHICS

Formal Opinion 2018-4: Duties When an Attorney Is Asked to Assist in a Suspicious Transaction

TOPICS: Client Due Diligence, Confidentiality, Duty of Candor, Duty to Refrain from Counseling Fraudulent or Illegal Conduct.

DIGEST: The New York Rules of Professional Conduct (the “Rules”) prohibit a lawyer from knowingly assisting a client’s crime or fraud but do not explicitly address a lawyer’s duty when the lawyer merely has doubts about the lawfulness of the client’s conduct; nor do the Rules explicitly require a lawyer to investigate in such circumstances in order to ascertain whether the legal services would in fact assist a crime or fraud before assisting the client. Nevertheless, when a lawyer is asked to assist in a transaction that the lawyer suspects may involve a crime or fraud, a duty of inquiry in some circumstances is implicit in the Rules. First, in order to render competent representation as required by Rule 1.1, a lawyer has a duty to the client in some circumstances to undertake an inquiry into suspicious transactions to render reasonable and candid advice

to the client about whether to undertake the proposed conduct and the consequences of doing so. Second, notwithstanding the absence of an explicit requirement, a duty to inquire into suspicious transactions under some circumstances is implicit in the duty to avoid knowingly assisting wrongful conduct. The lawyer's inquiry must be consistent with the confidentiality duty of Rule 1.6, which governs disclosures the lawyer may make to third parties during the inquiry, as well as with the duty to keep the client informed during the representation. If the lawyer concludes that the client will engage or is engaging in a crime or fraud, the lawyer must not assist, or further assist, the wrongdoing. The lawyer may undertake remedial measures to the extent permitted by the exceptions to the confidentiality rule.

RULES: 1.1, 1.2, 1.6, 1.16, 2.1, 8.4

QUESTION: When an individual client asks a lawyer to provide legal assistance in a transaction, and the lawyer suspects that the legal services may assist the client's crime or fraud, to what extent must the lawyer investigate to allay or confirm the suspicions, and what other conduct must the lawyer undertake under the Rules?

OPINION:

I. Introduction

In the context of the following scenario, this opinion addresses lawyers' obligations under the Rules when the lawyer is retained to assist an individual client in a transaction that appears to the lawyer to be suspicious.

A lawyer represents a client in the sale of a business in New York. The client advises the lawyer that the proceeds of the transaction will be used to purchase a different business. The client directs that after the first transaction closes, all payments be sent to a bank in a well-known secrecy jurisdiction. The client then asks the lawyer to proceed with the purchase. In preparing the documents and doing general due diligence, the lawyer realizes that the proposed purchase price is much more than the business is worth. The lawyer also learns inadvertently that the client has two passports, each from a secrecy jurisdiction different than the one in which the bank is located. The lawyer suspects, but does not know, that the transaction will involve a fraud or crime, such as money laundering or tax evasion, on the part of the client.

As set forth below, a number of Rules and considerations bear on whether a transactional lawyer has a duty to investigate the client's conduct in this scenario and whether there are other steps that must be taken. These include the lawyer's duties of competence [Rule 1.1], of confidentiality [Rule 1.6], and to refrain from assisting a client in conduct that the lawyer knows is illegal or fraudulent [Rule 1.2(d)].

II. A Transactional Lawyer May Have a Duty to Inquire When Serious Questions are Raised Regarding Whether the Lawyer is Assisting the Client in a Crime or Fraud

a. The duty of competence may require the lawyer to conduct due diligence into the client's potentially fraudulent conduct

Rule 1.1(a) requires a lawyer to provide “competent representation to a client.” In many contexts, the very purpose of the representation is to provide advice about the lawfulness of a client’s proposed course of conduct or to assist the client in structuring a proposed transaction in a manner that conforms to the law. Rule 1.2(d) authorizes a lawyer to “discuss the legal consequences of any proposed course of conduct with a client,” and in such cases, Rule 1.1 presupposes that the lawyer will provide competent advice about whether proposed conduct would be unlawful or about how to achieve the client’s objectives within the law.

Regardless of the client’s objectives, competent representation presupposes that the lawyer is rendering assistance in carrying out a client’s lawful objectives. Committing a crime or engaging in other illegal or fraudulent conduct is not a lawful objective. Rule 1.2(d) forbids a lawyer from assisting the client in conduct that the lawyer knows to be illegal or fraudulent. But even if the lawyer does not have the requisite knowledge under Rule 1.2(d), furthering a client’s illegal or fraudulent transaction—thereby subjecting a client to criminal or civil liability—may run afoul of the Rules if the lawyer did not act competently under Rule 1.1(a). In general, assisting in a suspicious transaction is not competent where a reasonable lawyer prompted by serious doubts would have refrained from providing assistance or would have investigated to allay suspicions before rendering or continuing to render legal assistance.

Further, Rules 1.4 and 2.1 require lawyers to render reasonable, candid advice. Unless the lawyer inquires in response to serious suspicions, the lawyer will not be in a position to advise the client about the attendant risks of civil or criminal liability. Thus, the duty of competence not only protects the client, but also in some situations requires the lawyer to take the steps necessary, including additional inquiry, to ensure that she is providing competent advice.

What constitutes a suspicion sufficient to trigger inquiry will depend on the circumstances. In many representations, there is no reason for the lawyer to doubt the lawfulness of the client’s proposed actions. On the other hand, there may be representations where the circumstances raise suspicions or questions. For example, in the hypothetical above, the lawyer may have a duty to inquire of the client as to the reasons for a purchase of a business at a higher-than-market price and for running the funds through a bank in a secrecy jurisdiction to determine whether the transaction is being used to launder money, to avoid legitimate taxes, or for some other criminal or fraudulent purpose. Depending upon the answer, the lawyer may conclude that the transaction is legitimate, that she needs to make further inquiry, or that she must not provide further assistance in the transaction.

These conclusions are consistent with Comment [5] to Rule 1.1 which notes that “[c]ompetent handling of a particular matter includes inquiry into an analysis of the factual and legal elements of the problem,” and with other authorities. *See, e.g.,* N.Y. City 2015-3 (2015) (a lawyer who believes he is the victim of a scam by a purported prospective client has a duty of competence to investigate further before proceeding with the matter); ABA Informal Op. 1470 (1981) (“Opinion 1470”) (“[A] lawyer should not undertake representation in disregard of facts suggesting that the representation might aid the client in perpetrating a fraud or otherwise committing a crime.”); *cf.* N.Y. City 2018-2 (2018) (“The duty of competence under Rule 1.1 establishes additional duties in the post-conviction context, including, in some cases, a duty to investigate new potentially exculpatory evidence regardless of whether Rule 3.8(c) is triggered.”).

b. A lawyer who fails to investigate potentially fraudulent conduct may also violate Rule 1.2(d), depending on the circumstances

Rule 1.2(d) prohibits a lawyer from assisting a client in conduct that the lawyer knows to be criminal or fraudulent. “Knowledge” under the Rules is defined as “actual knowledge of the fact in question . . . [which] may be inferred from the circumstances.” Rule 1.0(k). However, consistent with the criminal law standard of “conscious avoidance,” a lawyer may be deemed to have knowledge that the client is engaged in a criminal or fraudulent transaction if the lawyer is aware of serious questions about the legality of the transaction and renders assistance without considering readily available facts that would have confirmed the wrongfulness of the transaction. *See* N.Y. City 2018-2 (2018) (“Conscious avoidance of the fact in question may also constitute knowledge under the Rules, as under criminal law”) (citing N.Y. City 99-02 (1999) (“Lawyers have an obligation not to shut their eyes to what was plainly to be seen . . . A lawyer cannot escape responsibility by avoiding inquiry.”)).

Opinion 1470 similarly recognized that when lawyers are aware that the client’s proposed course of conduct is likely to be illegal, they “cannot escape responsibility by avoiding inquiry” but “must be satisfied, on the facts before [them] and readily available to [them], that [they] can perform the requested services without abetting fraudulent or criminal conduct and without relying on past client crime or fraud to achieve results the client now wants”; if lawyers are not satisfied that the client’s conduct is lawful, they have “a duty of further inquiry” before rendering assistance. Thus, while Rule 1.2(d) does not require lawyers to inquire when there is no ground for suspicion, they cannot ignore “red flags.” *Cf.* Rebecca Roiphe, *The Ethics of Willful Ignorance*, 24 GEO. J. LEGAL ETHICS 187 (2011), citing *In re Blatt* (holding that “a lawyer committed misconduct by helping a client effect a purchase after failing to investigate its suspicious nature”); *In re Dobson* (sanctioning “an attorney for helping his client while remaining deliberately ignorant of his client’s criminal conduct” and holding that the court would “not countenance the conscious avoidance of one’s ethical duties as an attorney”).

III. Limits on the Lawyer's Duty to Inquire

Ordinarily, a lawyer will begin an inquiry by seeking information from the client before turning to other sources. After concluding a reasonable inquiry, the lawyer may ordinarily credit the client when there are doubts. Whether a particular inquiry is adequate will vary with the circumstances.

To the extent that the lawyer must seek information from others, the Rules may impose conditions or limits. In general, the duty under Rule 1.4 to keep the client reasonably informed will require the lawyer to explain why there are doubts about the legality of the transaction and what steps the lawyer proposes to take to allay or confirm suspicions. If suspicions are sufficiently serious to give rise to a duty of inquiry under Rule 1.2(d), then the lawyer would render further assistance at her peril. A lawyer's fear that a client may seek to cover up his actions does not eliminate the duty of communication. Rule 1.4(a)(5). If the lawyer does suspect a cover-up and cannot persuade the client to be forthcoming, she may choose to terminate the representation. Rule 1.16(c)(2). Similarly, if the client will not authorize such an inquiry, the lawyer may have no realistic choice other than to cease assisting in the particular transaction, because to continue the representation may put her in jeopardy of violating Rule 1.2(d). And, needless to say, a client's refusal to authorize and assist in an inquiry into the lawfulness of the client's proposed conduct will ordinarily constitute an additional, and very significant, "red flag."

If the client greenlights an inquiry but refuses to pay for the time required to conduct it, the lawyer must decide whether to conduct the inquiry at her own expense or terminate the representation. The lawyer may discontinue the representation based on concerns as to the legality of the transaction. See Rule 1.2(f) (permitting a lawyer to refuse to participate in conduct that the lawyer believes to be unlawful, even if there is support for an argument that the conduct is legal); Rule 1.2, Cmt. [15].

IV. Remedial Obligations

If a lawyer gains knowledge during the course of representation that a client is engaged in unlawful conduct (or plans to be), the lawyer has a range of options. The lawyer's remedial steps should be dictated by such factors as the lawyer's knowledge of the facts at hand, the seriousness of the client's misconduct, and the extent of the lawyer's involvement in the client's misconduct. When the lawyer has actual knowledge of prospective wrongdoing, the lawyer may not assist in the wrongdoing and, further, must counsel the client against the illegal course of conduct under Rule 1.4(a)(5). This counseling obligation derives from the duty of competence under Rule 1.1. Despite the challenges involved in "persuading a client to take necessary preventive or corrective action" under Rule 1.4, such communications are appropriate not only to assist the client but to mitigate any risks the attorney is assuming by continuing to represent the client. Rule 1.2(d), Cmt. [10].

In our hypothetical situation, if the lawyer determines that the client may be engaged in tax fraud or tax evasion, the lawyer may choose to counsel the client to pay the appropriate taxes or take other corrective action. There may also be circumstances in which corrective action is not possible and the lawyer may have no alternative but to resign. Rule 1.16(b)(1).

V. Conclusion

When asked to represent a client in a transaction that a lawyer believes to be suspicious, the lawyer has an implicit duty under some circumstances to inquire into the client's conduct. If the lawyer believes that her client is entering into a transaction that is illegal or fraudulent, the lawyer ordinarily must attempt to inquire in order to provide competent representation to the client under Rule 1.1. Further, under Rule 1.2(d), which forbids knowingly assisting a client's illegal or fraudulent conduct, a lawyer has the requisite knowledge if the lawyer is aware of serious questions about the legality of the transaction and renders assistance without considering readily available facts that would have confirmed the wrongfulness of the transaction. Implicit in the rule, therefore, is the obligation to take reasonably available measures to ascertain whether the client's transaction is illegal or fraudulent. The lawyer's inquiry must be consistent with the confidentiality duty of Rule 1.6, which governs disclosures the lawyer may make to third parties during the inquiry, as well as with the duty to keep the client informed during the representation. If the lawyer concludes that the client's conduct is illegal or fraudulent, the lawyer must not further assist the wrongdoing and may undertake remedial measures to the extent permitted by the exceptions to the confidentiality rule.

SUPREME COURT OF NEW YORK, APPELLATE DIVISION, FIRST DEPARTMENT

In the Matter of John H. Jankoff (admitted as John Henry Jankoff), an attorney and counselor-at-law: Attorney Grievance Committee for the First Judicial Department, Petitioner, John H. Jankoff, Respondent.

September 20, 2018, Decided

PER CURIAM

Respondent, John H. Jankoff, was admitted to the practice of law in the State of New York by the First Judicial Department on December 23, 1968, under the name John Henry Jankoff. At all times relevant to this proceeding, respondent maintained an office for the practice of law within the First Judicial Department.

The Attorney Grievance Committee commenced this disciplinary proceeding by a petition of charges (Judiciary Law § 90[2], Rules for Attorney Disciplinary Matters [22 NYCRR] § 1240.8), alleging that respondent was guilty of certain misconduct in violation of the Rules of Professional Conduct (22 NYCRR 1200.0) because he counseled a client to engage in conduct he knew was illegal or fraudulent and misrepresented his personal experience and knowledge during a meeting with the client.

Specifically, respondent met with a potential client who represented himself as appearing on behalf of a West African minister. The individual stated that the minister desired to purchase real property in the form of a brownstone, an airplane, and a yacht in the United States and identified the money as “gray money” or “black money.” Respondent did not personally inquire as to the provenance of the money. Although respondent knew that the money was questionable, he informed the individual that he would have to consult with an expert to determine whether the money could be moved anonymously and to make sure that the money was “clean” and not criminally derived. Nonetheless, respondent offered suggestions on how to transfer the money into the United States from other countries in ways that would mask the minister as the ultimate or beneficial owner. He also misrepresented his personal experience and knowledge of the subject matter to keep the potential client interested.

The parties agree on the stipulated facts, including the admission to the acts of professional misconduct and the violation of rules 1.2(d) , 8.4(c) and 8.4(h), the relevant factors in mitigation, and on the discipline. The parties now jointly move pursuant to 22 NYCRR 1240.8(a)(5) for discipline on consent and request the imposition of a public censure.

In support of the joint motion for discipline by consent, the parties rely on *Matter of Scher* , *Matter of Lesser*, *Matter of Rosales*, and *Matter of Kanarek*, and agree that the circumstances in those case are analogous here and should be followed. In light of the significant factors in mitigation, including respondent’s cooperation, admitted conduct and acceptance of responsibility, and the fact that the misconduct was aberrational and occurred in the context of a single, open-ended conversation during a meeting with a potential clients after which respondent took no further steps, the parties agree that a public censure is appropriate.

Accordingly, the parties’ motion for discipline by consent should be granted, and respondent is censured. The Committee’s separately filed petition of charges should be denied as moot. . . .

Problem 5-3

As a final example of organized international corruption, consider the extensive prosecutions in the Eastern District of New York of individuals involved in the massive scandal in the operation of FIFA and other major organizations in the sport of soccer (football). The FIFA prosecutions have been largely predicated on RICO and the money laundering statutes, although they have also involved the wire fraud statute, as seen in the related court decision excerpted in Chapter 2. One of the main indictments is available at:

<https://www.justice.gov/opa/file/796966/download>.

There are also many summaries and reports readily available from online searches. Read a bit about the FIFA scandal if you haven't already, and consider these questions:

- (a) Should the FIFA case have been a criminal prosecution?
- (b) Should the FIFA case have been a *U.S.* criminal prosecution?
- (c) Why might the FIFA case have been brought in the Eastern District of New York?
- (d) Why hasn't the government used the FCPA in the FIFA prosecutions?

6. HEALTH CARE CRIMES

Corporations in the health care industry, which now accounts for 20 percent of U.S. gross domestic product, have paid billions of dollars to the government over the last two decades in penalties and settlements as a result of huge enforcement efforts in that sector. This short chapter touches on what is a large stand-alone practice field.

The idea in this chapter is to get a feel for the nature and breadth of the main substantive legal prohibitions the government relies on, the dynamics driving settlements, and some of the difficult problems that can face corporations and individuals subject to this legal regime.

A. Selected Statutes

The statutory and regulatory regime is as complex and extensive in the area of health care as anywhere in the field of corporate crime. The three provisions the government uses most often in this area are:

- (1) the **anti-kickback** statute, which is primarily used to police corrupt billing schemes in hospitals and medical practices;
- (2) the prohibitions against **misbranding** food and drugs (the FDCA), which are primarily used to target pharmaceutical companies' marketing practices; and
- (3) the **False Claims Act**, which is a general prohibition on bilking the government that includes a very significant private enforcement mechanism comprising the first of the "whistleblower" regimes we will encounter.

These statutes are lengthy. It is important to read the excerpts in full and identify the basic prohibitions in each, while thinking about their breadth of applications in terms of the size and diversity of health care products and services in the U.S. economy.

42 U.S.C. § 1320a-7b (Anti-kickback Statute) (excerpts)

- (a) Making or causing to be made false statements or representations

Whoever—

- (1) knowingly and willfully makes or causes to be made any false statement or representation of a material fact in any application for any benefit or payment under a Federal health care program (as defined in subsection (f) of this section),
- (2) at any time knowingly and willfully makes or causes to be made any false statement or representation of a material fact for use in determining rights to such benefit or payment,
- (3) having knowledge of the occurrence of any event affecting

(A) his initial or continued right to any such benefit or payment, or

(B) the initial or continued right to any such benefit or payment of any other individual in whose behalf he has applied for or is receiving such benefit or payment, conceals or fails to disclose such event with an intent fraudulently to secure such benefit or payment either in a greater amount or quantity than is due or when no such benefit or payment is authorized,

(4) having made application to receive any such benefit or payment for the use and benefit of another and having received it, knowingly and willfully converts such benefit or payment or any part thereof to a use other than for the use and benefit of such other person,

(5) presents or causes to be presented a claim for a physician's service for which payment may be made under a Federal health care program and knows that the individual who furnished the service was not licensed as a physician, or

(6) for a fee knowingly and willfully counsels or assists an individual to dispose of assets (including by any transfer in trust) in order for the individual to become eligible for medical assistance under a State plan under subchapter XIX of this chapter, if disposing of the assets results in the imposition of a period of ineligibility for such assistance under section 1396p(c) of this title,

shall

(i) in the case of such a statement, representation, concealment, failure, or conversion by any person in connection with the furnishing (by that person) of items or services for which payment is or may be made under the program, be guilty of a felony and upon conviction thereof fined not more than \$25,000 or imprisoned for not more than five years or both, or

(ii) in the case of such a statement, representation, concealment, failure, conversion, or provision of counsel or assistance by any other person, be guilty of a misdemeanor and upon conviction thereof fined not more than \$10,000 or imprisoned for not more than one year, or both. In addition, in any case where an individual who is otherwise eligible for assistance under a Federal health care program is convicted of an offense under the preceding provisions of this subsection, the administrator of such program may at its option (notwithstanding any other provision of such program) limit, restrict, or suspend the eligibility of that individual for such period (not exceeding one year) as it deems appropriate; but the imposition of a limitation, restriction, or suspension with respect to the eligibility of any individual under this sentence shall not affect the eligibility of any other person for assistance under the plan, regardless of the relationship between that individual and such other person.

(b) Illegal remunerations

(1) Whoever knowingly and willfully solicits or receives any remuneration (including any kickback, bribe, or rebate) directly or indirectly, overtly or covertly, in cash or in kind—

(A) in return for referring an individual to a person for the furnishing or arranging for the furnishing of any item or service for which payment may be made in whole or in part under a Federal health care program, or

(B) in return for purchasing, leasing, ordering, or arranging for or recommending purchasing, leasing, or ordering any good, facility, service, or item for which payment may be made in whole or in part under a Federal health care program,

shall be guilty of a felony and upon conviction thereof, shall be fined not more than \$25,000 or imprisoned for not more than five years, or both.

(2) Whoever knowingly and willfully offers or pays any remuneration (including any kickback, bribe, or rebate) directly or indirectly, overtly or covertly, in cash or in kind to any person to induce such person—

(A) to refer an individual to a person for the furnishing or arranging for the furnishing of any item or service for which payment may be made in whole or in part under a Federal health care program, or

(B) to purchase, lease, order, or arrange for or recommend purchasing, leasing, or ordering any good, facility, service, or item for which payment may be made in whole or in part under a Federal health care program,

shall be guilty of a felony and upon conviction thereof, shall be fined not more than \$25,000 or imprisoned for not more than five years, or both.

(3) Paragraphs (1) and (2) shall not apply to— [a long list of statutory exceptions]. . .

(h) Actual knowledge or specific intent not required

With respect to violations of this section, a person need not have actual knowledge of this section or specific intent to commit a violation of this section.

42 U.S.C. § 1320a-7 (Exclusion Statute) (excerpts)

(a) Mandatory exclusion

The Secretary shall exclude the following individuals and entities from participation in any Federal health care program (as defined in section 1320a-7b(f) of this title):

(1) Conviction of program-related crimes

Any individual or entity that has been convicted of a criminal offense related to the delivery of an item or service under subchapter XVIII of this chapter or under any State health care program.

(2) Conviction relating to patient abuse

Any individual or entity that has been convicted, under Federal or State law, of a criminal offense relating to neglect or abuse of patients in connection with the delivery of a health care item or service.

(3) Felony conviction relating to health care fraud

Any individual or entity that has been convicted for an offense which occurred after August 21, 1996, under Federal or State law, in connection with the delivery of a health care item or service or with respect to any act or omission in a health care program (other than those specifically described in paragraph (1)) operated by or financed in whole or in part by any Federal, State, or local government agency, of a criminal offense consisting of a felony relating to fraud, theft, embezzlement, breach of fiduciary responsibility, or other financial misconduct.

(4) Felony conviction relating to controlled substance

Any individual or entity that has been convicted for an offense which occurred after August 21, 1996, under Federal or State law, of a criminal offense consisting of a felony relating to the unlawful manufacture, distribution, prescription, or dispensing of a controlled substance.

(b) Permissive exclusion

The Secretary may exclude the following individuals and entities from participation in any Federal health care program (as defined in section 1320a–7b(f) of this title):

(1) Conviction relating to fraud

Any individual or entity that has been convicted for an offense which occurred after August 21, 1996, under Federal or State law—

(A) of a criminal offense consisting of a misdemeanor relating to fraud, theft, embezzlement, breach of fiduciary responsibility, or other financial misconduct—

(i) in connection with the delivery of a health care item or service, or

(ii) with respect to any act or omission in a health care program (other than those specifically described in subsection (a)(1) of this section) operated by or financed in whole or in part by any Federal, State, or local government agency; or

(B) of a criminal offense relating to fraud, theft, embezzlement, breach of fiduciary responsibility, or other financial misconduct with respect to any act or omission in a program (other than a health care program) operated by or financed in whole or in part by any Federal, State, or local government agency.

(2) Conviction relating to obstruction of an investigation or audit

Any individual or entity that has been convicted, under Federal or State law, in connection with the interference with or obstruction of any investigation or audit related to—

- (i) any offense described in paragraph (1) or in subsection (a); or
- (ii) the use of funds received, directly or indirectly, from any Federal health care program (as defined in section 1320a–7b(f) of this title).

(3) Misdemeanor conviction relating to controlled substance

Any individual or entity that has been convicted, under Federal or State law, of a criminal offense consisting of a misdemeanor relating to the unlawful manufacture, distribution, prescription, or dispensing of a controlled substance.

(4) License revocation or suspension

Any individual or entity—

- (A) whose license to provide health care has been revoked or suspended by any State licensing authority, or who otherwise lost such a license or the right to apply for or renew such a license, for reasons bearing on the individual's or entity's professional competence, professional performance, or financial integrity, or
- (B) who surrendered such a license while a formal disciplinary proceeding was pending before such an authority and the proceeding concerned the individual's or entity's professional competence, professional performance, or financial integrity.

(5) Exclusion or suspension under Federal or State health care program

Any individual or entity which has been suspended or excluded from participation, or otherwise sanctioned, under—

- (A) any Federal program, including programs of the Department of Defense or the Department of Veterans Affairs, involving the provision of health care, or
- (B) a State health care program,

for reasons bearing on the individual's or entity's professional competence, professional performance, or financial integrity.

(6) Claims for excessive charges or unnecessary services and failure of certain organizations to furnish medically necessary services

Any individual or entity that the Secretary determines—

(A) has submitted or caused to be submitted bills or requests for payment (where such bills or requests are based on charges or cost) under subchapter XVIII of this chapter or a State health care program containing charges (or, in applicable cases, requests for payment of costs) for items or services furnished substantially in excess of such individual's or entity's usual charges (or, in applicable cases, substantially in excess of such individual's or entity's costs) for such items or services, unless the Secretary finds there is good cause for such bills or requests containing such charges or costs;

(B) has furnished or caused to be furnished items or services to patients (whether or not eligible for benefits under subchapter XVIII of this chapter or under a State health care program) substantially in excess of the needs of such patients or of a quality which fails to meet professionally recognized standards of health care;

(C) is—

(i) a health maintenance organization (as defined in section 1396b (m) of this title) providing items and services under a State plan approved under subchapter XIX of this chapter, or

(ii) an entity furnishing services under a waiver approved under section 1396n (b)(1) of this title,

and has failed substantially to provide medically necessary items and services that are required (under law or the contract with the State under subchapter XIX of this chapter) to be provided to individuals covered under that plan or waiver, if the failure has adversely affected (or has a substantial likelihood of adversely affecting) these individuals; or

(D) is an entity providing items and services as an eligible organization under a risk-sharing contract under section 1395mm of this title and has failed substantially to provide medically necessary items and services that are required (under law or such contract) to be provided to individuals covered under the risk-sharing contract, if the failure has adversely affected (or has a substantial likelihood of adversely affecting) these individuals. . . .

Federal Food, Drug, and Cosmetic Act (FDCA) (Excerpts)

21 U.S.C. § 331

The following acts and the causing thereof are prohibited:

(a) The introduction or delivery for introduction into interstate commerce of any food, drug, device, tobacco product, or cosmetic that is adulterated or misbranded.

(b) The adulteration or misbranding of any food, drug, device, tobacco product, or cosmetic in interstate commerce.

(c) The receipt in interstate commerce of any food, drug, device, tobacco product, or cosmetic that is adulterated or misbranded, and the delivery or proffered delivery thereof for pay or otherwise. . . .

(jj)

(1) The failure to submit the certification required by section 282(j)(5)(B) of title 42, or knowingly submitting a false certification under such section.

(2) The failure to submit clinical trial information required under subsection (j) of section 282 of title 42.

(3) The submission of clinical trial information under subsection (j) of section 282 of title 42 that is false or misleading in any particular under paragraph (5)(D) of such subsection (j). . . .

21 U.S.C. § 352

A drug or device shall be deemed to be misbranded—

(a) False or misleading label

If its labeling is false or misleading in any particular. Health care economic information provided to a formulary committee, or other similar entity, in the course of the committee or the entity carrying out its responsibilities for the selection of drugs for managed care or other similar organizations, shall not be considered to be false or misleading under this paragraph if the health care economic information directly relates to an indication approved under section 355 of this title or under section 262(a) of title 42 for such drug and is based on competent and reliable scientific evidence. . . .

(f) Directions for use and warnings on label

Unless its labeling bears

(1) adequate directions for use; and

(2) such adequate warnings against use in those pathological conditions or by children where its use may be dangerous to health, or against unsafe dosage or methods or duration of administration or application, in such manner and form, as are necessary for the protection of users, except that where any requirement of clause (1) of this paragraph, as applied to any drug or device, is not necessary for the protection of the public health, the Secretary shall promulgate regulations exempting such drug or device from such requirement. . . .

(j) Health-endangering when used as prescribed

If it is dangerous to health when used in the dosage or manner, or with the frequency or duration prescribed, recommended, or suggested in the labeling thereof. . . .

21 U.S.C. § 333

(a) Violation of section 331 of this title; second violation; intent to defraud or mislead

(1) Any person who violates a provision of section 331 of this title shall be imprisoned for not more than one year or fined not more than \$1,000, or both.

(2) Notwithstanding the provisions of paragraph (1) of this section, if any person commits such a violation after a conviction of him under this section has become final, or commits such a violation with the intent to defraud or mislead, such person shall be imprisoned for not more than three years or fined not more than \$10,000, or both. . . .

(c) Exceptions in certain cases of good faith, etc.

No person shall be subject to the penalties of subsection (a)(1) of this section,

(1) for having received in interstate commerce any article and delivered it or proffered delivery of it, if such delivery or proffer was made in good faith, unless he refuses to furnish on request of an officer or employee duly designated by the Secretary the name and address of the person from whom he purchased or received such article and copies of all documents, if any there be, pertaining to the delivery of the article to him; or

(2) for having violated section 331(a) or (d) of this title, if he establishes a guaranty or undertaking signed by, and containing the name and address of, the person residing in the United States from whom he received in good faith the article, to the effect, in case of an alleged violation of section 331(a) of this title, that such article is not adulterated or misbranded, within the meaning of this chapter designating this chapter or to the effect, in case of an alleged violation of section 331(d) of this title, that such article is not an article which may not, under the provisions of section 344 or 355 of this title, be introduced into interstate commerce. . . .

False Claims Act (Excerpts)

31 U.S.C. § 3729

(a) Liability for Certain Acts.—

(1) In general.— Subject to paragraph (2), any person who—

(A) knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval;

(B) knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim;

(C) conspires to commit a violation of subparagraph (A), (B), (D), (E), (F), or (G);

(D) has possession, custody, or control of property or money used, or to be used, by the Government and knowingly delivers, or causes to be delivered, less than all of that money or property;

(E) is authorized to make or deliver a document certifying receipt of property used, or to be used, by the Government and, intending to defraud the Government, makes or delivers the receipt without completely knowing that the information on the receipt is true;

(F) knowingly buys, or receives as a pledge of an obligation or debt, public property from an officer or employee of the Government, or a member of the Armed Forces, who lawfully may not sell or pledge property; or

(G) knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the Government, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the Government,

is liable to the United States Government for a civil penalty of not less than \$5,000 and not more than \$10,000, as adjusted by the Federal Civil Penalties Inflation Adjustment Act of 1990 (28 U.S.C. 2461 note; Public Law 104–410), plus 3 times the amount of damages which the Government sustains because of the act of that person.

[Editor’s note on criminal liability: in addition to the more common imposition of civil liability under the False Claims Act, 18 U.S.C. § 287 provides that “Whoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or to any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years and shall be subject to a fine”]

(2) Reduced damages.— If the court finds that—

(A) the person committing the violation of this subsection furnished officials of the United States responsible for investigating false claims violations with all information known to such person about the violation within 30 days after the date on which the defendant first obtained the information;

(B) such person fully cooperated with any Government investigation of such violation; and

(C) at the time such person furnished the United States with the information about the violation, no criminal prosecution, civil action, or administrative action had commenced under this title with respect to such violation, and the person did not have actual knowledge of the existence of an investigation into such violation,

the court may assess not less than 2 times the amount of damages which the Government sustains because of the act of that person.

(3) Costs of civil actions.— A person violating this subsection shall also be liable to the United States Government for the costs of a civil action brought to recover any such penalty or damages.

(b) Definitions.— For purposes of this section—

(1) the terms “knowing” and “knowingly”—

(A) mean that a person, with respect to information—

(i) has actual knowledge of the information;

(ii) acts in deliberate ignorance of the truth or falsity of the information; or

(iii) acts in reckless disregard of the truth or falsity of the information; and

(B) require no proof of specific intent to defraud; . . .

(4) the term “material” means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.

31 U.S.C. § 3730

(a) Responsibilities of the Attorney General.— The Attorney General diligently shall investigate a violation under section 3729. If the Attorney General finds that a person has violated or is violating section 3729, the Attorney General may bring a civil action under this section against the person.

(b) Actions by Private Persons.—

(1) A person may bring a civil action for a violation of section 3729 for the person and for the United States Government. The action shall be brought in the name of the Government. The action may be dismissed only if the court and the Attorney General give written consent to the dismissal and their reasons for consenting.

(2) A copy of the complaint and written disclosure of substantially all material evidence and information the person possesses shall be served on the Government pursuant to Rule 4(d)(4) of the Federal Rules of Civil Procedure. The complaint shall be filed in camera, shall remain under seal for at least 60 days, and shall not be served on the defendant until the court so orders. The Government may elect to intervene and proceed with the action within 60 days after it receives both the complaint and the material evidence and information.

(3) The Government may, for good cause shown, move the court for extensions of the time during which the complaint remains under seal under paragraph (2). Any such motions may be supported by affidavits or other submissions in camera. The defendant shall not be required to respond to any complaint filed under this section until 20 days after the complaint is unsealed and served upon the defendant pursuant to Rule 4 of the Federal Rules of Civil Procedure.

(4) Before the expiration of the 60-day period or any extensions obtained under paragraph (3), the Government shall—

(A) proceed with the action, in which case the action shall be conducted by the Government; or

(B) notify the court that it declines to take over the action, in which case the person bringing the action shall have the right to conduct the action.

(5) When a person brings an action under this subsection, no person other than the Government may intervene or bring a related action based on the facts underlying the pending action.

(c) Rights of the Parties to Qui Tam Actions.—

(1) If the Government proceeds with the action, it shall have the primary responsibility for prosecuting the action, and shall not be bound by an act of the person bringing the action. Such person shall have the right to continue as a party to the action, subject to the limitations set forth in paragraph (2).

(2)

(A) The Government may dismiss the action notwithstanding the objections of the person initiating the action if the person has been notified by the Government of the filing of the motion and the court has provided the person with an opportunity for a hearing on the motion.

(B) The Government may settle the action with the defendant notwithstanding the objections of the person initiating the action if the court determines, after a hearing, that the proposed settlement is fair, adequate, and reasonable under all the circumstances. Upon a showing of good cause, such hearing may be held in camera.

(C) Upon a showing by the Government that unrestricted participation during the course of the litigation by the person initiating the action would interfere with or unduly delay the Government's prosecution of the case, or would be repetitious, irrelevant, or for purposes of harassment, the court may, in its discretion, impose limitations on the person's participation, such as—

- (i) limiting the number of witnesses the person may call;
- (ii) limiting the length of the testimony of such witnesses;
- (iii) limiting the person's cross-examination of witnesses; or
- (iv) otherwise limiting the participation by the person in the litigation.

(D) Upon a showing by the defendant that unrestricted participation during the course of the litigation by the person initiating the action would be for purposes of harassment or would cause the defendant undue burden or unnecessary expense, the court may limit the participation by the person in the litigation.

(3) If the Government elects not to proceed with the action, the person who initiated the action shall have the right to conduct the action. If the Government so requests, it shall be served with copies of all pleadings filed in the action and shall be supplied with copies of all deposition transcripts (at the Government's expense). When a person proceeds with the action, the court, without limiting the status and rights of the person initiating the action, may nevertheless permit the Government to intervene at a later date upon a showing of good cause.

(4) Whether or not the Government proceeds with the action, upon a showing by the Government that certain actions of discovery by the person initiating the action would interfere with the Government's investigation or prosecution of a criminal or civil matter arising out of the same facts, the court may stay such discovery for a period of not more than 60 days. Such a showing shall be conducted in camera. The court may extend the 60-day period upon a further showing in camera that the Government has pursued the criminal or civil investigation or proceedings with reasonable diligence and any proposed discovery in the civil action will interfere with the ongoing criminal or civil investigation or proceedings.

(5) Notwithstanding subsection (b), the Government may elect to pursue its claim through any alternate remedy available to the Government, including any administrative proceeding to determine a civil money penalty. If any such alternate remedy is pursued in another proceeding, the person initiating the action shall have

the same rights in such proceeding as such person would have had if the action had continued under this section. Any finding of fact or conclusion of law made in such other proceeding that has become final shall be conclusive on all parties to an action under this section. For purposes of the preceding sentence, a finding or conclusion is final if it has been finally determined on appeal to the appropriate court of the United States, if all time for filing such an appeal with respect to the finding or conclusion has expired, or if the finding or conclusion is not subject to judicial review.

(d) Award to Qui Tam Plaintiff.—

(1) If the Government proceeds with an action brought by a person under subsection (b), such person shall, subject to the second sentence of this paragraph, receive at least 15 percent but not more than 25 percent of the proceeds of the action or settlement of the claim, depending upon the extent to which the person substantially contributed to the prosecution of the action. Where the action is one which the court finds to be based primarily on disclosures of specific information (other than information provided by the person bringing the action) relating to allegations or transactions in a criminal, civil, or administrative hearing, in a congressional, administrative, or Government Accounting Office report, hearing, audit, or investigation, or from the news media, the court may award such sums as it considers appropriate, but in no case more than 10 percent of the proceeds, taking into account the significance of the information and the role of the person bringing the action in advancing the case to litigation. Any payment to a person under the first or second sentence of this paragraph shall be made from the proceeds. Any such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

(2) If the Government does not proceed with an action under this section, the person bringing the action or settling the claim shall receive an amount which the court decides is reasonable for collecting the civil penalty and damages. The amount shall be not less than 25 percent and not more than 30 percent of the proceeds of the action or settlement and shall be paid out of such proceeds. Such person shall also receive an amount for reasonable expenses which the court finds to have been necessarily incurred, plus reasonable attorneys' fees and costs. All such expenses, fees, and costs shall be awarded against the defendant.

(3) Whether or not the Government proceeds with the action, if the court finds that the action was brought by a person who planned and initiated the violation of section 3729 upon which the action was brought, then the court may, to the extent the court considers appropriate, reduce the share of the proceeds of the action which the person would otherwise receive under paragraph (1) or (2) of this subsection, taking into account the role of that person in advancing the case to litigation and any relevant circumstances pertaining to the violation. If the person bringing the action

is convicted of criminal conduct arising from his or her role in the violation of section 3729, that person shall be dismissed from the civil action and shall not receive any share of the proceeds of the action. Such dismissal shall not prejudice the right of the United States to continue the action, represented by the Department of Justice.

(4) If the Government does not proceed with the action and the person bringing the action conducts the action, the court may award to the defendant its reasonable attorneys' fees and expenses if the defendant prevails in the action and the court finds that the claim of the person bringing the action was clearly frivolous, clearly vexatious, or brought primarily for purposes of harassment. . . .

[This statutory scheme has a series of additional sections that govern many details of procedure and discovery in suits brought under the False Claims Act.]

B. “Qui Tam” Suits and the False Claims Act

Here is a nice example of a False Claims Act lawsuit (one in which the government declined to intervene), helpfully laid out for us by the Supreme Court. Notice how the Court's discussion of the requirements of proof under the FCA serves as review for concepts we have already covered. Once again, the legal concept of fraud proves pivotal to understanding a matter of corporate wrongdoing.

UNIVERSAL HEALTH SERVICES, INC. v. UNITED STATES, 136 S. Ct. 1989 (2016)

THOMAS, J., delivered the opinion for a unanimous Court.

The False Claims Act, 31 U.S.C. § 3729 *et seq.*, imposes significant penalties on those who defraud the Government. This case concerns a theory of False Claims Act liability commonly referred to as “implied false certification.” According to this theory, when a defendant submits a claim, it impliedly certifies compliance with all conditions of payment. But if that claim fails to disclose the defendant's violation of a material statutory, regulatory, or contractual requirement, so the theory goes, the defendant has made a misrepresentation that renders the claim “false or fraudulent” under § 3729(a)(1)(A). This case requires us to consider this theory of liability and to clarify some of the circumstances in which the False Claims Act imposes liability. . . .

Enacted in 1863, the False Claims Act “was originally aimed principally at stopping the massive frauds perpetrated by large contractors during the Civil War.” *United States v. Bornstein*. “[A] series of sensational congressional investigations” prompted hearings where witnesses “painted a sordid picture of how the United States had been billed for nonexistent or worthless goods, charged exorbitant prices for goods delivered, and generally robbed in purchasing the necessities of war.” *United States v. McNinch*. Congress responded by imposing civil and criminal liability for 10 types of fraud on the

Government, subjecting violators to double damages, forfeiture, and up to five years' imprisonment. Act of Mar. 2, 1863, ch. 67, 12 Stat. 696.

Since then, Congress has repeatedly amended the Act, but its focus remains on those who present or directly induce the submission of false or fraudulent claims. See 31 U.S.C. § 3729(a) (imposing civil liability on “any person who . . . knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval”). A “claim” now includes direct requests to the Government for payment as well as reimbursement requests made to the recipients of federal funds under federal benefits programs. See § 3729(b)(2)(A). The Act’s scienter requirement defines “knowing” and “knowingly” to mean that a person has “actual knowledge of the information,” “acts in deliberate ignorance of the truth or falsity of the information,” or “acts in reckless disregard of the truth or falsity of the information.” § 3729(b)(1)(A). And the Act defines “material” to mean “having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property.” § 3729(b)(4).

Congress also has increased the Act’s civil penalties so that liability is “essentially punitive in nature.” *Vermont Agency of Natural Resources v. United States ex rel. Stevens*. Defendants are subjected to treble damages plus civil penalties of up to \$10,000 per false claim. § 3729(a); 28 CFR § 85.3(a)(9) (2015) (adjusting penalties for inflation).

The alleged False Claims Act violations here arose within the Medicaid program, a joint state-federal program in which healthcare providers serve poor or disabled patients and submit claims for government reimbursement. *See generally* 42 U.S.C. § 1396 *et seq.* The facts recited in the complaint, which we take as true at this stage, are as follows. For five years, Yarushka Rivera, a teenage beneficiary of Massachusetts’ Medicaid program, received counseling services at Arbour Counseling Services, a satellite mental health facility in Lawrence, Massachusetts, owned and operated by a subsidiary of petitioner Universal Health Services. Beginning in 2004, when Yarushka started having behavioral problems, five medical professionals at Arbour intermittently treated her. In May 2009, Yarushka had an adverse reaction to a medication that a purported doctor at Arbour prescribed after diagnosing her with bipolar disorder. Her condition worsened; she suffered a seizure that required hospitalization. In October 2009, she suffered another seizure and died. She was 17 years old.

Thereafter, an Arbour counselor revealed to respondents Carmen Correa and Julio Escobar—Yarushka’s mother and stepfather—that few Arbour employees were actually licensed to provide mental health counseling and that supervision of them was minimal. Respondents discovered that, of the five professionals who had treated Yarushka, only one was properly licensed. The practitioner who diagnosed Yarushka as bipolar identified herself as a psychologist with a Ph.D., but failed to mention that her degree came from an unaccredited Internet college and that Massachusetts had rejected her application to be licensed as a psychologist. Likewise, the practitioner who prescribed medicine to Yarushka, and who was held out as a psychiatrist, was in fact a nurse who lacked authority to prescribe medications absent supervision. Rather than ensuring

supervision of unlicensed staff, the clinic's director helped to misrepresent the staff's qualifications. And the problem went beyond those who treated Yarushka. Some 23 Arbour employees lacked licenses to provide mental health services, yet—despite regulatory requirements to the contrary—they counseled patients and prescribed drugs without supervision.

When submitting reimbursement claims, Arbour used payment codes corresponding to different services that its staff provided to Yarushka, such as “Individual Therapy” and “family therapy.” Staff members also misrepresented their qualifications and licensing status to the Federal Government to obtain individual National Provider Identification numbers, which are submitted in connection with Medicaid reimbursement claims and correspond to specific job titles. For instance, one Arbour staff member who treated Yarushka registered for a number associated with “Social Worker, Clinical,” despite lacking the credentials and licensing required for social workers engaged in mental health counseling.

After researching Arbour's operations, respondents filed complaints with various Massachusetts agencies. Massachusetts investigated and ultimately issued a report detailing Arbour's violation of over a dozen Massachusetts Medicaid regulations governing the qualifications and supervision required for staff at mental health facilities. Arbour agreed to a remedial plan, and two Arbour employees also entered into consent agreements with Massachusetts.

In 2011, respondents filed a *qui tam* suit in federal court, see 31 U.S.C. § 3730, alleging that Universal Health had violated the False Claims Act under an implied false certification theory of liability. The operative complaint asserts that Universal Health (acting through Arbour) submitted reimbursement claims that made representations about the specific services provided by specific types of professionals, but that failed to disclose serious violations of regulations pertaining to staff qualifications and licensing requirements for these services. Specifically, the Massachusetts Medicaid program requires satellite facilities to have specific types of clinicians on staff, delineates licensing requirements for particular positions (like psychiatrists, social workers, and nurses), and details supervision requirements for other staff. *See* 130 Code Mass. Regs. §§ 429.422–424, 429.439 (2014). Universal Health allegedly flouted these regulations because Arbour employed unqualified, unlicensed, and unsupervised staff. The Massachusetts Medicaid program, unaware of these deficiencies, paid the claims. Universal Health thus allegedly defrauded the program, which would not have reimbursed the claims had it known that it was billed for mental health services that were performed by unlicensed and unsupervised staff. The United States declined to intervene. . . .

We first hold that the implied false certification theory can, at least in some circumstances, provide a basis for liability. By punishing defendants who submit “false or fraudulent claims,” the False Claims Act encompasses claims that make fraudulent misrepresentations, which include certain misleading omissions. When, as here, a

defendant makes representations in submitting a claim but omits its violations of statutory, regulatory, or contractual requirements, those omissions can be a basis for liability if they render the defendant's representations misleading with respect to the goods or services provided. . . .

The False Claims Act imposes civil liability on “any person who . . . knowingly presents, or causes to be presented, a false or fraudulent claim for payment or approval.” § 3729(a)(1)(A). Congress did not define what makes a claim “false” or “fraudulent.” But “[i]t is a settled principle of interpretation that, absent other indication, Congress intends to incorporate the well-settled meaning of the common-law terms it uses.” *Sekhar v. United States*). And the term “fraudulent” is a paradigmatic example of a statutory term that incorporates the common-law meaning of fraud. *See Neder v. United States*) (the term “actionable ‘fraud’ “is one with “a well-settled meaning at common law”).²⁰

Because common-law fraud has long encompassed certain misrepresentations by omission, “false or fraudulent claims” include more than just claims containing express falsehoods. The parties and the Government agree that misrepresentations by omission can give rise to liability.

The parties instead dispute whether submitting a claim without disclosing violations of statutory, regulatory, or contractual requirements constitutes such an actionable misrepresentation. Respondents and the Government invoke the common-law rule that, while nondisclosure alone ordinarily is not actionable, “[a] representation stating the truth so far as it goes but which the maker knows or believes to be materially misleading because of his failure to state additional or qualifying matter” is actionable. Restatement (Second) of Torts § 529, (1976). They contend that every submission of a claim for payment implicitly represents that the claimant is legally entitled to payment, and that failing to disclose violations of material legal requirements renders the claim misleading. Universal Health, on the other hand, argues that submitting a claim involves no representations, and that a different common-law rule thus governs: nondisclosure of legal violations is not actionable absent a special “duty . . . to exercise reasonable care to disclose the matter in question,” which it says is lacking in Government contracting. Brief for Petitioner 31 (quoting Restatement (Second) of Torts § 551(1)).

We need not resolve whether all claims for payment implicitly represent that the billing party is legally entitled to payment. The claims in this case do more than merely demand payment. They fall squarely within the rule that half-truths—representations that state the truth only so far as it goes, while omitting critical qualifying information—can be actionable misrepresentations. A classic example of an actionable half-truth in contract law is the seller who reveals that there may be two new roads near a property he is

²⁰ The False Claims Act abrogates the common law in certain respects. For instance, the Act's scienter requirement “require[s] no proof of specific intent to defraud.” 31 U.S.C. § 3729(b)(1)(B). But we presume that Congress retained all other elements of common-law fraud that are consistent with the statutory text because there are no textual indicia to the contrary. *See Neder*, 527 U.S., at 24–25, 119 S. Ct. 1827.

selling, but fails to disclose that a third potential road might bisect the property. See *Junius Constr. Co. v. Cohen*. . . . Likewise, an applicant for an adjunct position at a local college makes an actionable misrepresentation when his resume lists prior jobs and then retirement, but fails to disclose that his “retirement” was a prison stint for perpetrating a \$12 million bank fraud. See 3 D. Dobbs, P. Hayden, & H. Bublick, *Law of Torts* § 682 (2d ed. 2011) (citing *Sarvis v. Vermont State Colleges*).

So too here, by submitting claims for payment using payment codes that corresponded to specific counseling services, Universal Health represented that it had provided individual therapy, family therapy, preventive medication counseling, and other types of treatment. Moreover, Arbour staff members allegedly made further representations in submitting Medicaid reimbursement claims by using National Provider Identification numbers corresponding to specific job titles. And these representations were clearly misleading in context. Anyone informed that a social worker at a Massachusetts mental health clinic provided a teenage patient with individual counseling services would probably—but wrongly—conclude that the clinic had complied with core Massachusetts Medicaid requirements (1) that a counselor “treating children [is] required to have specialized training and experience in children’s services,” 130 Code Mass. Regs. § 429.422, and also (2) that, at a minimum, the social worker possesses the prescribed qualifications for the job, § 429.424(C). By using payment and other codes that conveyed this information without disclosing Arbour’s many violations of basic staff and licensing requirements for mental health facilities, Universal Health’s claims constituted misrepresentations.

Accordingly, we hold that the implied certification theory can be a basis for liability, at least where two conditions are satisfied: first, the claim does not merely request payment, but also makes specific representations about the goods or services provided; and second, the defendant’s failure to disclose noncompliance with material statutory, regulatory, or contractual requirements makes those representations misleading half-truths.

The second question presented is whether, as Universal Health urges, a defendant should face False Claims Act liability only if it fails to disclose the violation of a contractual, statutory, or regulatory provision that the Government expressly designated a condition of payment. We conclude that the Act does not impose this limit on liability. But we also conclude that not every undisclosed violation of an express condition of payment automatically triggers liability. Whether a provision is labeled a condition of payment is relevant to but not dispositive of the materiality inquiry.

Nothing in the text of the False Claims Act supports Universal Health’s proposed restriction. Section 3729(a)(1)(A) imposes liability on those who present “false or fraudulent claims” but does not limit such claims to misrepresentations about express conditions of payment. See *SAIC* (rejecting any textual basis for an express-designation rule). Nor does the common-law meaning of fraud tether liability to violating an express condition of payment. A statement that misleadingly omits critical facts is a

misrepresentation irrespective of whether the other party has expressly signaled the importance of the qualifying information.

The False Claims Act's materiality requirement also does not support Universal Health. Under the Act, the misrepresentation must be material to the other party's course of action. But, as discussed below, statutory, regulatory, and contractual requirements are not automatically material, even if they are labeled conditions of payment. *Cf. Matrixx Initiatives, Inc. v. Siracusano* (materiality cannot rest on "a single fact or occurrence as always determinative" (internal quotation marks omitted)).

Nor does the Act's scienter requirement, § 3729(b)(1)(A), support Universal Health's position. A defendant can have "actual knowledge" that a condition is material without the Government expressly calling it a condition of payment. If the Government failed to specify that guns it orders must actually shoot, but the defendant knows that the Government routinely rescinds contracts if the guns do not shoot, the defendant has "actual knowledge." Likewise, because a reasonable person would realize the imperative of a functioning firearm, a defendant's failure to appreciate the materiality of that condition would amount to "deliberate ignorance" or "reckless disregard" of the "truth or falsity of the information" even if the Government did not spell this out. . . .

We need not decide whether § 3729(a)(1)(A)'s materiality requirement is governed by § 3729(b)(4) or derived directly from the common law. Under any understanding of the concept, materiality "look[s] to the effect on the likely or actual behavior of the recipient of the alleged misrepresentation." 26 R. Lord, *Williston on Contracts* § 69:12, (4th ed. 2003) (Williston). In tort law, for instance, a "matter is material" in only two circumstances: (1) "[if] a reasonable man would attach importance to [it] in determining his choice of action in the transaction"; or (2) if the defendant knew or had reason to know that the recipient of the representation attaches importance to the specific matter "in determining his choice of action," even though a reasonable person would not. Restatement (Second) of Torts § 538. Materiality in contract law is substantially similar. *See* Restatement (Second) of Contracts § 162(2), and Comment *c* (1979) ("[A] misrepresentation is material" only if it would "likely . . . induce a reasonable person to manifest his assent," or the defendant "knows that for some special reason [the representation] is likely to induce the particular recipient to manifest his assent" to the transaction).

The materiality standard is demanding. The False Claims Act is not "an all-purpose antifraud statute," *Allison Engine*, or a vehicle for punishing garden-variety breaches of contract or regulatory violations. A misrepresentation cannot be deemed material merely because the Government designates compliance with a particular statutory, regulatory, or contractual requirement as a condition of payment. Nor is it sufficient for a finding of materiality that the Government would have the option to decline to pay if it knew of the defendant's noncompliance. Materiality, in addition, cannot be found where noncompliance is minor or insubstantial. . . .

In sum, when evaluating materiality under the False Claims Act, the Government's decision to expressly identify a provision as a condition of payment is relevant, but not automatically dispositive. Likewise, proof of materiality can include, but is not necessarily limited to, evidence that the defendant knows that the Government consistently refuses to pay claims in the mine run of cases based on noncompliance with the particular statutory, regulatory, or contractual requirement. Conversely, if the Government pays a particular claim in full despite its actual knowledge that certain requirements were violated, that is very strong evidence that those requirements are not material. Or, if the Government regularly pays a particular type of claim in full despite actual knowledge that certain requirements were violated, and has signaled no change in position, that is strong evidence that the requirements are not material.

These rules lead us to disagree with the Government's and First Circuit's view of materiality: that any statutory, regulatory, or contractual violation is material so long as the defendant knows that the Government would be entitled to refuse payment were it aware of the violation. At oral argument, the United States explained the implications of its position: If the Government contracts for health services and adds a requirement that contractors buy American-made staplers, anyone who submits a claim for those services but fails to disclose its use of foreign staplers violates the False Claims Act. To the Government, liability would attach if the defendant's use of foreign staplers would entitle the Government not to pay the claim in whole or part—irrespective of whether the Government routinely pays claims despite knowing that foreign staplers were used. Likewise, if the Government required contractors to aver their compliance with the entire U.S. Code and Code of Federal Regulations, then under this view, failing to mention noncompliance with any of those requirements would always be material. The False Claims Act does not adopt such an extraordinarily expansive view of liability. . . .

Because both opinions below assessed respondents' complaint based on interpretations of § 3729(a)(1)(A) that differ from ours, we vacate the First Circuit's judgment and remand the case for reconsideration of whether respondents have sufficiently pleaded a False Claims Act violation. We emphasize, however, that the False Claims Act is not a means of imposing treble damages and other penalties for insignificant regulatory or contractual violations. This case centers on allegations of fraud, not medical malpractice. Respondents have alleged that Universal Health misrepresented its compliance with mental health facility requirements that are so central to the provision of mental health counseling that the Medicaid program would not have paid these claims had it known of these violations. Respondents may well have adequately pleaded a violation of § 3729(a)(1)(A). But we leave it to the courts below to resolve this in the first instance.²¹

²¹ For the outcome of this case on remand, *see* 842 F.3d 103 (1st Cir. 2016).

Problem 6-1

What are the pluses and minuses of a “qui tam,” also known as a “private attorney general,” model for enforcing the law, as reflected in the False Claims Act? Should this model be used more widely? If so, how would one optimally structure such regimes in other areas of corporate wrongdoing?

C. Drug Misbranding

Moving from the False Claims Act to the Federal Food Drug and Cosmetic Act (FDCA), this case deals with the interaction of misbranding violations, the First Amendment, and corporate speech—a growing area for challenge to the regulatory and enforcement regime in this field.

UNITED STATES v. CARONIA, 703 F.3d 149 (2d Cir. 2008)

CHIN, Circuit Judge:

Defendant-appellant Alfred Caronia appeals from a judgment of conviction entered in the United States District Court for the Eastern District of New York (Eric N. Vitaliano, *J.*) on November 30, 2009, following a jury trial at which Caronia was found guilty of conspiracy to introduce a misbranded drug into interstate commerce, a misdemeanor violation of 21 U.S.C. §§ 331(a) and 333(a)(1). Specifically, Caronia, a pharmaceutical sales representative, promoted the drug Xyrem for “off-label use,” that is, for a purpose not approved by the U.S. Food and Drug Administration (the “FDA”). Caronia argues that he was convicted for his speech—for promoting an FDA-approved drug for off-label use—in violation of his right of free speech under the First Amendment. We agree. Accordingly, we vacate the judgment of conviction and remand the case to the district court.

Under the Federal Food, Drug and Cosmetic Act (the “FDCA”), before drugs are distributed into interstate commerce, they must be approved by the FDA for specific uses. 21 U.S.C. § 355(a). To obtain FDA approval, drug manufacturers are required to demonstrate, through clinical trials, the safety and efficacy of a new drug for each intended use or indication.

Once FDA-approved, prescription drugs can be prescribed by doctors for both FDA-approved and -unapproved uses; the FDA generally does not regulate how physicians use approved drugs. . . .

Indeed, courts and the FDA have recognized the propriety and potential public value of unapproved or off-label drug use. . . . The FDA itself has observed:

Once a drug has been approved for marketing, a physician may prescribe it for uses or in treatment regimens or patient populations that are not included in approved labeling. Such “unapproved” or, more precisely, “unlabeled” uses may be appropriate and rational in certain

circumstances, and may, in fact, reflect approaches to drug therapy that have been extensively reported in medical literature.

U.S. Food and Drug Administration, *FDA Drug Bulletin*, 12 FDA Drug Bull. (1982).

The FDCA prohibits “misbranding,” or “[t]he introduction or delivery for introduction into interstate commerce of any . . . drug . . . that is . . . misbranded.” 21 U.S.C. § 331(a). A drug is misbranded if, *inter alia*, its labeling fails to bear “adequate directions for use,” 21 U.S.C. § 352(f), which FDA regulations define as “directions under which the lay[person] can use a drug safely and for the purposes for which it is intended,” 21 C.F.R. § 201.5. FDA regulations define intended use by reference to “the objective intent of the persons legally responsible for the labeling of drugs,” which may be demonstrated by, among other evidence, “oral or written statements by such persons or their representatives” and “the circumstances that the article is, with the knowledge of such persons or their representatives, offered and used for a purpose for which it is neither labeled nor advertised.” 21 C.F.R. § 201.128.

The consequences for misbranding are criminal. 21 U.S.C. § 333(a)(2) (“[I]f any person commits such a violation . . . such persons shall be imprisoned for not more than three years or fined not more than \$10,000, or both.”). Pharmaceutical manufacturers and their representatives can face misdemeanor charges for misbranding or felony charges for fraudulent misbranding. The government has repeatedly prosecuted—and obtained convictions against—pharmaceutical companies and their representatives for misbranding based on their off-label promotion. . . .

The FDCA and its accompanying regulations do not expressly prohibit the “promotion” or “marketing” of drugs for off-label use. The regulations do recognize that promotional statements by a pharmaceutical company or its representatives can serve as proof of a drug’s intended use. Off-label promotional statements could thus presumably constitute evidence of an intended use of a drug that the FDA has not approved. The FDA, however, has concluded that “[a]n approved drug that is marketed for an unapproved use (whether in labeling or not) is misbranded because the labeling of such drug does not include ‘adequate directions for use.’” *See* FDA, Draft Guidance (quoting 21 U.S.C. § 352(f)); *accord United States v. Caronia*; *see also* Gov’t Br. 48 (contending no set of directions can constitute adequate labeling for drug’s off-label use). Thus, the government has treated promotional speech as more than merely evidence of a drug’s intended use—it has construed the FDCA to prohibit promotional speech as misbranding itself.

Orphan Medical, Inc. (“Orphan”), now known as Jazz Pharmaceutical, was a Delaware-incorporated pharmaceutical company that primarily developed drugs to treat pain, sleep disorders, and central nervous system disorders. Orphan manufactured the drug Xyrem, a powerful central nervous system depressant. In 2005, after Jazz Pharmaceuticals acquired Orphan, Jazz continued to manufacture and sell Xyrem, grossing \$20 million in combined Xyrem sales in 2005.

Xyrem can cause serious side effects, including difficulty breathing while asleep, confusion, abnormal thinking, depression, nausea, vomiting, dizziness, headache, bedwetting, and sleepwalking. If abused, Xyrem can cause additional medical problems, including seizures, dependence, severe withdrawal, coma, and death.

Xyrem's active ingredient is gamma-hydroxybutyrate ("GHB"). GHB has been federally classified as the "date rape drug" for its use in the commission of sexual assaults.

Despite the risks associated with Xyrem and GHB, the FDA approved Xyrem for two medical indications. In July 2002, the FDA approved Xyrem to treat narcolepsy patients who experience cataplexy, a condition associated with weak or paralyzed muscles. In November 2005, the FDA approved Xyrem to treat narcolepsy patients with excessive daytime sleepiness ("EDS"), a neurological disorder caused by the brain's inability to regulate sleep-wake cycles.

To protect against its serious safety concerns, in 2002, the FDA required a "black box" warning to accompany Xyrem. The black box warning is the most serious warning placed on prescription medication labels. Xyrem's black box labeling stated, among other things, that the drug's safety and efficacy were not established in patients under 16 years of age, and the drug had "very limited" experience among elderly patients.

To identify patients suffering side effects from the drug, the FDA also regulated Xyrem distribution, allowing only one centralized Missouri pharmacy to distribute Xyrem nationally.

In March 2005, Orphan hired Caronia as a Specialty Sales Consultant to promote Xyrem. Caronia primarily worked in Queens, Nassau, and Suffolk counties. Caronia's salary was based on his individual sales.

In July 2005, Caronia started Orphan's "speaker programs" for Xyrem. Speaker programs enlist physicians, for pay, to speak to other physicians about FDA-approved drug use. Orphan's speaker programs for Xyrem presented the benefits of the drug among patients with cataplexy and narcolepsy. Orphan hired Dr. Peter Gleason to promote Xyrem through its speaker programs.

Under Orphan's procedures, if Caronia, as a sales consultant for Xyrem, was asked about the off-label use of Xyrem, he was not permitted to answer; instead, when such questions were posed, Orphan sales consultants would fill out "medical information request forms" and send them to Orphan, and Orphan would send information to the inquiring physician. In contrast, physicians employed by Orphan as promotional speakers for Xyrem were permitted to answer off-label use questions; their responses were often informed by their own experiences with Xyrem.

In the spring of 2005, the federal government launched an investigation of Orphan and Gleason. The investigation focused on the off-label promotion of Xyrem. Caronia and Gleason were audio-recorded on two occasions as they promoted Xyrem for unapproved uses, including unapproved indications and unapproved subpopulations. The first

conversation was recorded on October 26, 2005 between Caronia and Dr. Stephen Charno, a physician who, as a government cooperator, posed as a prospective Xyrem customer. The second conversation was recorded on November 2, 2005; it taped a meeting arranged by Caronia to introduce Charno to Gleason.

On October 26, 2005, Caronia plainly promoted the use of Xyrem in unapproved indications with Charno:

[Caronia]: And right now the indication is for narcolepsy with cataplexy . . . excessive daytime . . . and fragmented sleep, but because of the properties that . . . it has it's going to insomnia, Fibromyalgia[,] periodic leg movement, restless leg, ahh also looking at ahh Parkinson's and . . . other sleep disorders are underway such as MS.

[Charno]: Okay, so then so then it could be used for muscle disorders and chronic pain and . . .

[Caronia]: Right.

[Charno]: . . . and daytime fatigue and excessive sleepiness and stuff like that?

[Caronia]: Absolutely. Absolutely. Ahh with the Fibromyalgia.

Caronia further directed Charno to list different "diagnosis codes" when prescribing Xyrem, for insurance purposes, including Fibromyalgia, chronic fatigue, or chronic pain.

On separate occasions, Caronia and Gleason each explained to prospective physician-customers that Xyrem could be used with patients under age sixteen, an unapproved Xyrem subpopulation:

[Caronia]: Um, the youngest patients we have are sixteen in the studies as old as sixty-five. Ahh there have been reports of patients as young as fourteen using it and obviously greater than sixty-five. It's a very safe drug.

(October 26, 2005 Recording Tr. (I) at 7).

[Gleason]: Well, it's actually approved for sixteen and above um, I've had people under thirteen and I've certainly talked to neurologists that have narcoleptics . . . between eight and ten . . . [but] I start at two-thirds the dose, but [if] they're real frail I only start with one-third the dose.

(November 2, 2005 Recording Tr. (II) at 51). . . .

On November 30, 2009, the district court sentenced Caronia to one year of probation, 100 hours of community service, and a \$25 special assessment.

On appeal, Caronia principally argues that the misbranding provisions of the FDCA prohibit off-label promotion, and therefore, unconstitutionally restrict speech. Caronia argues that the First Amendment does not permit the government to prohibit and criminalize a pharmaceutical manufacturer's truthful and non-misleading promotion of an FDA-approved drug to physicians for off-label use where such use is not itself illegal and others are permitted to engage in such speech. . . .

While the FDCA makes it a crime to misbrand or conspire to misbrand a drug, the statute and its accompanying regulations do not expressly prohibit or criminalize off-label promotion. Rather, the FDCA and FDA regulations reference "promotion" only as evidence of a drug's intended use. *See* 21 C.F.R. § 201.128 (discussing how drug's intended use can be demonstrated). Thus, under the principle of constitutional avoidance, explained *infra*, we construe the FDCA as not criminalizing the simple promotion of a drug's off-label use because such a construction would raise First Amendment concerns. Because we conclude from the record in this case that the government prosecuted Caronia for mere off-label promotion and the district court instructed the jury that it could convict on that theory, we vacate the judgment of conviction. . . .

The government contends—and the dissent agrees—that the First Amendment is not implicated in this case. Specifically, the government argues that "[p]romoting an approved drug for off-label uses is not itself a prohibited act under the FDCA" and "the promotion of off-label uses plays an *evidentiary* role in determining whether a drug is misbranded under 21 U.S.C. § 352(f)(1)." (Gov't Br. 51 (citing 21 U.S.C. § 331)). The government contends that Caronia was not prosecuted for his speech, but that Caronia's promotion of Xyrem for off-label use served merely as "evidence of intent," or evidence that the "off-label uses were intended ones[] for which Xyrem's labeling failed to provide any directions." (Gov't Br. 52).

Even assuming the government can offer evidence of a defendant's off-label promotion to prove a drug's intended use and, thus, mislabeling for that intended use, that is not what happened in this case.

First, the government's contention that it did not prosecute Caronia for promoting the off-label use of an FDA-approved drug is belied by its conduct and arguments at trial. The excerpts quoted above demonstrate that the government repeatedly argued that Caronia engaged in criminal conduct by promoting and marketing the off-label use of Xyrem, an FDA-approved drug. The district court record thus confirms overwhelmingly that Caronia was, in fact, prosecuted and convicted for promoting Xyrem off-label. Indeed, in the government's summation and rebuttal at trial, Caronia's off-label promotion of Xyrem is highlighted over forty times.

Second, the government's assertion now that it used Caronia's efforts to promote Xyrem for off-label use only as evidence of intent is simply not true. Even if the government could have used Caronia's speech as evidence of intent, the district court record clearly shows that the government did not so limit its use of that evidence. *See Mitchell* (instructing that, when speech is introduced as evidence of intent, "[s]uch testimony is to be scrutinized with care to be certain the statements are not expressions of mere lawful and permissible difference of opinion with our own government" (quoting *Haupt v. United States*)). The government never argued in summation or rebuttal that the promotion was evidence of intent. The government never suggested that Caronia engaged in any form of misbranding other than the promotion of the off-label use of an FDA-approved drug. The government never suggested, for example, that Caronia conspired to place false or deficient labeling on a drug. Rather, the record makes clear that the government prosecuted Caronia *for* his promotion and marketing efforts.

Third, the government's summation and the district court's instruction left the jury to understand that Caronia's speech was itself the proscribed conduct. Indeed, the district court flatly stated to the jury that pharmaceutical representatives are prohibited from engaging in off-label promotion. Although the district court explained the remaining elements of misbranding and conspiring to misbrand to the jury, this specific instruction—together with the government's summation—would have led the jury to believe that Caronia's promotional speech was, by itself, determinative of his guilt. . . .

Fourth, the government clearly prosecuted Caronia for his words—for his speech. A pharmaceutical representative's promotion of an FDA-approved drug's off-label use is speech. As the Supreme Court has held: "Speech in aid of pharmaceutical marketing . . . is a form of expression protected by the Free Speech Clause of the First Amendment." *Sorrell v. IMS Health, Inc.* Here, the proscribed conduct for which Caronia was prosecuted was precisely his speech in aid of pharmaceutical marketing.

Accordingly, we conclude that the government did prosecute Caronia for his speech, and we turn to whether the prosecution was permissible.

While the government and the FDA have construed the FDCA's misbranding provisions to prohibit off-label promotion by pharmaceutical manufacturers, as we have observed, the FDCA itself does not expressly prohibit or criminalize off-label promotion. The FDCA defines misbranding in terms of whether a drug's labeling is adequate for its intended use, and permits the government to prove intended use by reference to promotional statements made by drug manufacturers or their representatives. Assuming that this approach to the use of evidence of speech is permissible, it affords little support to the government on this appeal because Caronia was not prosecuted on this basis. Rather, the government's theory of prosecution identified Caronia's speech alone as the proscribed conduct. The district court accepted this theory. . . .

As we now explain, we decline the government's invitation to construe the FDCA's misbranding provisions to criminalize the simple promotion of a drug's off-label use by pharmaceutical manufacturers and their representatives because such a construction—

and a conviction obtained under the government's application of the FDCA—would run afoul of the First Amendment.

The First Amendment protects against government regulation and suppression of speech on account of its content. Content-based speech restrictions are subject to “strict scrutiny”—that is, the government must show that the regulation at issue is narrowly tailored to serve or promote a compelling government interest. Content-based government regulations are “presumptively invalid.” *R.A.V.* Meanwhile, non-content-based regulation and regulation of commercial speech—expression solely related to the economic interests of the speaker and its audience—are subject to intermediate scrutiny. Criminal regulatory schemes, moreover, warrant even more careful scrutiny. . . .

In applying these principles, we have a benefit not available to the district court: the Supreme Court's decision in *Sorrell v. IMS Health, Inc.*, a case involving speech restrictions on pharmaceutical marketing. In *Sorrell*, the Vermont Prescription Confidentiality Law (the “VPCL”) prohibited pharmaceutical companies and similar entities from using prescriber-identifying information for marketing purposes; it was challenged on First Amendment grounds.

The *Sorrell* Court held that “[s]peech in aid of pharmaceutical marketing . . . is a form of expression protected by the . . . First Amendment. . . . [The] creation and dissemination of information are speech within the meaning of the [Constitution].” The Court held that the Vermont statute set forth content- and speaker-based restrictions, and that the statute was therefore subject to heightened scrutiny. Because the VPCL disfavored speech with a particular content (marketing) when expressed by certain disfavored speakers (pharmaceutical manufacturers), the Court held that it unconstitutionally restricted speech.

In reaching this conclusion, *Sorrell* engaged in a two-step inquiry. First, the Court considered whether the government regulation restricting speech was content- and speaker-based. The Court held that it was; the regulation was therefore subject to heightened scrutiny and was “presumptively invalid.” Second, the Court considered whether the government had shown that the restriction on speech was consistent with the First Amendment under the applicable level of heightened scrutiny. The Court did not decide the level of heightened scrutiny to be applied, that is, strict, intermediate, or some other form of heightened scrutiny. Rather, after observing that “[i]n the ordinary case, it is all but dispositive to conclude that a law is content-based,” the Court concluded that the Vermont statute was unconstitutional even under the lesser intermediate standard set forth in *Central Hudson*. The Court further observed that the “outcome is the same whether a special commercial speech inquiry or a stricter form of judicial scrutiny is applied.”

In considering whether the government had shown that the restriction on speech was consistent with the First Amendment, the *Sorrell* Court turned to *Central Hudson*. *Central Hudson* sets forth a four-part test to determine whether commercial speech is protected by the First Amendment. First, as a threshold matter, to warrant First

Amendment protection, the speech in question must not be misleading and must concern lawful activity. Second, to justify regulations restricting speech, the asserted government interest must be substantial. Third, the regulation must directly advance the governmental interest asserted, “to a material degree,” “[A] commercial speech regulation ‘may not be sustained if it provides only ineffective or remote support for the government’s purpose.’” *Liquormart*, (quoting *Cent.*). Fourth, the regulation must be “narrowly drawn,” and may not be more extensive than necessary to serve the interest. The government cannot “completely suppress information when narrower restrictions on expression would serve its interests as well.” *Cent. Hudson*. “Under the commercial speech inquiry, it is the [government’s] burden to justify its content-based law as consistent with the First Amendment.” *Sorrell* (citing *Thompson*). . . .

The government’s construction of the FDCA’s misbranding provisions to prohibit and criminalize the promotion of off-label drug use by pharmaceutical manufacturers is content- and speaker-based, and, therefore, subject to heightened scrutiny.

First, the government’s interpretation of the FDCA’s misbranding provisions to prohibit off-label promotion is content-based because it distinguishes between “favored speech” and “disfavored speech on the basis of the ideas or views expressed.” See *Turner Broad.*; accord *Sorrell*. Under this construction, speech about the government-approved use of drugs is permitted, while certain speech about the off-label use of drugs—that is, uses not approved by the government—is prohibited, even though the off-label use itself is not. Indeed, the content of the regulated speech drives this construction of the FDCA; as in *Sorrell*, the “express purpose and practical effect” of the government’s ban on promotion is to “diminish the effectiveness of [off-label drug] marketing by manufacturers.” See *Sorrell*.

Second, this construction is speaker-based because it targets one kind of speaker—pharmaceutical manufacturers—while allowing others to speak without restriction. In *Sorrell*, pharmaceutical companies were barred from obtaining and using prescriber-identifying information for marketing purposes, but a wide range of other speakers, including private and academic researchers, could acquire and use the information. Similarly, here, because off-label prescriptions and drug use are legal, the government’s application of the FDCA permits physicians and academics, for example, to speak about off-label use without consequence, while the same speech is prohibited when delivered by pharmaceutical manufacturers. This construction “thus has the effect of preventing [pharmaceutical manufacturers]—and only [pharmaceutical manufacturers]—from communicating with physicians in an effective and informative manner.” *Sorrell*.

Additionally, a claim to First Amendment protection here is more compelling than in *Sorrell* because this case involves a criminal regulatory scheme subject to more careful scrutiny.

Accordingly, the government’s construction of the FDCA’s misbranding provisions to prohibit and criminalize off-label promotion is content- and speaker-based, and subject to heightened scrutiny under *Sorrell*.

The first two prongs of *Central Hudson* are easily satisfied here. First, promoting off-label drug use concerns lawful activity (off-label drug use), and the promotion of off-label drug use is not in and of itself false or misleading. Second, the government's asserted interests in drug safety and public health are substantial. . . .

The government's construction of the FDCA as prohibiting off-label promotion does not, by itself, withstand scrutiny under *Central Hudson*'s third prong. First, off-label drug usage is not unlawful, and the FDA's drug approval process generally contemplates that approved drugs will be used in off-label ways. In effect, even if pharmaceutical manufacturers are barred from off-label promotion, physicians can prescribe, and patients can use, drugs for off-label purposes. As off-label drug use itself is not prohibited, it does not follow that prohibiting the truthful promotion of off-label drug usage by a particular class of speakers would directly further the government's goals of preserving the efficacy and integrity of the FDA's drug approval process and reducing patient exposure to unsafe and ineffective drugs. *See Sorrell* (holding government interest in protecting physician privacy not directly served when law made prescriber-identifying information available to "all but a narrow class of disfavored speakers").

Second, prohibiting off-label promotion by a pharmaceutical manufacturer while simultaneously allowing off-label use "paternalistically" interferes with the ability of physicians and patients to receive potentially relevant treatment information; such barriers to information about off-label use could inhibit, to the public's detriment, informed and intelligent treatment decisions. . . . In fact, in granting safe harbor to manufacturers by permitting the dissemination of off-label information through scientific journals, the FDA itself "recognizes that public health can be served when health care professionals receive truthful and non-misleading scientific and medical information on unapproved uses" of approved drugs. Dep't of Health and Human Serv., Good Reprint Practices; *see Wash. Legal Found. v. Henney* (discussing FDA "safe harbor," where certain forums for off-label discussion, such as continuing medical education programs and scientific publications, would not be used against manufacturers in misbranding enforcement actions).

Here, as the FDA recognizes, it is the physician's role to consider multiple factors, including a drug's FDA-approval status, to determine the best course of action for her patient. . . . While some off-label information could certainly be misleading or unhelpful, this case does not involve false or misleading promotion. Moreover, in the fields of medicine and public health, "where information can save lives," it only furthers the public interest to ensure that decisions about the use of prescription drugs, including off-label usage, are intelligent and well-informed.

The government's construction of the FDCA essentially legalizes the outcome—off-label use—but prohibits the free flow of information that would inform that outcome. If the government's objective is to shepherd physicians to prescribe drugs only on-label, criminalizing manufacturer promotion of off-label use while permitting others to

promote such use to physicians is an indirect and questionably effective means to achieve that goal. . . .

The last prong of *Central Hudson* requires the government's regulation to be narrowly drawn to further the interests served. Here, the government's construction of the FDCA to impose a complete and criminal ban on off-label promotion by pharmaceutical manufacturers is more extensive than necessary to achieve the government's substantial interests. Numerous, less speech-restrictive alternatives are available, as are non-criminal penalties.

To advance the integrity of the FDA's drug approval process and increase the safety of off-label drug use, the government could pursue several alternatives without excessive First Amendment restrictions. For example, if the government is concerned about the use of drugs off-label, it could more directly address the issue. If the government is concerned that off-label promotion may mislead physicians, it could guide physicians and patients in differentiating between misleading and false promotion, exaggerations and embellishments, and truthful or non-misleading information. The government could develop its warning or disclaimer systems, or develop safety tiers within the off-label market, to distinguish between drugs. The government could require pharmaceutical manufacturers to list all applicable or intended indications when they first apply for FDA approval, enabling physicians, the government, and patients to track a drug's development. To minimize off-label use, or manufacturer evasion of the approval process for such use, the government could create other limits, including ceilings or caps on off-label prescriptions. The FDA could further remind physicians and manufacturers of, and even perhaps further regulate, the legal liability surrounding off-label promotion and treatment decisions. Finally, where off-label drug use is exceptionally concerning, the government could prohibit the off-label use altogether. . . .

The government contends that these alternative means of reducing patient exposure to unsafe, untested drugs and maintaining the integrity of the FDA-approval process are "indefensible" because they are not administrable, feasible, or otherwise effective. In the absence of any support, such conclusory assertions are insufficient to sustain the government's burden of demonstrating that the proposed alternatives are less effective than its proposed construction of the FDCA in furthering the government interests identified. . . .

The following decision of the First Circuit Court of Appeals provides some insight into how the government might succeed in prosecuting off-label marketing cases without running into the First Amendment problem that derailed the prosecution in *Caronia*.

UNITED STATES v. FACTEAU, 89 F.4th 1 (1st Cir. 2023)

LIPEZ, Circuit Judge.

After a thirty-day jury trial, appellants William Facteau and Patrick Fabian, former executives of the medical device manufacturer Acclarent, Inc., were found guilty of multiple misdemeanor violations of the Federal Food, Drug, and Cosmetic Act (“FDCA”) for commercially distributing an adulterated and misbranded medical device. See 21 U.S.C. § 331(a). The charges related to a device developed and sold by Acclarent that the government alleged served an intended use different from the one for which it had been cleared by the U.S. Food and Drug Administration (“FDA”). . . .

The FDCA strictly limits the ways in which manufacturers may market medical devices, including a prohibition on the distribution of “adulterated” or “misbranded” devices. A device is adulterated or misbranded if its “intended use”—as determined objectively by the seller's statements and conduct—differs from the use(s) for which the FDA has cleared it.

Facteau, former CEO of Acclarent, and Fabian, the company's former vice president of sales, played prominent roles in the marketing of a new device for the treatment of chronic sinusitis, the Relieva Stratus Microflow Spacer (“Stratus”). Acclarent obtained preliminary approval to market Stratus for use as a “spacer” that would dispense a saline solution to the ethmoid sinuses and maintain an opening created by sinus surgery. Facteau and Fabian were convicted of unlawfully marketing Stratus to dispense a steroid, an “off-label” (i.e. unapproved) use, and fined \$1 million and \$500,000, respectively. . . .

In sum, it is unlawful for a manufacturer to commercially distribute a device for an intended use that represents a “major change or modification” from the specific use for which the device received § 510(k) clearance. Such off-label marketing would amount to the commercial distribution of an “adulterated” and “misbranded” device. At the same time, however, the FDCA expressly protects the “authority of a health care practitioner to prescribe or administer any legally marketed device to a patient for any condition or disease. . . .” 21 U.S.C. § 396. Accordingly, medical professionals may lawfully prescribe and administer a device for an off-label use as long as that device has received § 510(k) clearance for any intended use. The statutory and regulatory scheme governing medical devices thus limits the commercial distribution of devices to ensure that devices on the market are reasonably safe and effective, while preserving health care professionals' discretion to prescribe and administer devices as they deem appropriate. . . .

[S]inusitis in the ethmoid sinuses is not treatable with balloon sinuplasty. As early as 2005, therefore, the members of Acclarent's Scientific Advisory Board (“SAB”), led by Facteau, discussed the possibility of developing a device that could provide relief for ethmoid sinusitis by delivering Kenalog-40 (“Kenalog”)—a topical steroid commonly used to reduce sinus inflammation—directly to the ethmoid sinuses. These discussions culminated in the January 2006 approval by Facteau and other Acclarent officers of a

project aimed at developing an “Ethmoid Sinus Stent” that, in the words of the project specification prepared as a roadmap for the design process, would be able “to deliver . . . Kenalog 40 for a duration of 14 days” “to the ethmoid [sinuses].” . . .

The FDA sent a letter to Acclarent communicating that the proposed use of Stratus with a therapeutic agent might render it a drug-device “combination product” under 21 C.F.R. § 3.2(e), and hence subject to review both as a drug and as a device. The letter also made clear that, even if the use of Stratus with a therapeutic agent did not render it a combination product, the proposed changes to the device's indications for use signaled a significant change or modification in the intended use of the device such that Acclarent would “need to submit a new 510(k)” and receive FDA clearance “prior to marketing [Stratus]” with the proposed changes in intended use. . . .

Despite the lack of § 510(k) clearance for Stratus to be used with Kenalog, Acclarent proceeded with the plan to begin marketing the device for that use in the second half of 2008. With Facteau's approval, Acclarent promoted Stratus for use with Kenalog at the July 2008 meeting of the Sinus Forum, an annual conference fully sponsored at the time by Acclarent, which Facteau and Fabian both attended. One panel session featured, via video feed, live demonstrations of Stratus by two surgeons, Dr. Douglas Hoisington and Dr. Michael Friedman, whose display included filling the balloon with Kenalog. The panel members explained how Stratus was designed to allow Kenalog to escape gradually into the ethmoid cavity while the device was in situ. Hoisington, a member of Acclarent's SAB, also indicated that Stratus was not suited for its cleared use by demonstrating how saline solution would immediately run out of the device upon injection. Hoisington explained that the perforations in the balloon were designed to be small enough so that Kenalog, a more viscous fluid, would seep out slowly. This live demonstration of Stratus was included in the 2008 Sinus Forum at Facteau's direction. Facteau's goal was to showcase Stratus's use with Kenalog, although Hoisington and Friedman themselves made the ultimate decisions to go ahead with their demonstrations.

Around this time, Acclarent also began commercially distributing Stratus on a limited market release, selling the device on a trial basis within a small number of sales territories and to a select group of doctors. The limited launch of Stratus was a commercial success. Acclarent's management therefore decided to expand the marketing of Stratus to all potential customers. Leading up to this full commercial launch, Facteau emailed several members of the SAB with a slide presentation on how Stratus would be commercially positioned. The presentation described Stratus as “simply a way to obtain sustained drug delivery to [a] targeted sinus or sinus complex.” In this period, Facteau and Fabian also participated in a conference call with some of Acclarent's sales and training personnel, during which Facteau spoke about presenting Stratus to ENT surgeons as a way of delivering Kenalog to the ethmoid sinuses.

Acclarent launched Stratus for full commercial distribution at the 2008 meeting of the American Academy of Otolaryngologists and American Rhinologic Society (“AAO conference”), which took place in September 2008. As the annual meeting of the major

professional organization for ENT surgeons, the AAO conference provides an opportunity for device manufacturers to set up booths to exhibit their products and share information about these products with potential customers. Acclarent's booth was divided into two sides, one staffed by sales representatives focused on selling to the U.S. market, the other by representatives focused on the international market. As directed by Acclarent regulatory officers, representatives on the U.S. side refrained from discussing off-label uses for Stratus, although the U.S.-side representatives also did not discuss or demonstrate Stratus for use as a spacer with saline. U.S.-side representatives were instructed to send attendees who asked about the uses for Stratus to the international side. The international-side representatives would then share information about using Stratus for delivering Kenalog.

Acclarent required newly hired sales representatives to complete a month-long training program, including two weeks of on-site training, where they would learn how to promote Stratus and other Acclarent products. Fabian led some of the training sessions and generally attended throughout to supervise. Facticeau also spoke and gave a presentation at some of these sessions. Trainees were taught how to present Stratus to ENT surgeons who were potential customers for the product by describing Stratus's features and benefits and how to operate it.

The sales training staff and other presenters repeatedly conveyed to new hires that Stratus was designed to be used, and was expected to be used by most surgeons, to deliver Kenalog. Trainees were not taught about any clinical benefit that Stratus could provide when used as a spacer with saline, and they were trained to tell surgeons that although Stratus was cleared for use in the United States only as a spacer with saline, it was approved for use with Kenalog in Europe. In addition, new hires were advised to ask surgeons “probing” or leading questions that would prompt the surgeons to inquire about Stratus's potential use for steroid delivery to the sinuses. . . .

Particularly successful sales representatives were invited by the sales team management, including Fabian, to share their sales techniques and marketing materials with other representatives. The promotional slide presentation for Stratus used by one such top-performing sales representative, Jason Elmore, was widely shared in this way. This presentation described Stratus as “designed to elute Kenalog-40,” that is, designed to allow the steroid to diffuse gradually out of the device.

The Acclarent sales representatives who testified at trial reported that they were never given marketing materials for Stratus that described benefits from using the device as a spacer with saline. By contrast, Acclarent made available a video for representatives to use in their pitches that depicted a surgeon implanting Stratus and filling the balloon with Kenalog. Acclarent also provided “sell sheets”—reviewed and approved by Fabian—that sales representatives could use in pitching Stratus. These sell sheets included a picture of Stratus that appeared to show the balloon filled with Kenalog.

The Acclarent sales representatives who testified about how they promoted Stratus to their customers uniformly stated that their pitches positioned Stratus as a device to

deliver Kenalog, rather than as a spacer with saline. This testimony was corroborated by testimony from multiple ENT surgeons who had been approached by Acclarent sales representatives about Stratus. The surgeons testified that the sales pitches they received positioned Stratus as a device for delivering Kenalog, not for use as a spacer with saline.

These sales pitches bore abundant fruit. From 2008, when Stratus was brought to market, until 2011, the final year appellants were employed at Acclarent, the gross revenue Acclarent earned from sales of Stratus totaled \$33.5 million. . . .

Facteau's First Amendment attack on his conviction takes the form of an instructional challenge. He argues that the district court improperly refused appellants' proposed instruction, which would have prevented the jury from considering any truthful, non-misleading promotional speech as evidence of the intended use of Stratus. Instead, the court instructed the jury that it could consider such speech. Facteau maintains that the court erred for two reasons. First, using promotional speech as evidence of intended use in effect criminalizes that speech, in contravention of a growing body of law in the Second Circuit holding that truthful, non-misleading speech promoting off-label use is protected. Second, because the FDA has adopted a policy that shields certain non-promotional speech from evidentiary use, allowing speech outside of this safe harbor to serve as evidence imposes an impermissible content-based burden on "disfavored" speech, especially off-label promotional statements. . . .

[A]s a general matter, the First Amendment does not apply to the "evidentiary use of speech to establish the elements of a crime or to prove motive or intent." *Wisconsin v. Mitchell*. . . .

Facteau's First Amendment argument is in obvious tension with the Court's holding in *Mitchell*. For the crux of his instructional error claim, he argues that because a manufacturer's truthful, non-misleading speech promoting the off-label use of a device is protected under the First Amendment, the district court should have instructed the jury that, in effect, it may not consider any such speech as evidence of the device's intended use. To do otherwise, the court's instruction would need to withstand heightened scrutiny, which Facteau argues it could not. But, as indicated, *Mitchell* makes clear that the First Amendment offers no protection against using otherwise protected speech as evidence of intent or to establish the elements of a crime. Facteau offers two explanations for why the Court's holding in *Mitchell* does not reach this case, and hence appellants' proposed instruction was compelled by the First Amendment. . . .

Taking his cue from *Caronia*, Facteau contends that permitting the jury to consider his off-label promotional speech in assessing his guilt under the FDCA amounts to the de facto criminalization of his protected speech, creating a "backdoor" through which the government may sneak past the First Amendment's reach and punish appellants simply for the things they said about Stratus. In *Caronia*, the government argued, as it does here, that it was merely relying on the defendant's speech as evidence of his intended use for the drug, rather than punishing him for his speech. While stressing that its opinion did not question the general principle that speech can constitute evidence of intended use,

the *Caronia* majority was not persuaded that the government's use of speech was limited to evidentiary purposes in that case. . . .

Though Facteau's reliance on *Caronia* is understandable, that case is meaningfully different from the one at hand and provides us with no basis to depart from the rule in *Mitchell* that the evidentiary use of speech does not violate the First Amendment. Unlike in *Caronia*, the government's case here relied on a wide array of evidence, which included not only promotional speech about off-label uses but also internal communications regarding regulatory and marketing strategy and the product's physical design. It is not the case, as it was in *Caronia*, that the government set out to punish appellants for what they said about the product; rather, what appellants said about Stratus simply shed light on how they intended it to be used. The district court's instructions made as much clear, specifying that “[i]t is not illegal in and of itself for a device manufacturer to provide truthful, not misleading information about an off-label use” and that the jury may not find a defendant guilty “based solely on truthful, non-misleading statements promoting an FDA-cleared or approved device, even if the use being promoted is not a cleared or approved use.”

Moreover, the government's successful theories for misbranding and adulteration did not turn on whether Acclarent's statements left Stratus without adequate directions for use, as was the case in *Caronia*. Though the government did present that theory of misbranding to the jury, the jury rejected that approach and instead found appellants guilty of misbranding because Stratus lacked the proper regulatory clearance—a theory of misbranding less intertwined with appellants' speech. And, unlike the defendant in *Caronia*, both Facteau and Fabian were high-level executives at Acclarent responsible not just for what was said about Stratus publicly but also for internal decisions on product design and regulatory strategy (in the case of Facteau), as well as sales strategy (in the case of both).

In short, *Caronia* does not render appellants' proposed instruction an accurate statement of law that properly captured the nuances of the First Amendment interests at stake in this case. Calculated to cut off any evidentiary use of off-label promotional speech, appellants' preferred instruction would have removed this case from the teachings of *Mitchell* and placed it within the domain of *Caronia* without the facts to justify such a move. We discern no error in the district court's refusal to take that step, nor in the instructions it ultimately handed down, which better respected the sensitive balance between protecting promotional speech without shielding such speech from evidentiary value.

In so holding, we note that we are in alignment with our sister circuits—including the Second. The courts to consider the issue have uniformly concluded that using speech merely as evidence of a misbranding offense under the FDCA does not raise First Amendment concerns. Indeed, as we have noted, the *Caronia* court assumed that evidentiary use of statements to prove FDCA violations would be permissible under the

First Amendment but concluded on the facts that the prosecution did not use speech in that way.

We find relevant and persuasive this consistent authority from other circuits that the First Amendment is not implicated by the evidentiary use of truthful, non-misleading promotional speech to establish a drug's intended use to obtain a conviction under the FDCA. Appellants' convictions fall soundly within that domain. The trial court did not criminalize appellants' speech itself, instructing the jury to consider promotional speech only insofar as it shed light on appellants' intended use for Stratus. Accordingly, Facteau's reliance on *Caronia* fails. . . .

Problem 6-2

(1) If you were advising a pharmaceutical company client on what marketing activities can still be treated as criminal violations of the FDCA in spite of First Amendment protections, how would you do so given the current state of the law?

(2) Does the Second Circuit's *Caronia* opinion hold promise for the corporate crime defense bar in areas of enforcement beyond off-label drug promotion? Can you think of a context *outside* of the health care fraud area in which the defense could mount an argument based on the *Caronia* decision?

D. Alternative Theories for Pharmaceutical Misconduct (and the opioid crisis)

The argument adopted by the court in *Caronia* has the potential to seriously impede the government's efforts to apply a "misbranding" theory under the FDCA to deal with misconduct in pharmaceutical marketing. As the following examples demonstrate, the creative federal prosecutor can often find alternative statutes and theories to use with corporate wrongdoing.

The following prosecution was predicated on 18 U.S.C. § 371, which is the broad, catch-all federal conspiracy statute.²² A compounding center in Massachusetts—which is a small pharmacy-like business that does not simply sell medications but also manufactures some types in small volume—produced an epidural steroid injection that caused a meningitis outbreak in 2012, sickening hundreds of people and causing over 100 deaths. Prosecutors sought a legal theory that would fit this terrible conduct and its unusual regulatory context.

²² "If two or more persons conspire either to commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both." 18 U.S.C. § 371.

UNITED STATES v. CARTER, 15 F.4th 26 (1st Cir. 2021)

BARRON, Circuit Judge:

These consolidated appeals are the latest to reach us in connection with the federal criminal investigation that ensued after patients across the country became seriously ill or died in the fall of 2012 after having been injected with a contaminated medication traced to the New England Compounding Center (“NECC”). NECC was a licensed pharmacy based in Framingham, Massachusetts. It combined drugs with other substances to create specialized medications—a practice known as compounding. . . . [T]he appellant here is the government. It challenges the post-verdict judgments of acquittal that the District Court entered in favor of Sharon Carter and Gregory Conigliaro, who were, respectively, NECC’s former Director of Operations and NECC’s former Vice President, Secretary, Treasurer, and General Manager. . . .

Neither Carter nor Conigliaro was charged with playing any direct role in the physical compounding of the contaminated medication that was linked to patient illnesses and deaths. Instead, each was charged only with counts that pertained to their roles in connection with other aspects of NECC’s operations. Among those charges was one that alleged that each had, while working at NECC, conspired to defraud the United States in violation of 18 U.S.C. § 371 “by interfering with and obstructing” the ability of the United States Food and Drug Administration (“FDA”) to oversee the practices of NECC. . . .

In detailing the alleged § 371 conspiracy, the indictment charged the defendants with “interfering with and obstructing the lawful governmental functions of the FDA.” In support of this contention, the indictment alleged that Carter, Conigliaro, and their co-conspirators had agreed to enter into a conspiracy defraud the FDA by “purport[ing] to be operating NECC as a state-regulated pharmacy, dispensing drugs pursuant to valid, patient-specific prescriptions as required by Massachusetts law, rather than as a drug manufacturer distributing drugs in bulk to customers without prescriptions and thereby subject to heightened regulatory oversight by the FDA” pursuant to its authority under the Food, Drug, and Cosmetic Act (“FDCA”).

Passed in 1938, the FDCA gave the FDA authority to regulate “any new drug.” Act of June 25, 1938, (codified at 21 U.S.C. § 301 et seq.); FDCA § 505(a) (codified at 21 U.S.C. § 355(a)). During the time of the alleged conspiracy, the FDCA defined “new drug” as “[a]ny drug . . . not generally recognized . . . as safe and effective for use under the conditions prescribed, recommended, or suggested in the labeling thereof.” 21 U.S.C. § 321(p). It further provided that “[n]o person shall introduce or deliver for introduction into interstate commerce any new drug, unless an approval of an application filed [with the FDA] is effective with respect to such drug.” *Id.* § 355(a). In addition, it provided that any “new drug” must be made in accordance with “current good manufacturing practice” (“GMP”)—a set of regulations that the FDA subsequently promulgated to impose strict safety controls on manufacturers of new drugs. § 351(a)(2)(B); see also 21 U.S.C. § 371(a) (“The authority to promulgate regulations for the efficient enforcement

of this chapter, except as otherwise provided in this section, is vested in the [Commissioner of the FDA].”).

Compounded drugs would appear to fit within the FDCA’s definition of a “new drug.” After all, “[d]rug compounding is a process [that] combines, mixes, or alters ingredients to create a medication tailored to the needs of an individual patient . . . that [is typically] not commercially available.” *Thompson v. Western States Med. Cntr.* Nevertheless, for the first fifty years after the FDCA’s enactment, “the FDA generally left regulation of compounding to the States.”

“[E]ventually,” however, the FDA “became concerned . . . that some pharmacists were manufacturing and selling drugs under the guise of compounding, thereby avoiding the FDCA’s new drug requirements.” It then began to take a more proactive role in the oversight of compounders—at least those compounders that the FDA concluded behaved as manufacturers.

The indictment here centered on the role that the alleged conspirators supposedly played in defrauding the FDA. In particular, the indictment claimed that the defendants conspired to prevent the FDA from being able to determine whether NECC was a manufacturer or a pharmacy by intentionally misrepresenting the nature of the company’s operations. The indictment explained in that respect that, as a “manufacturer,” NECC would have been subject to heightened regulatory oversight by the FDA pursuant to its authority under the FDCA, while, as a “pharmacy,” NECC would have been primarily regulated by state pharmacy boards. By conspiring to misrepresent to the FDA that NECC was operating only as a pharmacy and not as a manufacturer, the indictment alleged, the defendants conspired to interfere with the FDA’s oversight function with respect to NECC and thereby conspired to defraud the United States in violation of § 371, given that such regulatory oversight by FDA is a “government function.”

The indictment also alleged how the defendants carried out the alleged conspiracy to misrepresent the company’s operations. Specifically, it alleged that the defendants agreed to participate in a conspiracy by which NECC would regularly misrepresent to the FDA that it was shipping its compounded medications to customers (which were hospitals and medical facilities rather than patients in their own right) pursuant to valid, patient-specific prescriptions. Yet, in fact, the indictment alleged, the company was processing the customers’ orders for those medications without there being any such prescriptions. It then described three methods by which NECC allegedly disguised the fact that it was shipping compounded drugs in this manner before turning to the roles that that conspirators allegedly each played in carrying out the deception.

One such alleged method involved “backfilling.” Here, NECC allegedly allowed customers to place their first order for medications without supplying any prescriptions or patient names. NECC then collected from customers the roster of patient names to whom these customers ended up prescribing and administering the medications on site. Thereafter, NECC allegedly attached such a roster either retrospectively to that first

order or used it to process a subsequent order by the same customer—thereby making it look as if NECC had filled the orders only after it had received valid, patient-specific prescriptions from a customer.

A second alleged method involved NECC’s processing of orders using prescriptions for fictitious patients. Sometimes, according to the indictment, NECC processed orders using the names of celebrities or fantasy characters that customers had supplied, such as “Michael Jackson” and “Wonder Woman.” At other times, the indictment alleged, NECC used the names of customers’ staff members or those of previous patients that customers had supplied. At still other times, NECC allegedly fabricated the prescriptions rather than relying on its customers to do so. And, finally, according to the indictment, NECC sometimes used a given patient name for multiple medications and for multiple units of the same medication in a single order, applying a ratio that would look plausible to regulators rather than filling a valid multidose prescription.

Pursuant to yet a third alleged method of shipping the drugs without a valid patient-specific prescription, according to the indictment, NECC processed some customers’ orders using just the names of those institutional customers. NECC allegedly did so even though the customer was a hospital or medical facility that would then itself later dispense the drug to a patient and thus was not itself a patient for whom a prescription had been issued. Under this method, then, the drug was shipped by NECC to its customers without there being any patient identified who had been issued a prescription for it.

The indictment alleged that the defendants helped NECC deploy these methods despite knowing that the company was representing to the FDA that it was a compounding pharmacy that dispensed drugs only pursuant to valid prescriptions for individual patients and therefore was not subject to the FDA’s GMP regulations that govern drug manufacturers. In setting forth this allegation, the indictment highlighted several statements allegedly made by the defendants that purportedly showed their awareness of both the alleged scheme and the regulatory background in which NECC’s scheme was taking place.

The indictment included, for example, Conigliaro’s alleged statements to the FDA that NECC was a “compounding-only pharmacy, not a manufacturer” and thus “not subject to GMP.” Also cited in the indictment was an email Carter shared with NECC’s order-processing staff, instructing them that “the MAX total number of units . . . per patient must make sense,” that “all names must resemble ‘real’ names,” and not to use “obviously fake names [] (Mikey Mouse)” because she “must be able to logically explain to a regulator why [NECC] processed x# of units per patient”

Many of the documents that the government introduced at trial were the product of two search warrants executed against NECC and its sales-affiliate, Medical Sales Management. The evidence introduced included order forms that NECC had filled for its customers under various “patient” names, such as “Ted Bundy” and “Barney Fife.” The evidence also included an employee manual that Carter signed that detailed the

“FDA Modernization Act of 1997-Pharmacy Compounding Provisions” and “[h]ow to handle an FDA inspection” (as well as many of the emails described in the indictment).

In addition, the government introduced testimony from several former employees who testified to Carter’s and Conigliaro’s understanding of the importance to NECC of the company being considered a pharmacy and not a manufacturer in the eyes of regulators. Ken Boneau, for example, one such former sales representative, testified that during his training as a new employee, it was explained to him that “if the FDA regulated [NECC], there would be a lot of limitations” and that it was “important that the FDA not regulate NECC.” Beth Reynolds, an NECC licensing coordinator, further testified to conversations that she had with Conigliaro and others about NECC needing to comply with state laws requiring the compounder to meet state manufacturing guidance. As to Carter, the government introduced testimony from former employees, including Boneau and Mario Giamei, Jr., about emails that they had received from Carter about what to do in the event that NECC’s customers did not provide patient names with orders. And, finally, FDA Agent Michael Mangiacotti testified that during the search of NECC’s offices, he found signs posted in the sales staff’s cubicles with instructions from Carter warning NECC employees about the need to give “regulators” the impression that NECC was compounding drugs after receipt of real patient names. . . .

The FDA responded to the concerns about compounding by issuing a Compliance Policy Guide in 1992. FDA Compliance Policy Guide (CPG) Sec. 7132.16 (1992) (the “1992 CPG”). It explained “that while retail pharmacies . . . are exempted from certain requirements of the [FDCA], they are not the subject of any general exemption from the [FDCA’s] new drug, adulteration, or misbranding provisions.” Western States (quoting the 1992 CPG).

The Guide announced that the FDA “may, in the exercise of its enforcement discretion, initiate federal enforcement actions . . . when the scope and nature of a pharmacy’s activities raise[] the kinds of concerns normally associated with a manufacturer and ... result[] in significant violations of the new drug, adulteration, or misbranding provisions of the Act.” But, the Guide also announced that the FDA otherwise would continue to exercise discretionary abstention from the policing of prescription-based compounding pharmacies as well as pharmacies that compounded drugs without prescriptions in “very limited quantities” for buyers with whom they could demonstrate an “established professional practitioner-patient-pharmacy relationship.”

Congress codified parts of the FDA’s 1992 Guide concerning compounding a number of years later in the Food and Drug Administration Modernization Act of 1997 (“FDAMA”). See Pub. L. 105-115, 111 Stat. 2296, § 127 (codified at 21 U.S.C. § 503A (1997)). In particular, as the District Court noted:

[The FDAMA] created a safe harbor for compounded drugs, exempting them from the FDCA’s “new drug” requirements provided that certain criteria were met, most pertinently, that they

be compounded in response to a valid prescription or only in limited non-prescription quantities where an established relationship existed between the specific pharmacist, patient, and prescribing physician.

The next major development of note occurred in 2002. That was when the Supreme Court of the United States struck down adjacent provisions of the FDAMA in *Thompson v. Western States* on the ground that they violated the First Amendment. See *Western States*. The Court did not reach the question of severability in that decision. But, thereafter, a circuit split ensued as to what, if anything, remained of the FDAMA and its provisions regulating compounders.

The Ninth Circuit held that the FDAMA as a whole was invalid. See *Western States Med. Ctr. v. Shalala*. The Fifth Circuit held, in contrast, that the FDAMA stripped of those unconstitutional provisions remained viable after *Western States*. See *Med. Ctr. Pharmacy v. Mukasey*. Our circuit did not weigh in on the issue.

The FDA reacted to *Western States* in 2002 by issuing a new CPG. See FDA Compliance Policy Guide Sec. 460.200 Pharmacy Compounding (2002) (the “2002 CPG”). The 2002 CPG sought to head off any uncertainty that might result from the Supreme Court’s decision in *Western States* with respect to the FDA’s continued enforcement approach by, as the District Court explained, “essentially reembrac[ing] the FDA’s 1992 guidance.” Conigliaro.

The 2002 CPG reiterated that, for enforcement purposes, the FDA would continue to draw a line between, on the one hand, compounders that operated like traditional retail pharmacies in that they produced and sold drugs “upon receipt of a valid prescription for an individually identified patient from a licensed practitioner,” and, on the other hand, compounders that operated like manufacturers in that they, for instance, “receive[d] and use[d] large quantities of bulk drug substances to manufacture large quantities of unapproved drug products in advance of receiving a valid prescription for them.” The FDA assured compounders of the first kind, which operated as retail pharmacies, that it would abstain from enforcement actions, but warned compounders of the second kind, which operated as manufacturers, that it would “seriously consider enforcement action” against them. The FDA, moreover, specified that one of the factors it would consider in determining whether a compounder fell into this latter category of manufacturers was whether it “compound[ed] . . . drugs in anticipation of receiving prescriptions, except in very limited quantities in relation to the amounts of drugs compounded after receiving valid prescriptions.” This 2002 CPG, while not legally binding, remained in effect through the end of the alleged conspiracy in 2012.

Carter and Conigliaro drew on this regulatory history in making their legal impossibility and due process arguments to the District Court. They claimed that, during the relevant period, there was “no discernible federal law” or regulation that “defin[ed] any clear distinction between a compounding pharmacy and a drug manufacturer.” As a result, the

defendants argued, it was legally impossible to conspire to interfere with the FDA's "government functions" overseeing compounders. Moreover, the defendants argued that, in light of this history, it would violate notions of fair warning embedded in the Due Process Clause of the Fifth Amendment to find them criminally liable under § 371. . . .

Questions implicating the FDA's authority to regulate compounders as "manufacturers" under the FDCA in the relevant period are of central import to the defenses at issue. We thus emphasize up front that the analysis of those defenses that follows adopts—as we have explained above we understand the District Court itself to have also adopted—the premise (for which no preserved challenge has been made) that, during the life of the conspiracy, the FDA possessed the statutory authority under the FDCA to regulate NECC as a "manufacturer" because a compounded drug was a "new drug" within the meaning of the FDCA, see 21 U.S.C. § 321(p), whatever the FDA's own view (even if "mistaken") may have been as to whether it possessed that authority.

It is important to be clear about this premise for the following reason. We do not dispute that, if the FDCA itself were properly construed to be limited in a way that precluded the FDA from exercising such regulatory power over NECC during the period of the alleged conspiracy, even if the FDA sought to exercise such authority after making known in advance its intention to do so, a legal impossibility defense would be available to the defendants on that basis. Thus, in rejecting the defense of legal impossibility here, we do not mean to suggest otherwise. . . .

As a threshold matter, we are dubious that, even if the FDA had disavowed its legal authority during the life of the conspiracy, it would follow that the offense charged here was legally impossible to commit. And that is so because the offense charged here was conspiracy to defraud the FDA by means of deceptive practices that were designed to prevent the agency from determining that the company was operating as a manufacturer.

An agency's "mistaken" disavowal of authority is not written in stone. See *FCC v. Fox Television Stations, Inc.*; *Massachusetts v. EPA*. Thus, the FDA would appear to have been entitled at any time to reverse course and assert the authority that (for purposes of evaluating the existence of this variant of the legal impossibility defense) we understand the FDCA itself would have entitled it to assert vis-a-vis compounders like NECC, at least so long as the FDA in reversing course did so on a going-forward basis and after providing due notice. Indeed, it is hard for a disavowal of authority to be "mistaken" — as the District Court plainly indicated it was assuming any disavowal here might have been—if the authority in fact does not exist. See Conigliaro.

Thus, even if there had been a mistaken disavowal of authority by the FDCA vis-a-vis its power to treat compounders like NECC as manufacturers, we do not see why such a mistaken disavowal would provide the basis for a legal impossibility defense that would bar a finding that Carter and Conigliaro violated § 371. Regulated parties who conspire to trick an agency into thinking they are conducting themselves other than they are—and in a manner that would be material to an agency's decision about whether it may wish to assert regulatory authority that it had previously disavowed but legally might be

capable of asserting upon rethinking the disavowal—may easily be understood to have defrauded the United States, notwithstanding that during the period that the conspiracy was ongoing the agency had wrongly construed its power too narrowly. The deception by the alleged conspirators could be found to have prevented the agency from rethinking its authority in light of how regulated parties were in fact operating and thereby lulled the agency into not determining that it needed to reverse course and, on a prospective basis after providing due notice, assert the regulatory authority that it had previously disclaimed.

There is, however, also a more record-specific reason in this case for rejecting this disavowal-based ground for crediting a defense of legal impossibility to the charges at issue. The record fails to support a finding that the claimed disavowal occurred. . . .

[T]he District Court did not identify any statement in which the FDA during the time period in question publicly or internally disavowed that it possessed regulatory power to treat a compounding pharmacy as a manufacturer, including even one engaged in practices not unlike those in which the government asserts the record suffices to show that NECC was then engaged. . . .

As an initial matter, we do not find persuasive the notion that it was legally impossible for the defendants to have conspired to interfere with a government function just because it was unclear during the life of the conspiracy whether the government had that function or understood itself to have it. That it is unclear to alleged conspirators whether the government will assert a regulatory function because it is convinced that the government is uncertain of its authority to assert it provides no basis for concluding that such a function does not exist. Thus, if the government function was one that the government had the legal authority to exercise—and we have no reason not to assume that was the case, at least with respect to prospective exercise after the provision of due notice—then we do not see how it would be legally impossible for the defendants to conspire to trick the government into wrongly concluding through misrepresentations about NECC’s means of operating that it could not be regulated pursuant to that function. . . .

Thus, such lack of clarity cannot in and of itself make it legally impossible for the defendants to have conspired to interfere with a government function, insofar as the function’s existence is not disputed as a matter of law and there is no basis for concluding that the function could not be asserted after the provision of due notice prospectively. For, if that is the case, then so long as the evidence is otherwise sufficient the fact that the FDA’s authority was less than clear during the alleged conspiracy—and that the FDA itself understood it to be unclear during that time frame—is of no moment for purposes of assessing the availability of the defense of legal impossibility to the § 371 charges at issue. After all, those charges concern an alleged conspiracy to trick the FDA into thinking that a company subject to its regulatory authority was operating differently than it was in order to conceal the fact that its actual manner of operating would make it subject to more intensive regulatory oversight.

Nor is there force to the contention that the defendants' legal impossibility defense to their § 371 charges has merit because—due to concerns about fair warning—the high degree of uncertainty about which compounders were subject to FDA's regulations pertaining to drug manufacturers during the period of time at issue itself precluded the FDA from lawfully exercising regulatory authority over NECC as if it were a manufacturer even if the FDA otherwise would have had such authority under the FDCA. The defendants were not charged with violating the FDCA based on evidence showing that NECC was operating as a manufacturer. They were charged with violating § 371 for conspiring to interfere with the FDA's ability to determine whether to regulate NECC as such by misleading the FDA about practices of the company that could bear on just that determination.

Thus, absent the FDA lacking the legal power to do so even on a going forward basis—and after having given the requisite degree of fair warning of its intention to do so—we see no basis for concluding that the ambiguity about the FDA's authority that the District Court identified precluded it from being “reasonably clear at the relevant time that the defendant's conduct was criminal.” Lanier. We appreciate the District Court's concern with the “worrisome position that, in this context, what is not affirmatively permitted by the law is criminally prohibited.” Conigliaro. But, because the defendants were charged with conspiring to defraud the FDA by impeding its ability to determine NECC's status through misrepresentations about the company's operations, we do not find that “worrisome position” implicated here. . . .

[F]or purposes of a defense of legal impossibility, the FDA's actual exercise of its legal authority over compounders in general and over NECC specifically is irrelevant. That is so because the FDA's exercise of its legal authority can at most show the factual impossibility of actually interfering with the FDA's oversight function during the time of the alleged conspiracy. The defendants, however, were convicted of conspiring to defraud the United States by interfering with the FDA's oversight function, not of actually interfering with its oversight function. And, because, as the District Court correctly stated, “factual impossibility is not a defense to . . . liability . . . for inchoate offenses such as conspiracy or attempt,” the literal inability of the defendants to actually interfere with the FDA's enforcement actions cannot be a defense. Conigliaro. Or, to put it differently, if a juror could find the defendants guilty of conspiring to interfere with the FDA's oversight function regardless of whether they succeeded in interfering with it, then that juror could also find them guilty of doing so even if the FDA did not actually engage in oversight over compounders during that time. *See United States v. Jimenez Recio*. . . .

What is the line between selling pharmaceuticals and dealing drugs? Nothing has raised this question more pointedly than the massive opioids crisis of the last decade or so. The Supreme Court recently attempted to clarify that line. Before the Court had issued its opinion, the First Circuit had taken a detailed stab at the problem in the most prominent

criminal case charged to date involving a pharmaceutical company selling opioid products. The Supreme Court’s opinion comes first.

XIULU RUAN V. UNITED STATES, 142 S. Ct. 2370 (2022)

JUSTICE BREYER delivered the opinion of the Court.

A provision of the Controlled Substances Act, codified at 21 U. S. C. §841, makes it a federal crime, “[e]xcept as authorized[,] . . . for any person knowingly or intentionally . . . to manufacture, distribute, or dispense . . . a controlled substance,” such as opioids. 84 Stat. 1260, 21 U. S. C. §841(a). Registered doctors may prescribe these substances to their patients. But, as provided by regulation, a prescription is only authorized when a doctor issues it “for a legitimate medical purpose . . . acting in the usual course of his professional practice.” 21 CFR §1306.04(a) (2021).

In each of these two consolidated cases, a doctor was convicted under §841 for dispensing controlled substances not “as authorized.” The question before us concerns the state of mind that the Government must prove to convict these doctors of violating the statute. We hold that the statute’s “knowingly or intentionally” *mens rea* applies to authorization. After a defendant produces evidence that he or she was authorized to dispense controlled substances, the Government must prove beyond a reasonable doubt that the defendant knew that he or she was acting in an unauthorized manner, or intended to do so.

The question we face concerns §841’s exception from the general prohibition on dispensing controlled substances contained in the phrase “[e]xcept as authorized.” In particular, the question concerns the defendant’s state of mind. To prove that a doctor’s dispensation of drugs via prescription falls within the statute’s prohibition and outside the authorization exception, is it sufficient for the Government to prove that a prescription was *in fact* not authorized, or must the Government prove that the doctor *knew* or *intended* that the prescription was unauthorized?

Petitioners Xiulu Ruan and Shakeel Kahn are both doctors who actively practiced medicine. They both possessed licenses permitting them to prescribe controlled substances. The Government separately charged them with unlawfully dispensing and distributing drugs in violation of §841. Each proceeded to a jury trial, and each was convicted of the charges.

At their separate trials, Ruan and Kahn argued that their dispensation of drugs was lawful because the drugs were dispensed pursuant to valid prescriptions. As noted above, a regulation provides that, “to be effective,” a prescription “must be issued for a legitimate medical purpose by an individual practitioner acting in the usual course of his professional practice.” 21 CFR §1306.04(a). We assume, as did the courts below and the parties here, that a prescription is “authorized” and therefore lawful if it satisfies this standard. At Ruan’s and Kahn’s trials, the Government argued that the doctors’

prescriptions failed to comply with this standard. The doctors argued that their prescriptions did comply, and that, even if not, the doctors did not knowingly deviate or intentionally deviate from the standard. . . .

Applying the presumption of scienter, we have read into criminal statutes that are “*silent* on the required mental state”—meaning statutes that contain no *mens rea* provision whatsoever—“that *mens rea* which is necessary to separate wrongful conduct from ‘otherwise innocent conduct.’” *Elonis*.

And when a statute is not silent as to *mens rea* but instead “*includes* a general scienter provision,” “the presumption applies with equal or greater force” to the scope of that provision. *Rehaif*. We have accordingly held that a word such as “knowingly” modifies not only the words directly following it, but also those other statutory terms that “separate wrongful from innocent acts.”

Section 841 contains a general scienter provision—“knowingly or intentionally.” And in §841 prosecutions, a lack of authorization is often what separates wrongfulness from innocence. Defendants who produce evidence that they are “authorized” to dispense controlled substances are often doctors dispensing drugs via prescription. We normally would not view such dispensations as inherently illegitimate; we expect, and indeed usually want, doctors to prescribe the medications that their patients need. In §841 prosecutions, then, it is the fact that the doctor issued an *unauthorized* prescription that renders his or her conduct wrongful, not the fact of the dispensation itself. In other words, authorization plays a “crucial” role in separating innocent conduct—and, in the case of doctors, socially beneficial conduct—from wrongful conduct. Applying §841’s “knowingly or intentionally” *mens rea* to the authorization clause thus “helps advance the purpose of scienter, for it helps to separate wrongful from innocent acts.” *Rehaif*.

In addition, the regulatory language defining an authorized prescription is, we have said, “ambiguous,” written in “generalit[ies], susceptible to more precise definition and open to varying constructions.” *Gonzales v. Oregon* (regulation “gives little or no instruction on” major questions); see also 21 CFR §1306.04(a) (regulation defining “effective” prescription as one “issued for a legitimate medical purpose by an individual practitioner acting in the usual course of his professional practice”). The conduct prohibited by such language (issuing invalid prescriptions) is thus “often difficult to distinguish from the gray zone of socially acceptable . . . conduct” (issuing valid prescriptions). *United States Gypsum*. A strong scienter requirement helps to diminish the risk of “overdeterrence,” *i.e.*, punishing acceptable and beneficial conduct that lies close to, but on the permissible side of, the criminal line. . . .

The Government, of course, can prove knowledge of a lack of authorization through circumstantial evidence. And the regulation defining the scope of a doctor’s prescribing authority does so by reference to objective criteria such as “legitimate medical purpose” and “usual course” of “professional practice.” 21 CFR §1306.04(a); see *Gonzales* (“The

use of the word ‘legitimate’ connotes an *objective* standard of ‘medicine’”); *Moore* (describing Congress’ intent “to confine authorized medical practice within *accepted* limits” (emphasis added)). As we have said before, “the more unreasonable” a defendant’s “asserted beliefs or misunderstandings are,” especially as measured against objective criteria, “the more likely the jury . . . will find that the Government has carried its burden of proving knowledge.” *Cheek v. United States*. But the Government must still carry this burden. And for purposes of a criminal conviction under §841, this requires proving that a defendant knew or intended that his or her conduct was unauthorized. . . .

In this case involving a pharmaceutical company’s marketing of prescription opioids, federal prosecutors employed the RICO statute, with predicate violations including narcotics offenses, honest services fraud, and ordinary mail and wire fraud charges.

UNITED STATES v. SIMON, 12 F.4th 1 (1st Cir. 2021)

SELYA, Circuit Judge:

The tale told by this case chronicles the pernicious practices employed by a publicly held pharmaceutical firm, Insys Therapeutics, Inc. (Insys), with respect to the marketing and sale of Subsys, a fentanyl-laced medication approved by the United States Food and Drug Administration (FDA) for use in the treatment of breakthrough cancer pain. When the government got wind of these practices, it launched an investigation. That investigation produced evidence that led a federal grand jury to indict seven of the company’s top executives on charges brought under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1962(d). Two of the executives eventually entered into plea agreements, but the rest stood their ground. Following a fifty-one-day trial, the jury convicted the five remaining defendants as charged (with an exception described below), and the district court (again with an exception described below) declined to set aside the jury verdicts. The court then sentenced the defendants to prison terms of varying lengths, ordered defendant-specific restitution, and directed the forfeiture of certain assets. . . .

We begin with a snapshot of the relevant facts drawn from the evidence adduced at trial. . . . Insys is a pharmaceutical firm founded by one of the defendants, Dr. John Kapoor. Under the Insys umbrella, Kapoor sought to develop sublingual spray drug-delivery formulations. The firm explored various options, but soon concentrated on developing a sublingual fentanyl spray. This product came to be called “Subsys.”

In early 2012, the FDA approved Subsys for the treatment of patients suffering from “breakthrough cancer pain.” The term “breakthrough cancer pain” is a term of art: it refers to brief spikes in pain (typically lasting less than one hour) in patients with cancer who are already dealing with constant and relatively steady pain. All other uses of Subsys were deemed “off-label.”

When Subsys went on the market, its FDA-approved label declared that “[t]he initial dose of Subsys to treat episodes of breakthrough cancer pain is always 100 micrograms.” Moreover, the label warned that “Subsys contains fentanyl,” which is a “Schedule II controlled substance with an abuse liability similar to other opioid analgesics.” Relatedly, the label carried a limitation on who could prescribe the drug: due to “the risk for misuse, abuse, addiction and overdose,” Subsys could be prescribed “only through a restricted program . . . called ‘Risk Evaluation and Mitigation Strategy’” (REMS). This program formed part of the FDA’s Transmucosal Immediate Release Fentanyl REMS Access Program, which required patients, prescribers, and pharmacists to sign a form stating that they understood the risks presented by the prescribed drug.

Subsys made its debut in the marketplace in March of 2012 (shortly after FDA approval was secured). At that point in time, Kapoor was serving as Insys’s executive chairman, Michael Babich was serving as its chief executive officer, Shawn Simon was serving as its vice president of sales, and Matthew Napoletano was serving as its vice president of marketing.

Around the time of the Subsys launch, Insys assembled a marketing team. It proceeded to provide its sales force with access to data that ranked physicians “based on their history of prescribing within the opiate market, in particular, the fentanyl market.” The ranking system assigned a number between 1 and 10 to each doctor—the higher the number the greater the volume of prescriptions written. Salespeople were instructed to target doctors ranked 5 or above and to give their “highest attention” to those assigned a 10. They were also told to employ a “switch strategy” aimed at persuading prescribers whose patients already had been determined to need a similar fentanyl product to jettison the similar product in favor of Subsys. Although the only approved use for Subsys was for treatment of breakthrough cancer pain, most of the prescribers listed in the database were pain-management specialists, not oncologists.

Notwithstanding Insys’s strategic plan, Kapoor was disappointed with initial sales and revenue figures. He told colleagues that it was “the worst f*****g launch in pharmaceutical history he’s ever seen.” In Kapoor’s view, the “main issue” was that the majority of patients who started on Subsys would stay on the drug only for the first month and would not refill their prescriptions. Napoletano hypothesized that patients were electing not to stick with Subsys because insurance companies were choosing not to cover it. Patients, he suggested, did not want to pay out of pocket to refill Subsys prescriptions.

Kapoor, though, had a different take: he attributed the widespread failure to refill Subsys prescriptions to patients “starting on too low of a dose.” Because the Subsys label specified the initial dose as 100 micrograms, Kapoor expressed concern that patients who were used to a higher dose of a competing product would not be satisfied with the pain management offered by Subsys at that initial dosage. Consistent with Kapoor’s concerns, sales data (which Insys executives analyzed daily) showed that the lower a patient’s starting dose, the higher the “falloff rate.”

By the fall of 2012, Insys had begun to overhaul its marketing team. Shawn Simon was cashiered, and Alec Burlakoff (previously a regional manager) replaced him as vice president of sales. Defendant Joseph A. Rowan was promoted into Burlakoff's former role. Defendants Sunrise Lee and Richard M. Simon were installed as regional managers, and defendant Michael J. Gurry became vice president for managed markets

In addition to these executive-suite changes, Insys revamped its sales and marketing strategy. That fall, it hosted both a national sales meeting and a national sales call to train its sales force on a "new plan of attack." This plan had several components:

- A new "switch program" allowed patients who were transitioning to Subsys from a competing drug to receive vouchers to defray the cost of Subsys for as long as they needed it or until it was covered by their insurance.
- A new "super voucher" program offered a means of providing free product to patients.
- A specially crafted "effective dose" message informed prescribers that, despite the statements on the FDA-approved labelling, 100- or 200-microgram doses were not effective. To complement this "effective dose" messaging, sales representatives were notified "each and every time" a prescriber wrote a Subsys prescription for 100-or 200-micrograms; and they were instructed to report back within 24 hours both as to the reason why the doctor had prescribed the low dose and as to how the doctor planned to titrate the patient to the "effective dose."
- A revised compensation structure was put in place. This structure rewarded sales representatives for pushing doctors to prescribe higher doses of Subsys. Under it, larger prescribed doses yielded salespeople larger bonuses both because bonus percentages were higher for higher doses and because higher doses were more costly.

The icing on the cake was Insys's inauguration of a speaker program in August of 2012. The ostensible "objective of the program" was to provide "peer-to-peer education." To that end, Insys would invite physicians whom it envisioned as potential Subsys prescribers and the speaker (a fellow health-care provider) would "present the information [about the drug] to them." These presentations would take place through "online web hosting[s]" or at "dinner meetings." Each sales region was to host a roughly equal number of programs.

In its original incarnation, the speaker program never got off the ground. Instead, Kapoor transmogrified it. About a month after Napoletano announced the inauguration of the program, Kapoor "put on hold all speaker programs effective immediately." This directive emanated from Kapoor's disagreement with Napoletano about what the objective of the program ought to be: as Kapoor saw it, the speaker program "was designed for the speakers," not for the physicians who comprised the audience. Kapoor "wanted every speaker to write" Subsys prescriptions.

To accomplish this objective, Kapoor asked Napoletano for a list of the doctors who served as speakers, along with data as to “how many of them were writing [Subsys]” and data as to “what percentage of the prescriptions came from them.” Napoletano balked, responding that “it’s the attendees that you measure”—not the speakers. Kapoor “was not in agreement with that” and continued to insist upon a restructuring of the program.

In September, Kapoor, Burlakoff, Babich, and Napoletano met to discuss the direction of the speaker program. Consistent with Kapoor’s vision, Burlakoff argued against the original peer-to-peer education model. When Napoletano pointed out that “in accordance with pharma code” each event had to have “a minimum of two to four people” attend, Burlakoff replied that he “d[idn’t] care if there are any attendees” and that “he expect[ed] every speaker to write” prescriptions. He said that the speaker program should be “about the speaker and getting return from the speaker.” Although the meeting “was very contentious,” Kapoor was satisfied that his message had been received and proceeded to lift his “hold” on the speaker program.

Burlakoff then emailed the sales force stating that speaker programs are “the number one opportunity to grow [their] business.” He predicted that “[t]he hungry, motivated sales representatives will be facilitating as many speaker programs as humanly possible.” He also suggested that a successful speaker program would require salespersons to seek out speakers who are “expert[s] with the utilization of Subsys in [their] clinical practice” and who “have at least 20 patients on Subsys.”

Even with this sharp change in direction, Insys’s top brass disagreed as to how to measure the program’s success. In October, Kapoor, Napoletano, Babich, and Burlakoff met regarding that issue. Napoletano wanted to “track [the attendees] moving forward to see if the presentation had any impact and if they adopted the product in their practice.” Burlakoff disagreed and reiterated that “the metric to track is the speaker.” The meeting concluded with the issue still up in the air.

At a subsequent meeting, Kapoor resolved the issue. He stated that he “wanted to make sure every speaker wrote” Subsys prescriptions and “wanted a positive ROI”—a shorthand reference to return on investment. The ROI, as Kapoor measured it, would be the ratio between net revenue and the amount paid for speaker services. After a heated exchange, Napoletano capitulated and agreed to begin preparing reports tracking speakers and their corresponding ROIs. These reports allowed Kapoor to “see how successful [the] speakers were and how much product they were writing, based on how much money [Insys] had given them so far.” Once this data became available, any speaker who “did not generate at least two times in revenue what was being paid to them” was “flagged” for a “temporary hold on programming.” Refined to bare essence, the flagged speakers “wouldn’t get programs” and, thus, would not receive honorariums.

This new protocol transformed the speaker programs from pedagogical exercises into funding mechanisms for a pay-for-play fandango. It is, therefore, unsurprising that with the new protocol in place, Burlakoff sought to identify “whales.” He coined the term “whales” to refer to physicians who “ha[d] agreed in a very clear and concise manner

that they [were] up for the deal, which [meant that] they [would] be compensated based on the number of prescriptions of Subsys they wr[ote].” A corollary to that deal was that “the more they wr[ote] and the more they increase[d] the dose, the more they’[d] get paid to speak.” At Burlakoff’s urging, regional sales managers were to have a “candid conversation” with each potential whale and make clear that if the physician was going to receive payments from Insys, he was “going to write a significant amount of Subsys prescriptions to new patients as well as increase the doses of current patients.” Burlakoff told sales managers to view speakers as their “business partner[s]. . . .

Without exception, the prescription numbers of these physicians increased when they joined the speaker program. In an email, Burlakoff described the doctors as “clueless” because they “prescribe strictly based on their relationship with the sales manager.” As a result of that relationship and the pressure that sales representatives exerted, practitioners designated as “[s]peakers” generated approximately \$4,200,000 in net revenue (60 percent of Insys’s total net revenue) after receiving more than \$550,000 in speakers’ fees. Pleased with the success of the reconstituted speaker program, Kapoor raised the speaker budget in subsequent years.

Insys allocated speaker programs primarily to whales and other prolific Subsys prescribers. These practitioners were paid between \$1,000 and \$3,000 per event, depending on the particular practitioner’s “résumé or . . . influence.” Speakers’ payments were routinely sent by mail. Multiple speaker events featured the same practitioner. Insys initially capped annual speaking fees at \$100,000 per practitioner but later raised the ceiling to \$125,000. At a meeting in January of 2014, Babich, Burlakoff, and Richard Simon compiled a list of “doctors that had the highest potential to write.” Burlakoff then “mobilized the sales force to go out and make sure that these 19 or 20 doctors reached their [fees] cap.”

Despite the largess shown to speakers, the speaking events themselves had little to no attendance. Often, only the speaker, a friend or family member, and the sales representative were on hand. Even when more people were in attendance, the speaker programs were mostly “social outings” or “just a reason to gather people and have dinner and pay [the doctor].” Although sales representatives were required to submit sign-in forms and attendee evaluation forms to a third-party compliance firm (Sci Medica), they frequently submitted inaccurate documentation, including sign-in sheets with names and signatures of people who were not present, to give the speaking programs an aura of legitimacy. And when Kapoor replaced Sci Medica with an in-house compliance officer, the apocryphal documentation continued to flow.

While the revamped speakers’ program drove up the volume of Subsys prescriptions, insurance coverage remained a problem. Medicare, Medicaid, and private insurance companies covered the cost of Subsys prescriptions only if a practitioner obtained prior authorization to prescribe the drug. And because of the FDA label, coverage was limited to patients with a current cancer diagnosis who both suffered from breakthrough cancer pain and already had tried other opioid medication.

Nor did the coverage limitations stop there. As a condition precedent to coverage, insurers required that a patient had tried a generic fentanyl product that had either failed to ameliorate the breakthrough cancer pain or proved difficult to ingest. To seek prior authorization, a practitioner typically submitted patient and diagnosis information to the insurer, and the insurer relied upon the accuracy of the submitted information in its decisionmaking. When Insys launched Subsys, it processed prior authorization requests through a third party and achieved only a 30-35 percent success rate for prior authorization approvals.

To enhance the approval rate, Gurry suggested bringing the approval process in-house. With Kapoor's blessing, Gurry hired Elizabeth Gurrieri in October of 2012 to found the Insys Reimbursement Center (IRC), which operated out of Insys headquarters. Insys created an opt-in form through which Subsys prescribers could authorize the IRC to contact insurers and request prior authorizations. The form listed patient information that insurers typically would request during the prior authorization process, such as whether the patient had tried certain medications. Particular items from the list could be checked off as applying to a specific case. This streamlined the process: a prescriber would sign and fax an opt-in form to the IRC; the IRC would call the insurer; and if the insurer needed additional information, the IRC would reach out to the sales representative who would then follow up with the prescriber. Insys encouraged physicians to use the IRC, knowing that if the prior authorization was approved, "[t]he sales rep would get paid, Insys would get paid, and the script would get paid." A pilot program achieved an approval rate of 65–70 percent. As a result, Insys quickly transitioned the IRC out of its pilot phase and expanded it. Gurrieri was promoted to manager of reimbursement services in March of 2013.

The IRC proved to be a rousing success. It owed much of its success to the sales representatives. They interacted with the physicians and collected documentation requested by insurers during the prior-authorization process. A sales representative would often spend at least one day per week in a physician's office, reviewing patient files, assisting with authorizations, and completing the opt-in forms.

Another factor in the IRC's success was the hiring of "area business liaison[s]." These individuals were assigned to the physicians who prescribed Subsys in substantial volume. Each area business liaison worked in a physician's office processing authorizations, but was paid by Insys, thereby reducing the physician's overhead.

The third, and perhaps most impactful, factor in the IRC's success was Insys's decision to begin collecting data on each coverage decision. The IRC identified diagnoses and conditions that historically had prompted particular insurers to approve Subsys prescriptions. It proceeded to list these diagnoses and conditions on the opt-in form, and sales representatives encouraged physicians to employ them when seeking Subsys authorizations. For example, Gurrieri noted success using "the terminology 'history of cancer,' which means that they didn't have cancer at the time but they had a history of cancer." Once salespeople heard that use of that phrase could help obtain insurance

approval, the IRC, “all of a sudden, saw more opt-ins having ‘history of cancer’ on them, which [led] to better approval ratings.”

Management regularly discussed the IRC on the daily 8:30 a.m. calls. All updates about the IRC were communicated by Gurry during those calls. Although Insys had made great strides in upping its approval rate, Kapoor put constant pressure on the IRC to achieve a rate of 90 percent or higher. Striving to attain this benchmark, the IRC started to offer training sessions to sales representatives on “how to get the drug approved.” Similarly, Gurry started to advise sales representatives about what diagnoses and conditions should be checked on the opt-in forms. He famously directed IRC employees “to ride the gray line,” that is, to “work around the insurance companies” and “find ways around their questions.” Following that direction, the IRC developed strategies to mislead insurers into granting prior authorizations for the use of Subsys. Some of these strategies included misleading the insurer into believing that the caller was calling from the physician’s office rather than from the IRC; representing that a patient had cancer even if the available information reflected only a history of cancer; giving the ICD-9 diagnosis code as “338” to obscure the fact that the diagnosis was chronic pain (which uses code 338.29 or 338.4) and not cancer pain or neoplasm-related pain (which uses code 338.3); listing tried-and-failed medications that the patient had never used; and falsely stating that patients had dysphagia (difficulty swallowing).

Insys expected insurance companies to ask whether a physician had prescribed Subsys to treat “breakthrough cancer pain.” Gurrieri instructed IRC staff to respond with “the spiel,” which was pat phrasing designed to obfuscate the purpose of the prescription. The essence of the spiel was that “[t]he physician is aware that the medication is intended for the management of breakthrough pain in cancer patients, and the physician is treating the breakthrough pain.” Phrased in this way, the expectation was that “the person on the other end of the phone would be misled to think the patient had cancer and approve the prior authorization.”

The record makes manifest that the IRC, in practice, was more interested in transmitting information that would prompt favorable coverage determinations than it was in transmitting accurate information. Through the IRC, the insurers were fed a steady diet of deceptions, evasions, and half-truths.

Just as sales representatives were incentivized to push physicians to prescribe higher doses of Subsys, IRC staffers were incentivized to obtain insurance approvals. Goals known as “gates” were set weekly. If the gate was opened, the staff member (usually paid a low hourly wage) would receive a bonus.

The cocktail that Insys had mixed—including its revised marketing and sales strategies, its use of speaker programs as vehicles for bribes to physicians, its use of business liaisons, and its no-holds-barred tactics within the IRC—proved to be lucrative. Insys was able to go public only a year after introducing Subsys to the market. Within two years after the initial public offering, the company reached a market cap of over

\$3,000,000,000. And by the end of 2015, Insys's stock price had nearly quadrupled. Throughout, the defendants received substantial salaries, bonuses, and stock options.

But Insys's meteoric rise appeared too good to be true, and the company attracted unwanted attention. When federal authorities began probing the details of how Insys was marketing Subsys, the defendants' scheme began to unravel. . . .

The record is replete with support for the proposition that Kapoor intended physicians to write medically illegitimate prescriptions. Kapoor sought out pill mill doctors (that is, doctors who were notorious for their readiness to prescribe drugs regardless of medical necessity). *See, e.g., United States v. Iriele* (describing as "pill mill" a clinic where people "could get prescriptions for their controlled substances of choice with few, if any, questions asked"). For instance, Burlakoff testified that, to increase sales, Kapoor wanted him to do "[w]hatever it took with whomever [they] called on, including pill mill doctors."

Perhaps the best illustration of Kapoor's intent is found in the evidence concerning his attitude toward Dr. Madison. Kapoor encouraged dealings with Dr. Madison despite having reviewed an email in which a sales representative wrote that "Dr. Madison runs a very shady pill mill and only accepts cash. . . . He basically just shows up to sign his name on the prescription pad, if he shows up at all." Kapoor also knew that another sales representative had observed a "shady setup" in Dr. Madison's office with "many patients . . . going in and out of there . . . just seeking medication." As one expert witness put it, this prescribing behavior was inconsistent with a doctor's duty to carry out "those things that are necessary to reasonably diagnose the problem," such as "history taking, physical examination, and the obtaining and evaluation of diagnostic studies."

Although on unmistakable notice of the kind of operation that Dr. Madison appeared to be running, Kapoor pursued him. Babich testified that Kapoor "wanted [Dr. Madison] to write the drug" and awarded him speaker programs (and, thus, kickbacks) "as much as once a week." This was consistent both with Babich's description of Kapoor's avowed "philosophy" and with other evidence reflecting Kapoor's appetite for whales. The jury reasonably could have found that Kapoor's decision to continue courting and compensating Dr. Madison, notwithstanding his knowledge that the doctor was running a notorious pill mill, was proof of at least a tacit understanding of Kapoor's culpable role in the distribution scheme. *See United States v. King*.

Kapoor complains that this is a bridge too far. He laments that he received hundreds of emails a day, that he was busy with other business pursuits and charitable endeavors, and that Dr. Madison is only one of 13 doctors discussed in the four-page email. It follows, Kapoor suggests, that a reasonable jury could not infer that he read the sales representative's description of Dr. Madison.

This suggestion is little more than whistling past the graveyard. It conveniently overlooks that the jury heard evidence that Kapoor demanded information on "every [Subsys] script that was written" and "every doctor that wrote it." He demanded

spreadsheets to parse doctor-level data and sought to identify “whales”—doctors who understood that, in exchange for speaker-program payments, they would prescribe “a significant amount of Subsys prescriptions.”

What is more, Babich testified that Kapoor expressed great interest in these kinds of sales reports. Kapoor “want[ed] every single rep every Friday to e-mail [Babich] a list of all their top physicians and what happened with those top physicians that week.” An assistant “print[ed] these out” and put “them on [Kapoor’s] desk for Monday morning, so he c[ould] review” them. Given that level of attention to detail vis-à-vis prescribers, the inference that Kapoor read the email about Dr. Madison seems compelling.

Last—but surely not least—Babich confirmed that he gave the four-page email directly to Kapoor. He also testified that—several months after he had forwarded that email about Dr. Madison to Kapoor—the same sales representative again reiterated that Dr. Madison operated a pill mill and added that Dr. Madison faced possible legal action. Babich described this matter as “a serious issue” and testified that he personally reviewed this information with Kapoor. Kapoor responded that Dr. Madison “still has a medical license. I don’t want him taken off the call list” for speaker programs.

We need not tarry. The evidence, taken in the light most hospitable to the verdict, plainly supports the inference that Kapoor knew of Dr. Madison’s illegitimate prescribing habits yet took steps to ensure that he would continue prescribing Subsys. Indeed, the evidence warrants an inference that Kapoor sought to recruit Dr. Madison as a speaker (that is, as a kickback recipient) precisely because of these habits. Such an inference is consistent with other evidence that pill mill doctors were prized by Kapoor: he tracked physicians’ prescription patterns, gave favorable treatment to the doctors who prescribed Subsys most profligately, and—according to Burlakoff—did “whatever it took” to increase Subsys sales. As Burlakoff put it, Kapoor’s message to the sales force was that “pill mills for [Insys] meant dollar signs.”

The evidence also showed that Kapoor led Insys’s effort to influence physicians’ prescription decisions through “effective dose” messaging. The FDA-approved label stated that “[t]he initial dose of Subsys to treat episodes of breakthrough cancer pain is always 100 micrograms.” Doctors were supposed to “look at one patient at a time” and “titrate one patient at a time” to the dose of the drug that achieves “the desired effect.” Noting that patients on higher doses were more likely to refill their Subsys prescriptions, Kapoor sought to ride roughshod over this regime and “move patients to higher doses.” His mantra was to “push the dose.” To that end, he incorporated into the speaker program kickbacks for dosage increases—the greater the increase, the greater the payout. Predictably, Kapoor’s campaign to increase dosages resulted in the sales force negotiating dosage agreements with doctors. And Insys closely monitored these agreements: for example, when Dr. Somerville’s dosage numbers appeared to be low, a sales representative was instructed to “[d]rill into [the medical assistant’s] head that every refill has to be 180 to 240 [micrograms]” because “Dr. Somerville agreed to do this.”

To sum up, the evidence plainly supports a finding that Kapoor intended practitioners to prescribe Subsys as much as possible, even when there was no medical necessity for the drug or the dosage prescribed. His “effective dose” campaign was designed to dissuade doctors from prescribing medically appropriate lower dosages and to accelerate dose titration. A reasonable jury could infer that, by taking these actions, Kapoor pushed physicians—in Burlakoff’s words—to “initiate a new habit” that would transform patients into repeat customers, quite apart from medical necessity. See *United States v. Clough* (concluding that giving “opioid-dependent patients high dosages of this highly-addictive fentanyl drug, even when patients had no problems with their existing regimen” supported reasonable inference that defendant’s “behavior was not reminiscent of a physician assistant prescribing based on need, but rather [that] of a drug pusher”). And having thrown medical necessity to the wind, Kapoor’s “push the dose” message effectively directed Insys salespersons, who were not health-care professionals, to enforce mandatory ranges of dosages. Following Kapoor’s lead, they shaped doctors’ prescription decisions without regard to any individual patient information by getting the doctors to commit to meeting prescription-quantity numbers on a weekly basis. Jurors are allowed to use common sense and—surveying this unattractive tableau—a reasonable jury could have inferred that Kapoor, in “push[ing] the dose,” intended doctors to increase doses of Subsys regardless of who the patient was or what the patient’s medical needs might be. See *United States v. Guzman* (“[T]he jury could reasonably infer the requisite agreement to distribute controlled substances, as well as knowledge and participation” from “evidence showing that [defendants] tried to modify the prescribing practices of another nurse practitioner,” including by directing a “nurse to prescribe short-acting rather than long-acting medications and to prescribe prednisone for all customers.”). . . .

Of course, any treatment of the opioid catastrophe in the field of corporate crime must include the most publicized case, the investigation and prosecution of Purdue Pharma, a private company long controlled by the Sackler family. As to the company, the Purdue matter concluded in 2020 with a massive “global” settlement involving a corporate guilty plea and the resolution of many related civil proceedings. Because the company was subject to a bankruptcy proceeding at the time of the settlements, the particulars of the relevant agreements are too long and complicated to tackle here.

The most important element of the Purdue settlement, of course, is the description of the criminal conduct in the case. Below is a portion of the summary of the facts included in the settlement agreement. The government’s theory for Purdue’s criminal liability was based principally on a conspiracy to defraud the U.S. government (specifically the DEA) and a conspiracy to violate the anti-kickback statute excerpted at the outset of this chapter. For by far the best comprehensive account to date, see PATRICK RADDEN KEEFE, *EMPIRE OF PAIN: THE SECRET HISTORY OF THE SACKLER DYNASTY* (2021).

ADDENDUM A TO SETTLEMENT AGREEMENT

I. Introduction

1. Purdue Pharma L.P.'s ("Purdue") profits declined precipitously in 2010 after the introduction of its Reformulated OxyContin, which was intended to be more difficult (though not impossible) to crush or manipulate for purposes of abuse and misuse.

2. Purdue attributed the majority of the decline to two trends: (i) individuals abusing opioids moving from OxyContin to opioids that were easier to abuse through insufflation or injection and (ii) increased scrutiny of prescribers, pharmacists, and other actors in the opioid distribution chain.

3. Purdue sought to recapture lost sales and increase Purdue's share of the opioid market.

4. As a result, from 2010 through approximately February 2018, Purdue developed and implemented several strategies to ensure that the revenues generated from its opioid prescriptions, including those that Purdue knew or should have known were not medically necessary, would continue to flow to Purdue.

5. At the center of these strategies was Purdue's aggressive marketing program that focused on detailing over 100,000 doctors and nurse practitioners nationwide each year, including thousands of prescribers that Purdue knew or should have known were prescribing opioids for uses many of which were not for a medically accepted indication, were unsafe, ineffective, and medically unnecessary, and/or were diverted for uses that lacked a legitimate medical purpose. By 2013, Purdue intensified its detailing of the very highest-volume prescribers, *i.e.*, those writing "25 times as many OxyContin scripts" as their similarly situated peers, because it knew that its detailing was highly effective in causing these prescribers to write more prescriptions for Purdue's opioids. This strategy was referred to as the "Evolve to Excellence" or "E2E" program.

6. Purdue also rewarded and induced prescriptions from some of its most lucrative prescribers by paying kickbacks through its Key Opinion Leader corporate advisor and speaker programs. Indeed, some of the prescribers whom Purdue paid through these programs were poor speakers, showed indicia of abuse and diversion, or, in at least one case, requested an express *quid pro quo* from Purdue employees.

7. Increasingly concerned that pharmacies would not fill OxyContin prescriptions as pharmacies and regulators increased safeguards against the filling of medically unnecessary prescriptions, Purdue developed and implemented a strategy to detail the pharmacies of its highest volume prescribers, including those that Purdue knew were writing medically unnecessary prescriptions, to ensure that Purdue opioids would be dispensed. Further, after Purdue determined that a large number of its prescriptions were still being rejected, Purdue considered an "alternative distribution strategy" and later developed a program focused on Hysingla through which it paid kickbacks to three

specialty pharmacies to dispense prescriptions for Purdue's opioids that traditional pharmacies refused to fill.

8. Finally, from April 2016 through December 2016, Purdue paid kickbacks to Practice Fusion, an electronic health records company ("EHR"), to induce it to recommend and arrange for prescriptions of opioids by creating alerts that would appear within Practice Fusion's software while providers were seeing patients. Purdue did so with the intent that these alerts would cause more prescriptions for extended release opioids like those manufactured and sold by Purdue.

9. Through its marketing and kickbacks, from 2010 through 2018, Purdue knowingly caused the submission of false and fraudulent claims to Federal healthcare programs for its opioid drugs that were: (1) prescribed for uses that were not for a medically accepted indication, were unsafe, ineffective, and medically unnecessary, and that were often diverted for uses that lacked a legitimate medical purpose; or (2) tainted by illegal kickbacks.

II. Prior Resolution

10. In 2007, The Purdue Frederick Company, Inc. ("Purdue Frederick"), an affiliate of Purdue, pled guilty to misbranding OxyContin by falsely marketing it as less addictive, less subject to abuse and diversion, and less likely to cause dependence and withdrawal than other pain medications. Purdue and Purdue Frederick also agreed to pay more than \$600 million, of which over \$100 million was paid to settle civil False Claims Act liability for knowingly causing the submission of false claims to Federal healthcare programs for OxyContin. In conjunction with the resolution, Purdue entered into a five-year Corporate Integrity Agreement with the Department of Health and Human Services, Office of Inspector General (OIG-HHS). OIG-HHS closed the corporate integrity agreement in January 2013.

III. Organization of Purdue Pharma

11. Purdue Pharma L.P. carries on operations, including distributing and selling the extended-release opioid drugs OxyContin, Butrans, and Hysingla. Prior to February 2018, it employed a sales force of, at times, over five hundred representatives to market its opioid drugs.

12. Purdue was owned (through trusts) and controlled by members of the Sackler family. Several members of the Sackler family served on the Board of Directors of Purdue Pharma Inc., which oversaw Purdue and certain related companies during the relevant time period.

13. The Sacklers, as members of the Purdue Board, exercised substantial oversight over management's operations of Purdue. For instance, in February of 2011, a memorandum observed: "There seems to be a consensus that the role of the board and that of the management is blurred compared with the distinctions made by other major corporations," and, historically, certain members of Sackler family functioned as

“executives, management, board, and shareholders all-in-one [and] worked collaboratively with other managers on a daily basis.”

14. As late as 2017, a high-level Purdue executive commented: “Three distinct business types (branded Rx [including Purdue]/biosimilars, consumer/OTC, generics) are being run through four separate regions (five if Rhodes is included), with the Board of Directors serving as the ‘de-facto’ CEO.”

IV. The Opioid Drugs Purdue Manufactured, Marketed, Promoted, and Sold

A. *OxyContin*

15. Oxycodone is an opioid agonist with a morphine milligram equivalent (“MME”) of 1.5 and a high potential for abuse similar to other opioids including fentanyl, hydromorphone, methadone, morphine, and oxymorphone.

16. It is classified as a Schedule II narcotic under the Controlled Substances Act, 21 U.S.C. § 801, *et seq.* (“CSA”).

17. Purdue manufactured, marketed, promoted, sold, and distributed OxyContin, an extended-release oxycodone tablet, nationwide, including by sending sales representatives to prescribers’ offices and pharmacies, to persuade healthcare providers to prescribe and pharmacists to dispense OxyContin.

18. In April 2010, Purdue received FDA approval to market a reformulated version of OxyContin.

19. Reformulated OxyContin was more difficult to crush or dissolve, but FDA cautioned that Reformulated OxyContin “is not completely tamper-resistant and those intent on abusing this new formulation will likely find a means to do so. In addition, the product can still be misused or abused and result in overdose by simply administering or ingesting larger than recommended oral doses.”

20. In August 2010, Purdue discontinued the original version of OxyContin.

B. *Butrans*

21. Buprenorphine is an opioid partial agonist with an MME of 12.6 that exposes users to the risks of addiction, abuse, and misuse. It is classified as a Schedule III narcotic under the CSA.

22. In June 2010, Purdue received FDA approval to market Butrans, a buprenorphine patch, and began manufacturing, marketing, promoting, and selling Butrans nationwide.

C. *Hysingla*

23. Hydrocodone is an opioid agonist with an MME of 1.0 that exposes users to the risks of addiction, abuse, and misuse. It is classified as a Schedule II narcotic under the CSA.

24. In November 2014, Purdue received FDA approval to market Hysingla, an extended-release hydrocodone tablet, which is formulated with abuse-deterrent properties, and began manufacturing, marketing, promoting, and selling Hysingla nationwide.

V. Purdue Knowingly Caused Medically Unnecessary Prescription to be Submitted to Federal Healthcare Programs

25. From 2010 to February 2018, Purdue engaged in strategies that resulted in prescriptions of its drugs for uses that were not for a medically accepted indication, were unsafe, ineffective, and medically unnecessary, and that were diverted for uses that lacked a legitimate medical purpose. Such prescriptions are not reimbursable by Federal healthcare programs.

26. The paragraphs below describe the fraudulent scheme to cause extreme high-volume prescribers to write medically unnecessary OxyContin prescriptions for Federal healthcare program beneficiaries.

A. *“Calling On” and “Detailing” Prescribers Causes Them to Write More Prescriptions*

27. Until it stopped marketing opioids in February 2018, Purdue sought to increase and maintain opioid sales by sending sales representatives to prescribers’ offices and pharmacies to meet with prescribers in person; deliver company-developed messaging; give the prescribers meals (such as coffee, breakfast, and lunch) and marketing materials (such as articles, brochures, posters, and other media); and provide information about pharmacies stocking Purdue opioids and prescription coverage, including coverage under Federal healthcare benefit programs.

28. This practice is known in the pharmaceutical industry as “calling on” or “detailing” healthcare providers and pharmacies.

29. Purdue knew that calling on or detailing healthcare providers and pharmacies caused them to prescribe and dispense, respectively, more of Purdue’s opioid drugs.

30. In September 2010, at a presentation to Purdue’s sales supervisors, a Purdue executive explained: “As I have stated several times, we know increases in the prescriber call average will have the single largest impact of anything you can do to increase prescriptions of Purdue products with our core and super core prescribers.”

31. Additionally, presentations related to E2E recognized: “Increased calls have a significant impact on OxyContin TRx.”

32. Likewise, Purdue prepared return-on-investment analyses comparing the cost of detailing as compared to the OxyContin prescriptions that would not have been written but for Purdue's in-person marketing, as well as "sensitivity" analyses showing the impact of Purdue's detailing on OxyContin prescribing.

B. The Sales Revenue Purdue Calculated from Federal Healthcare Programs

33. Purdue knew that Federal healthcare programs paid claims for Purdue's opioid drugs, including OxyContin, and those payments accounted for a significant percentage of Purdue's revenue.

34. For example, an April 11, 2012, budget presentation to Purdue's Board of Directors showed that certain Federal healthcare programs accounted for over 30% of Purdue's revenue from sales of OxyContin.

35. Additionally, Purdue developed messaging and marketing materials associated with prescription coverage for OxyContin, including Federal healthcare program coverage, to induce prescribers to write OxyContin prescriptions for Federal healthcare program beneficiaries.

36. Purdue knew that it was reasonably foreseeable that its promotional activities for its drugs were a substantial factor in claims being submitted to Federal healthcare programs.

C. Purdue's Marketing of OxyContin After Reformulation.

37. Shortly after the introduction of Reformulated OxyContin, Purdue's profits declined, in large part, because some individuals who abused OxyContin moved to more easily manipulated opioids.

38. Purdue executives closely analyzed Purdue's internal data, including data purchased from vendors, in order to target high-volume prescribers and monitor their prescriptions.

39. Purdue ranked the prescribers based on their aggregate opioid prescriptions in deciles from numbers 1 through 10, with 10 being the highest.

40. From 2010 to 2013, Purdue instructed its sales force to primarily focus on the top three deciles of prescribers.

41. The purpose of focusing the sales force on these highest deciles of prescribers was to cause an even higher volume of prescriptions to be written by them.

42. Purdue knew, at that time, that the three highest deciles of prescribers combined accounted for only 1.5% of all opioid prescribers nationwide, but wrote 80% of all OxyContin prescriptions nationwide. Purdue also knew that these prescribers were the most responsive to Purdue's detailing.

43. Specifically, in June 2010, Purdue executives discussed instructing sales representatives to “build their target list with a focus on the highest prescribers across all three categories (Tier 1), and then fill in target list with the next highest potential and keep in front of OER [opioid extended release] high prescribers.” . . .

44. While the targeting strategies and terminology differed over time, from 2010 through 2013, sales representatives were instructed to develop call plans around these high volume prescribers and detail them with the most frequency. In turn, sales representatives were rewarded with incentive compensation tied to the volume of OxyContin prescriptions generated from the health care providers they had detailed and faced corrective action plans, such as performance improvement plans, when they did not meet their sales goals. . . .

45. Purdue also found that, if it stopped detailing those extreme high-volume prescribers, the number of Purdue prescriptions written by them would not just have stayed stagnant - it would have declined. For example, on September 16, 2011, a Purdue executive stated that high-volume prescribers’ OxyContin prescriptions decreased between 23 to 28% without detailing.

46. Approximately a year later, on July 13, 2012, a Purdue executive advised others that “OxyContin base sales will most likely erode with time when marketing programs are removed” and that incremental prescription lift was 32% after detailing by Purdue sales representatives.

D. Declining Sales and Higher Sales Goals

47. From 2010 to 2018, Purdue’s profits were almost entirely driven by its success in selling OxyContin.

48. On January 25, 2010, Richard Sackler emailed other members of Purdue’s Board: “By way of background, the most important driver of our sales growth or decline is the performance of all the oxycodone extended release forms in the market (called OER); this is comprised of OxyContin® tablets plus all the generics in the space.” By virtue of OxyContin’s importance, certain of the Sacklers placed pressure on executives to meet OxyContin sales goals set by the Board and participated in decision-making regarding Purdue’s sales strategies for OxyContin, at times overruling the targets set by Purdue’s executives.

49. For example, in January 2010, Purdue executives and certain of the Sacklers engaged in an exchange regarding the executives’ proposed 2010 budget.

50. The executives proposed that OxyContin growth should be pegged at 3%. Richard Sackler thought this target was too low and would “lead to an OxyContin[] tablets forecast that is almost the same as our sales in 2009.” A Purdue executive informed Richard Sackler that “in looking at the recent [oxycodone extended release] prescription growth trends and knowing the overall dynamics of the market OxyContin competes in—I just can’t see a way of the prescription growth tracking to a level

substantially higher than the 3% on which this budget is based” and that the higher target suggested by Richard Sackler would “be interpreted as an imposition as opposed to an action that will stimulate the type of business building behaviors we want to encourage.”

51. In response, Richard Sackler, who believed that Purdue’s OxyContin growth target should be much higher, told a Purdue executive “I’m disappointed and don’t agree with you. This is a matter that the Board will have to take up and give you a settled direction.”

52. Later that month, on January 25, 2010, Richard Sackler emailed the Board and informed them that he had “engaged management on this subject,” referring to the proposed 2010 budget, and explained his view that management’s number was “unduly conservative.”

53. On the same day, Mortimer D.A. Sackler followed up with Theresa Sackler regarding Richard’s proposal, stating “we should push management to agree to a higher target.”

54. After the release of Reformulated OxyContin in August 2010, OxyContin sales immediately began to decline.

55. Purdue management presented information regarding the slipping demand for Purdue’s OxyContin to Purdue’s Board in December 2010, showing that the total weekly kilograms dispensed of branded OxyContin declined from August to November 2010.

56. This downward trend continued the following year. On or about June 15, 2011, a Purdue executive prepared a memorandum to a Purdue executive, among others, identifying an expected budget shortfall of over \$1 billion. The memorandum stated that “Kilograms dispensed have declined since the transition to the reformulated, primarily due to fewer 40mg and 80mg tablets being dispensed.”

57. In or around June 20, 2011, a Purdue executive shared this information with the Board in a presentation stating, “Since the transition, 40 and 80mg tablet prescriptions have decreased significantly. The 10mg and 20mg tablet prescriptions initially increased, but given their lower value not enough to offset the higher strength decline.” The presentation went on to revise the forecast of projected OxyContin sales from \$3.9 billion to \$2.8 billion.

58. Sales continued to trend downward in 2012.

59. On April 15, 2012, Richard Sackler emailed a Purdue executive, stating, “We should . . . discuss the sudden decline in [OxyContin] sales in the past year or two. What are we doing to identify corrective actions?” The following day, a Purdue executive forwarded Richard Sackler’s email to another Purdue executive, among others, stating, “I am surprised that Dr. Richard is asking this. Since the decline is related to reformulation I’m not sure how to proceed with him.”

60. On July 17, 2012, Mortimer D.A. Sackler emailed fellow Purdue Board members stating that Purdue should “start a search asap for a new CEO” and consider “replacing the head of sales and marketing.”

61. In November 2012, looking back at the time period since Reformulated OxyContin replaced original OxyContin, a Purdue executive reported to Purdue’s Board of Directors that there was a “Decline in OxyContin [Prescriptions] From Late 2010 Through 2011.” The executive added that 2012 gross sales of OxyContin were “3.7%[] below budget” and 2012 net sales of OxyContin were “4.3% below budget due to lower prescription demand, lower trade inventory, and higher returns than budgeted.”

62. In October 2013, Mortimer D.A. Sackler inquired directly with Purdue’s leadership to request additional data concerning the downward trend in sales by dosage, requesting a chart to “show the breakdown of the OxyContin market share by strength against competitors. I would like to understand more the recent dynamics of the market and where the patients are shifting to that we are losing.” Later that same day, responses to Mortimer’s questions explained that the loss of sales was due to “the recent dynamics of the market,” the pressures of increased government regulation, and that there were “fewer patients titrating to the higher strengths from the lower ones.”

E. Post-Reformulation Decline Attributed, in Large Part, to Medically Unnecessary Prescriptions

63. Purdue studied the drivers of the post-reformulation OxyContin sales decline, and it attributed the decline, in large part, to a reduction in prescriptions written for individuals who abused OxyContin through insufflation or injection and increases in safeguards intended to hinder medically unnecessary prescribing.

64. Purdue also conducted a number of post-marketing studies of Reformulated OxyContin.

65. Purdue’s studies and analyses showed that the decline in overall OxyContin prescriptions was most pronounced among both extreme high-volume opioid prescribers and its highest dosage tablets, the 40 mg and 80 mg tablets.

66. Purdue also attributed approximately 40% of the decline in OxyContin prescriptions in 2010 to 2011 to “Region Zero” prescribers. Region Zero prescribers were prescribers that Purdue instructed sales representatives not to call on because, based on information maintained by its Abuse and Diversion Detection (“ADD”) Program, Purdue determined that “there is a concern about potential abuse or diversion related activities” by them. Purdue had detailed information (down to the number of prescriptions written, product, and dosage) of Purdue products prescribed by all prescribers, including Region Zero doctors from which it could determine that Purdue had been making substantial profits from these prescriptions.

67. Purdue knew that the remainder of prescribers who experienced a significant drop in sales post-reformulation were not on Purdue's Region Zero do-not-call list, meaning representatives could continue detailing them.

68. At the December 2010 Board briefing, a Purdue executive discussed a chart stating that "Region 0 Accounts For Much Of The TRx Decline At The Regional Level."

69. In April 2011, Purdue prepared an excel sheet showing prescribers who experienced significant drops in prescriptions post-reformulation. Among the 134 prescribers listed in the prescription change analysis, Purdue was continuing to detail about one-third of them. The spreadsheet specifically identified substantial declines in prescriptions for 80 mg tablets.

70. On October 25, 2011, Purdue's Board received a copy of Purdue's September Executive Committee Meeting Notes & Actions, which provided Board members with information regarding the impact of Reformulated OxyContin on abuse.

71. Among the Board materials was a presentation stating that there was a "[d]ecline in 80 mg prescriptions, esp[ecially] among 'Do not Call' prescribers," and a "[s]hift in routes of abuse, especially injecting and snorting."

72. The study, which surveyed individuals being treated for opioid use disorder who reported abusing OxyContin through any route, also found that while the overall rate of OxyContin abuse decreased, some users continued to abuse Reformulated OxyContin through insufflation or injection-albeit with more difficulty-and that the percentage of users who reported abusing OxyContin through oral ingestion increased from 54% to 76% following the introduction of Reformulated OxyContin.

73. The materials provided to the Board in October 2011 also included a study, "Changes in Prescribing Patterns Following Introduction of Reformulated OxyContin: A Window into Diversion." The study examined a two-year period, August 2009 to July 2011, and found that data for Region Zero prescribers showed an 86% decline in their OxyContin prescriptions after Purdue's introduction of its reformulated version, and especially at the highest dosages, 40 and 80 mg tablets. The study found that prescribers suspected of abuse and diversion also prescribed the highest dose (80 mg) of OxyContin more frequently than other prescribers.

74. The study also found that Region Zero prescribers accounted for only 38.4% of the overall decline in sales post-reformulation, which Purdue attributed to reduced abuse of OxyContin. The remaining 61.6% of the decline was among other prescribers that were not on Purdue's Region Zero lists, meaning that sales representatives either were continuing to call on these prescribers or were permitted to do so.

75. Figures in the presentation further showed that immediate-release oxycodone prescribing increased at a similar rate (an approximately 32% increase) to the decline in 80 mg and 40 mg tablets of Reformulated OxyContin prescriptions (which experienced a 24% decrease and 26% decrease, respectively) among the non-Region Zero

comparator prescribers, indicating that patients who had been abusing OxyContin may have been shifted to a non-reformulated oxycodone product that they could continue to misuse.

76. Versions of the presentation, including at least one provided to Richard Sackler in August 2013, repeated key findings, including: “Greater declines for doctors that were potentially problematic prescribers”; “Greater declines for high versus low dosage strengths”; “A small number of prescribers contribute to a large proportion of potential diversion of opioids from legal to illegal channels”; and “there were doctors in the [Purdue’s] database who were prescribing painkillers ‘for what appears to be the wrong reasons.’”

77. In sum, Purdue knew that, after the release of its Reformulated OxyContin, the product continued to be abused, but the method of abuse shifted to abuse through oral ingestion. Furthermore, Purdue knew that abuse and diversion appeared concentrated among a cohort of high-volume prescribers. As described below, certain of Purdue’s marketing efforts were concentrated on extreme high-volume prescribers.

F. Decline in OxyContin Revenue Also Attributed to Safeguards Intended to Curb Abuse and Diversion.

78. At the same time, Purdue also attributed declines in OxyContin prescription revenue post-reformulation to safeguards intended to reduce medically unnecessary opioid sales, including increased scrutiny of opioid prescribing by law enforcement, wholesalers, distributors, and retail pharmacies.

79. For example, a Business Condition Report from a May 2–3, 2013 Board of Directors Meeting described sales as being “\$144mm behind Q12013 budget” with “\$36mm attributed to lower Rx demand” and stated that “[p]ossible causes of fewer tabs/Rx in the market” include “Increased State Regulations”; “Anti-opioid environment”; and “Increased DEA/law enforcement scrutiny of physicians, pharmacies and wholesalers.”

80. A consulting company that worked for Purdue since approximately the mid-2000s similarly attributed the decline in sales, in large part, to both the reformulation and safeguards against medically unnecessary prescriptions.

81. In 2013, the consulting company informed Purdue and its Board, that “[t]he retail channel, both pharmacies and distributors, is under intense scrutiny and direct risk.”

82. More specifically, the consulting company explained “[t]here are reports of wholesalers stopping shipments entirely to an increasing number of pharmacies,” “[m]any wholesalers are also imposing hard quantity limits on orders based on prior purchase levels,” and “[p]harmacy chains are implementing guidelines for which patients can fill opioid prescriptions.”

83. Later, Purdue's 2014 budget presentation to the Board listed these safeguards - intended to prevent medically unnecessary prescriptions of opioids, including OxyContin—among the “challenges” to achieving revenue goals.

G. Re-catalyzing Medically Unnecessary Prescriptions: Turbocharging Sales Through E2E.

84. On May 25, 2013 Richard Sackler had a call with a senior executive from the consulting company to discuss various business opportunities, including opportunities related to OxyContin.

85. On May 28, 2013, Purdue entered into a contract with the consulting company to “conduct a rapid assessment of the underlying drivers of current OxyContin performance, identify key opportunities to increase near-term OxyContin revenue and develop plans to capture priority opportunities.”

86. Between July 18 and August 8, 2013, the consulting company provided several reports to a Purdue executive, at least two of which were provided to the Board, including the Sacklers.

87. The consulting company proposed that Purdue adopt what was later referred to as the “Evolve to Excellence” initiative, or “E2E.”

88. The reports concluded that there existed a “significant opportunity to improve sales through better targeting.”

89. “Better targeting” meant focusing sales calls on extreme high-volume opioid prescribers and removing sales representative discretion with respect to call plans.

90. Purdue and the consulting company analyzed Purdue prescription data and other Purdue data sources broken down by deciles based on, primarily, their opioid prescribing. According to Purdue and the consulting company's deciling calculations, the prescribers writing “25 times as many OxyContin prescriptions as” other providers—those within the top five deciles—comprised less than seven percent of all prescribers nationwide, but wrote approximately as many opioid prescriptions as the remaining 93 percent of prescribers combined.

91. The consulting company contended that, in contrast to the decile ranking undertaken by Purdue from 2010 to 2012, its rankings focused on “value deciles,” which purported to be qualitatively different. In practice, the value decile ranking only enhanced Purdue's marketing focus on extreme high-volume prescribers and ensured a focus on Federal healthcare program beneficiaries.

92. The “value decile” analysis purported to use the following metrics: (1) overall opioid prescriptions, including number of branded versus generic prescriptions; (2) whether the prescriber had rules in place prohibiting sales representatives from calling on them; (3) managed care access, including access to Federal healthcare program

beneficiaries; and (4) the number of the prescriber's new to brand prescriptions (including new opioid patients and switches from other opioid products).

93. The consulting company reports showed that the highest-volume prescribers were the most susceptible to marketing: detailing resulted in a 53% increase in prescriptions compared to only 33% for the middle decile prescribers. They also showed that, in the absence of detailing, high-volume prescribers' Purdue prescriptions would decline considerably.

94. The consulting company told Purdue and its Board that its proposed marketing plan would slow or reverse that decline and recapture those sales.

95. The memoranda asked Purdue to "make a clear go or no go decision on Turbocharging the Sales Engine," meaning implementing E2E.

96. On August 15, 2013, two Purdue executives discussed the consulting company's progress on evaluating growth opportunities for OxyContin with the Board. Their presentation noted that the analysis would include an examination of "relatively more sudden declines in tablets per prescriptions and prescriptions for 40 mg and 80 mg strengths" and "prescriber segmentation and targeting."

97. Later that same day, Richard Sackler emailed Mortimer D. A. Sackler: "The 'discoveries' of [the consulting company] are astonishing."

98. Richard Sackler subsequently arranged for a face-to-face meeting for the Board with the consulting company outside of the presence of Purdue executives.

99. On August 23, 2013, certain Sackler family members met with the consulting company and examined its "unvarnished" findings and recommendations.

100. Following the meeting, one of the consulting company partners that led the meeting with the Sacklers memorialized in an email: "[T]he room was filled with only family, including the elder statesman Dr. Raymond [Sackler]. We went through exhibit by exhibit for about 2 hrs. . . . They were extremely supportive of the findings and our recommendations . . . and wanted to strongly endorse getting going on our recommendations."

101. Another consulting company partner further remarked in the email correspondence that their "findings were crystal clear to" the Sacklers "and [the Sacklers] gave a ringing endorsement of 'moving forward fast.'"

102. After the "ringing endorsement" by the Sacklers, Purdue, in collaboration with the consulting company, implemented many of the consulting company's recommendations.

103. The Board received a presentation on E2E's implementation at the September 2013 Board meeting.

104. In September 2013, Richard Sackler emailed an advisor asking when Purdue could reach out to a newly-hired Purdue executive to brief him on E2E.

105. E2E took a multifaceted approach to increasing OxyContin prescribing and Purdue's profits. The consulting company recommended, among other strategies, refreshing Purdue's marketing messaging—particularly around titration to higher, more lucrative dosages—and undertaking strategies to ensure prescriptions would be filled. At its core, however, E2E focused on intensifying marketing to the very highest-volume prescribers in the country by targeting them with increased frequency and minimizing sales representative discretion in identifying prescribers to target. The E2E call plans targeted the highest-volume prescribers in the country, and the program demanded stricter adherence with call plans than had existed in years past.

106. In late 2013, the Board received a 2014 Budget presentation again reviewing E2E's implementation. Board notes show the Board discussed ensuring E2E's funding at that meeting.

107. In sum, Purdue understood E2E's core strategies, namely, that it relied on generating prescriptions from extreme high-volume prescribers, and implemented it anyway.

H. E2E's Aggressive OxyContin Sales and Marketing Strategies.

108. E2E was overseen by the consulting company and some of Purdue's top executives through the creation of the E2E Executive Oversight Team ("EOT") and Project Management Office ("PMO").

a. Increasing the Frequency of Calls on Extreme High-Volume Prescribers

109. Based on a study showing that providers in deciles 7–10 were most responsive to sales calls and were the most prolific writers, the E2E call plans instructed sales representatives to call on the very highest deciles of high-volume prescribers with the most frequency.

110. Specifically, Purdue instructed its sales representatives to call on the highest volume OxyContin prescribers (*i.e.*, those in so-called "deciles" 7 through 10) at least 24 times a year and "heavily favor" promoting OxyContin over other Purdue opioids in their messaging.

111. Purdue executives also emphasized the focus of E2E at national sales meetings: "The single core objective of E2E is to make sure that we're making calls on the highest potential customers with the right frequency to maximize prescribing potential."

112. An email between two Purdue executives dated October 23, 2013, entitled "S&P Final Version" attached Board presentations, a 2014 Budget Presentation to the Board on OxyContin Tablets, which reflected that the extreme high-volume prescribers that E2E targeted were most sensitive to Purdue's marketing:

113. Speaker notes to this presentation discussed focusing on these top tier prescribers because “Increased calls with decile 8–10 prescribers have a significant impact on OxyContin® TRx growth”—an over 39% increase as compared to a decline of approximately 17% among prescribers receiving fewer calls.

b. Messaging to Cause High Volume Prescribers to Get More Patients on OxyContin and Titrate Patients to Higher Dosages

114. Purdue’s sales and marketing departments prepared scripts, visual aids, brochures, and messaging for representatives to use with the providers they called on. A large part of this marketing was intended to cause the highest volume prescribers in the nation to “commit” to writing more OxyContin prescriptions.

115. At the same time, Purdue also refined its marketing message through the S.T.A.R.T. (Supplement, Titrate, Adjust, Reassess, Tailor) initiative by focusing sales conversations with prescribers on titrating patients to dosages.

116. The goal of the program was to discourage patient discontinuation of OxyContin due to perceived lack of pain relief by encouraging providers to increase the OxyContin dosage, or “titrate up.”

117. For example, a 2011 script stated: “We discussed the discontinuation rate of extended-release opioids by day 35. One of the potential reasons for discontinuation is the lack of efficacy perhaps as a result of lack of titration.” E2E created a refreshed 2014 version of the script that stated: “According to an analysis 57% of patients initiated on some commonly prescribed extended-release opioids are no longer on those products by day 35,” “Assuming a patient discontinues therapy by day 35 due to their perceived lack of pain relief, what is the impact on your patient, you and your staff? (pause for effect),” and then “Doctor, working with you and your staff, I can provide support to you when initiating and titrating dosages on my products.”

118. In addition, representatives were trained to “[o]vercome . . . objection[s]” raised by providers and get physicians to “commit” to prescribe more Purdue products. Specifically, representatives were trained to pivot from legitimate physician concerns about addiction to statements about “dependence” and opioid “tolerance.” When asked about the safety of high dosages, representatives were instructed to respond that OxyContin “does not have a ceiling dose.”

119. The Board received information concerning “OxyContin strength Rx history as well as statistical projections” that attributed the decline in sales of the high dosage tablets to “DEA pressures and ‘good faith dispensing policies’ at large chain pharmacies, *fewer patients switching into the ERO market from other products*, and there are *fewer patients titrating to the higher strengths from the lower ones*.”.

120. At the November 2013 meeting concerning Purdue’s 2014 budget, a Purdue executive discussed with the Board the company’s plan to “refine the message” of the company’s titration up marketing campaign and specifically referenced the

“Individualize the Dose” campaign, a Conversion & Titration Guide, and the S.T.A.R.T. principles to “highlight important elements of titration throughout the course of treatment.”

121. Briefings to the Board also showed that the E2E marketing pushed by sales representatives in these calls specifically discussed titrating to higher dosages, initiating opioid naive patients on opioid therapy, and switching patients from immediate release opioids to Reformulated OxyContin.

122. In December 2013 correspondence, a Purdue executive told the Board that “[t]he E2E sales force focus/effectiveness initiatives [that] are being implemented starting October 2013 through April 2014 are already showing positive results.”

I. Purdue’s Internal Systems Confirm That E2E Caused Medically Unnecessary Prescribing

123. Purdue’s Abuse and Diversion Detection (“ADD”) program and Region Zero list contain examples of high-volume prescribers detailed during E2E that Purdue’s own employees suspected were writing medically unnecessary prescriptions.

124. At all relevant times, Purdue maintained an ADD program, through which Purdue had the means and ability to identify prescribers suspected of engaging in abuse and diversion.

125. The ADD program began in or around 2002 and ended in or around February 2018. It was governed during most of that time period by Standard Operating Procedure (“SOP”) 1.7.1.

126. SOP 1.7.1 instructed Purdue employees to refer prescribers who displayed indicia of abuse and diversion to ADD. Employees referred these prescribers to ADD by issuing a Report of Concern (“ROC”).

127. The indicia of abuse and diversion in SOP 1.7.1 were amended over time and included, among other things, excessive numbers of patients; brief or nonexistent contact with patients; high numbers of cash pay patients; information that a prescriber or his or her patients may be diverting opioids; allegations of patient overdoses; allegations of unauthorized individuals signing prescriptions; large numbers of patients traveling long distances; and allegations that a prescriber is under investigation.

128. After prescribers were referred to ADD, Purdue reviewed information concerning the prescribers to determine whether Purdue should continue to market its opioids to them.

129. If Purdue determined a sales representative should not continue to call on a prescriber, the prescriber was placed on the Region Zero list.

130. Purdue was aware that Region Zero providers were responsible for a major drop in sales after Reformulated OxyContin was released, and that there were also declines

among prescribers that were not on Region Zero that Purdue sales representatives could continue to detail.

131. Purdue sales representatives were trained to report prescribers suspected of abuse and diversion to ADD, and some sales representatives did so.

132. However, high-volume prescribers were often not reported and, even if they were, they were sometimes not added to Region Zero until they lost the ability to prescribe through legal or medical board action. In addition, certain Purdue policies resulted in high-volume prescribers not being reported to ADD, and thus not being added to Region Zero. For example, Purdue trained its sales representatives to only report clear instances of abuse and diversion, and sales representatives were instructed to discuss the reports with their district managers prior to filing. In addition, although Purdue's policy stated that it required timely reporting, Purdue had few, if any, effective compliance measures to address an employee's failure to report, and very few sales representatives were penalized for failing to timely report.

133. Purdue's Sales and Marketing Department tracked prescribing of opioids by all health care providers, including providers included in ADD and Region Zero, placing them into deciles as described above. ADD contained a field that reflected whether a health care provider was a high-volume prescriber. When the sales force petitioned for a prescriber to be removed from Region Zero so that detailing of him or her could resume, and when ADD reviewed such petitions, both the sales force and ADD were aware of the volume of sales generated by that prescriber.

134. From 2002 through the end of 2012, Purdue conducted various data analyses to identify prescribers with red flags for abuse and diversion. The red flags included prescribers with high numbers of prescriptions for 80mg tablets; prescribers with large numbers of patients that used multiple prescribers or pharmacies; and prescribers with large numbers of cash paying patients.

135. Purdue also evaluated prescribers whose prescriptions declined sharply following reformulation.

136. Although the analyses identified many red flag prescribers, only a fraction were reviewed as part of the ADD program and Purdue knowingly continued detailing others without any further scrutiny.

137. Further, even for those prescribers who were placed on Region Zero, Purdue engaged in other practices to increase those prescribers' opioid prescriptions.

a. Purdue permitted sales representatives to continue calling on other members of the exact same practice, although doing so could increase the prescriptions of the Region Zero prescriber;

b. Purdue detailed its highest-volume prescribers' pharmacies in order to increase the likelihood that Region Zero prescriptions would be filled; and

c. Purdue permitted sales representatives and managers to petition to have Region Zero status reversed so they could resume calling on Region Zero prescribers. These petitions were sometimes granted.

138. For example, in 2012, Purdue employees petitioned for over 180 mid to high-decile Region Zero providers to be reinstated.

139. Purdue also failed to maintain updated and complete Region Zero lists.

140. Purdue knowingly continued detailing prescribers suspected of abuse and diversion, including at times after a ROC was filed with ADD.

Doctor-1

141. From January 2010 through May 2018, Purdue representatives detailed Doctor-1 at least 300 times, although calls after February 2018 did not promote opioid products. During this time, the doctor caused the submission of a high number of OxyContin claims to Medicare.

142. Purdue knew that Doctor-1 was prescribing medically unnecessary opioids. From 2009 through 2011, Purdue received at least three different ROCs about Doctor-1.

143. In October 2009, a Purdue sales representative reported: “Pharmacist . . . says they’ve had all kinds of problems with abuse and diversion of Oxycontin . . . [Pharmacist] said [he] and [other doctor] are too loose [sic] when writing prescriptions of Oxycontin. He says of the patients he thinks are selling their prescriptions, he has notified the doctors, but nothing has changed.”

144. In June 2010, the sales representative further reported: “the pharmacy manager, says [the doctor] is known as the “Candyman” . . . because she will immediately put every patient on the highest dose of narcotics she can, whether it’s Oxycontin or another product. He says when he goes to local pharmacist meetings, when her name comes up everyone in the room cringes and moans because of her practices. He says she is doing all kinds of wacky dosing and tablet strengths. He says he feels like she is not doing what she should be doing with medications. On occasion he has refused to fill prescriptions from her office. He said he’s been seeing some crazy dosing of Oxycontin coming in, especially from [Doctor-1].”

145. In July 2010, a Purdue sales representative reported: Another physician “said he had a patient from [the doctor] who was on 80 mg 5 times per day. He thought this was over the top and asked me today what the maximum dose was. He felt this patient was definitely exceeding it. I told him since it was a single entity opioid, there is no ceiling dose. It is only limited by side effects. He said he would not continue this type of dose.”

146. The same representative “became concerned on March 18, 2010, when she realized that patients were being treated by . . . a registered nurse without prescribing

privileges, in [the doctor's] absence. According to [the representative], this 'was not an isolated incident.'"

147. The representatives' call notes showed other instances where Doctor-1 was absent during business hours, including a February 2010 incident when the doctor left in the middle of the day to get a tattoo.

148. The ADD program placed Doctor-1 on Region Zero and instructed sales representatives to cease calling on the doctor in August 2010.

149. However, in October 2011, Purdue informed sales representatives that they may resume calling on Doctor-1, and the sales representatives did so until the spring of 2018.

150. Purdue's detailing caused Doctor-1 to write medically unnecessary prescriptions for OxyContin, claims for which were submitted to Federal healthcare programs.

Doctor-2

151. From January 2010 to May 2018, Purdue representatives detailed Doctor-2 at least 260 times, although calls after February 2018 did not promote opioid products.

152. During this time, Doctor-2 caused Medicare claims for OxyContin, the overwhelming majority of which were for OxyContin 80mg tablets.

153. On September 23, 2003, a Purdue employee flagged Doctor-2 for ADD review stating, "Have you looked at the doctor with [the doctor's ME number]? This person is in specialty decile 7 and has about twice the volume as anyone else in that decile."

154. Purdue performed an ADD review in July 2004 after reviewing information showing the doctor had abnormally high opioid volume and a high percentage of cash-paying patients, and receiving reports that the doctor was under investigation for his opioid prescribing. The ADD team did not place Doctor-2 on the Region Zero list at that time.

155. Doctor-2's name came up again in 2008 and 2009 in connection with Purdue's internal investigation of a diverting pharmacy. The investigation revealed, in part, the following red flags regarding the pharmacy, including: it was a high traffic pharmacy; cars observed at the pharmacy had out of state plates; it had pharmacy clients loitering outside; it had pharmacy clients entering and exiting vehicles not their own; and it had pharmacy clients exchanging prescription drugs. As part of the investigation, Purdue identified Doctor-2 as one of the "Three (3) Main Doctors who prescribe for [pharmacy]," but undertook no further review of the doctor after this event.

156. Purdue sales representatives' call notes also identified ongoing concerns regarding abuse by the doctor's patients. For example, a 2010 call note stated: "Had a patient that died this week that was taking OxyContin (2 tablets of 80mg at Q12h). She was 45-48 years old and had been seen by [the doctor] for 10 years. The patient had complained previously (was reported) that the reformulation made her sick and tried to

get a refund for the reformulation (the pharmacy refused). She did find generic OxyContin. Patient was found dead sitting at the kitchen table with a syringe beside her. It has been ruled as an accidental death by the police.”

157. Following the reformulation of OxyContin, Doctor-2 was flagged for review by a December 2010 data analysis due to the doctor’s drop in Reformulated OxyContin prescription rates. Months after the analysis, on August 1, 2011, Purdue completed an ADD review, deciding to take no action based on Doctor-2’s explanation for why he stopped prescribing Reformulated OxyContin.

158. In early 2013, the state Board of Medical Examiners filed a complaint against Doctor-2 outlining his practice of prescribing OxyContin and other opioids outside the course of legitimate medical practice, which detailed the excessive amounts of OxyContin he prescribed to certain patients.

159. On February 27, 2013, a Purdue sales representative filed a ROC that Doctor-2 was subject to disciplinary action by the Board of Medical Examiners. On April 5, 2013, Doctor-2 was placed on the Region Zero list. Purdue representatives had detailed Doctor-3 146 times between 2007 and his addition to Region Zero in April 2013.

160. Although under ADD review since February 27, 2013, Purdue sales representatives called on Doctor-2 several more times until April 5, 2013.

161. Four months later, on August 26, 2013, a Purdue sales representative requested to resume calling on the doctor. In response, the ADD program wondered if it was “[t]oo soon to put him back on the list.” It initially recommended a “resume call” status due to a “lack of progress on the resolution of the board’s complaint and the doctor’s continuation in practice,” but, after further discussion, kept him on Region Zero.

162. In February 2015, the same Purdue sales representative again requested that the doctor be removed from the Region Zero list. The doctor was removed from the list on March 2015 after an “Expedited Review” of requests to resume calling on several high-volume doctors. Purdue sales representatives detailed Doctor-2 an additional 117 times between March 2015 and spring 2018, although calls after February 2018 did not promote opioid medications.

163. In sum, Purdue’s detailing caused Doctor-2 to write medically unnecessary prescriptions for OxyContin, claims for which were submitted to Federal healthcare programs.

Doctor-3

164. From January 2010 through March 2013, Purdue sales representatives detailed Doctor-3, who was, at one time, the highest volume Medicare prescriber of opioids in the nation, over 100 times. The majority of Doctor-3’s prescriptions were for 80 mg tablets.

165. Doctor-3 surrendered his medical and DEA licenses in 2013. In October 2016, Doctor-3 pled guilty to distribution of a controlled substance and healthcare fraud.

166. Over the course of a little over a year, Purdue's ADD program received at least five ROCs concerning Doctor-3. Additionally, Doctor-3's practice had numerous, easily identifiable indicia of abuse and diversion, including large numbers of high dosage patients, long lines of patients waiting outside his clinic, brief or nonexistent patient examinations, and drug transactions in the parking lot. Yet, Doctor-3 was not placed on Region Zero during this time period and sales representatives were directed to continue calling on him.

167. In fact, Doctor-3 was not placed on Region Zero at all until he lost his medical license and could no longer prescribe Purdue's opioids.

168. Purdue's detailing caused Doctor-3 to write medically unnecessary prescriptions for OxyContin, claims for which were submitted to Federal healthcare programs. . . .

VI. Kickbacks to Doctors to Induce and Reward Prescriptions

169. As an additional means to induce doctors to prescribe Purdue's opioid drugs, from 2010 through at least March 2018, Purdue paid kickbacks to certain prescribers in the form of speaker programs, advisory board memberships, research programs and honoraria.

170. Purdue allowed its sales and marketing personnel, who had data on each doctor's prescribing of Purdue's drugs and whose compensation depended on increasing their assigned doctors' prescribing of Purdue's drugs, to select speakers instead of Purdue's medical education staff.

171. Purdue also allowed its sales representatives to relay and endorse doctors' requests to be retained, and the doctors could be selected even if they had not been identified by the consulting company Purdue had retained for this purpose. Within Purdue, these were known as "unsolicited requests."

172. Purdue vested final authority to select doctors in Purdue's Marketing department, which had data on each doctor's Purdue prescriptions.

173. Purdue's list of speakers included providers that Purdue knew or should have known were writing prescriptions that were not for a medically accepted indication; for uses that were unsafe, ineffective, and medically unnecessary; and/or that were diverted for uses that lacked a legitimate medical purpose.

174. Under the processes described above, Purdue knowingly and willfully selected doctors to retain as paid corporate advisors and speakers specifically to induce them to prescribe and reward them for prescribing Purdue's drugs in violation of the Anti-Kickback Statute, 42 U.S.C. § 1320a-7b(b) (AKS).

175. For example:

a. Purdue paid the highest-volume OxyContin prescriber in the United States over \$160,000 between 2013 and May 2018 because he was, in the words of Purdue's employees, "the biggest prescriber in CT," "the #3 prescriber of opioids nationally," and "very important to our success," even after he indicated that if he stopped receiving speaking assignments from Purdue, "the love may be lost."

b. Purdue paid the highest-volume OxyContin prescriber in Medicare approximately \$475,000 between 2013 and January 2017 to deliver speeches and advice even though Purdue observed he was "not a strong speaker or presenter" and "attendees couldn't follow him," he engaged in "heavy prescribing, particularly in large doses for long periods of time," and was excluded by Florida Medicaid.

Purdue paid more than \$110,000 to a high-volume prescriber who demanded speaking assignments or else he would "re-evaluate the use of [Purdue's] products." . . .

Problem 6-3

Much more has been written, and remains to be written, about the opioid scandal, of course. Based on just the information in this chapter, what might this particular and massive problem teach us about the matter of corporate crime generally—as a matter of law, enforcement policy, corporate management, politics, etc.?

7. MANAGERIAL LIABILITY

Perhaps the most commonly expressed public frustration with the problem of corporate crime is the infrequency with which senior corporate managers face criminal prosecution even after serious and widespread crimes have been committed within a corporation. As the materials in this chapter will explore, the difficulty of such prosecutions primarily results from (1) the nature of the large corporation, and (2) fundamental principles about the limits of criminal law, which current debates about corporate responsibility may or may not cause to be altered in the longer run.²³

A. “Responsible Corporate Officer” Liability

The “responsible corporate officer” (RCO) doctrine is a special criminal law doctrine that, for corporate officers, relaxes requirements on two dimensions: (1) mens rea and (2) accessory liability. Think about the first-year criminal law course and consider whether the RCO doctrine is consistent with foundational principles in criminal law, including the mens rea and actus reus requirements traditionally associated with accomplice and conspiracy liability. Also, pay attention to the limits of RCO doctrine even under existing law—it is far from a vehicle for prosecutors to widely lock up corporate executives for scandals that occur on their watches.

The following case, *United States v. Park*, is the central Supreme Court decision that is cited for the existence of the RCO doctrine in criminal law. Following *Park* are a couple of cases from the circuit courts of appeals that show that the RCO doctrine is alive in other statutes and contemporary prosecutions as well. Note that the RCO doctrine is a *statutory* doctrine, and thus the cases that follow are exercises in statutory interpretation. Which statutes have the courts held to impose RCO liability? What are the doctrine’s contours and requirements? What kinds of facts are needed for managerial liability on this theory?

UNITED STATES v. PARK, 421 U.S. 658 (1975)

MR. CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari to consider whether the jury instructions in the prosecution of a corporate officer under § 301(k) of the Federal Food, Drug, and Cosmetic Act, 52 Stat. 1042, as amended, 21 U.S.C. § 331 (k), were appropriate under *United States v. Dotterweich*.

Acme Markets, Inc., is a national retail food chain with approximately 36,000 employees, 874 retail outlets, 12 general warehouses, and four special warehouses. Its headquarters, including the office of the president, respondent Park, who is chief

²³ For extended treatment of the problem, see Samuel W. Buell, *The Responsibility Gap in Corporate Crime*, 12 CRIMINAL LAW & PHILOSOPHY 471 (2018); Samuel W. Buell, *Criminally Bad Management* in RESEARCH HANDBOOK ON CORPORATE CRIME AND FINANCIAL MISDEALING (J. Arlen ed. 2018).

executive officer of the corporation, are located in Philadelphia, Pa. In a five-count information filed in the United States District Court for the District of Maryland, the Government charged Acme and respondent with violations of the Federal Food, Drug, and Cosmetic Act. Each count of the information alleged that the defendants had received food that had been shipped in interstate commerce and that, while the food was being held for sale in Acme's Baltimore warehouse following shipment in interstate commerce, they caused it to be held in a building accessible to rodents and to be exposed to contamination by rodents. These acts were alleged to have resulted in the food's being adulterated within the meaning of 21 U. S. C. §§ 342 (a) (3) and (4), in violation of 21 U. S. C. § 331 (k).

Acme pleaded guilty to each count of the information. Respondent pleaded not guilty. The evidence at trial demonstrated that in April 1970 the Food and Drug Administration (FDA) advised respondent by letter of insanitary conditions in Acme's Philadelphia warehouse. In 1971 the FDA found that similar conditions existed in the firm's Baltimore warehouse. An FDA consumer safety officer testified concerning evidence of rodent infestation and other insanitary conditions discovered during a 12-day inspection of the Baltimore warehouse in November and December 1971. He also related that a second inspection of the warehouse had been conducted in March 1972. On that occasion the inspectors found that there had been improvement in the sanitary conditions, but that "there was still evidence of rodent activity in the building and in the warehouses and we found some rodent-contaminated lots of food items."

The Government also presented testimony by the Chief of Compliance of the FDA's Baltimore office, who informed respondent by letter of the conditions at the Baltimore warehouse after the first inspection. There was testimony by Acme's Baltimore division vice president, who had responded to the letter on behalf of Acme and respondent and who described the steps taken to remedy the insanitary conditions discovered by both inspections. The Government's final witness, Acme's vice president for legal affairs and assistant secretary, identified respondent as the president and chief executive officer of the company and read a bylaw prescribing the duties of the chief executive officer. He testified that respondent functioned by delegating "normal operating duties," including sanitation, but that he retained "certain things, which are the big, broad, principles of the operation of the company," and had "the responsibility of seeing that they all work together."

Respondent was the only defense witness. He testified that, although all of Acme's employees were in a sense under his general direction, the company had an "organizational structure for responsibilities for certain function" according to which different phases of its operation were "assigned to individuals who, in turn, have staff and departments under them." He identified those individuals responsible for sanitation, and related that upon receipt of the January 1972 FDA letter, he had conferred with the vice president for legal affairs, who informed him that the Baltimore division vice president "was investigating the situation immediately and would be taking corrective action and would be preparing a summary of the corrective action to reply to the letter."

Respondent stated that he did not “believe there was anything [he] could have done more constructively than what [he] found was being done.”

On cross-examination, respondent conceded that providing sanitary conditions for food offered for sale to the public was something that he was “responsible for in the entire operation of the company,” and he stated that it was one of many phases of the company that he assigned to “dependable subordinates.” Respondent was asked about and, over the objections of his counsel, admitted receiving, the April 1970 letter addressed to him from the FDA regarding insanitary conditions at Acme’s Philadelphia warehouse. He acknowledged that, with the exception of the division vice president, the same individuals had responsibility for sanitation in both Baltimore and Philadelphia. Finally, in response to questions concerning the Philadelphia and Baltimore incidents, respondent admitted that the Baltimore problem indicated the system for handling sanitation “wasn’t working perfectly” and that as Acme’s chief executive officer he was responsible for “any result which occurs in our company.”

The jury found respondent guilty on all counts of the information, and he was subsequently sentenced to pay a fine of \$50 on each count. . . .

The question presented by the Government’s petition for certiorari in *United States v. Dotterweich, supra*, and the focus of this Court’s opinion, was whether “the manager of a corporation, as well as the corporation itself, may be prosecuted under the Federal Food, Drug, and Cosmetic Act of 1938 for the introduction of mis-branded and adulterated articles into interstate commerce.”

Central to the Court’s conclusion that individuals other than proprietors are subject to the criminal provisions of the Act was the reality that “the only way in which a corporation can act is through the individuals who act on its behalf.” The Court also noted that corporate officers had been subject to criminal liability under the Federal Food and Drugs Act of 1906, and it observed that a contrary result under the 1938 legislation would be incompatible with the expressed intent of Congress to “enlarge and stiffen the penal net” and to discourage a view of the Act’s criminal penalties as a “license fee for the conduct of an illegitimate business.”

At the same time, however, the Court was aware of the concern which was the motivating factor in the Court of Appeals’ decision, that literal enforcement “might operate too harshly by sweeping within its condemnation any person however remotely entangled in the proscribed shipment.” A limiting principle, in the form of “settled doctrines of criminal law” defining those who “are responsible for the commission of a misdemeanor,” was available. In this context, the Court concluded, those doctrines dictated that the offense was committed “by all who . . . have . . . a responsible share in the furtherance of the transaction which the statute outlaws.”

The Court recognized that, because the Act dispenses with the need to prove “consciousness of wrongdoing,” it may result in hardship even as applied to those who share “responsibility in the business process resulting in” a violation. It regarded as “too

treacherous” an attempt “to define or even to indicate by way of illustration the class of employees which stands in such a responsible relation.” The question of responsibility, the Court said, depends “on the evidence produced at the trial and its submission—assuming the evidence warrants it—to the jury under appropriate guidance.” The Court added: “In such matters the good sense of prosecutors, the wise guidance of trial judges, and the ultimate judgment of juries must be trusted.”

The rule that corporate employees who have “a responsible share in the furtherance of the transaction which the statute outlaws” are subject to the criminal provisions of the Act was not formulated in a vacuum. *Cf. Morissette v. United States*. Cases under the Federal Food and Drugs Act of 1906 reflected the view both that knowledge or intent were not required to be proved in prosecutions under its criminal provisions, and that responsible corporate agents could be subjected to the liability thereby imposed. Moreover, the principle had been recognized that a corporate agent, through whose act, default, or omission the corporation committed a crime, was himself guilty individually of that crime. The principle had been applied whether or not the crime required “consciousness of wrongdoing,” and it had been applied not only to those corporate agents who themselves committed the criminal act, but also to those who by virtue of their managerial positions or other similar relation to the actor could be deemed responsible for its commission.

In the latter class of cases, the liability of managerial officers did not depend on their knowledge of, or personal participation in, the act made criminal by the statute. Rather, where the statute under which they were prosecuted dispensed with “consciousness of wrongdoing,” an omission or failure to act was deemed a sufficient basis for a responsible corporate agent’s liability. It was enough in such cases that, by virtue of the relationship he bore to the corporation, the agent had the power to prevent the act complained of.

The rationale of the interpretation given the Act in *Dotterweich*, as holding criminally accountable the persons whose failure to exercise the authority and supervisory responsibility reposed in them by the business organization resulted in the violation complained of, has been confirmed in our subsequent cases. Thus, the Court has reaffirmed the proposition that “the public interest in the purity of its food is so great as to warrant the imposition of the highest standard of care on distributors.” *Smith v. California*. In order to make “distributors of food the strictest censors of their merchandise,” the Act punishes “neglect where the law requires care, or inaction where it imposes a duty.” *Morissette v. United States*. “The accused, if he does not will the violation, usually is in a position to prevent it with no more care than society might reasonably expect and no more exertion than it might reasonably exact from one who assumed his responsibilities.” Similarly, in cases decided after *Dotterweich*, the Courts of Appeals have recognized that those corporate agents vested with the responsibility, and power commensurate with that responsibility, to devise whatever measures are necessary to ensure compliance with the Act bear a “responsible relationship” to, or have a “responsible share” in, violations.

Thus *Dotterweich* and the cases which have followed reveal that in providing sanctions which reach and touch the individuals who execute the corporate mission—and this is by no means necessarily confined to a single corporate agent or employee—the Act imposes not only a positive duty to seek out and remedy violations when they occur but also, and primarily, a duty to implement measures that will insure that violations will not occur. The requirements of foresight and vigilance imposed on responsible corporate agents are beyond question demanding, and perhaps onerous, but they are no more stringent than the public has a right to expect of those who voluntarily assume positions of authority in business enterprises whose services and products affect the health and well-being of the public that supports them.

The Act does not, as we observed in *Dotterweich*, make criminal liability turn on “awareness of some wrong-doing” or “conscious fraud.” The duty imposed by Congress on responsible corporate agents is, we emphasize, one that requires the highest standard of foresight and vigilance, but the Act, in its criminal aspect, does not require that which is objectively impossible. The theory upon which responsible corporate agents are held criminally accountable for “causing” violations of the Act permits a claim that a defendant was “powerless” to prevent or correct the violation to “be raised defensively at a trial on the merits.” *United States v. Wiesenfeld Warehouse Co.* If such a claim is made, the defendant has the burden of coming forward with evidence, but this does not alter the Government’s ultimate burden of proving beyond a reasonable doubt the defendant’s guilt, including his power, in light of the duty imposed by the Act, to prevent or correct the prohibited condition. Congress has seen fit to enforce the accountability of responsible corporate agents dealing with products which may affect the health of consumers by penal sanctions cast in rigorous terms, and the obligation of the courts is to give them effect so long as they do not violate the Constitution.

We cannot agree with the Court of Appeals that it was incumbent upon the District Court to instruct the jury that the Government had the burden of establishing “wrongful action” in the sense in which the Court of Appeals used that phrase. The concept of a “responsible relationship” to, or a “responsible share” in, a violation of the Act indeed imports some measure of blameworthiness; but it is equally clear that the Government establishes a prima facie case when it introduces evidence sufficient to warrant a finding by the trier of the facts that the defendant had, by reason of his position in the corporation, responsibility and authority either to prevent in the first instance, or promptly to correct, the violation complained of, and that he failed to do so. The failure thus to fulfill the duty imposed by the interaction of the corporate agent’s authority and the statute furnishes a sufficient causal link. The considerations which prompted the imposition of this duty, and the scope of the duty, provide the measure of culpability.

Turning to the jury charge in this case, it is of course arguable that isolated parts can be read as intimating that a finding of guilt could be predicated solely on respondent’s corporate position. But this is not the way we review jury instructions, because “a single instruction to a jury may not be judged in artificial isolation, but must be viewed in the context of the overall charge.” *Cupp v. Naughten*.

Reading the entire charge satisfies us that the jury's attention was adequately focused on the issue of respondent's authority with respect to the conditions that formed the basis of the alleged violations. Viewed as a whole, the charge did not permit the jury to find guilt solely on the basis of respondent's position in the corporation; rather, it fairly advised the jury that to find guilt it must find respondent "had a responsible relation to the situation," and "by virtue of his position . . . had . . . authority and responsibility" to deal with the situation. The situation referred to could only be "food . . . held in unsanitary conditions in a warehouse with the result that it consisted, in part, of filth or . . . may have been contaminated with filth."

Moreover, in reviewing jury instructions, our task is also to view the charge itself as part of the whole trial. "Often isolated statements taken from the charge, seemingly prejudicial on their face, are not so when considered in the context of the entire record of the trial." *United States v. Birnbaum*. The record in this case reveals that the jury could not have failed to be aware that the main issue for determination was not respondent's position in the corporate hierarchy, but rather his accountability, because of the responsibility and authority of his position, for the conditions which gave rise to the charges against him.

We conclude that, viewed as a whole and in the context of the trial, the charge was not misleading and contained an adequate statement of the law to guide the jury's determination. . . .

UNITED STATES v. BRITAIN, 931 F.2d 1413 (10th Cir. 1991)

BALDOCK, Circuit Judge:

A jury convicted defendant-appellant, Raymond T. Britain, of eighteen felony counts of falsely reporting a material fact to a government agency, 18 U.S.C. § 1001, and two misdemeanor counts of discharging pollutants into the waters of the United States in violation of §§ 301(a) & 309(c)(1) of the Federal Water Pollution Control Act of 1972 (Clean Water Act), codified at 33 U.S.C. §§ 1311(a) & 1319(c)(1). Defendant appeals, contending: (1) the government did not establish materiality as required by 18 U.S.C. § 1001; (2) he is not a "person" who discharged pollutants as contemplated by the Clean Water Act; and (3) the evidence is insufficient to prove that he discharged pollutants in violation of the Clean Water Act. We affirm. . . .

In 1984, the city of Enid obtained a renewed NPDES permit from the EPA to discharge pollutants from the city's wastewater treatment plant into nearby Boggy Creek. The original NPDES permit provided for two discharge point sources, outfalls 001 and 002; whereas the new permit allowed for only one discharge point source, outfall 001. Discharges from outfall 002, although expressly prohibited by the renewed NPDES permit, continued during times of heavy rain. The discharges resulted from a thirty-six-inch bypass pipe which would divert raw sewage through outfall 002 when heavy rain caused excess water to flow through the sewage system. The evidence reveals that the plant supervisor informed defendant, in defendant's capacity as public utilities director,

that the plant was discharging raw sewage from outfall 002, and that defendant physically observed two such discharges in January and August 1986. Moreover, the evidence reveals that defendant instructed the plant supervisor not to report the discharges to the EPA as required by the permit. The jury convicted defendant on two counts pursuant to 33 U.S.C. §§ 1311(a) & 1319(c) for the January and August 1986 permit violations.

As stated above, § 1311(a) of the Clean Water Act prohibits “any person” from discharging “any pollutant” into the waters of the United States except as authorized by the EPA or an EPA authorized state agency. The EPA authorizes certain discharges pursuant to the NPDES permitting system. *See* § 1342. At the time of the indictment period, § 1319(c) provided for criminal sanctions for “any person” who “willfully or negligently” violated § 1311(a) or any NPDES permit. This case involves a “willful or negligent” violation of an NPDES permit.

Defendant claims . . . he is not a “person” as contemplated by §§ 1319(c) & 1362(5) of the Clean Water Act. . . .

As with any question of statutory interpretation, we must begin with the language of the statutes. If the statutory language “is unambiguous and free of irrational result, that language controls.” *United States v. Morgan* (quoting *Glenpool Util. Servs. Auth. v. Creek County Rural Water Dist.*, *cert. denied*). The plain language of the relevant statute includes “individuals” in the definition of “persons” subject to the Clean Water Act. *See* § 1362(5). Defendant certainly is an “individual.” Section 1311(a) prohibits “any person”—any “individual” according to § 1362(5)—from discharging pollutants except as in accordance with an NPDES permit or other specified provisions in the Act. Section 1319(c), at the time of the indictment, provided for criminal sanctions for “any person”—“any individual”—who “willfully or negligently” caused such a violation. Thus, it appears that defendant, as an “individual,” is subject to criminal liability under the Act.

Defendant, however, contends that an “individual” is subject to § 1319(c)’s criminal sanctions for NPDES permit violations only if he is the permittee. As support for this interpretation, he points to § 1319(c)(3)’s addition of “responsible corporate officers” to the Act’s general definition of “persons” as contained in § 1362(5). He argues that § 1319(c)(3)’s addition of “responsible corporate officers” is meaningless if § 1362(5) already makes “persons” of “individuals” who merely are related to discharging permittees. Accordingly, he argues, he is not a “person” subject to criminal liability because the government did not prove that he was the permittee or a “responsible corporate officer” of the discharging permittee.

Section 1319(c)(3) does not define a “responsible corporate officer” and the legislative history is silent regarding Congress’s intention in adding the term. The Supreme Court, however, first recognized the concept of “responsible corporate officer” in 1943. *See United States v. Dotterweich*. The *Dotterweich* Court held that a corporation’s misdemeanor offense under the Federal Food, Drug, and Cosmetic Act of 1938 (FDCA)

was committed by all corporate officers “who do have . . . a responsible share in the furtherance of the transaction which the statute outlaws . . . though consciousness of wrongdoing be totally wanting.” *See also United States v. Park; United States v. Cattle King Packing Co.*, *cert. denied*; 21 U.S.C. § 333(a) (misdemeanor criminal responsibility under FDCA does not require “consciousness of wrongdoing”). The rationale for this harsh rule lay in the type of legislative action that the *Dotterweich* Court was interpreting. Congress passed the FDCA in order to protect the public health, and, according to the Court, Congress perceived the public health interest to outweigh the hardship suffered by criminally liable responsible corporate officers who had no consciousness of wrongdoing. *Dotterweich*. The same rationale applies to the Clean Water Act. Congress intended, with the Act, “to restore and maintain the chemical, physical, and biological integrity of the Nation’s waters . . . [and that] the discharge of pollutants into the navigable waters be eliminated by 1985.” 33 U.S.C. § 1251(a). We think that Congress perceived this objective to outweigh hardships suffered by “responsible corporate officers” who are held criminally liable in spite of their lack of “consciousness of wrongdoing.” We interpret the addition of “responsible corporate officers” as an expansion of liability under the Act rather than, as defendant would have it, an implicit limitation. The plain language of the statute, after all, states that “responsible corporate officers” are liable “*in addition to* the definition [of persons] contained in section 1362(5). . . .” § 1319(c)(3). Under this interpretation, a “responsible corporate officer,” to be held criminally liable, would not have to “willfully or negligently” cause a permit violation. Instead, the willfulness or negligence of the actor would be imputed to him by virtue of his position of responsibility. This in no way limits other “persons,” as defined by § 1362(5), to permittees. The statute plainly states that any “person,” permittee or nonpermittee, who causes a permit violation through willful or negligent conduct, is subject to criminal sanctions. We hold that defendant, as an “individual,” is a “person” subject to criminal liability under the Act. . . .

UNITED STATES v. DECOSTER, 828 F.3d 626 (8th Cir. 2016)

MURPHY, Circuit Judge:

Austin “Jack” DeCoster and Peter DeCoster both pled guilty, as “responsible corporate officers” of Quality Egg, LLC, to misdemeanor violations of 21 U.S.C. § 331(a) for introducing eggs that had been adulterated with salmonella enteritidis into interstate commerce. The district court sentenced Jack and Peter to three months imprisonment. The DeCosters appeal, arguing that their prison sentences and 21 U.S.C. § 333(a)(1) are unconstitutional. . . . We affirm.

Jack DeCoster owned Quality Egg, LLC, an Iowa egg production company. Jack’s son Peter DeCoster served as the company’s chief operating officer. Quality Egg operated six farm sites with 73 barns which were filled with five million egg laying hens. It also had 24 barns which were filled with young chickens that had not yet begun to lay eggs. Additionally, the company owned several processing plants where eggs were cleaned, packed, and shipped.

Jack also owned and operated several egg production companies in Maine, and Peter worked at those facilities. In 2008, salmonella enteritidis (“salmonella”) tests conducted at the Maine facilities came back positive. The DeCosters succeeded in eliminating salmonella from their Maine facilities by following the recommendations of hired consultants, including poultry disease specialist Dr. Charles Hofacre and rodent control expert Dr. Maxcy Nolan.

Periodically the DeCosters also tested the Iowa hens and facilities for salmonella. Some of these tests came back positive in 2006, and the positive test results increased in frequency through the fall of 2010. Until the USDA adopted its new egg safety rule in July 2010, Quality Egg was not legally obligated to conduct salmonella tests of its eggs after receiving positive environmental test results. Nevertheless, Quality Egg tested its eggs in April 2009 after being notified that a Minnesota restaurant purchaser had had a salmonella outbreak. The sample of its eggs tested negative for salmonella.

Other than conducting the single egg test in April 2009, Quality Egg did not test or divert eggs from the market before July 2010 despite receiving multiple positive environmental and hen test results. In 2009 the DeCosters hired Dr. Hofacre and Dr. Nolan to consult on the company’s Iowa operations. The consultants recommended implementing the same measures in Iowa as had been used in Maine. Although the DeCosters claim they adopted all of the recommendations, the precautions implemented by Quality Egg failed to eradicate salmonella. The Centers for Disease Control and Prevention estimated that about 56,000 Americans fell ill with salmonellosis in 2010 after consuming contaminated eggs. In August 2010, federal and state officials determined that the salmonella outbreak had originated at Quality Egg’s facilities. In response Quality Egg recalled eggs that had been shipped from five of its six Iowa farm sites between May and August 2010.

The FDA inspected the Quality Egg operations in Iowa from August 12–30, 2010. Investigators discovered live and dead rodents and frogs in the laying areas, feed areas, conveyer belts, and outside the buildings. They also found holes in the walls and baseboards of the feed and laying buildings. The investigators discovered that some rodent traps were broken, and others had dead rodents in them. In one building near the laying hens, manure was found piled to the rafters; it had pushed a screen out of the door which allowed rodents into the building. Investigators also observed employees not wearing or changing protective clothing and not cleaning or sanitizing equipment.

The FDA concluded that Quality Egg had failed to comply with its written plans for biosecurity and salmonella prevention. One government expert reported that “there were minimal to no records from the poultry [] barns to indicate that company personnel [had] implemented the written plans [to eliminate salmonella].” The agency also discovered that the company’s eggs tested positive for salmonella at a rate of contamination approximately 39 times higher than the current national rate, and that the contamination had spread throughout all of the Quality Egg facilities. In October 2010 the FDA

instructed Quality Egg to euthanize every hen, remove the manure, repair its facilities, and disinfect its barns to prevent the risk of another outbreak.

The government then began a criminal investigation of the company's food safety practices and ultimately filed a criminal information against Quality Egg and both of the DeCosters. The investigation revealed that Quality Egg previously had falsified records about food safety measures and had lied to auditors for several years about pest control measures and sanitation practices. Although its food safety plan stated that Quality Egg performed flock testing to identify and control salmonella, no flock testing was ever done. Quality Egg employees had also bribed a USDA inspector in 2010 to release eggs for sale which had been retained or "red tagged" for failing to meet minimum quality grade standards. Quality Egg also misled state regulators and retail customers by changing the packing dates of its eggs and selling the misbranded eggs into interstate commerce. The parties additionally stipulated that one Quality Egg employee was prepared to testify at trial that Jack DeCoster had once reprimanded him because he had not moved a pallet of eggs in time to avoid inspection by the USDA. The investigation also revealed that in 2008 Peter DeCoster had made inaccurate statements to Walmart about Quality Egg's food safety and sanitation practices. . . .

Before sentencing, the DeCosters argued that sentences of incarceration would be unconstitutional because they had not known that the eggs were contaminated at the time they were shipped. The district court denied the motions, imposed \$100,000 fines on both Jack and Peter DeCoster and sentenced them to three months imprisonment. *See* 21 U.S.C. § 333(a)(1) (explaining that anyone who violates section 331 "shall be imprisoned for not more than one year or fined not more than \$1,000, or both"); 18 U.S.C. § 3571(b)(5) (setting maximum fine of \$100,000 for class A misdemeanor not resulting in death). The court determined that although nothing in the record indicated that Peter and Jack had actual knowledge that the eggs they sold were infected with salmonella, the record demonstrated that their safety and sanitation procedures were "egregious," that they ignored the positive salmonella environmental test results before July 2010 by not testing their eggs, and that they knew that their employees had deceived and bribed USDA inspectors. The district court explained that the record supported the inference that the DeCosters had "created a work environment where employees not only felt comfortable disregarding regulations and bribing USDA officials, but may have even felt pressure to do so." The district court accordingly concluded that this was not a case involving "a mere unaware corporate executive." . . .

The DeCosters . . . argue that the penalty of incarceration of any length for this misdemeanor offense would violate substantive due process. *See Zadvydas v. Davis*; *see also United States v. Greenbaum* (concluding that three month prison sentence for corporate officer's FDCA misdemeanor violation did not violate due process); *United States v. Higgins* (same for nine month prison sentence).

We review de novo a substantive due process claim. *United States v. Clemmons*. The DeCosters argue that their prison sentences are unconstitutional because they did not

personally commit wrongful acts. They analogize this case to others where courts have determined that due process is violated when prison terms are imposed for vicarious liability crimes. *See Lady J. Lingerie; State v. Guminga; Davis v. City of Peachtree City; Commonwealth v. Koczwarra*. The Eleventh Circuit explained in *Lady J.* that “due process prohibits the state from imprisoning a person without proof of some form of personal blameworthiness more than a ‘responsible relation.’”

Officer liability under the FDCA, however, is not equivalent to vicarious liability. *See Park*. Under vicarious liability, a supervisory party is held liable “for the actionable conduct of a subordinate . . . based on the relationship between the two parties.” *Liability*, Black’s Law Dictionary (10th ed. 2014). Under the FDCA, in contrast, a corporate officer is held accountable not for the acts or omissions of others, but rather for his own failure to prevent or remedy “the conditions which gave rise to the charges against him.” *See Park*. Thus, “some measure of blameworthiness” is “import[ed]” directly to the corporate officer.

Here, as owner of Quality Egg, Jack decided which barns were subject to salmonella environmental testing, and as chief operating officer, Peter coordinated many of the company’s salmonella prevention and rodent control efforts. Neither of the DeCosters claim to have been “powerless” to prevent Quality Egg from violating the FDCA. *See id.* Despite their familiarity with the conditions in the Iowa facilities, they failed to take sufficient measures to improve them. On this record, the district court reasonably found that “the defendants ‘knew or should have known,’ of the risks posed by the insanitary conditions at Quality Egg in Iowa, ‘knew or should have known’ that additional testing needed to be performed before the suspected shell eggs were distributed to consumers, and ‘knew or should have known’ of [] proper remedial and preventative measures to reduce the presence of [salmonella].” The FDCA “punishes neglect where the law requires care.” (internal quotation marks omitted). We conclude that the record here shows that the DeCosters are liable for negligently failing to prevent the salmonella outbreak. *See id.* (reading majority opinion in *Park* as establishing a negligence standard).

The DeCosters argue that their prison sentences also violate the Due Process Clause because they did not know that the eggs the company distributed had salmonella. We have explained that “the imposition of severe penalties, especially a felony conviction, for the commission of a morally innocent act may violate” due process. *See United States v. Enochs*. The elimination of a mens rea requirement does not violate the Due Process Clause for a public welfare offense where the penalty is “relatively small,” the conviction does not gravely damage the defendant’s reputation, and congressional intent supports the imposition of the penalty. *See Staples v. United States* (citing *Morissette v. United States; Holdridge v. United States*).

The three month prison sentences the DeCosters received were relatively short. *See Staples*. We have previously determined that even a maximum statutory penalty of one year imprisonment for a misdemeanor offense is “relatively small” and does not violate

due process. See *United States v. Flum*; cf. *United States v. Wulff* (concluding that a felony conviction which carried a penalty of a maximum of two years imprisonment was not relatively small).

The DeCosters' misdemeanor convictions also do not gravely damage their reputations. In *Flum*, we explained that a misdemeanor conviction under a federal law which provided for a maximum imprisonment of one year did not gravely "besmirch" the defendant's reputation because it did not brand him as a "felon or subject him to any burden beyond the sentence imposed." cf. *Wulff* (felony conviction would irreparably damage a defendant's reputation because a felon loses his civil rights). Similarly in this case, the DeCosters will not be branded as felons, and the record does not identify any additional civil sanctions they may be subject to beyond their sentences. Finally, the elimination of criminal intent under 21 U.S.C. § 333(a) did not violate due process because, as the Supreme Court has explained, "Congress has seen fit to enforce the accountability of responsible corporate agents dealing with products which may affect the health of consumers by penal sanctions cast in rigorous terms." *Park*.

The dissent argues that we must treat the FDCA, 21 U.S.C. §§ 331(a), 333(a)(1), as requiring a defendant to know he violated the statute in order to be subject to its penalties because the statute has "no express congressional statement" to omit a mens rea requirement. We rely however "on the nature of the statute and the particular character of the items regulated to determine whether congressional silence concerning the mental element of the offense should be interpreted as dispensing with conventional mens rea requirements." *Staples*. The FDCA regulates services and products which affect the health and well being of the public. For this reason, Congress has not required "awareness of some wrongdoing" in order to hold responsible corporate agents accountable for violating the statute. *Park* (internal quotation marks omitted). Although the "requirements of foresight and vigilance imposed on responsible corporate agents [in 21 U.S.C. § 331(a)] are beyond question demanding, and perhaps onerous, [] they are no more stringent" than required to protect the unknowing public from consuming hazardous food, such as salmonella infected eggs. The language in the FDCA and Supreme Court precedent interpreting the statute support the conclusion that defendants are not required to have known that they violated the FDCA to be subject to the statutory penalties. . . .

GRUENDER, Circuit Judge, concurring.

The DeCosters do not challenge either the constitutionality of § 331(a) or the sufficiency of the factual basis for their pleas. Rather, they claim that due process concerns prevent them from being sentenced to prison for a crime involving no mens rea on their part because it is based solely on their positions as responsible corporate officers—i.e., vicarious liability. I agree with the dissent that imprisonment based on vicarious liability would raise serious due process concerns. However, because the district court found the DeCosters negligent, they were not held vicariously liable for violations committed by others, and this case thus does not implicate these concerns. I therefore concur in the

judgment and join Judge Murphy's opinion to the extent that it recognizes that the DeCosters were negligent. I write separately in order to make clear my view that *Park* requires a finding of negligence in order to convict a responsible corporate officer under § 331. . . .

BEAM, Circuit Judge, dissenting.

Austin (Jack) and Peter DeCoster, entered pleas of guilty because their corporation sold eggs contaminated by a strain of salmonella enteritidis bacteria during a period of time extending "[b]etween about the beginning of 2010 and in or about August 2010." The government contends that these were federal misdemeanor offenses under 21 U.S.C. § 331(a) and § 333(a)(1). As noted by the district court, they were at the time of the alleged offenses the two ranking corporate officers of Quality Egg, LLC (Quality Egg)—Jack being the trustee of the trust that owned Quality Egg and Peter, his son, being the Chief Operating Officer of this multistate corporate enterprise.

At all relevant times, Quality Egg operated six Iowa farms with 73 barns filled with 5 million laying hens and 24 barns filled with young chicks that had not begun to lay eggs. Quality Egg also had several processing plants where eggs were cleaned, packed, and shipped. Jack also owned several other egg-production companies in the state of Maine where Peter apparently spent part of his working time. Collectively, these were large, diverse, and labor-intensive agricultural operations requiring several levels and areas of management, as well as a substantial number of "hands-on" production workers. . . .

The record discloses that salmonella contamination of eggs sold by Quality Egg was the sole basis for adulteration claims under § 331(a) concerning the DeCosters as individuals. Given such factual predicate, the government stipulated that "[t]o date" (April 18, 2014), "the government's investigation has not identified any personnel employed by or associated with Quality Egg, including the defendant[s], who had knowledge during the [charged] time frame from January 2010 through August 12, 2010, that eggs sold by Quality Egg were, in fact, contaminated with *Salmonella* [*Enteritidis*]. Further, the government conceded that the criminal complaint against the DeCosters as executives of Quality Egg was animated by salmonella-prevention regulations published by the FDA on July 9, 2009, but not placed in force until July 9, 2010, through adoption of an Egg Safety Rule. The government also stipulated that "until adoption of the Egg Safety Rule in July 2010, there was no legal or regulatory requirement" for Quality Egg to comply with these regulations. The record also establishes that, given the state of the art of poultry-sanitation management, egg-safety difficulties, especially involving salmonella contamination, are inherent in such operations.

In short, large numbers of employees and supervisors were needed and employed by Quality Egg in an attempt to avoid problems with this ubiquitous pathogen. Thus, the misdemeanor convictions found and imposed by the district court in response to the DeCosters' very limited guilty pleas amounted to crimes and sentences based upon almost wholly nonculpable conduct.

On the record and the stipulated facts, it is also clear that the DeCosters lacked the necessary mens rea or “guilty mind,” that is “[t]he state of mind that the prosecution, to secure a conviction, must prove that a defendant had when committing a crime,” *Mens Rea*, Black’s Law Dictionary (10th ed. 2014). This mens rea requirement is especially applicable when the crime, as here, is punished by imprisonment. Although § 333(a)(1) purports to authorize a criminal misdemeanor sentence of “imprison[ment] for not more than one year,” the DeCosters’ presentence motions to preclude any such sentence of imprisonment based upon the vicarious-liability standard the district court applied should have been granted.

The Fifth Amendment Due Process Clause forbids the government from depriving any person of liberty without due process of law. “Freedom from imprisonment—from government custody, detention, or other forms of physical restraint—lies at the heart of the liberty that Clause protects.” *Zadvydas v. Davis*. Such a due process violation as attends the DeCosters’ prison sentence is well illustrated in *Staples v. United States*. Under the National Firearms Act, 26 U.S.C. §§ 5801–5872, any fully automatic weapon is a “firearm” within the meaning of the statute. *Staples*. The Act, in turn, makes it a crime to possess a firearm that is not registered. Staples possessed an unregistered semi-automatic rifle that, unbeknownst to him, had been modified to permit automatic firing. Upon prosecution under the Act, the district court ruled that the government did not have to prove that Staples knew the weapon fired automatically because of the modification by someone else. He was convicted and sentenced to prison.

On appeal, the Supreme Court reversed, saying “we must construe [an imprisonment] statute in light of the background rules of the common law in which the requirement of some *mens rea* for a crime is firmly embedded.” While the government argued, as it does in this case, that a presumption of the need for a finding of mens rea did not apply in *Staples*, the Supreme Court rejected the argument and reversed, holding that Staples’s lack of knowledge of the weapon’s capability of automatic fire prohibited his conviction and prison sentence. . . .

There is, of course, no express congressional statement to the contrary contained in § 331(a) or § 333(a)(1). While it might be possible to concoct an actionable interpretation of § 333(a)(1) that omits a mens rea requirement, Congress has no power to enact a federal statute that violates the Fifth Amendment Due Process Clause. . . .

[T]he court validates the district court’s prison sentence based upon the DeCosters’ supposed negligence in performing executive functions on behalf of Quality Egg. However, there is no precedent that supports imprisonment without establishing some measure of a guilty mind on the part of these two individuals, and none is established in this case. The government concedes in the DeCosters’ plea agreements that they did not know that any eggs distributed by Quality Egg at any relevant times “were, in fact, contaminated with *Salmonella* [*Enteritidis*].” Indeed, the plea agreements explicated above further concede that no person associated with Quality Egg had knowledge of salmonella contamination at any relevant time. And when first alerted to the problem by

the FDA in August of 2010, Quality Egg immediately, and at great expense, voluntarily recalled “hundreds of millions of shell eggs produced at Quality Egg’s facilities.” This is hardly the stuff of “guilty minds.” . . .

There is no proof that the DeCosters, as individuals, were infected with a “guilty mind” or, perhaps, even with negligence. Clearly, the improvident prison sentences imposed in this case were due process violations. . . .

Many observers expected the *DeCoster* case to get Supreme Court review. Certiorari, however, was denied. With respect to the current status of the RCO doctrine, it is reasonable to ask (1) whether the Supreme Court’s future approval of the doctrine, as reflected in *Dotterweich* and *Park*, would be contingent on the nature of the penalty imposed on any individual convicted on the RCO theory, and additionally (2) whether the present Court might wholly reject the doctrine as unconstitutional.

B. Theories of Supervisory Liability Beyond the RCO Doctrine?

Consider the following items—two pieces of legislation (the first an enacted UK statute; the second a proposed but not enacted US bill) and one case—(1) in terms of the problem of managerial criminal responsibility and (2) in light of general principles of criminal responsibility you learned in introductory criminal law.

UK Financial Services (Banking Reform) Act 2013

Section 36. Offence relating to a decision causing a financial institution to fail.

(1) A person (“S”) commits an offence if—

(a) at a time when S is a senior manager in relation to a financial institution (“F”), S—

(i) takes, or agrees to the taking of, a decision by or on behalf of F as to the way in which the business of a group institution is to be carried on, or

(ii) fails to take steps that S could take to prevent such a decision being taken,

(b) at the time of the decision, S is aware of a risk that the implementation of the decision may cause the failure of the group institution,

(c) in all the circumstances, S’s conduct in relation to the taking of the decision falls far below what could reasonably be expected of a person in S’s position, and

(d) the implementation of the decision causes the failure of the group institution.

(2) A “group institution”, in relation to a financial institution (“F”), means F or any other financial institution that is a member of F’s group for the purpose of FSMA 2000 (see section 421 of that Act).

(3) Subsections (1) and (2) are to be read with the interpretative provisions in section 37.

(4) A person guilty of an offence under this section is liable—

(a) on summary conviction—

(i) in England and Wales, to imprisonment for a term not exceeding 12 months (or 6 months, if the offence was committed before the commencement of section 154(1) of the Criminal Justice Act 2003) or a fine, or both;

(ii) in Scotland, to imprisonment for a term not exceeding 12 months or a fine not exceeding the statutory maximum, or both;

(iii) in Northern Ireland, to imprisonment for a term not exceeding 6 months or a fine not exceeding the statutory maximum, or both;

(b) on conviction on indictment, to imprisonment for a term not exceeding 7 years or a fine, or both.

Section 37: interpretation

(1) This section has effect for the interpretation of section 36.

(2) “Financial institution” means a UK institution which—

(a) meets condition A or B, and

(b) is not an insurer or a credit union.

(3) Condition A is that it has permission under Part 4A of FSMA 2000 to carry on the regulated activity of accepting deposits.

(4) Condition B is that—

(a) it is for the purposes of FSMA 2000 an investment firm (see section 424A of that Act),

(b) it has permission under Part 4A of that Act to carry on the regulated activity of dealing in investments as principal, and

(c) when carried on by it, that activity is a PRA-regulated activity.

(5) In subsection (2)—

(a) “UK institution” means an institution which is incorporated in, or formed under the law of any part of, the United Kingdom;

(b) “insurer” means an institution which is authorised under FSMA 2000 to carry on the regulated activity of effecting or carrying out contracts of insurance as principal;

(c) “credit union” means a credit union as defined by section 31 of the Credit Unions Act 1979 or a credit union as defined by Article 2(2) of the Credit Unions (Northern Ireland) Order 1985.

(6) Subsections (3), (4) and (5)(b) are to be read in accordance with sections 22 and 22A of FSMA 2000, taken with Schedule 2 to that Act and any order under section 22.

(7) A person is a “senior manager” in relation to a financial institution if, under an arrangement entered into by the institution, or by a contractor of the institution, in relation to the carrying on by the institution of a regulated activity, the person performs a senior management function.

(8) A “senior management function” is a function designated as such—

(a) by the FCA under subsection (6A) of section 59 of FSMA 2000 (approval for particular arrangements), or

(b) by the PRA under subsection (6B) of that section.

(9) A financial institution (“F”) is to be regarded as failing where—

(a) F enters insolvency,

(b) any of the stabilisation options in Part 1 of the Banking Act 2009 is achieved in relation to F, or

(c) F is taken for the purposes of the Financial Services Compensation Scheme to be unable, or likely to be unable, to satisfy claims against F.

(10) In subsection (9)(a) “insolvency” includes—

(a) bankruptcy,

(b) liquidation,

(c) bank insolvency,

(d) administration,

(e) bank administration,

(f) receivership,

(g) a composition between F and F’s creditors, and

(h) a scheme of arrangement of F’s affairs.

113th CONGRESS, 2d Session

A BILL

To establish criminal penalties for failing to inform and warn of serious dangers.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. CRIMINAL PENALTIES.

(a) IN GENERAL.—Part I of title 18, United States Code, is amended by inserting after chapter 101 the following:

“CHAPTER 101A—REPORTING STANDARDS

“Sec.

“2081. Definitions.

“2082. Failure to inform and warn.

“§ 2081. Definitions

“In this chapter—

“(1) the term ‘appropriate Federal agency’ means an agency with jurisdiction over a covered product, covered service, or business practice;

“(2) the term ‘business entity’ means a corporation, company, association, firm, partnership, sole proprietor, or other business entity;

“(3) the term ‘business practice’ means a method or practice of—

“(A) manufacturing, assembling, designing, researching, importing, or distributing a covered product;

“(B) conducting, providing, or preparing to provide a covered service; or

“(C) otherwise carrying out business operations relating to covered products or covered services;

“(4) the term ‘covered product’ means a product manufactured, assembled, designed, researched, imported, or distributed by a business entity that enters interstate commerce;

“(5) the term ‘covered service’ means a service conducted or provided by a business entity that enters interstate commerce;

“(6) the term ‘responsible corporate officer’ means a person who—

“(A) is an employer, director, or officer of a business entity;

“(B) has the responsibility and authority, by reason of his or her position in the business entity and in accordance with the rules or practice of the business entity, to acquire knowledge of any serious danger associated with a covered product (or component of a covered product), covered service, or business practice of the business entity; and

“(C) has the responsibility, by reason of his or her position in the business entity, to communicate information about the serious danger to—

“(i) an appropriate Federal agency;

“(ii) employees of the business entity;

or

“(iii) individuals, other than employees of the business entity, who may be exposed to the serious danger;

“(7) the term ‘serious bodily injury’ means an impairment of the physical condition of an individual, including as a result of trauma, repetitive motion, or disease, that—

“(A) creates a substantial risk of death; or

“(B) causes—

“(i) serious permanent disfigurement;

“(ii) unconsciousness;

“(iii) extreme pain; or

“(iv) permanent or protracted loss or impairment of the function of any bodily member, organ, bodily system, or mental faculty;

“(8) the term ‘serious danger’ means a danger, not readily apparent to a reasonable person, that the normal or reasonably foreseeable use of, or the exposure of an individual to, a covered product, covered service, or business practice has an imminent risk of causing death or serious bodily injury to an individual; and

“(9) the term ‘warn affected employees’ means take reasonable steps to give, to each individual who is exposed or may be exposed to a serious danger in the course of work for a business entity, a description of the serious danger that is sufficient to make the individual aware of the serious danger.

“§ 2082. Failure to inform and warn

“(a) REQUIREMENT.—After acquiring actual knowledge of a serious danger associated with a covered product (or component of a covered product), covered service, or business practice of a business entity, a business entity and any responsible corporate officer with respect to the covered product, covered service, or business practice, shall—

“(1) as soon as practicable and not later than 24 hours after acquiring such knowledge, verbally inform an appropriate Federal agency of the serious danger, unless the business entity or responsible corporate officer has actual knowledge that an appropriate Federal agency has been so informed;

“(2) not later than 15 days after acquiring such knowledge, inform an appropriate Federal agency in writing of the serious danger;

“(3) as soon as practicable, warn affected employees in writing, unless the business entity or responsible corporate officer has actual knowledge that affected employees have been so warned; and

“(4) as soon as practicable, inform individuals, other than affected employees, who may be exposed to the serious danger of the serious danger if such individuals can reasonably be identified.

“(b) PENALTY.—

“(1) IN GENERAL.—Whoever knowingly violates subsection (a) shall be fined under this title, imprisoned for not more than 5 years, or both.

“(2) PROHIBITION OF PAYMENT BY BUSINESS ENTITIES.—If a final judgment is rendered and a fine is imposed on an individual under this subsection, the fine may not be paid, directly or indirectly, out of the assets of any business entity on behalf of the individual. . . .

The problem with criminal liability for senior managers in connection with corporate scandals is one of both actus reus (distance from the conduct involved in the relevant harm or risk) and mens rea (lack of detailed knowledge or clear intent with regard to the conduct involved in the relevant harm or risk). An additional problem is the normative question of whether recklessness or negligence should be a sufficient basis for criminal punishment in the business context.

Consider the following case in terms of the defendant's mental state and his level of mens rea: intent, knowledge, recklessness, or something else. Also consider the court's discussion of the meaning of the mens rea term "willfulness" in light of that term's treatment in other contexts, such as the *Bank of New England* case in Chapter 1, as well as the efforts of some courts in the context of fraud to describe an elevated level of mens rea such as "specific intent to defraud" or "consciousness of wrongdoing," as discussed in Chapter 2.

UNITED STATES v. BLANKENSHIP, 846 F.3d 663 (4th Cir. 2017)

WYNN, Circuit Judge:

Defendant Donald Blankenship ("Defendant"), former chairman and chief executive officer of Massey Energy Company ("Massey"), makes four arguments related to his conviction for conspiring to violate federal mine safety laws and regulations. After careful review, we conclude the district court committed no reversible error. Accordingly, we affirm.

This case arises from a tragic accident on April 5, 2010 at the Upper Big Branch coal mine in Montcoal, West Virginia, which caused the death of 29 miners. Massey owned and operated the Upper Big Branch mine.

In the years leading up to the accident, the federal Mine Safety & Health Administration (the "Mine Safety Administration") repeatedly cited Massey for violations at the Upper Big Branch mine of the Mine Safety & Health Act of 1977, 30 U.S.C. § 801 et seq. (the "Mine Safety Act"), and its implementing regulations. In 2009 alone, the Mine Safety Administration identified 549 violations at the Upper Big Branch mine. Indeed, in the 15 months preceding the April 2010 accident, the Upper Big Branch mine received the third-most serious safety citations of any mine in the United States. Many of these violations related to improper ventilation and accumulation of combustible materials—problems that were key contributing factors to the accident. Defendant was aware of the violations at the Upper Big Branch mine in the years leading up to the accident, receiving daily reports showing the numerous citations for safety violations at the mine.

Not only did Defendant receive daily reports of the safety violations, beginning in mid-2009, but Defendant also received warnings from a senior Massey safety official about the serious risks posed by the violations at Upper Big Branch. And the safety official informed Defendant that "[t]he attitude at many Massey operations is 'if you can get the

footage, we can pay the fines.” Evidence suggested that Defendant had fostered this attitude by directing mine supervisors to focus on “run[ning] coal” rather than safety compliance and to forego construction of safety systems. Defendant also told the Massey employee in charge of the Upper Big Branch mine that “safety violations were the cost of doing business” and that it was “cheaper to break the safety laws and pay the fines than to spend what would be necessary to follow the safety laws.”

Notwithstanding the numerous citations and warnings, Defendant had a “policy to invariably press for more production even at mines that he knew were struggling to keep up with the safety laws.” For example, Defendant directed the supervisor of Upper Big Branch to reopen a mine section to production even though it lacked a legal return airway. Additionally, Massey employees advised Defendant that the lack of adequate staff was a key factor in the high number of safety violations at Upper Big Branch. Contrary to this advice, Massey reduced staff at the Upper Big Branch mine less than two months before the accident, a decision that Defendant would have had to approve given his close supervision of mine operations and staffing.

On November 13, 2014, a federal grand jury indicted Defendant for: (1) conspiring to willfully violate federal mine safety laws and regulations; (2) conspiring to defraud federal mine safety regulators; (3) making false statements to the Securities & Exchange Commission regarding Massey’s safety compliance; and (4) engaging in securities fraud. The grand jury issued a superseding three-count indictment (the “Superseding Indictment”) on March 10, 2015, which combined the conspiracy counts into a single, multi-object conspiracy charge and included additional factual allegations. Following a six-week trial, a jury convicted Defendant of conspiring to violate federal mine safety laws and acquitted him of the remaining indicted offenses. The district court sentenced Defendant to one year imprisonment and assessed a \$250,000 fine, both of which were the maximum permitted by law. Defendant timely appealed. . . .

The jury convicted Defendant of conspiring to violate 30 U.S.C. § 820(d), which, in pertinent part, makes it unlawful for “[a]ny operator [to] willfully violate[] a mandatory [mine] health or safety standard.” The Superseding Indictment alleged that Defendant was “an operator[] of [Upper Big Branch],” and in that capacity, conspired to “routinely violate federal mandatory mine safety and health standards.” . . .

Defendant takes issue with the following instructions regarding the meaning of “willfully” in Section 820(d):

1. A person with supervisory authority at or over a mine willfully fails to perform an act required by a mandatory safety or health standard if he knows that the act is not being performed and knowingly, purposefully, and voluntarily allows that omission to continue.
2. A person with supervisory authority at or over a mine also willfully violates a mandatory mine safety or health standard if he knowingly,

purposefully, and voluntarily takes actions that he knows will cause a standard to be violated[;]

3. [O]r knowingly, purposefully, and voluntarily fails to take actions that are necessary to comply with the mandatory mine safety or health standard[;]

4. [O]r if he knowingly, purposefully, and voluntarily takes action or fails to do so with reckless disregard for whether that action or failure to act will cause a mandatory safety or health standard to be violated.

Defendant first argues that the fourth instruction improperly allowed the jury to convict Defendant for “reckless” conduct, rather than requiring the government to prove Defendant “knew his conduct would cause a violation of safety regulations . . . and was unlawful.” In particular, Defendant contends that the Supreme Court’s decisions in *Bryan v. United States*, and *Safeco Insurance Co. of America v. Burr*, bar courts from defining “willfully” in criminal statutes in terms of “reckless disregard.”

In *Bryan*, the Supreme Court reviewed whether the government introduced sufficient evidence to convict the defendant of “willfully” violating the federal Gun Control Act, which, among other things, prohibits dealing in firearms without a license. 524 U.S. at 189, 118 S. Ct. 1939; *see also* 18 U.S.C. § 924(a)(1)(D). The defendant argued that in order to prove that he “willfully” violated federal gun laws, the government had to introduce evidence that “he was aware of the federal law that prohibits dealing in firearms without a federal license.” The Supreme Court rejected the defendant’s argument, holding that, as a result of the long-standing principle that ignorance of the law is no excuse, the government need not prove that the defendant knew of the statutory provision at issue to violate it.

In reaching this conclusion, the Court noted that “willfully” is “a word of many meanings whose construction is often dependent on the context in which it appears.” The Court said that, “[a]s a general matter,” in the criminal context, “willful” means an act “undertaken with a ‘bad purpose,’” and a “‘willful’ violation of a statute” occurs when “‘the defendant acted with knowledge that his conduct was unlawful.’” The Court provided several additional examples of criminally “willful” conduct, including: (1) acting “without justifiable excuse”; (2) acting “stubbornly, obstinately, perversely”; (3) acting “without ground for believing it is lawful”; and (4) acting with “careless disregard [as to] whether or not one has the right so to act.”

Safeco involved a civil action under Section 1681n of the Fair Credit Reporting Act, which establishes a cause of action against entities that “willfully” fail to comply with the statute. 551 U.S. at 56–57, 127 S. Ct. 2201. The Supreme Court rejected the defendant’s argument that willfully limited liability to “acts known to violate the Act, not to reckless disregard of statutory duty.” In reaching this conclusion, the Court said that “where willfulness is a statutory condition of civil liability, we have generally taken it to cover not only knowing violations of a standard, but reckless ones as well.” The

Court further noted that, as explained in *Bryan*, in the criminal context “willfully” often requires the government to prove a defendant to have a “bad purpose” or to have “acted with knowledge that his conduct was unlawful.”

Neither *Bryan* nor *Safeco* supports Defendant’s position that reckless disregard cannot amount to criminal willfulness. In particular, *Bryan* and *Safeco* emphasized that “willful” has multiple meanings and that the “bad purpose” language upon which Defendant relies defines willful only as a “general matter”—i.e. not in all circumstances. Additionally, even if *Bryan* and *Safeco* had required a showing that a Defendant acted with a “bad purpose”—which they did not—the Supreme Court long ago recognized—in a decision relied on in *Bryan*—that “reckless disregard” can amount to acting with a “bad purpose” for purposes of criminal “willfulness.” *Screws v. United States*. And *Bryan*—upon which *Safeco* entirely relied—expressly recognized that “conduct marked by careless disregard” constitutes “willfulness.” Accordingly, *Bryan* and *Safeco* did not overturn longstanding Supreme Court precedent holding that reckless disregard can amount to criminal willfulness.

We further point out that this Court repeatedly has held, post-*Bryan* and *Safeco*, that “reckless disregard” and “plain indifference” can constitute criminal “willfulness.” For example, in a decision addressing the meaning of “willfully” in the civil and criminal penalty provisions in federal gun control laws, we concluded that “[a]t its core [willful] describes conduct that results from an exercise of the will, distinguishing ‘intentional, knowing, or voluntary’ action from that which is ‘accidental’ or inadvertent.” *RSM, Inc. v. Herbert*. Accordingly, “when determining the willfulness of conduct, we must determine whether the acts were committed in deliberate disregard of, or with plain indifference toward, either known legal obligations or the general unlawfulness of the actions.”). We further held that this construction of “willfully” was “in accordance with *Bryan*’s construction of the term in the criminal context of § 924(a)(1)(D).”

Applying this standard to the conduct at issue, we held that the defendant’s repeated failure to comply with federal gun laws in the face of warnings by federal officials amounted to “willfulness”:

To be sure, a single, or even a few, inadvertent errors in failing to complete forms may not amount to “willful” failures, even when the legal requirement to complete the form was known. Yet at some point, when such errors continue or even increase in the face of repeated warnings given by enforcement officials, accompanied by explanations of the severity of the failures, one may infer as a matter of law that the licensee simply does not care about the legal requirements. At that point, the failures show the licensee’s plain indifference and therefore become willful.

Thus, we have held that “not car[ing]” about adherence to legal requirements amounts to criminal “willfulness,” which is what the fourth instruction stated here. Notably, *RSM*’s description of the defendant’s willful conduct tracks the government’s theory of

the case here: Defendant was repeatedly informed of safety violations at Upper Big Branch, and notwithstanding that knowledge, Defendant chose to prioritize production and pay fines rather than to take steps necessary to prevent the safety violations from continuing.

Following *RSM*, which post-dated *Bryan* but pre-dated *Safeco*, we held that *Safeco* did not call into question *RSM*'s analysis of the meaning of "willfully." *Am. Arms Int'l v. Herbert*. Additionally, in *American Arms*, we expressly equated "plain indifference" with "reckless disregard" for purposes of finding willfulness. . . .

Having determined that "reckless disregard" can constitute criminal "willfulness," we now must determine whether the district court properly concluded that "reckless disregard" amounts to willfulness for purposes of Section 820(d). In deciding this question, we do not write on a clean slate. In *United States v. Jones*, we affirmed a trial court's instruction that a criminal defendant "willfully" violated a federal mine safety standard if he acted "either in intentional disobedience of the [safety] standard or in reckless disregard of its requirements." "This language conforms to the interpretations of willfulness provided by several of the circuits," we held. In reaching this conclusion, we relied on the Sixth Circuit's decision in *United States v. Consolidation Coal Co.*—the only appellate decision interpreting the meaning of "willfully" in a criminal provision of a federal mine safety statute—which held that an act or omission is "willful if done knowingly and purposefully by a coal mine operator who, having a free will or choice, either intentionally disobeys the standard or recklessly disregards its requirements." *Jones*.

Defendant contends that we should disregard *Jones* because, notwithstanding that the district court instructed the jury on the meaning of "willfully," *Jones* involved a prosecution under a provision in the Mine Safety Act with a "knowing," as opposed to "willful," mens rea requirement. But we see no reason to depart from *Jones*' statement that, for purposes of the Mine Safety Act's criminal provision, willfulness encompasses reckless disregard—nor does Defendant provide us with any.

Section 820(d) derives from a substantively identical provision in the federal Coal Mine Health and Safety Act of 1969 (the "Coal Act"), which the Mine Safety Act replaced. At the time Congress enacted the Mine Safety Act, the Sixth Circuit had already interpreted "willfully" in the Coal Act in terms of "reckless disregard." *Consol. Coal Co.* Because "[w]e assume that Congress is aware of existing law when it passes legislation," *Miles v. Apex Marine Corp.*, we must presume that Congress intended "willfully" in Section 820(d) to have the same meaning as the judicial construction of the term in the Coal Act, see *United States v. Georgopoulos* (construing, post-*Bryan*, "willfulness" element in labor union bribery statute as requiring only general intent because such a construction accorded with the judicial construction of willfulness in the statute from which the bribery provision derived). That Congress enacted the Mine Safety Act because it believed the penalties available under the Coal Act had proven insufficient to deter safety violations further evidences that Congress did not intend for courts to

construe “willfully” in the Mine Safety Act more strictly than they had interpreted the term in the parallel provision in the Coal Act, as Defendant invites us to do here. *See* S. Rep. 95-181, at 4, 9 (1977) (“[E]nforcement sanctions under the [Coal Act] are insufficient to deal with chronic violators.”).

Other Congressional statements in the legislative history of the Mine Safety Act further indicate that Congress intended to bring conduct evidencing reckless disregard within the meaning of “willfully.” In particular, Congress imposed enhanced penalties in the Mine Safety Act because it found “[m]ine operators still find it cheaper to pay minimal civil penalties than to make the capital investments necessary to adequately abate unsafe or unhealthy conditions, and there is still no means by which the government can bring habitual and chronic violators of the law into compliance.” S. Rep. 95-181, at 4. Accordingly, Congress saw criminal penalties as a mechanism to punish “habitual” and “chronic” violators that choose to pay fines rather than remedy safety violations.

As noted previously, we explained in *RSM* that an inference of plain indifference—and therefore willfulness—arises from evidence of “continu[ing]” or “increas[ing]” violations “in the face of repeated warnings given by enforcement officials.” Put differently, a “long history of repeated failures, warnings, and explanations of the significance of the failures, combined with knowledge of the legal obligations, readily amounts to willfulness.” . . .

That (1) Congress imposed enhanced penalties on mine operators in order to punish operators who “chronic[ally]” and “habitual[ly]” violate mine safety laws, rather than to devote resources to safety compliance, and that (2) courts construe willfulness in terms of reckless disregard when a statute is intended to levy criminal penalties on defendants who persist in violating a federal law notwithstanding repeated warnings of the violations, further indicates Congress intended to define “willfully” in Section 820(d) in terms of reckless disregard. . . .

Defendant and amici coal industry trade associations nonetheless maintain that, as a matter of policy, Congress did not intend for reckless disregard to amount to willfulness, as that term is used in Section 820(d), for four reasons: (1) Congress could not have intended to hold mine operators criminally liable for making “budgeting” and “business” decisions about how to allocate resources between production and safety compliance; (2) “violations inexorably result from coal production” and therefore violations should not give rise to criminal liability absent evidence a defendant committed such violations with specific intent to violate a particular mine safety statute or regulation; (3) defining willfully in terms of reckless disregard would allow juries to find mine operators criminally liable even when the operators did not want safety violations to occur; and (4) if “reckless disregard” amounts to willfulness, then operators will be deterred from engaging “in detailed oversight over important aspects of safety and regulatory compliance.” We disagree.

First, the legislative history of the Mine Safety Act contradicts Defendant’s and amici’s argument that Congress did not intend to punish mine operators for the type of budgeting

and business decisions the government challenged here. In particular, Congress repeatedly stated that the Mine Safety Act's enforcement provisions were designed to deter mine operators from choosing to prioritize production over safety compliance on grounds that it was "cheaper to pay the penalties than to strive for a violation-free mine." S. Rep. No. 95-181, at 9; *see also id.* at 4 (expressing concern that "[m]ine operators still find it cheaper to pay minimal civil penalties than to make the capital investments necessary to adequately abate unsafe or unhealthy conditions"). To that end, Congress said that operators should not balance the financial returns to increasing output against the costs of safety compliance. *See id.* ("The Committee strongly believes that industry-wide compliance with strong health and safety standards must be a basic ground rule for increased production.").

Congress imposes penalties on corporate officers—like Defendant—alongside enterprise penalties because it is often impossible to impose monetary penalties on corporations large enough to deter corporate misconduct. John C. Coffee, "*No Soul to Damn: No Body to Kick*": *An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. (1980) ("[O]ur ability to deter the corporation may be confounded by our inability to set an adequate punishment cost which does not exceed the corporation's resources."). And when the returns to violating a law exceed a potential corporate fine, discounted by the likelihood of the government imposing the fine, corporate officers who do not face personal liability will treat "criminal penalties as a 'license fee for the conduct of an illegitimate business'"—as the government's evidence showed Defendant did here. *See United States v. Park* (quoting *United States v. Dotterweich*).

By subjecting mine operators to personal liability, including incarceration, Congress forced mine operators to internalize the costs associated with noncompliance with mine safety laws, even when such noncompliance would be profit-maximizing from a business perspective. *See* Timothy P. Glynn, *Beyond "Unlimiting" Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 430–31 (2004) (explaining that subjecting corporate officers to personal liability forces such officers to internalize risk associated with corporation's non-compliance with laws). Put differently, in subjecting mine operators—who have "primary responsibility for providing a safe and healthful working environment," S. Rep. No. 95-181, at 18—to personal liability, Congress wanted to deter operators from choosing to treat penalties for violating safety provisions as a "license fee" to be factored into profit-maximization analyses, *Park*. Accordingly, contrary to Defendant's and amici's position, a mine operator cannot immunize himself from criminal liability under Section 820(d) by characterizing his mine's repeated failure to comply with safety laws as a consequence of "tough decisions" he had to make weighing "production, safety, and regulatory compliance." Amicus Br. at 26.

Second, regarding amici's contention that the "unavoidability" and "inexorability" of mine safety violations precludes use of such violations to establish criminal intent, we rejected an identical argument in *RSM*. There, the defendant—a firearms dealer—argued

that its repeated failure to correctly fill out forms establishing that a customer was qualified to purchase a firearm did not amount to willfulness because, given the complexity of the regulatory regime and the number firearms the defendant sold, “human errors were virtually inevitable.” In rejecting defendant’s argument, we explained that even though “inadvertent” violations may not amount to willfulness, continuing violations in “the face of repeated warnings” allows a jury to infer criminal intent. We see no reason to diverge from that principle here, particularly in light of the parallels between Section 820(d) and Section 924(d)(1).

Next, Defendant argues that defining willfully in terms of reckless disregard impermissibly allowed the jury to convict him even if it concluded that Defendant desired “to eliminate and reduce the [safety] hazards and violations” at the Upper Big Branch mine. But just as the law holds criminally liable an individual who drives a car with brakes he knows are inoperable, even if he does not intend to harm anyone, *e.g.*, *State v. Conyers*, so too Section 820(d) holds criminally liable a mine operator who fails to take actions necessary to remedy safety violations in the face of repeated warnings of such violations, regardless of whether the operator subjectively wanted the violations to continue.

Finally, contrary to amici’s assertion, defining willfully in terms of reckless disregard should not deter mine operators from engaging in detailed safety oversight. The Mine Safety Act declares that “operators”—like Defendant—“have the primary responsibility to prevent . . . unsafe and unhealthful conditions and practices” at mines. 30 U.S.C. § 801. And in *Jones*, we affirmed the trial court’s instruction that “[r]eckless disregard means the closing of the eyes to or deliberate indifference toward the requirements of a mandatory safety standard, which standard the defendant should have known and had reason to know at the time of the violation.” Here, the district court correctly defined “reckless disregard” using the language we endorsed in *Jones*. Because mine operators have “primary” responsibility for safety and regulatory compliance and because an operator acts with reckless disregard if he “clos[es] [his] eyes” to safety compliance or “should have known” that an action or omission would lead to a safety violation, a mine operator cannot avoid liability under Section 820(d) by failing to engage in close oversight over safety and regulatory compliance.

In sum, the district court properly instructed the jury that it could conclude that Defendant “willfully” violated federal mine safety laws if it found that Defendant acted or failed to act with reckless disregard as to whether the action or omission would lead to a violation of mine safety laws.

As the *Blankenship* prosecution shows, the government is less likely to rely on the responsible corporate officer doctrine, even when it is available, if it has good evidence of actual knowledge by senior managers of the relevant wrongdoing. For example, the government recently prosecuted Texas-based ice cream manufacturer Blue Bell Creamery and its CEO Paul Kruse in connection with a 2015 bacterial (*listeria*) outbreak

that killed three people and sickened others. The corporation pled guilty and paid a fine. At trial in August 2022, a jury hung (reportedly divided 10-2 in favor of acquittal) on mail and wire fraud charges that include extensive allegations that Kruse was personally aware of the listeria contamination and directed employees to cover it up. In a subsequent plea agreement, Kruse agreed to plead guilty to a single misdemeanor count and pay a \$100,000 fine. The indictment against Kruse is available here: <https://www.justice.gov/opa/press-release/file/1329726/download>.

Problem 7-1

- (a) As a normative matter, is the responsible corporate officer doctrine beneficial and defensible? Should it be expanded to other areas? Would broader or different statutes imposing criminal liability for failure to act by corporate officers be a good idea? If so, in what form? How might such laws be retributively justified?
- (b) Is there an acceptable way to define mens rea for managerial involvement in crime committed at lower level of a corporation that would accommodate the requirements of notice and fairness in criminal law with the desire to use criminal law to incentivize greater care and supervision by senior managers in preventing corporate crimes?

AUTHOR

Samuel W. Buell is the Bernard M. Fishman Professor of Law at Duke University. He is the author of *Capital Offenses: Business Crime and Punishment in America's Corporate Age* (W.W. Norton & Co. 2016), as well as dozens of articles and book chapters on corporate misconduct and government enforcement. From 1994 to 2004, he served in the U.S. Department of Justice, including as a lead prosecutor assigned to the DOJ's Enron Task Force.

CORPORATE CRIME

VOLUME TWO

CORPORATE CRIME:
AN INTRODUCTION TO
THE LAW AND ITS
ENFORCEMENT
VOLUME TWO

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Bernard M. Fishman Professor of Law

Duke University

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Author's Note

This text was developed over the course of a decade or so of teaching from and editing self-created materials. It emerged from the ground up, out of one instructor's particular approach to preparing upper-level law students, most of whom head to jobs in "Biglaw" or the federal government, for entering the field of corporate enforcement and defense.

The course from which these materials emerged earns four credits and is designed to be demanding and cover many difficult topics. This book is meant to allow the author to use it to continue that particular approach, while providing a low-cost bound book for future students who take the course. Due to the confines of the self-publishing platform, this could be accomplished only by producing a two-volume text.

Those interested in using these materials in their own related courses, or to learn about aspects of the field, are welcome to draw from the materials in part and selectively. Each individual chapter is available for free in pdf at buelloncorporatecrime.com. That site will develop to include other materials, such as syllabus suggestions and sample exam problems.

Many thanks to the hundreds of students over the years who have tolerated these materials as they have been improved and refined, with their invaluable feedback. Special and deep gratitude to Lauren Smith and Sarah Lowe, for their essential roles in shepherding a loose pile of course materials into the first edition of the published text. Thanks to Jacob Kornhauser for assistance with the second edition and Jean Wilson-Stayton for help with the third and fourth editions.

Corporate crime is now one of the largest and most important fields in American law. Relative to its importance to practice and policy, it remains under-covered in law school curricula and in scholarship. It is hoped that this project, which will be updated frequently, will over the longer term serve as a path to more mature and settled treatments of the subject that inevitably will follow. In the meantime, errata, comments, and suggestions are most welcome. Please send them to buell@law.duke.edu.

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8. OBSTRUCTION OF JUSTICE

Nearly every case of corporate crime includes the potential for obstruction of justice charges because (1) the federal statutes cover a very wide range of conduct; and (2) there is a near universal human impulse to avoid punishment, which almost always yields (in spite of the best efforts of skilled counsel!) some lying and covering up during the investigative process. Prosecutors indeed bring such charges in many corporate crime cases, for reasons we will discuss. The statutory scheme is, unfortunately, convoluted and has created a host of interpretive issues for the federal courts, especially on questions of mens rea.

As in other areas of the corporate crime field, however, the line-drawing problems do not come only from statutory drafting. It is once again hard for the law to find crisp distinctions—in this instance between undesirable conduct that perverts legal process and regular adversary behavior. Notice how each case in this chapter deals in some way with that basic line-drawing problem.

A. Selected Federal Obstruction of Justice Statutes

The obstruction laws are situated in Title 18 of the U.S. Code. Section 1503, successor to the first federal obstruction law, includes the famous “omnibus” clause (in bold below) that has long been the go-to provision for prosecuting obstruction in federal court. But § 1503 has some limitations.

Section 1505 is § 1503’s counterpart for agency and congressional proceedings. (And thus has similar limitations.)

Section 1512 is for problems of “witness tampering” and covers a more specific series of behaviors. But notice how § 1512’s coverage goes well beyond witness tampering and includes several things that §§ 1503 and 1505 would not cover. Pay careful attention to the definitional provisions in § 1515 that apply to § 1512.

Finally, § 1519 is an extremely broad anti-evidence destruction statute, enacted in the wake of the Enron scandal.

As with the FCPA statutes, it pays to make a summary chart for these obstruction statutes. They give prosecutors a menu to choose from, and often more than one may apply in a particular case. The statutes differ principally on these dimensions: (1) the conduct that they cover (e.g., document destruction only or also false statements?); (2) mens rea (e.g., knowledge of exactly what and/or intent to do precisely what are required for conviction?); and (3) temporal or jurisdictional application (e.g., does the statute apply only after judicial proceedings have commenced or also during an investigation?).

Particularly important terms in the statutes are highlighted in bold.

18 U.S.C. § 1503. Influencing or injuring officer or juror generally.

(a) Whoever corruptly, or by threats or force, or by any threatening letter or communication, endeavors to influence, intimidate, or impede any grand or petit juror, or officer in or of any court of the United States, or officer who may be serving at any examination or other proceeding before any United States magistrate judge or other committing magistrate, in the discharge of his duty, or injures any such grand or petit juror in his person or property on account of any verdict or indictment assented to by him, or on account of his being or having been such juror, or injures any such officer, magistrate judge, or other committing magistrate in his person or property on account of the performance of his official duties, or **corruptly** or by threats or force, or by any threatening letter or communication, **influences, obstructs, or impedes, or endeavors to influence, obstruct, or impede, the due administration of justice**, shall be punished as provided in subsection (b). If the offense under this section occurs in connection with a trial of a criminal case, and the act in violation of this section involves the threat of physical force or physical force, the maximum term of imprisonment which may be imposed for the offense shall be the higher of that otherwise provided by law or the maximum term that could have been imposed for any offense charged in such case.

(b) The punishment for an offense under this section is—

- (1) in the case of a killing, the punishment provided in sections 1111 and 1112;
- (2) in the case of an attempted killing, or a case in which the offense was committed against a petit juror and in which a class A or B felony was charged, imprisonment for not more than 20 years, a fine under this title, or both; and
- (3) in any other case, imprisonment for not more than 10 years, a fine under this title, or both.

18 U.S.C. § 1505. Obstruction of proceedings before departments, agencies, and committees.

Whoever **corruptly**, or by threats or force, or by any threatening letter or communication **influences, obstructs, or impedes or endeavors to influence, obstruct, or impede the due and proper administration of the law under which any pending proceeding is being had before any department or agency of the United States**, or the due and proper exercise of the power of inquiry under which any **inquiry or investigation is being had by either House, or any committee of either House or any joint committee of the Congress**—Shall be fined under this title, imprisoned not more than 5 years or, if the offense involves international or domestic terrorism (as defined in section 2331), imprisoned not more than 8 years, or both.

18 U.S.C. § 1512. Tampering with a witness, victim, or an informant.

(a) (1) Whoever kills or attempts to kill another person, with intent to—

- (A) prevent the attendance or testimony of any person in an official proceeding;
- (B) prevent the production of a record, document, or other object, in an official proceeding; or
- (C) prevent the communication by any person to a law enforcement officer or judge of the United States of information relating to the commission or possible commission of a Federal offense or a violation of conditions of probation, parole, or release pending judicial proceedings;

shall be punished as provided in paragraph (3).

(2) Whoever uses physical force or the threat of physical force against any person, or attempts to do so, with intent to—

- (A) influence, delay, or prevent the testimony of any person in an official proceeding;
- (B) cause or induce any person to—
 - (i) withhold testimony, or withhold a record, document, or other object, from an official proceeding;
 - (ii) alter, destroy, mutilate, or conceal an object with intent to impair the integrity or availability of the object for use in an official proceeding;
 - (iii) evade legal process summoning that person to appear as a witness, or to produce a record, document, or other object, in an official proceeding; or
 - (iv) be absent from an official proceeding to which that person has been summoned by legal process;
- (C) hinder, delay, or prevent the communication to a law enforcement officer or judge of the United States of information relating to the commission or possible commission of a Federal offense or a violation of conditions of probation, supervised release, parole, or release pending judicial proceedings;

shall be punished as provided in paragraph (3).

(3) The punishment for an offense under this subsection is—

- (A) in the case of a killing, the punishment provided in sections 1111 and 1112;
- (B) in the case of—
 - (i) an attempt to murder; or

(ii) the use or attempted use of physical force against any person;

imprisonment for not more than 30 years

(C) in the case of the threat of use of physical force against any person, imprisonment for not more than 20 years.

(b) Whoever knowingly uses intimidation, threatens, or **corruptly persuades** another person, or attempts to do so, or **engages in misleading conduct toward another person**, with intent to—

(1) influence, delay, or prevent the testimony of any person in an official proceeding;

(2) cause or induce any person to—

(A) withhold testimony, or withhold a record, document, or other object, from an official proceeding;

(B) alter, destroy, mutilate, or conceal an object with intent to impair the object's integrity or availability for use in an official proceeding;

(C) evade legal process summoning that person to appear as a witness, or to produce a record, document, or other object, in an official proceeding; or

(D) be absent from an official proceeding to which such person has been summoned by legal process; or

(3) hinder, delay, or prevent the communication to a law enforcement officer or judge of the United States of information relating to the commission or possible commission of a Federal offense or a violation of conditions of probation supervised release, parole, or release pending judicial proceedings;

shall be fined under this title or imprisoned not more than 20 years, or both.

(c) Whoever **corruptly**—

(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or

(2) **otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so,**

shall be fined under this title or imprisoned not more than 20 years, or both.

(d) Whoever intentionally harasses another person and thereby hinders, delays, prevents, or dissuades any person from—

(1) attending or testifying in an official proceeding;

(2) reporting to a law enforcement officer or judge of the United States the commission or possible commission of a Federal offense or a violation of conditions of probation supervised release, parole, or release pending judicial proceedings;

(3) arresting or seeking the arrest of another person in connection with a Federal offense; or

(4) causing a criminal prosecution, or a parole or probation revocation proceeding, to be sought or instituted, or assisting in such prosecution or proceeding;

or attempts to do so, shall be fined under this title or imprisoned not more than 3 years, or both.

(e) In a prosecution for an offense under this section, it is an affirmative defense, as to which the defendant has the burden of proof by a preponderance of the evidence, that the conduct consisted solely of lawful conduct and that the defendant's sole intention was to encourage, induce, or cause the other person to testify truthfully.

(f) For the purposes of this section—

(1) **an official proceeding need not be pending or about to be instituted** at the time of the offense; and

(2) the testimony, or the record, document, or other object need not be admissible in evidence or free of a claim of privilege.

(g) In a prosecution for an offense under this section, **no state of mind need be proved with respect to the circumstance—**

(1) that the official proceeding before a judge, court, magistrate judge, grand jury, or government agency is before a judge or court of the United States, a United States magistrate judge, a bankruptcy judge, a Federal grand jury, or a Federal Government agency; or

(2) that the judge is a judge of the United States or that the law enforcement officer is an officer or employee of the Federal Government or a person authorized to act for or on behalf of the Federal Government or serving the Federal Government as an adviser or consultant. . . .

18 U.S.C. § 1515. Definitions for certain provisions; general provision.

(a) As used in sections 1512 and 1513 of this title and in this section—

(1) the term “**official proceeding**” means—

(A) a proceeding before a judge or court of the United States, a United States magistrate judge, a bankruptcy judge, a judge of the United States Tax Court, a special trial judge of the Tax Court, a judge of the United States Court of Federal Claims, or a Federal grand jury;

- (B) a proceeding before the Congress;
 - (C) a proceeding before a Federal Government agency which is authorized by law;
or
 - (D) a proceeding involving the business of insurance whose activities affect interstate commerce before any insurance regulatory official or agency or any agent or examiner appointed by such official or agency to examine the affairs of any person engaged in the business of insurance whose activities affect interstate commerce;
- (2) the term “physical force” means physical action against another, and includes confinement;
- (3) the term “misleading conduct” means—
- (A) knowingly making a false statement;
 - (B) intentionally omitting information from a statement and thereby causing a portion of such statement to be misleading, or intentionally concealing a material fact, and thereby creating a false impression by such statement;
 - (C) with intent to mislead, knowingly submitting or inviting reliance on a writing or recording that is false, forged, altered, or otherwise lacking in authenticity;
 - (D) with intent to mislead, knowingly submitting or inviting reliance on a sample, specimen, map, photograph, boundary mark, or other object that is misleading in a material respect; or
 - (E) knowingly using a trick, scheme, or device with intent to mislead;
- (4) the term “law enforcement officer” means an officer or employee of the Federal Government, or a person authorized to act for or on behalf of the Federal Government or serving the Federal Government as an adviser or consultant—
- (A) authorized under law to engage in or supervise the prevention, detection, investigation, or prosecution of an offense; or
 - (B) serving as a probation or pretrial services officer under this title;
- (5) the term “bodily injury” means—
- (A) a cut, abrasion, bruise, burn, or disfigurement;
 - (B) physical pain;
 - (C) illness;
 - (D) impairment of the function of a bodily member, organ, or mental faculty; or

(E) any other injury to the body, no matter how temporary; and

(6) the term “corruptly persuades” does not include conduct which would be misleading conduct but for a lack of a state of mind.

(b) **As used in section 1505, the term “corruptly” means** acting with an improper purpose, personally or by influencing another, including making a false or misleading statement, or withholding, concealing, altering, or destroying a document or other information.

(c) This chapter does not prohibit or punish the providing of lawful, bona fide, legal representation services in connection with or anticipation of an official proceeding.

18 U.S.C. § 1519. Destruction, alteration, or falsification of records in Federal investigations and bankruptcy

Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of **any matter within the jurisdiction of any department or agency of the United States** or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both. . . .

When considering a particular matter or problem, *never* make the mistake of relying solely on a statutory summary as a substitute for rereading the applicable statutory language. That said, to summarize, on the basis of both the statutory text and some of the interpretive decisions included in this chapter, see the chart on the following page:

Statutory Summary Chart

Statute	Conduct (Actus Reus)	Mens Rea	Proceedings Covered	Temporal Limitations
§ 1503 §1505	Any obstructive effort (“omnibus” clauses).	“Corruptly” (see case law, including “nexus” requirement).	Judicial, including grand jury, under 1503. Congressional or administrative if “official” (formal), under 1505.	Proceeding must be pending, which means formally instituted.
§ 1512(a) §1512(b)	Various forms of violent and nonviolent witness tampering (with varying penalty levels).	Intent to obstruct government. If the witness tampering involves only “persuasion,” actor must also be “conscious of wrongdoing.”	“Official” (formal) federal proceeding, in any of the three branches of government.	Anticipatory obstruction covered. Proceeding need not be pending or about to be instituted, but there must be nexus to specific potential proceeding.
§ 1512(c)	All obstruction (“impede”) involving records, documents, or objects.	“Corruptly” (see case law, including “nexus” requirement).	“Official” (formal) federal proceeding, in any of the three branches of government.	Anticipatory obstruction covered. Proceeding need not be pending or about to be instituted, but there must be nexus to specific potential proceeding.
§ 1519	All tampering with regard to any evidence of white collar crime.	Knowingly (as to the tampering) plus intent to impede the government.	Any “matter” (including informal investigations), within the jurisdiction of the federal government.	None on the face of the statute, but courts likely will say some “nexus” to a specific actual or potential investigation required.

B. Elements and Examples: Section 1503 and the “Omnibus” Clause

The following case is the major Supreme Court decision on § 1503. The “nexus” idea discussed here is critical to the concept of obstruction and potentially to the interpretation of all the federal obstruction statutes.

UNITED STATES v. AGUILAR, 515 U.S. 593 (1995)

Chief Justice REHNQUIST delivered the opinion of the Court.

A jury convicted United States District Judge Robert Aguilar of one count of illegally disclosing a wiretap in violation of 18 U.S.C. § 2232(c), and of one count of endeavoring to obstruct the due administration of justice in violation of § 1503. . . . We granted certiorari to resolve a conflict among the Federal Circuits over whether § 1503 punishes false statements made to potential grand jury witnesses. . . .

Many facts remain disputed by the parties. Both parties appear to agree, however, that a motion for postconviction relief filed by one Michael Rudy Tham represents the starting point from which events bearing on this case unfolded. Tham was an officer of the International Brotherhood of Teamsters, and was convicted of embezzling funds from the local affiliate of that organization. In July 1987, he filed a motion under 28 U.S.C. § 2255 to have his conviction set aside. The motion was assigned to Judge Stanley Weigel. Tham, seeking to enhance the odds that his petition would be granted, asked Edward Solomon and Abraham Chalupowitz, a.k.a. Abe Chapman, to assist him by capitalizing on their respective acquaintances with another judge in the Northern District of California, respondent Aguilar. Respondent knew Chapman as a distant relation by marriage and knew Solomon from law school. Solomon and Chapman met with respondent to discuss Tham's case, as a result of which respondent spoke with Judge Weigel about the matter.

Independent of the embezzlement conviction, the Federal Bureau of Investigation (FBI) identified Tham as a suspect in an investigation of labor racketeering. On April 20, 1987, the FBI applied for authorization to install a wiretap on Tham's business phones. Chapman appeared on the application as a potential interceptee. . . . The 30-day wiretap expired by law, . . . but Chief Judge Peckham maintained the secrecy of the wiretap under § 2518(8)(d) after a showing of good cause. During the course of the racketeering investigation, the FBI learned of the meetings between Chapman and respondent. The FBI informed Chief Judge Peckham, who, concerned with appearances of impropriety, advised respondent in August 1987 that Chapman might be connected with criminal elements because Chapman's name had appeared on a wiretap authorization.

Five months after respondent learned that Chapman had been named in a wiretap authorization, he noticed a man observing his home during a visit by Chapman. He alerted his nephew to this fact and conveyed the message (with an intent that his nephew relay the information to Chapman) that Chapman's phone was being wiretapped. . . .

Two months after the disclosure to his nephew, a grand jury began to investigate an alleged conspiracy to influence the outcome of Tham's habeas case. Two FBI agents questioned respondent. During the interview, respondent lied about his participation in the Tham case and his knowledge of the wiretap. The grand jury returned an indictment; a jury convicted Aguilar of one count of disclosing a wiretap, 18 U.S.C. § 2232(c), and one count of endeavoring to obstruct the due administration of justice, § 1503. . . .

[T]he "Omnibus Clause" serves as a catchall, prohibiting persons from endeavoring to influence, obstruct, or impede the due administration of justice. The latter clause, it can be seen, is far more general in scope than the earlier clauses of the statute. Respondent was charged with a violation of the Omnibus Clause, to wit: with "corruptly endeavor[ing] to influence, obstruct, and impede the . . . grand jury investigation."

The first case from this Court construing the predecessor statute to § 1503 was *Pettibone v. United States*. There we held that "a person is not sufficiently charged with obstructing or impeding the due administration of justice in a court unless it appears that he knew or

had notice that justice was being administered in such court.” The Court reasoned that a person lacking knowledge of a pending proceeding necessarily lacked the evil intent to obstruct. . . . The action taken by the accused must be with an intent to influence judicial or grand jury proceedings; it is not enough that there be an intent to influence some ancillary proceeding, such as an investigation independent of the court’s or grand jury’s authority. *United States v. Brown*. Some courts have phrased this showing as a “nexus” requirement—that the act must have a relationship in time, causation, or logic with the judicial proceedings. *United States v. Wood*. In other words, the endeavor must have the “natural and probable effect” of interfering with the due administration of justice. *Wood*. This is not to say that the defendant’s actions need be successful; an “endeavor” suffices. *United States v. Russell*. But as in *Pettibone*, if the defendant lacks knowledge that his actions are likely to affect the judicial proceeding, he lacks the requisite intent to obstruct.

Although respondent urges various broader grounds for affirmance, we find it unnecessary to address them because we think the “nexus” requirement developed in the decisions of the Courts of Appeals is a correct construction of § 1503. We have traditionally exercised restraint in assessing the reach of a federal criminal statute, both out of deference to the prerogatives of Congress, *Dowling v. United States*, and out of concern that “a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed,” *McBoyle v. United States*. We do not believe that uttering false statements to an investigating agent—and that seems to be all that was proved here—who might or might not testify before a grand jury is sufficient to make out a violation of the catchall provision of § 1503.

The Government did not show here that the agents acted as an arm of the grand jury, or indeed that the grand jury had even summoned the testimony of these particular agents. The Government argues that respondent “understood that his false statements would be provided to the grand jury” and that he made the statements with the intent to thwart the grand jury investigation and not just the FBI investigation. . . .

[T]he evidence goes no further than showing that respondent testified falsely to an investigating agent. Such conduct, we believe, falls on the other side of the statutory line from that of one who delivers false documents or testimony to the grand jury itself. Conduct of the latter sort all but assures that the grand jury will consider the material in its deliberations. But what use will be made of false testimony given to an investigating agent who has not been subpoenaed or otherwise directed to appear before the grand jury is far more speculative. We think it cannot be said to have the “natural and probable effect” of interfering with the due administration of justice.

Justice SCALIA criticizes our treatment of the statutory language for reading the word “endeavor” out of it, inasmuch as it excludes defendants who have an evil purpose but use means that would “only unnaturally and improbably be successful.” This criticism is unwarranted. Our reading of the statute gives the term “endeavor” a useful function to

fulfill: It makes conduct punishable where the defendant acts with an intent to obstruct justice, and in a manner that is likely to obstruct justice, but is foiled in some way. Were a defendant with the requisite intent to lie to a subpoenaed witness who is ultimately not called to testify, or who testifies but does not transmit the defendant's version of the story, the defendant has endeavored to obstruct, but has not actually obstructed, justice. Under our approach, a jury could find such defendant guilty.

Justice SCALIA also apparently believes that *any* act, done with the intent to "obstruct . . . the due administration of justice," is sufficient to impose criminal liability. Under the dissent's theory, a man could be found guilty under § 1503 if he knew of a pending investigation and lied to his wife about his whereabouts at the time of the crime, thinking that an FBI agent might decide to interview her and that she might in turn be influenced in her statement to the agent by her husband's false account of his whereabouts. The intent to obstruct justice is indeed present, but the man's culpability is a good deal less clear from the statute than we usually require in order to impose criminal liability. . . .

The following case involves a federal tax obstruction statute, 26 U.S.C. § 7212. However, its discussion of the meaning of the phrase "due administration of justice" is relevant to our understanding of §§ 1503 and 1505.

MARINELLO v. UNITED STATES, 138 S. Ct. 1101 (2018)

BREYER, J.:

A clause in § 7212(a) of the Internal Revenue Code makes it a felony "corruptly or by force" to "endeavo[r] to obstruct or imped[e] the due administration of this title." 26 U.S.C. § 7212(a). The question here concerns the breadth of that statutory phrase. Does it cover virtually all governmental efforts to collect taxes? Or does it have a narrower scope? In our view, "due administration of [the Tax Code]" does not cover routine administrative procedures that are near-universally applied to all taxpayers, such as the ordinary processing of income tax returns. Rather, the clause as a whole refers to specific interference with targeted governmental tax-related proceedings, such as a particular investigation or audit.

The Internal Revenue Code provision at issue, § 7212(a), has two substantive clauses. The first clause, which we shall call the "Officer Clause," forbids

"corruptly or by force or threats of force (including any threatening letter or communication) endeavor[ing] to intimidate or impede any *officer or employee* of the United States acting in an official capacity under [the Internal Revenue Code]."

The second clause, which we shall call the "Omnibus Clause," forbids

"corruptly or by force or threats of force (including any threatening letter or communication) obstruct[ing] or imped[ing], or endeavor[ing]

to obstruct or impede, *the due administration* of [the Internal Revenue Code].” . . .

Between 2004 and 2009, the Internal Revenue Service (IRS) opened, then closed, then reopened an investigation into the tax activities of Carlo Marinello, the petitioner here. In 2012 the Government indicted Marinello, charging him with violations of several criminal tax statutes including the Omnibus Clause. In respect to the Omnibus Clause the Government claimed that Marinello had engaged in at least one of eight different specified activities, including “failing to maintain corporate books and records,” “failing to provide” his tax accountant “with complete and accurate” tax “information,” “destroying . . . business records,” “hiding income,” and “paying employees . . . with cash.”

Before the jury retired to consider the charges, the judge instructed it that, to convict Marinello of violating the Omnibus Clause, it must find unanimously that he engaged in at least one of the eight practices just mentioned, that the jurors need not agree on which one, and that he did so “corruptly,” meaning “with the intent to secure an unlawful advantage or benefit, either for [himself] or for another.” The judge, however, did not instruct the jury that it must find that Marinello knew he was under investigation and intended corruptly to interfere with that investigation. The jury subsequently convicted Marinello on all counts. . . .

As to Congress’ intent, the literal language of the statute is neutral. The statutory words “obstruct or impede” are broad. They can refer to anything that “block[s],” “make[s] difficult,” or “hinder[s].” Black’s Law Dictionary (10th ed. 2014) (obstruct); Webster’s New International Dictionary (Webster’s) (2d ed. 1954) (impede); (obstruct); accord, 5 Oxford English Dictionary (1933) (impede); (obstruct). But the verbs “obstruct” and “impede” suggest an object—the taxpayer must hinder a particular person or thing. Here, the object is the “due administration of this title.” The word “administration” can be read literally to refer to every “[a]ct or process of administering” including every act of “managing” or “conduct[ing]” any “office,” or “performing the executive duties of” any “institution, business, or the like.” Webster’s 34. But the whole phrase—the due administration of the Tax Code—is best viewed, like the due administration of justice, as referring to only some of those acts or to some separable parts of an institution or business. *Cf. Aguilar* (concluding false statements made to an investigating agent, rather than a grand jury, do not support a conviction for obstruction of justice).

Here statutory context confirms that the text refers to specific, targeted acts of administration. The Omnibus Clause appears in the middle of a statutory sentence that refers specifically to efforts to “intimidate or impede *any officer or employee of the United States* acting in an official capacity.” 26 U.S.C. § 7212(a). The first part of the sentence also refers to “force or threats of force,” which the statute elsewhere defines as “threats of bodily harm to the *officer or employee of the United States or to a member of his family*.” The following subsection refers to the “forcibl[e] rescu[e]” of “any *property* after it shall have been seized under” the Internal Revenue Code. § 7212(b) (emphasis

added). Subsections (a) and (b) thus refer to corrupt or forceful actions taken against individual identifiable persons or property. And, in that context the Omnibus Clause logically serves as a “catchall” in respect to the obstructive conduct the subsection sets forth, not as a “catchall” for every violation that interferes with what the Government describes as the “continuous, ubiquitous, and universally known” administration of the Internal Revenue Code. . . .

A broad interpretation would also risk the lack of fair warning and related kinds of unfairness that led this Court in *Aguilar* to “exercise” interpretive “restraint.” *see also Yates*; *Arthur Andersen LLP v. United States*. Interpreted broadly, the provision could apply to a person who pays a babysitter \$41 per week in cash without withholding taxes, *see* 26 C.F.R. § 31.3102–1(a)(2017); IRS, Publication 926, (2018), leaves a large cash tip in a restaurant, fails to keep donation receipts from every charity to which he or she contributes, or fails to provide every record to an accountant. Such an individual may sometimes believe that, in doing so, he is running the risk of having violated an IRS rule, but we sincerely doubt he would believe he is facing a potential felony prosecution for tax obstruction. Had Congress intended that outcome, it would have spoken with more clarity than it did in § 7212(a).

The Government argues that the need to show the defendant’s obstructive conduct was done “corruptly” will cure any overbreadth problem. But we do not see how. The Government asserts that “corruptly” means acting with “the specific intent to obtain an unlawful advantage” for the defendant or another. Yet, practically speaking, we struggle to imagine a scenario where a taxpayer would “willfully” violate the Tax Code (the *mens rea* requirement of various tax crimes, including misdemeanors, *see, e.g.*, 26 U.S.C. §§ 7203, 7204, 7207) without intending someone to obtain an unlawful advantage. *See Cheek v. United States* (“Willfulness . . . requires the Government to prove that the law imposed a duty on the defendant, that the defendant knew of this duty, and that he voluntarily and intentionally violated that duty”). A taxpayer may know with a fair degree of certainty that her babysitter will not declare a cash payment as income—and, if so, a jury could readily find that the taxpayer acted to obtain an unlawful benefit for another. For the same reason, we find unconvincing the dissent’s argument that the distinction between “willfully” and “corruptly”—at least as defined by the Government—reflects any meaningful difference in culpability. . . .

In sum, we follow the approach we have taken in similar cases in interpreting § 7212(a)’s Omnibus Clause. To be sure, the language and history of the provision at issue here differ somewhat from that of other obstruction provisions we have considered in the past. *See Aguilar* (interpreting a statute prohibiting the obstruction of “the due administration of justice”); *Arthur Andersen* (interpreting a statute prohibiting the destruction of an object with intent to impair its integrity or availability for use in an official proceeding); *Yates* (interpreting a statute prohibiting the destruction, concealment, or covering up of any “record, document, or tangible object with the intent to” obstruct the “investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States”). The Government and

the dissent urge us to ignore these precedents because of those differences. The dissent points out, for example, that the predecessor to the obstruction statute we interpreted in *Aguilar*, 18 U.S.C. § 1503, prohibited influencing, intimidating, or impeding “any witness or officer in any court of the United States” or endeavoring “to obstruct or impede the due administration of justice therein.” *Pettibone v. United States*. But Congress subsequently deleted the word “therein,” leaving only a broadly worded prohibition against obstruction of “the due administration of justice.” Act of June 25, 1948, § 1503, 62 Stat. 769–770. Congress then used that same amended formulation when it enacted § 7212, prohibiting the “obstruction of the due administration” of the Tax Code. Internal Revenue Code of 1954, 68A Stat. 855. Given this similarity, it is helpful to consider how we have interpreted § 1503 and other obstruction statutes in considering § 7212. The language of some and the underlying principles of all these cases are similar. We consequently find these precedents—though not controlling—highly instructive for use as a guide toward a proper resolution of the issue now before us. *See Smith v. City of Jackson*.

We conclude that, to secure a conviction under the Omnibus Clause, the Government must show (among other things) that there is a “nexus” between the defendant’s conduct and a particular administrative proceeding, such as an investigation, an audit, or other targeted administrative action. That nexus requires a “relationship in time, causation, or logic with the [administrative] proceeding.” *Aguilar* (citing *Wood*). By “particular administrative proceeding” we do not mean every act carried out by IRS employees in the course of their “continuous, ubiquitous, and universally known” administration of the Tax Code. While we need not here exhaustively itemize the types of administrative conduct that fall within the scope of the statute, that conduct does not include routine, day-to-day work carried out in the ordinary course by the IRS, such as the review of tax returns. The Government contends the processing of tax returns is part of the administration of the Internal Revenue Code and any corrupt effort to interfere with that task can therefore serve as the basis of an obstruction conviction. But the same could have been said of the defendant’s effort to mislead the investigating agent in *Aguilar*. The agent’s investigation was, at least in some broad sense, a part of the administration of justice. But we nevertheless held the defendant’s conduct did not support an obstruction charge. In light of our decision in *Aguilar*, we find it appropriate to construe § 7212’s Omnibus Clause more narrowly than the Government proposes. Just because a taxpayer knows that the IRS will review her tax return every year does not transform every violation of the Tax Code into an obstruction charge.

In addition to satisfying this nexus requirement, the Government must show that the proceeding was pending at the time the defendant engaged in the obstructive conduct or, at the least, was then reasonably foreseeable by the defendant. *See Arthur Andersen* (requiring the Government to prove a proceeding was foreseeable in order to convict a defendant for persuading others to shred documents to prevent their “use in an official proceeding”). It is not enough for the Government to claim that the defendant knew the IRS may catch on to his unlawful scheme eventually. To use a maritime analogy, the proceeding must at least be in the offing.

The following case illustrates the outer limits of the kind of conduct that could be prosecuted under § 1503's "omnibus" clause. As you read it, think about the potential lines between obstruction and regular litigation, and the role of lawyers in obstruction cases.

UNITED STATES v. CUETO, 151 F.3d 620 (7th Cir. 1998)

BAUER, Circuit Judge:

Thomas Venezia owned B & H Vending/Ace Music Corporation ("B & H"), a vending and amusement business, and operated an illegal video gambling business through a pattern of racketeering activities and illegal gambling payouts, in violation of state and federal anti-gambling and racketeering laws. Venezia hired Amiel Cueto, an attorney, to represent him as well as to defend the tavern owners associated with B & H in the event of any arrests and/or criminal charges for their participation in the illegal gambling operation. In March of 1995, Venezia and B & H were indicted on federal racketeering charges, in addition to other related charges including illegal gambling. Throughout the investigation and prior to Venezia's indictment, Cueto served as Venezia's lawyer and advisor. Cueto was not Venezia's attorney of record during the trial; nonetheless, the record indicates that Venezia continued to rely on Cueto's advice throughout the prosecution of the racketeering case.

On December 2, 1995, Venezia and B & H were convicted of racketeering, illegal gambling, and conspiracy arising out of the operation of the illegal gambling business. *United States v. B & H Vending/Ace Music Corp. & Thomas Venezia, et al.* Seven months later, another federal grand jury returned a second indictment naming Cueto, Venezia, and Robert Romanik, a local public official and investigator who worked for Cueto and Venezia. They were charged with, *inter alia*: (1) conspiracy to defraud the United States, in violation of 18 U.S.C. § 371, and (2) obstruction of justice, in violation of the omnibus clause of 18 U.S.C. § 1503, for their conduct throughout the investigation of Venezia and his illegal gambling operation and the indictment and prosecution of the racketeering case. This second indictment is the impetus for the current appeal.

To understand the context of the instant indictment, convictions, and appeal, we examine the nature and scope of Cueto's relationship with Venezia, his association with the illegal gambling operation, and his involvement in the investigation, indictment, and prosecution of Venezia, the illegal gambling operation, and the racketeering enterprise. In 1987, Venezia purchased a vending and amusement business, later known as B & H, which operated an illegal video gambling business for about eight years. B & H supplied video poker games to local bars in the metropolitan area of East St. Louis, Illinois, including a Veterans of Foreign Wars Post ("VFW") on Scott Air Force Base, and the tavern owners agreed to make illegal gambling payouts to its customers. State agents believed the video games were being used for illegal gambling purposes, and beginning in 1992, the Illinois Liquor Control Commission ("ILCC") and the State Police initiated

a joint investigation in St. Clair County, which targeted illegal gambling operations in Southern Illinois.

The ILCC has broad investigatory powers to supervise liquor licensees, and ILCC Agent Bonds Robinson worked on the task force and investigated the gambling operations in cooperation with the state police. Initially, Robinson worked in a non-undercover capacity as part of the state investigation to determine, in the course of routine liquor inspections, whether any establishment was making illegal gambling payouts. Agents of the ILCC began to strictly enforce the gambling regulations and frequently visited the taverns to ensure compliance. Eventually, the FBI became interested in the state's investigation, and ultimately decided to use Robinson in a federal investigation of illegal gambling operations in St. Clair County, particularly Venezia's gambling operation. At some later point, Robinson assumed an undercover role for the FBI as a corrupt liquor agent in an attempt to gather evidence against Venezia and B & H. Soon thereafter, the state police raided the VFW Post, seized B & H's video poker games, and arrested two VFW employees for maintaining an illegal gambling establishment. After the raid, Venezia and B & H supplied additional video games to the VFW, which continued to provide its customers with illegal gambling payouts.

In an attempt to gather evidence, Robinson, who was present at the VFW raid, indicated that Venezia could avoid further interruptions of his illegal gambling operation if he were to offer a bribe to discourage the investigation and the interference, and he suggested to Venezia that they meet. Venezia consulted with Cueto, who instructed Venezia to meet with Tom Daley, one of his law partners at the time. In an attempt to portray Robinson as a dishonest agent, Daley reported to the ILCC that Robinson had solicited a bribe at the VFW. A meeting was then scheduled between Venezia and Robinson, who met at B & H corporate headquarters. Robinson taped the conversation at the FBI's request, and the tape was introduced into evidence in the racketeering case and at Cueto's trial. Soon after the meeting, the VFW was raided again; B & H video poker games were seized, and two employees were arrested. The ILCC issued an administrative violation to the VFW as well as a warning to remove the illegal gambling machines, otherwise, its liquor license would be revoked. Again, Venezia consulted with Cueto about the raids, the criminal charges, and the prosecutions, and they discussed available options and courses of action.

First, Cueto and Venezia drafted a letter, detailing Robinson's alleged "corrupt" conduct and accusing him of soliciting bribes, and delivered it to St. Clair County State's Attorney Robert Haida. Cueto also filed a complaint in state court against Robinson, in which Cueto alleged that Robinson was a corrupt agent. *See Venezia v. Robinson*. Cueto obtained a court order that required Robinson to appear for a hearing in *People v. Moore*, one of the gambling prosecutions arising from the VFW raid. Pursuant to the order, Robinson appeared in state court, and Cueto immediately served him with a subpoena, which required him to appear in court within fifteen minutes for an injunction hearing in *Venezia v. Robinson*. Cueto had prepared a petition, requesting either a temporary restraining order or a preliminary and permanent injunction against alleged extortion and

other vexation to prevent Robinson from interfering with the operation of Venezia's business. Robinson had not seen a copy of the complaint, had not been served with process, and was not represented by counsel.

At the hearing, Robinson's requests for an attorney were denied, and the state court judge permitted Cueto to question Robinson about the FBI's investigation (which at that point was still a covert operation) and the evidence it had obtained in the course of the investigation. Without permitting Robinson to put on a defense and without articulating any findings of fact or conclusions of law, the state court entered a preliminary injunction against Robinson, which indefinitely enjoined him from interfering with Venezia's business operations. Venezia then returned to the VFW, as well as other taverns affiliated with the gambling operation, to advise them that a state court judge had entered an injunction against Robinson and that he could no longer interfere with their establishments and the illegal gambling operation.

Notwithstanding the injunction and pursuant to instructions from the Director of ILCC to continue his routine liquor inspections, Robinson visited another establishment associated with B & H's gambling operation and discovered that the tavern owner was providing illegal gambling payouts on some of the video machines. Thereafter, Dorothy McCaw was arrested for operating and maintaining an illegal gambling establishment, and she signed a written confession for her participation in illegal gambling activities. Upon learning of the inspection and arrest, Venezia contacted Cueto, who arranged for Venezia and Romanik, the third individual charged in the instant indictment, to obtain another statement from McCaw. Cueto then drafted a letter to the ILCC, State's Attorney Haida, the Office of the United States Attorney for the Southern District of Illinois, and the FBI, claiming that his client was suffering damage as a result of Robinson's "unlawful" interference with the operation of Venezia's business and threatened that if the conduct continued, he would file suit against the ILCC, in addition to Robinson, for damages incurred. Without McCaw's knowledge, Cueto attached to that letter the statement she had given to Venezia and Romanik, which supported Cueto's allegations of interference. Cueto also filed a rule to show cause in state court, which described Robinson's violations of the injunction and requested the court to find him in contempt; McCaw's statement also was attached to the rule to show cause, again without her knowledge. . . .

During the investigation, the record indicates that Cueto and Venezia developed more than a professional attorney-client relationship, entering into various financial transactions and business deals, some of which involved secret partnerships. A few examples include: (1) they purchased unimproved real estate, developed the real estate, built and managed a topless nightclub (Club Exposed), which operated some of B & H's illegal gambling machines; (2) Venezia and Cueto incorporated Millennium III, an asbestos removal company, and applied for and obtained a \$600,000 line of credit to complete the purchase acquisition; and (3) Venezia purchased Cueto's office building and moved B & H corporate headquarters into it. The record demonstrates that in order to obtain financing, Venezia reported B & H as a principal asset on his financial

statements and loan applications to establish the necessary credit he and Cueto needed to become joint borrowers on various loans. Moreover, the record indicates that the lender in the Millennium purchase relied upon Venezia's financial statement in its decision to loan the money for the acquisition.

About the time the Millennium purchase was finalized, state police and Robinson arrested George Vogt, a B & H customer, for gambling. At a hearing in the state's prosecution of Vogt, Robinson testified and Cueto cross-examined him. After the hearing, Cueto again approached State's Attorney Haida, provided him with the transcripts from the *Vogt* hearing, and urged Haida to indict Robinson for perjury. Thereafter, Haida commenced an investigation of Robinson's activities. Nothing came of Cueto's allegations of perjury, and the investigation ended without any charges being filed.

The investigation of Venezia and B & H began in early 1992, and the events discussed above occurred over a period of approximately three years. We briefly mentioned some of the initial business and financial dealings between Venezia and Cueto, but . . . we think it unnecessary to specifically discuss every financial transaction contained in the record except to point out that together Venezia and Cueto participated in various business transactions, in which millions of dollars exchanged hands to finance the purchases of various real estate interests and construction costs relating to various development projects, including certain gambling operations. The indictment specifically charged that Club Exposed, the nightclub owned by Venezia and Cueto, Millennium III, as well as other business transactions in which they were involved, depended upon the continued operation of B & H and the illegal gambling business to secure and to cover the various loans and debts they incurred in their financial ventures.

Even after Cueto became a business partner of Venezia, . . . he continued to give Venezia legal advice. Although Cueto was not an attorney of record, he participated in the preparation of Venezia's defense in the racketeering prosecution. Cueto continued to urge State's Attorney Haida to indict Robinson for perjury. He also contacted Congressman Jerry Costello, who owned an equal one-third partnership interest in a gambling development project with Cueto and Venezia, and asked the Congressman to contact Haida and to offer him a seat on the judiciary in exchange for Haida's recommendation that Cueto be appointed as the next State's Attorney. Cueto also began to publish a newspaper, the *East Side Review*, and authored an article in which he indicated that in the next election he intended to run for St. Clair County State's Attorney, and in the event he was elected, he would prosecute Robinson.

In August of 1994, the government empaneled a grand jury to examine the evidence obtained in the FBI's investigation of Venezia and B & H, and the grand jury also initiated its own investigation of these allegations. In response, Cueto prepared and filed various motions to hinder the investigation and to discharge the grand jury, all of which were denied. Notwithstanding the defense tactics and delays, the grand jury indicted

Venezia, among others; he was prosecuted, and ultimately, convicted for operating an illegal gambling enterprise, in addition to other related convictions. . . .

After a jury trial, Cueto was convicted of the charges in Counts 1, 2, 6, and 7 and the district court ordered him to serve a prison term of 87 months, to be followed by two years of supervised release, and imposed monetary penalties. . . .

Cueto asserts several arguments with respect to his convictions on Counts 2, 6, and 7 for obstruction of justice, contending that the omnibus clause of § 1503 is unconstitutionally vague as applied to the conduct charged in the indictment . . . Cueto argues that “much of what lawyers *do*—are attempts to influence the justice system,” and that the omnibus clause of § 1503 was not intended to apply to the type of conduct charged in the indictment. . . .

“[I]n determining the scope of a statute, one is to look first at its language. If the language is unambiguous, ordinarily it is to be regarded as conclusive unless there is ‘a clearly expressed legislative intent to the contrary.’” *Dickerson v. New Banner Institute, Inc.* (quoting *Consumer Product Safety Comm’n v. GTE Sylvania, Inc.*). The omnibus clause of § 1503 is a catch-all provision . . . intended to ensure that criminals could not circumvent the statute’s purpose “by devising novel and creative schemes that would interfere with the administration of justice but would nonetheless fall outside the scope of § 1503’s specific prohibitions.” . . .

Cueto also contends that the vagueness problems are exacerbated by this court’s broad construction of the term “corruptly,” arguing that it fails to provide meaningful and adequate notice as to what conduct is proscribed by the statute. The Seventh Circuit has approved a jury instruction which articulates a definition for the term “corruptly”:

Corruptly means to act with the purpose of obstructing justice. The United States is not required to prove that the defendant’s only or even main purpose was to obstruct the due administration of justice. The government only has to establish that the defendant should have reasonably seen that the natural and probable consequences of his acts was the obstruction of justice. Intent may be inferred from all of the surrounding facts and circumstances. Any act, by any party, whether lawful or unlawful on its face, may violate Section 1503, if performed with a corrupt motive.

The mere fact that a term “covers a broad spectrum of conduct” does not render it vague, and the requirement that a statute must give fair notice as to what conduct is proscribed “cannot be used as a shield by one who is already bent on serious wrongdoing.” *Griffin*.

There is little case authority directly on point to consider whether an attorney acting in his professional capacity could be criminally liable under the omnibus clause of § 1503 for traditional litigation-related conduct that results in an obstruction of justice. “Correct application of Section 1503 thus requires, in a very real sense, that the factfinder

discern—by direct evidence or from inference—the motive which led an individual to perform particular actions. . . . ‘Intent may make any otherwise innocent act criminal, if it is a step in a plot.’” *United States v. Cintolo*. . . . Otherwise lawful conduct, even acts undertaken by an attorney in the course of representing a client, can transgress § 1503 if employed with the corrupt intent to accomplish that which the statute forbids. . . .

The government’s theory of prosecution is predicated on the fact that Cueto held a personal financial interest in protecting the illegal gambling enterprise, which formed the requisite corrupt intent for his conduct to qualify as violations of the statute. Cueto focuses entirely on the legality of his conduct, and not the requisite criminal intent proscribed by § 1503. It is undisputed that an attorney may use any *lawful* means to defend his client, and there is no risk of criminal liability if those means employed by the attorney in his endeavors to represent his client remain within the scope of lawful conduct. However, it is the corrupt endeavor to protect the illegal gambling operation and to safeguard his own financial interest, which motivated Cueto’s otherwise legal conduct, that separates his conduct from that which is legal.

Even though courts may be hesitant, with good reason and caution, to include traditional litigation-related conduct within the scope of § 1503, the omnibus clause has been interpreted broadly in accordance with congressional intent to promote the due administration of justice and to prevent the miscarriage of justice, and an individual’s status as an attorney engaged in litigation-related conduct does not provide protection from prosecution for criminal conduct. . . . More so than an ordinary individual, an attorney, in particular a criminal defense attorney, has a sophisticated understanding of the type of conduct that constitutes criminal violations of the law. There is a discernable difference between an honest lawyer who unintentionally submits a false statement to the court and an attorney with specific corrupt intentions who files papers in bad faith knowing that they contain false representations and/or inaccurate facts in an attempt to hinder judicial proceedings. It is true that, to a certain extent, a lawyer’s conduct influences judicial proceedings, or at least attempts to affect the outcome of the proceedings. However, that influence stems from a lawyer’s attempt to advocate his client’s interests *within the scope of the law*. It is the “corrupt endeavor” to influence the due administration of justice that is the heart of the offense, and Cueto’s personal financial interest is the heart of his corrupt motive. . . .

We have carefully examined the fears articulated by the National Association of Criminal Defense Lawyers, in addition to the arguments put forth by the defendant, that a decision upholding the application of the omnibus clause of § 1503 to litigation-related conduct may deter or somehow chill the criminal defense lawyers in zealous advocacy, and we find those concerns to be exaggerated, at least as considered in light of the facts in the present case. Although we appreciate that it is of significant importance to avoid chilling vigorous advocacy and to maintain the balance of effective representation, we also recognize that a lawyer’s misconduct and criminal acts are not absolutely immune from prosecution. We cannot ignore Cueto’s corrupt endeavors to manipulate the

administration of justice and his clear criminal violations of the law. As the First Circuit recognized in *Cintolo*:

Nothing in the caselaw, fairly read, suggests that lawyers should be plucked gently from the maddening [sic] crowd and sheltered from the rigors of 18 U.S.C. § 1503 in the manner urged by appellant and by the amici. Nor is there sufficient public policy justification favoring such a result. To the contrary, the overriding public policy interest is that “[t]he attorney-client relationship cannot . . . be used to shield or promote illegitimate acts. . . .” “[A]ttorneys, just like all other persons, . . . are not above the law and are subject to its full application under appropriate circumstances.”

Accordingly, we conclude that the omnibus clause of § 1503 may be used to prosecute a lawyer’s litigation-related criminality and that neither the omnibus clause of § 1503 nor this court’s construction of the term “corruptly” is unconstitutionally vague as applied to the conduct charged in the indictment for which Cueto was convicted.

We now turn to Cueto’s argument that his convictions on the obstruction of justice counts were not supported by sufficient evidence. Cueto’s task is a formidable one, and an examination of the record illuminates that the evidence presented in this case overwhelmingly supports the jury’s verdict. . . .

Cueto’s conduct, though nominally litigation-related conduct on behalf of his client, was undertaken with the corrupt intent to protect Venezia, Venezia’s associates, and his business from criminal prosecution and to safeguard his personal financial interest in the illegal gambling operation, whatever the costs and consequences to the due administration of justice.

The charges in Count 2 of the indictment included allegations of a corrupt endeavor to obstruct the due administration of justice in *Venezia v. Robinson* by filing pleadings in federal district court and a continued attempt to hinder the proceedings by filing an appeal in this court and a petition for certiorari in the United States Supreme Court. The evidence demonstrates that Cueto successfully exposed the FBI’s investigation, uncovered the evidence it had gathered, obtained the injunction against Robinson, and continued to file frivolous appeals after the district court dismissed the injunction and the complaint. . . . The jury was amply justified in concluding that Cueto’s repeated filings were motivated by his attempt to protect his client from prosecution and to safeguard his financial interest. Cueto’s actions may qualify as traditional litigation-related conduct in form, but not in substance, and the evidence presented at trial demonstrates that Cueto clearly intended and corruptly endeavored to obstruct the due administration of justice in *Venezia v. Robinson*.

Similar to Count 2, Count 7 includes allegations of preparing and filing and causing defense counsel to prepare and file false pleadings and other court papers; the indictment specifically charged Cueto with encouraging defense counsel in the racketeering case to

file false motions and pleadings for the purpose of impeding and obstructing the administration of justice in that case. We have no doubt that Cueto in fact intended to interfere with the investigation, attempted to delay the indictment, and endeavored to obstruct the proceedings in federal district court in connection with the prosecution of Venezia. We simply are not dealing with non-corrupt, legitimate involvement in the preparation of Venezia's (and his co-defendants') defense. Nor are we dealing with inadvertent interference. From the evidence presented at trial, the jury was amply justified in concluding without a doubt that Cueto corruptly endeavored to obstruct the district court's proceedings in the gambling and racketeering prosecution.

In response to his conviction on Count 6, Cueto argues that his conviction should be reversed because the *Aguilar* nexus is absent; he contends that the government presented insufficient evidence to establish the relationship between his attempts to persuade State's Attorney Haida to investigate and indict Robinson and a pending judicial proceeding. . . . "It is well established that investigations undertaken with the intention of presenting evidence before a grand jury are sufficient to constitute 'the due administration of justice' under § 1503." *Maloney*.

Though Cueto's initial calls and letters to State's Attorney Haida may pre-date the empaneling of the grand jury, the phone call to Congressman Costello occurred after the indictment was unsealed. In addition, his letters to the State's Attorney occurred throughout the investigation, and the evidence indicates that Cueto knew of the investigation. Accordingly, Cueto's conduct prior to the empaneling of the grand jury as well as his subsequent acts to encourage State's Attorney Haida to investigate and prosecute Agent Robinson have the requisite nexus to the judicial proceedings. . . .

Whatever the contours of the line between traditional lawyering and criminal conduct, they must inevitably be drawn case-by-case. We refuse to accept the notion that lawyers may do anything, including violating the law, to zealously advocate their clients' interests and then avoid criminal prosecution by claiming that they were "just doing their job." . . . We respect the importance of allowing defense counsel to perform legitimate activities without hindrance and recognize the potential dangers that could arise if prosecutors were permitted to inquire into the motives of criminal defense attorneys ad hoc. This case, however, does not create that avenue of inquiry; our conclusion is limited to the specific facts of this case. . . . The jury was justified in concluding that Cueto had the requisite knowledge of the FBI's investigation of Venezia, the grand jury's inquiry, and the district court's proceedings and then acted in a manner that had the natural and probable effect of interfering with the lawful function of those governmental entities and the due administration of justice. His role as a defense attorney did not insulate him from the criminal consequences of his corruptly-motivated actions. . .

C. Elements and Examples: Section 1512 and Document Destruction

This case involves the interpretation of (an older version of) § 1512 and its mens rea requirements, as well as further discussion of the nexus issue. More importantly, it involves another line-drawing problem relevant to the corporate context: How do we distinguish between acceptable evidence destruction in advance of litigation and obstruction of justice?

ARTHUR ANDERSEN LLP v. UNITED STATES, 544 U.S. 696 (2005)

Chief Justice REHNQUIST delivered the opinion of the Court.

As Enron Corporation's financial difficulties became public in 2001, petitioner Arthur Andersen LLP, Enron's auditor, instructed its employees to destroy documents pursuant to its document retention policy. A jury found that this action made petitioner guilty of violating 18 U.S.C. §§ 1512(b)(2)(A) and (B). These sections make it a crime to "knowingly us[e] intimidation or physical force, threat[e]n, or corruptly persuad[e] another person . . . with intent to . . . cause" that person to "withhold" documents from, or "alter" documents for use in, an "official proceeding." The Court of Appeals for the Fifth Circuit affirmed. We hold that the jury instructions failed to convey properly the elements of a "corrup[t] persua[sion]" conviction under § 1512(b), and therefore reverse.

Enron Corporation, during the 1990's, switched its business from operation of natural gas pipelines to an energy conglomerate, a move that was accompanied by aggressive accounting practices and rapid growth. Petitioner audited Enron's publicly filed financial statements and provided internal audit and consulting services to it. Petitioner's "engagement team" for Enron was headed by David Duncan. Beginning in 2000, Enron's financial performance began to suffer, and, as 2001 wore on, worsened. On August 14, 2001, Jeffrey Skilling, Enron's Chief Executive Officer (CEO), unexpectedly resigned. Within days, Sherron Watkins, a senior accountant at Enron, warned Kenneth Lay, Enron's newly reappointed CEO, that Enron could "implode in a wave of accounting scandals." She likewise informed Duncan and Michael Odom, one of petitioner's partners who had supervisory responsibility over Duncan, of the looming problems.

On August 28, an article in the Wall Street Journal suggested improprieties at Enron, and the SEC opened an informal investigation. By early September, petitioner had formed an Enron "crisis-response" team, which included Nancy Temple, an in-house counsel. On October 8, petitioner retained outside counsel to represent it in any litigation that might arise from the Enron matter. The next day, Temple discussed Enron with other in-house counsel. Her notes from that meeting reflect that "some SEC investigation" is "highly probable."

On October 10, Odom spoke at a general training meeting attended by 89 employees. . . . Odom urged everyone to comply with the firm's document retention policy. He added:

“[I]f it’s destroyed in the course of [the] normal policy and litigation is filed the next day, that’s great. . . . [W]e’ve followed our own policy, and whatever there was that might have been of interest to somebody is gone and irretrievable.” On October 12, Temple entered the Enron matter into her computer, designating the “Type of Potential Claim” as “Professional Practice—Government/Regulatory Inv[estigation].” Temple also e-mailed Odom, suggesting that he “remin[d] the engagement team of our documentation and retention policy.”

On October 16, Enron announced its third quarter results. That release disclosed a \$1.01 billion charge to earnings. The following day, the SEC notified Enron by letter that it had opened an investigation in August and requested certain information and documents. On October 19, Enron forwarded a copy of that letter to petitioner.

On the same day, Temple also sent an e-mail to a member of petitioner’s internal team of accounting experts and attached a copy of the document policy. On October 20, the Enron crisis-response team held a conference call, during which Temple instructed everyone to “[m]ake sure to follow the [document] policy.” On October 23, Enron CEO Lay declined to answer questions during a call with analysts because of “potential lawsuits, as well as the SEC inquiry.” After the call, Duncan met with other Andersen partners on the Enron engagement team and told them that they should ensure team members were complying with the document policy. Another meeting for all team members followed, during which Duncan distributed the policy and told everyone to comply. These, and other smaller meetings, were followed by substantial destruction of paper and electronic documents.

On October 26, one of petitioner’s senior partners circulated a New York Times article discussing the SEC’s response to Enron. His e-mail commented that “the problems are just beginning and we will be in the cross hairs. The marketplace is going to keep the pressure on this and is going to force the SEC to be tough.” On October 30, the SEC opened a formal investigation and sent Enron a letter that requested accounting documents.

Throughout this time period, the document destruction continued, despite reservations by some of petitioner’s managers. On November 8, Enron announced that it would issue a comprehensive restatement of its earnings and assets. Also on November 8, the SEC served Enron and petitioner with subpoenas for records. On November 9, Duncan’s secretary sent an e-mail that stated: “Per Dave—No more shredding. . . . We have been officially served for our documents.” Enron filed for bankruptcy less than a month later. Duncan was fired and later pleaded guilty to witness tampering.

In March 2002, petitioner was indicted in the Southern District of Texas on one count of violating §§ 1512(b)(2)(A) and (B). The indictment alleged that, between October 10 and November 9, 2001, petitioner “did knowingly, intentionally and corruptly persuade . . . other persons, to wit: [petitioner’s] employees, with intent to cause” them to withhold documents from, and alter documents for use in, “official proceedings, namely:

regulatory and criminal proceedings and investigations.” . . . The jury returned a guilty verdict.

Chapter 73 of Title 18 of the United States Code provides criminal sanctions for those who obstruct justice. Sections 1512(b)(2)(A) and (B), part of the witness tampering provisions, provide in relevant part:

Whoever knowingly uses intimidation or physical force, threatens, or corruptly persuades another person, or attempts to do so, or engages in misleading conduct toward another person, with intent to . . . cause or induce any person to . . . withhold testimony, or withhold a record, document, or other object, from an official proceeding [or] alter, destroy, mutilate, or conceal an object with intent to impair the object’s integrity or availability for use in an official proceeding . . . shall be fined under this title or imprisoned not more than ten years, or both.

In this case, our attention is focused on what it means to “knowingly . . . corruptly persuad[e]” another person “with intent to . . . cause” that person to “withhold” documents from, or “alter” documents for use in, an “official proceeding.” . . .

Indeed, “persuad[ing]” a person “with intent to . . . cause” that person to “withhold” testimony or documents from a Government proceeding or Government official is not inherently malign. Consider, for instance, a mother who suggests to her son that he invoke his right against compelled self-incrimination, *see* U.S. Const., Amdt. 5, or a wife who persuades her husband not to disclose marital confidences.

Nor is it necessarily corrupt for an attorney to “persuad[e]” a client “with intent to . . . cause” that client to “withhold” documents from the Government. In *Upjohn Co. v. United States*, for example, we held that Upjohn was justified in withholding documents that were covered by the attorney-client privilege from the Internal Revenue Service (IRS). No one would suggest that an attorney who “persuade[d]” Upjohn to take that step acted wrongfully, even though he surely intended that his client keep those documents out of the IRS’ hands.

“Document retention policies,” which are created in part to keep certain information from getting into the hands of others, including the Government, are common in business. It is, of course, not wrongful for a manager to instruct his employees to comply with a valid document retention policy under ordinary circumstances. . . .

Section 1512(b) punishes not just “corruptly persuad[ing]” another, but “*knowingly* corruptly persuad[ing]” another. The Government suggests that “knowingly” does not modify “corruptly persuades,” but that is not how the statute most naturally reads. It provides the *mens rea*—“knowingly”—and then a list of acts—“uses intimidation or physical force, threatens, or corruptly persuades.” We have recognized with regard to similar statutory language that the *mens rea* at least applies to the acts that immediately follow, if not to other elements down the statutory chain. The Government suggests that

it is “questionable whether Congress would employ such an inelegant formulation as ‘knowingly . . . corruptly persuades.’” Long experience has not taught us to share the Government’s doubts on this score, and we must simply interpret the statute as written.

The parties have not pointed us to another interpretation of “knowingly . . . corruptly” to guide us here. . . . “[K]nowledge” and “knowingly” are normally associated with awareness, understanding, or consciousness. “Corrupt” and “corruptly” are normally associated with wrongful, immoral, depraved, or evil. Joining these meanings together here makes sense both linguistically and in the statutory scheme. Only persons conscious of wrongdoing can be said to “knowingly . . . corruptly persuad[e].” And limiting criminality to persuaders conscious of their wrongdoing sensibly allows § 1512(b) to reach only those with the level of “culpability . . . we usually require in order to impose criminal liability.”

The outer limits of this element need not be explored here because the jury instructions at issue simply failed to convey the requisite consciousness of wrongdoing. Indeed, it is striking how little culpability the instructions required. . . . The instructions also diluted the meaning of “corruptly” so that it covered innocent conduct.

The parties vigorously disputed how the jury would be instructed on “corruptly.” The District Court based its instruction on the definition of that term found in the Fifth Circuit Pattern Jury Instruction for § 1503. This pattern instruction defined “corruptly” as “knowingly and dishonestly, with the specific intent to subvert or undermine the integrity” of a proceeding. The Government, however, insisted on excluding “dishonestly” and adding the term “impede” to the phrase “subvert or undermine.” The District Court agreed over petitioner’s objections, and the jury was told to convict if it found petitioner intended to “subvert, undermine, or impede” governmental factfinding by suggesting to its employees that they enforce the document retention policy.

These changes were significant. No longer was any type of “dishonest[y]” necessary to a finding of guilt, and it was enough for petitioner to have simply “impede[d]” the Government’s factfinding ability. As the Government conceded at oral argument, “[i]mpede” has broader connotations than “subvert” or even “[u]ndermine,” and many of these connotations do not incorporate any “corrupt[ness]” at all. The dictionary defines “impede” as “to interfere with or get in the way of the progress of” or “hold up” or “detract from.” Webster’s. By definition, anyone who innocently persuades another to withhold information from the Government “get[s] in the way of the progress of” the Government. With regard to such innocent conduct, the “corruptly” instructions did no limiting work whatsoever.

The instructions also were infirm for another reason. They led the jury to believe that it did not have to find *any* nexus between the “persua[sion]” to destroy documents and any particular proceeding. In resisting any type of nexus element, the Government relies heavily on § 1512(e)(1), which states that an official proceeding “need not be pending or about to be instituted at the time of the offense.” It is, however, one thing to say that a proceeding “need not be pending or about to be instituted at the time of the offense,”

and quite another to say a proceeding need not even be foreseen. A “knowingly . . . corrup[t] persaude[r]” cannot be someone who persuades others to shred documents under a document retention policy when he does not have in contemplation any particular official proceeding in which those documents might be material.

We faced a similar situation in *Aguilar*. Respondent Aguilar lied to a Federal Bureau of Investigation agent in the course of an investigation and was convicted of “‘corruptly endeavor[ing] to influence, obstruct, and impede [a] . . . grand jury investigation’.” All the Government had shown was that Aguilar had uttered false statements to an investigating agent “who might or might not testify before a grand jury.” We held that § 1503 required something more—specifically, a “nexus” between the obstructive act and the proceeding. “[I]f the defendant lacks knowledge that his actions are likely to affect the judicial proceeding,” we explained, “he lacks the requisite intent to obstruct.” . . .

The following very recent decision of the Supreme Court deals with the scope and reach of 18 U.S.C. § 1512(c)(2), a provision that was added to § 1512 in the wake of the Enron scandal discussed in the foregoing *Andersen* opinion. DOJ, at least, thought Congress at the time of enactment of (c)(2) was widely expanding 1512 into a kind of “omnibus” anti-obstruction law that could apply to pre-proceeding obstruction, partly at DOJ’s urging. The Supreme Court has now decided that is not what Congress did.

FISCHER v. UNITED STATES, 144 S.Ct. 2176 (2024)

CHIEF JUSTICE ROBERTS delivered the opinion of the Court.

The Sarbanes-Oxley Act of 2002 imposes criminal liability on anyone who corruptly “alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object’s integrity or availability for use in an official proceeding.” 18 U.S.C. § 1512(c)(1). The next subsection extends that prohibition to anyone who “otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so.” § 1512(c)(2). We consider whether this “otherwise” clause should be read in light of the limited reach of the specific provision that precedes it.

This case concerns the prosecution of petitioner Joseph Fischer for his conduct on January 6, 2021. That day, both Houses of Congress convened in a joint session to certify the votes in the 2020 Presidential election. While they did so, a crowd of supporters of then-President Donald Trump gathered outside the Capitol. As set forth in the criminal complaint against Fischer, some of the crowd eventually “forced entry” into the building, “breaking windows,” and “assaulting members of the U.S. Capitol Police.” This breach of the Capitol caused Members of Congress to evacuate the Chambers and delayed the certification process. The complaint alleges that Fischer was one of those who invaded the building.

According to the complaint, about an hour after the Houses recessed, Fischer trespassed into the Capitol and was involved in a physical confrontation with law enforcement.

Fischer claimed in Facebook posts that he “pushed police back about 25 feet,” and that he “was inside the [Capitol] talking to police.” Body camera footage shows Fischer near a scrum between the crowd and police who were trying to eject trespassers from the building.

A grand jury returned a seven-count superseding indictment against Fischer. Six of those counts allege that Fischer forcibly assaulted a federal officer, entered and remained in a restricted building, and engaged in disorderly and disruptive conduct in the Capitol, among other crimes. 18 U.S.C. §§ 111(a), 231(a)(3), 1752(a)(1), (a)(2); 40 U.S.C. §§ 5104(e)(2)(D), (G). Those six counts carry maximum penalties ranging from six months’ to eight years’ imprisonment.

In Count Three, the only count now before us, the Government charged Fischer with violating 18 U.S.C. § 1512(c)(2). Fischer moved to dismiss that count, arguing that the provision criminalizes only attempts to impair the availability or integrity of evidence. . . .

The controversy before us is about the scope of the residual “otherwise” clause in Section 1512(c)(2). On the one hand, Fischer contends that (c)(2) “applies only to acts that affect the integrity or availability of evidence.” On the other, the Government argues that (c)(2) “capture[s] all forms of obstructive conduct beyond Section 1512(c)(1)’s focus on evidence impairment.” . . .

Subsection (c)(1) describes particular types of criminal conduct in specific terms. To ensure the statute would not be read as excluding substantially similar activity not mentioned, (c)(2) says it is also illegal to engage in some broader range of unenumerated conduct.

The purpose of the “otherwise” clause is therefore, as the parties agree, to cover some set of “matters not specifically contemplated” by (c)(1). The problem is defining what exactly Congress left for (c)(2). Perhaps Congress sought to criminalize all obstructive acts in Section 1512(c), and having named a few examples in (c)(1), devised (c)(2) to prohibit the rest in one go. The point of (c)(1) would then be to illustrate just one type of conduct among many (c)(2) prohibits; it would be subsidiary to the overarching prohibition in (c)(2). But (c)(2) could well have a narrower scope if Congress designed it with the focused language of (c)(1) in mind. Subsection (c)(1) would then prohibit particular types of obstructive conduct and (c)(2) would fill any inadvertent gaps that might exist.

One way to discern the reach of an “otherwise” clause is to look for guidance from whatever examples come before it. Two general principles are relevant. First, the canon of *noscitur a sociis* teaches that a word is “given more precise content by the neighboring words with which it is associated.” *United States v. Williams*. That “avoid[s] ascribing to one word a meaning so broad that it is inconsistent with” “the company it keeps.” *Gustafson v. Alloyd Co.* And under the related canon of *ejusdem generis*, “a ‘general or collective term’ at the end of a list of specific items” is typically “‘controlled and defined

by reference to' the specific classes. . .that precede it." *Southwest Airlines Co. v. Saxon*. These approaches to statutory interpretation track the common sense intuition that Congress would not ordinarily introduce a general term that renders meaningless the specific text that accompanies it.

To see why, consider a straightforward example. A zoo might post a sign that reads, "do not pet, feed, yell or throw objects at the animals, or otherwise disturb them." If a visitor eats lunch in front of a hungry gorilla, or talks to a friend near its enclosure, has he obeyed the regulation? Surely yes. Although the smell of human food or the sound of voices might well disturb gorillas, the specific examples of impermissible conduct all involve direct interaction with and harassment of the zoo animals. Merely eating or talking is so unlike the examples that the zoo provided that it would be implausible to assume those activities were prohibited, even if literally covered by the language. . . .

If, as the Government asserts, (c)(2) covers "all forms of obstructive conduct beyond Section 1512(c)(1)'s focus on evidence impairment," there would have been scant reason for Congress to provide any specific examples at all. The sweep of subsection (c)(2) would consume (c)(1), leaving that narrower provision with no work to do. Indeed, subsection (c)(1) would be an elaborate pumpfake: a list of four types of highly particularized conduct, performed with respect to a record, document, or object and "with the intent to impair the object's integrity or availability for use in an official proceeding," followed in the very next subsection—in the same sentence, no less—by a superseding prohibition on all means of obstructing, influencing, or impeding any official proceeding. Construing Section 1512 in such a way gets the "familiar" analysis we apply to these types of statutes "exactly backwards," eliminating specific terms because of broad language that follows them, rather than limiting the broad language in light of narrower terms that precede it. . . .

Prior to the Sarbanes-Oxley Act, Section 1512 imposed criminal liability on anyone who "knowingly uses intimidation or physical force, threatens, or corruptly persuades another person" to, among other things, shred documents. 18 U.S.C. § 1512(b)(2)(B) (2000 ed.). But the Enron accounting scandal revealed a loophole: Although Enron's "outside auditor, Arthur Andersen LLP, had systematically destroyed potentially incriminating documents," the statute curiously failed to "impos[e] liability on a person who destroys records himself." *Yates*. As a result, prosecutors had to prove that higher-ups at Enron and Arthur Andersen persuaded someone else to shred documents rather than the more obvious theory that someone who shreds documents is liable for doing so.

The parties agree that to plug this loophole, Congress enacted Section 1512(c)—the provision at issue here—as part of the broader Sarbanes-Oxley Act. It would be peculiar to conclude that in closing the Enron gap, Congress actually hid away in the second part of the third subsection of Section 1512 a catchall provision that reaches far beyond the document shredding and similar scenarios that prompted the legislation in the first place. The better conclusion is that subsection (c)(2) was designed by Congress to capture other

forms of evidence and other means of impairing its integrity or availability beyond those Congress specified in (c)(1). . . .

Our usual approach in obstruction cases has been to “resist reading” particular sub-provisions “to create a coverall” statute, as the Government would have us do here. And there is no reason to depart from that practice today. Nothing in the text or statutory history suggests that subsection (c)(2) is designed to impose up to 20 years’ imprisonment on essentially all defendants who commit obstruction of justice in any way and who might be subject to lesser penalties under more specific obstruction statutes. See, e.g., §§ 1503(b)(3), 1505. If Congress had wanted to authorize such penalties for any conduct that delays or influences a proceeding in any way, it would have said so. Instead, Section 1512 mentions “record,” “document,” or other “object” 26 times. . . .

Justice BARRETT, with whom Justice SOTOMAYOR and Justice KAGAN join, dissenting.

Joseph Fischer allegedly joined a mob of rioters that breached the Capitol on January 6, 2021. At the time, Congress was meeting in a joint session to certify the Electoral College results. The riot forced Congress to suspend the proceeding, delaying it for several hours.

The Court does not dispute that Congress’s joint session qualifies as an “official proceeding”; that rioters delayed the proceeding; or even that Fischer’s alleged conduct (which includes trespassing and a physical confrontation with law enforcement) was part of a successful effort to forcibly halt the certification of the election results. Given these premises, the case that Fischer can be tried for “obstructing, influencing, or impeding an official proceeding” seems open and shut. So why does the Court hold otherwise?

Because it simply cannot believe that Congress meant what it said. Section 1512(c)(2) is a very broad provision, and admittedly, events like January 6th were not its target. (Who could blame Congress for that failure of imagination?) But statutes often go further than the problem that inspired them, and under the rules of statutory interpretation, we stick to the text anyway. The Court, abandoning that approach, does textual backflips to find some way—any way—to narrow the reach of subsection (c)(2). I respectfully dissent. . . .

The case for the Government’s interpretation is straightforward. It can be accomplished in three paragraphs, as compared to the Court’s many, many more.

Start with the verbs: To “obstruct” and to “impede” mean to “hinder” or “retard” something’s “passage” or “progress.” 10 Oxford English Dictionary 668 (2d ed. 1989). We have previously explained that these words are “broad.” *Marinello v. United States*. To “influence” is similarly expansive, meaning “[t]o affect the condition of” or “to have an effect on” something. 7 Oxford English Dictionary. The object of these verbs is an “official proceeding,” defined to include “a proceeding before the Congress.” 18 U.S.C.

§ 1515(a)(1)(B). So (c)(2) covers all sorts of actions that affect or interfere with official proceedings.

“[O]therwise,” which introduces 18 U.S.C. § 1512(c)(2), does not narrow its scope. “Otherwise” means “in a different manner,” “by other means,” or “in other respects.” 10 Oxford English Dictionary, at 984; Webster's Third New International Dictionary (2002). It is often used to introduce a “catchall phras[e].” Here, “otherwise” tells the reader how (c)(1) and (c)(2) fit together. Subsection (c)(1) prohibits “alter[ing], destroy[ing], mutilat[ing], or conceal[ing] a record, document, or other object” with “intent to impair [its] integrity or availability for use in an official proceeding.” In other words, (c)(1) targets document and object spoliation—classic means of obstruction. Subsection (c)(2) then prohibits obstructing, influencing, or impeding an official proceeding by means different from those specified in (c)(1), thereby serving as a catchall. The “enumerated” crimes in (c)(1) and the “unenumerated crimes” in (c)(2) are similar “on one specific dimension”: “the particular similarity specified after the ‘otherwise.’” Here, that means that each crime represents one means through which to obstruct, influence, or impede an official proceeding.

Joseph Fischer allegedly participated in a riot at the Capitol that forced the delay of Congress's joint session on January 6th. Blocking an official proceeding from moving forward surely qualifies as obstructing or impeding the proceeding by means other than document destruction. Fischer's alleged conduct thus falls within (c)(2)'s scope. . . .

[The] canons are valuable tools. But applying either to (c)(2) is like using a hammer to pound in a screw—it looks like it might work, but using it botches the job. Unlike the pattern to which the noscitur canon applies, § 1512(c) is not a list of terms that includes an ambiguous word. So the Court does not do what it does when applying noscitur: select between multiple accepted meanings of the words “obstructs,” “influences,” and “impedes.” Instead, it modifies those words by adding an adverbial phrase: obstructs, influences or impedes by “impair[ing] the availability or integrity for use in an official proceeding of records, documents, or objects.” The ejusdem canon is an equally poor fit. Unlike the pattern to which ejusdem applies, (c)(2) is “not a general or collective term following a list of specific items to which a particular statutory command is applicable.” *United States v. Aguilar*. Instead, (c)(1) and (c)(2) are “distinct and independent prohibitions.” Though they share a subject and an adverb—“[w]hoever corruptly”—the two clauses contain different verbs that take different objects. § 1512(c). Moreover, (c)(1) has a separate mens rea provision that further disrupts the connection between the clauses.

To my knowledge, we have never applied either of these canons to a statute resembling § 1512(c). Rather than identify such a case, the Court invents examples of a sign at the zoo The zoo example (“do not pet, feed, yell or throw objects at the animals, or otherwise disturb them”) does not help, because it mimics the typical ejusdem format of specific words followed by a catchall. The list of specific verbs makes clear that the cleanup phrase (“otherwise disturb”) is limited to conduct that involves direct interaction

with the animals. But in the absence of a laundry list followed by a catchall, it is hard to see why the *ejusdem* canon fits.

The Court's football example is only slightly better. As a refresher:

“[A] football league might adopt a rule that players must not ‘grab, twist, or pull a facemask, helmet, or other equipment with the intent to injure a player, or otherwise attack, assault, or harm any player.’ If a linebacker shouts insults at the quarterback and hurts his feelings, has the linebacker nonetheless followed the rule? Of course he has. The examples of prohibited actions all concern dangerous physical conduct that might inflict bodily harm; trash talk is simply not of that kind.”

Put aside that it is hard to imagine anyone describing “trash talk” as inflicting an “injury” or “harming” a player in a football game. The league rule plainly forecloses the possibility. Consistent with the *noscitur* canon, “harm” takes its meaning from its companions “attack” and “assault.” And while the Court tries to track § 1512(c)’s structure by adding an extra intent clause, the two clauses in its example are still tightly focused on actions directed at the player. (After all, who is wearing the facemask, helmet, or other equipment?) Given that shared theme, it is easy to understand that the first clause’s focus on physical conduct limits the (only slightly) more general clause. But § 1512(c)’s subsections are not so closely related—(c)(1) focuses specifically on objects in a proceeding, and (c)(2) broadens the lens to the proceeding itself.

Consider a rule that actually mirrors § 1512(c):

“Any player who:

“(1) punches, chokes, or kicks an opposing player with the intent to remove him from the game; or

“(2) otherwise interrupts, hinders, or interferes with the game,

“shall be suspended.”

While the specific verbs in the first clause involve actions directed at an opposing player, the second clause is a separate prohibition with an entirely different object. Imagine that, just before the opposing team's kicker attempts a field goal, players leave the sidelines and storm the field, some tackling referees in the process. Those players have surely “interrupt[ed], hinder[ed], or interfer[ed] with the game,” even though they have not physically injured any opponent. This hypothetical, not the Court's, is analogous to § 1512(c)—and it supports the Government's interpretation. . . .

Problem 8-1

Mary, General Counsel of Garmentcorp, learns that Garmentcorp is to be subject to a DOJ investigation for potential violations of the Foreign Corrupt Practices Act involving its operations in Bangladesh. DOJ informs Mary that it intends to interview dozens of Garmentcorp employees and/or subpoena them to testify before a grand jury. Mary retains Biglawfirm, which does not represent Garmentcorp as a corporation, to represent the Garmentcorp employees individually in their interactions with the government, at Garmentcorp's expense. After discussing the fee arrangements with the lead partner on the matter at Biglawfirm, Mary says to her, "Make sure to pound it into their heads that they should say they 'do not recall' if they are the least bit unsure about whether they are getting a fact correct." Has Mary committed a crime?

Special Counsel Robert Mueller's report on obstruction of justice in connection with President Trump and the investigation of 2016 Russian election interference, excerpted below, serves two purposes here: (i) to summarize the law of obstruction of justice (at least prior to *Fischer*); and (ii) to provide a challenging scenario, based on which you should ask: Did the President commit one or more violations of the obstruction statutes in this scenario, leaving aside the question of whether a sitting president is constitutionally amenable to indictment?¹

Report On The Investigation Into Russian Interference In The 2016 Presidential Election

Volume II of II

Special Counsel Robert S. Mueller, III

Washington, D.C. March 2019

EXECUTIVE SUMMARY TO VOLUME II

Our obstruction-of-justice inquiry focused on a series of actions by the President that related to the Russia interference investigations, including the President's conduct towards the law enforcement officials overseeing the investigations and the witnesses to relevant events.

¹ The legal analysis in Volume II of the report is far longer than these excerpts and is a useful reference source on the law of obstruction, as well as on some separation-of-powers questions. For the full volume, see ROBERT S. MUELLER, REPORT ON THE INVESTIGATION INTO RUSSIAN INTERFERENCE IN THE 2016 PRESIDENTIAL ELECTION (March 2019), <https://www.justice.gov/storage/report.pdf>.

FACTUAL RESULTS OF THE OBSTRUCTION INVESTIGATION

The key issues and events we examined include the following:

The Campaign's response to reports about Russian support for Trump. During the 2016 presidential campaign, questions arose about the Russian government's apparent support for candidate Trump. After WikiLeaks released politically damaging Democratic Party emails that were reported to have been hacked by Russia, Trump publicly expressed skepticism that Russia was responsible for the hacks at the same time that he and other Campaign officials privately sought information about any further planned WikiLeaks releases. Trump also denied having any business in or connections to Russia, even though as late as June 2016 the Trump Organization had been pursuing a licensing deal for a skyscraper to be built in Russia called Trump Tower Moscow. After the election, the President expressed concerns to advisors that reports of Russia's election interference might lead the public to question the legitimacy of his election.

Conduct involving FBI Director Comey and Michael Flynn. In mid-January 2017, incoming National Security Advisor Michael Flynn falsely denied to the Vice President, other administration officials, and FBI agents that he had talked to Russian Ambassador Sergey Kislyak about Russia's response to U.S. sanctions on Russia for its election interference. On January 27, the day after the President was told that Flynn had lied to the Vice President and had made similar statements to the FBI, the President invited FBI Director Comey to a private dinner at the White House and told Comey that he needed loyalty. On February 14, the day after the President requested Flynn's resignation, the President told an outside advisor, "Now that we fired Flynn, the Russia thing is over." The advisor disagreed and said the investigations would continue.

Later that afternoon, the President cleared the Oval Office to have a one-on-one meeting with Comey. Referring to the FBI's investigation of Flynn, the President said, "I hope you can see your way clear to letting this go, to letting Flynn go. He is a good guy. I hope you can let this go." Shortly after requesting Flynn's resignation and speaking privately to Comey, the President sought to have Deputy National Security Advisor K.T. McFarland draft an internal letter stating that the President had not directed Flynn to discuss sanctions with Kislyak. McFarland declined because she did not know whether that was true, and a White House Counsel's Office attorney thought that the request would look like a quid pro quo for an ambassadorship she had been offered.

The President's reaction to the continuing Russia investigation. In February 2017, Attorney General Jeff Sessions began to assess whether he had to recuse himself from campaign-related investigations because of his role in the Trump Campaign. In early March, the President told White House Counsel Donald McGahn to stop Sessions from recusing. And after Sessions announced his recusal on March 2, the President expressed anger at the decision and told advisors that he should have an Attorney General who would protect him. That weekend, the President took Sessions aside at an event and urged him to "unrecuse." Later in March, Comey publicly disclosed at a congressional hearing that the FBI was investigating "the Russian government's efforts to interfere in

the 2016 presidential election,” including any links or coordination between the Russian government and the Trump Campaign. In the following days, the President reached out to the Director of National Intelligence and the leaders of the Central Intelligence Agency (CIA) and the National Security Agency (NSA) to ask them what they could do to publicly dispel the suggestion that the President had any connection to the Russian election-interference effort. The President also twice called Comey directly, notwithstanding guidance from McGahn to avoid direct contacts with the Department of Justice. Comey had previously assured the President that the FBI was not investigating him personally, and the President asked Comey to “lift the cloud” of the Russia investigation by saying that publicly.

The President’s termination of Comey. On May 3, 2017, Comey testified in a congressional hearing, but declined to answer questions about whether the President was personally under investigation. Within days, the President decided to terminate Comey. The President insisted that the termination letter, which was written for public release, state that Comey had informed the President that he was not under investigation. The day of the firing, the White House maintained that Comey’s termination resulted from independent recommendations from the Attorney General and Deputy Attorney General that Comey should be discharged for mishandling the Hillary Clinton email investigation. But the President had decided to fire Comey before hearing from the Department of Justice. The day after firing Comey, the President told Russian officials that he had “faced great pressure because of Russia,” which had been “taken off” by Comey’s firing. The next day, the President acknowledged in a television interview that he was going to fire Comey regardless of the Department of Justice’s recommendation and that when he “decided to just do it,” he was thinking that “this thing with Trump and Russia is a made-up story.” In response to a question about whether he was angry with Comey about the Russia investigation, the President said, “As far as I’m concerned, I want that thing to be absolutely done properly,” adding that firing Comey “might even lengthen out the investigation.”

The appointment of a Special Counsel and efforts to remove him. On May 17, 2017, the Acting Attorney General for the Russia investigation appointed a Special Counsel to conduct the investigation and related matters. The President reacted to news that a Special Counsel had been appointed by telling advisors that it was “the end of his presidency” and demanding that Sessions resign. Sessions submitted his resignation, but the President ultimately did not accept it. The President told aides that the Special Counsel had conflicts of interest and suggested that the Special Counsel therefore could not serve. The President’s advisors told him the asserted conflicts were meritless and had already been considered by the Department of Justice.

On June 14, 2017, the media reported that the Special Counsel’s Office was investigating whether the President had obstructed justice. Press reports called this “a major turning point” in the investigation: while Comey had told the President he was not under investigation, following Comey’s firing, the President now was under investigation. The President reacted to this news with a series of tweets criticizing the Department of Justice

and the Special Counsel's investigation. On June 17, 2017, the President called McGahn at home and directed him to call the Acting Attorney General and say that the Special Counsel had conflicts of interest and must be removed. McGahn did not carry out the direction, however, deciding that he would resign rather than trigger what he regarded as a potential Saturday Night Massacre.

Efforts to curtail the Special Counsel's investigation. Two days after directing McGahn to have the Special Counsel removed, the President made another attempt to affect the course of the Russia investigation. On June 19, 2017, the President met one-on-one in the Oval Office with his former campaign manager Corey Lewandowski, a trusted advisor outside the government, and dictated a message for Lewandowski to deliver to Sessions. The message said that Sessions should publicly announce that, notwithstanding his recusal from the Russia investigation, the investigation was "very unfair" to the President, the President had done nothing wrong, and Sessions planned to meet with the Special Counsel and "let [him] move forward with investigating election meddling for future elections." Lewandowski said he understood what the President wanted Sessions to do.

One month later, in another private meeting with Lewandowski on July 19, 2017, the President asked about the status of his message for Sessions to limit the Special Counsel investigation to future election interference. Lewandowski told the President that the message would be delivered soon. Hours after that meeting, the President publicly criticized Sessions in an interview with the New York Times, and then issued a series of tweets making it clear that Sessions's job was in jeopardy. Lewandowski did not want to deliver the President's message personally, so he asked senior White House official Rick Dearborn to deliver it to Sessions. Dearborn was uncomfortable with the task and did not follow through.

Efforts to prevent public disclosure of evidence. In the summer of 2017, the President learned that media outlets were asking questions about the June 9, 2016 meeting at Trump Tower between senior campaign officials, including Donald Trump Jr., and a Russian lawyer who was said to be offering damaging information about Hillary Clinton as "part of Russia and its government's support for Mr. Trump." On several occasions, the President directed aides not to publicly disclose the emails setting up the June 9 meeting, suggesting that the emails would not leak and that the number of lawyers with access to them should be limited. Before the emails became public, the President edited a press statement for Trump Jr. by deleting a line that acknowledged that the meeting was with "an individual who [Trump Jr.] was told might have information helpful to the campaign" and instead said only that the meeting was about adoptions of Russian children. When the press asked questions about the President's involvement in Trump Jr.'s statement, the President's personal lawyer repeatedly denied the President had played any role.

Further efforts to have the Attorney General take control of the investigation. In early summer 2017, the President called Sessions at home and again asked him to reverse his

recusal from the Russia investigation. Sessions did not reverse his recusal. In October 2017, the President met privately with Sessions in the Oval Office and asked him to “take [a] look” at investigating Clinton. In December 2017, shortly after Flynn pleaded guilty pursuant to a cooperation agreement, the President met with Sessions in the Oval Office and suggested, according to notes taken by a senior advisor, that if Sessions unrecused and took back supervision of the Russia investigation, he would be a “hero.” The President told Sessions, “I’m not going to do anything or direct you to do anything. I just want to be treated fairly.” In response, Sessions volunteered that he had never seen anything “improper” on the campaign and told the President there was a “whole new leadership team” in place. He did not unrecuse.

Efforts to have McGahn deny that the President had ordered him to have the Special Counsel removed. In early 2018, the press reported that the President had directed McGahn to have the Special Counsel removed in June 2017 and that McGahn had threatened to resign rather than carry out the order. The President reacted to the news stories by directing White House officials to tell McGahn to dispute the story and create a record stating he had not been ordered to have the Special Counsel removed. McGahn told those officials that the media reports were accurate in stating that the President had directed McGahn to have the Special Counsel removed. The President then met with McGahn in the Oval Office and again pressured him to deny the reports. In the same meeting, the President also asked McGahn why he had told the Special Counsel about the President’s effort to remove the Special Counsel and why McGahn took notes of his conversations with the President. McGahn refused to back away from what he remembered happening and perceived the President to be testing his mettle.

Conduct towards Flynn, Manafort. After Flynn withdrew from a joint defense agreement with the President and began cooperating with the government, the President’s personal counsel left a message for Flynn’s attorneys reminding them of the President’s warm feelings towards Flynn, which he said “still remains,” and asking for a “heads up” if Flynn knew “information that implicates the President.” When Flynn’s counsel reiterated that Flynn could no longer share information pursuant to a joint defense agreement, the President’s personal counsel said he would make sure that the President knew that Flynn’s actions reflected “hostility” towards the President. During Manafort’s prosecution and when the jury in his criminal trial was deliberating, the President praised Manafort in public, said that Manafort was being treated unfairly, and declined to rule out a pardon. After Manafort was convicted, the President called Manafort “a brave man” for refusing to “break” and said that “flipping” “almost ought to be outlawed.” . . .

Conduct involving Michael Cohen. The President’s conduct towards Michael Cohen, a former Trump Organization executive, changed from praise for Cohen when he falsely minimized the President’s involvement in the Trump Tower Moscow project, to castigation of Cohen when he became a cooperating witness. From September 2015 to June 2016, Cohen had pursued the Trump Tower Moscow project on behalf of the Trump Organization and had briefed candidate Trump on the project numerous times, including discussing whether Trump should travel to Russia to advance the deal. In 2017, Cohen

provided false testimony to Congress about the project, including stating that he had only briefed Trump on the project three times and never discussed travel to Russia with him, in an effort to adhere to a “party line” that Cohen said was developed to minimize the President’s connections to Russia. While preparing for his congressional testimony, Cohen had extensive discussions with the President’s personal counsel, who, according to Cohen, said that Cohen should “stay on message” and not contradict the President. After the FBI searched Cohen’s home and office in April 2018, the President publicly asserted that Cohen would not “flip,” contacted him directly to tell him to “stay strong,” and privately passed messages of support to him. Cohen also discussed pardons with the President’s personal counsel and believed that if he stayed on message he would be taken care of. But after Cohen began cooperating with the government in the summer of 2018, the President publicly criticized him, called him a “rat,” and suggested that his family members had committed crimes.

Overarching factual issues. We did not make a traditional prosecution decision about these facts, but the evidence we obtained supports several general statements about the President’s conduct. Several features of the conduct we investigated distinguish it from typical obstruction-of-justice cases. First, the investigation concerned the President, and some of his actions, such as firing the FBI Director, involved facially lawful acts within his Article II authority, which raises constitutional issues discussed below. At the same time, the President’s position as the head of the Executive Branch provided him with unique and powerful means of influencing official proceedings, subordinate officers, and potential witnesses—all of which is relevant to a potential obstruction-of-justice analysis. Second, unlike cases in which a subject engages in obstruction of justice to cover up a crime, the evidence we obtained did not establish that the President was involved in an underlying crime related to Russian election interference. Although the obstruction statutes do not require proof of such a crime, the absence of that evidence affects the analysis of the President’s intent and requires consideration of other possible motives for his conduct. Third, many of the President’s acts directed at witnesses, including discouragement of cooperation with the government and suggestions of possible future pardons, took place in public view. That circumstance is unusual, but no principle of law excludes public acts from the reach of the obstruction laws. If the likely effect of public acts is to influence witnesses or alter their testimony, the harm to the justice system’s integrity is the same.

Although the series of events we investigated involved discrete acts, the overall pattern of the President’s conduct towards the investigations can shed light on the nature of the President’s acts and the inferences that can be drawn about his intent. In particular, the actions we investigated can be divided into two phases, reflecting a possible shift in the President’s motives. The first phase covered the period from the President’s first interactions with Comey through the President’s firing of Comey. During that time, the President had been repeatedly told he was not personally under investigation. Soon after the firing of Comey and the appointment of the Special Counsel, however, the President became aware that his own conduct was being investigated in an obstruction-of-justice inquiry. At that point, the President engaged in a second phase of conduct, involving

public attacks on the investigation, non-public efforts to control it, and efforts in both public and private to encourage witnesses not to cooperate with the investigation. Judgments about the nature of the President's motives during each phase would be informed by the totality of the evidence. . . .

Because we determined not to make a traditional prosecutorial judgment, we did not draw ultimate conclusions about the President's conduct. The evidence we obtained about the President's actions and intent presents difficult issues that would need to be resolved if we were making a traditional prosecutorial judgment. At the same time, if we had confidence after a thorough investigation of the facts that the President clearly did not commit obstruction of justice, we would so state. Based on the facts and the applicable legal standards, we are unable to reach that judgment. Accordingly, while this report does not conclude that the President committed a crime, it also does not exonerate him.

I. BACKGROUND LEGAL AND EVIDENTIARY PRINCIPLES

A. Legal Framework of Obstruction of Justice

Three basic elements are common to most of the relevant obstruction statutes: (1) an obstructive act; (2) a nexus between the obstructive act and an official proceeding; and (3) a corrupt intent. *See, e.g.*, 18 U.S.C. §§ 1503, 1505, 1512(c)(2). We describe those elements as they have been interpreted by the courts. We then discuss a more specific statute aimed at witness tampering, *see* 18 U.S.C. § 1512(b), and describe the requirements for attempted offenses and endeavors to obstruct justice, *see* 18 U.S.C. §§ 1503, 1512(c)(2).

Obstructive act. Obstruction-of-justice law “reaches all corrupt conduct capable of producing an effect that prevents justice from being duly administered, regardless of the means employed.” *United States v. Silverman* (interpreting 18 U.S.C. § 1503). An “effort to influence” a proceeding can qualify as an endeavor to obstruct justice even if the effort was “subtle or circuitous” and “however cleverly or with whatever cloaking of purpose” it was made. *United States v. Roe*; *see also United States v. Quattrone*. The verbs “‘obstruct or impede’ are broad” and “can refer to anything that blocks, makes difficult, or hinders.” *Marinello v. United States*.

An improper motive can render an actor's conduct criminal even when the conduct would otherwise be lawful and within the actor's authority. *See United States v. Cueto* (affirming obstruction conviction of a criminal defense attorney for “litigation- related conduct”); *United States v. Cintolo* (“any act by any party—whether lawful or unlawful on its face-may abridge § 1503 if performed with a corrupt motive”).

Nexus to a pending or contemplated official proceeding. Obstruction-of-justice law generally requires a nexus, or connection, to an official proceeding. In Section 1503, the nexus must be to pending “judicial or grand jury proceedings.” *United States v. Aguilar*. In Section 1505, the nexus can include a connection to a “pending” federal agency

proceeding or a congressional inquiry or investigation. Under both statutes, the government must demonstrate “a relationship in time, causation, or logic” between the obstructive act and the proceeding or inquiry to be obstructed. *see also Arthur Andersen LLP v. United States*. Section 1512(c) prohibits obstructive efforts aimed at official proceedings including judicial or grand jury proceedings. 18 U.S.C. § 1515(a)(1)(A). For purposes of Section 1512, “an official proceeding need not be pending or about to be instituted at the time of the offense.” 18 U.S.C. § 1512(f)(1). Although a proceeding need not already be in progress to trigger liability under Section 1512(c), a nexus to a contemplated proceeding still must be shown. *United States v. Young*; *United States v. Petruk*; *United States v. Phillips*; *United States v. Reich*. The nexus requirement narrows the scope of obstruction statutes to ensure that individuals have “fair warning” of what the law proscribes. *Aguilar*.

The nexus showing has subjective and objective components. As an objective matter, a defendant must act “in a manner that is likely to obstruct justice,” such that the statute “excludes defendants who have an evil purpose but use means that would only unnaturally and improbably be successful.” *Aguilar*. “[T]he endeavor must have the natural and probable effect of interfering with the due administration of justice.” As a subjective matter, the actor must have “contemplated a particular, foreseeable proceeding.” *Petruk*. A defendant need not directly impede the proceeding. Rather, a nexus exists if “discretionary actions of a third person would be required to obstruct the judicial proceeding if it was foreseeable to the defendant that the third party would act on the [defendant’s] communication in such a way as to obstruct the judicial proceeding.” *United States v. Martinez*.

Corruptly. The word “corruptly” provides the intent element for obstruction of justice and means acting “knowingly and dishonestly” or “with an improper motive.” *United States v. Richardson*; *United States v. Gordon* (to act corruptly means to “act[] with an improper purpose and to engage in conduct knowingly and dishonestly with the specific intent to subvert, impede or obstruct” the relevant proceeding) (some quotation marks omitted); *see* 18 U.S.C. § 1515(6) (“As used in section 1505, the term ‘corruptly’ means acting with an improper purpose, personally or by influencing another.”); *see also Arthur Andersen* (interpreting “corruptly” to mean “wrongful, immoral, depraved, or evil” and holding that acting “knowingly . . . corruptly” in 18 U.S.C. § 1512(c) requires “consciousness of wrongdoing”). The requisite showing is made when a person acted with an intent to obtain an “improper advantage for [him]self or someone else, inconsistent with official duty and the rights of others.” *BALLENTINE’S LAW DICTIONARY* (3d ed. 1969); *see United States v. Pasha*; *Aguilar* (characterizing this definition as the “longstanding and well-accepted meaning” of “corruptly”).

Witness tampering. A more specific provision in Section 1512 prohibits tampering with a witness. *See* 18 U.S.C. § 1512(b)(1)(3) (making it a crime to “knowingly use[] intimidation . . . or corruptly persuade[] another person,” or “engage[] in misleading conduct towards another person,” with the intent to “influence, delay, or prevent the testimony of any person in an official proceeding” or to “hinder, delay, or prevent the

communication to a law enforcement officer . . . of information relating to the commission or possible commission of a Federal offense”). To establish corrupt persuasion, it is sufficient that the defendant asked a potential witness to lie to investigators in contemplation of a likely federal investigation into his conduct. The “persuasion” need not be coercive, intimidating, or explicit; it is sufficient to “urge,” “induce,” “ask[],” “argu[e],” “giv[e] reasons,” *Sparks*, or “coach[] or remind[] witnesses by planting misleading facts,” *Edlund*. Corrupt persuasion is shown “where a defendant tells a potential witness a false story as if the story were true, intending that the witness believe the story and testify to it.” *United States v. Rodolitz*; see *United States v. Gabriel*. It also covers urging a witness to recall a fact that the witness did not know, even if the fact was actually true. See *LaShay*. Corrupt persuasion also can be shown in certain circumstances when a person, with an improper motive, urges a witness not to cooperate with law enforcement. See *United States v. Shotts* (telling secretary “not to [say] anything [to the FBI] and [she] would not be bothered”). . . .

Attempts and endeavors. Section 1512(c)(2) covers both substantive obstruction offenses and attempts to obstruct justice. Under general principles of attempt law, a person is guilty of an attempt when he has the intent to commit a substantive offense and takes an overt act that constitutes a substantial step towards that goal. “[T]he act [must be] substantial, in that it was strongly corroborative of the defendant’s criminal purpose.” *United States v. Pratt*. While “mere abstract talk” does not suffice, any “concrete and specific” acts that corroborate the defendant’s intent can constitute a “substantial step.” *United States v. Irving*. Thus, “soliciting an innocent agent to engage in conduct constituting an element of the crime” may qualify as a substantial step. Model Penal Code § 5.01(2)(g); see *United States v. Lucas*.

The omnibus clause of 18 U.S.C. § 1503 prohibits an “endeavor” to obstruct justice, which sweeps more broadly than Section 1512’s attempt provision. “It is well established that a[n] [obstruction-of-justice] offense is complete when one corruptly endeavors to obstruct or impede the due administration of justice; the prosecution need not prove that the due administration of justice was actually obstructed or impeded.” *United States v. Davis*. . . .

The Mueller report went on to analyze and reject arguments that principles regarding the presidency and presidential powers located in Article II of the Constitution restricted the application of the obstruction statutes to the actions of the President at issue in this scenario. That analysis would have to be reformulated in light of the Supreme Court’s decision in July 2024 in *Trump v. United States*, 603 U.S. ____ (2024), in which the Court fashioned new constitutional principles of presidential immunity from criminal prosecution. In addition, the report did not reach a legal conclusion regarding the President’s conduct, which it described as presenting “difficult issues,” on the ground that an existing opinion of the Department of Justice concluded that a President may not constitutionally be subject to indictment while still in office. It would be inappropriate

for a prosecutor to state a position on the President's liability, the report concluded, when there could be no prospect of contesting such an allegation in court.

D. Elements and Examples: Section 1519

The following two cases deal with interpretation of the newer § 1519 statute, specifically with regards to what mens rea and/or nexus requirements it might or might not have, and what kinds of acts the statute covers. This statute involves many of the same policy problems presented by the other statutes but in the context of different statutory text. Notice how courts try to deal with the interaction of policy considerations and text.

UNITED STATES v. YIELDING, 657 F.3d 688 (8th Cir. 2011)

COLLTON, Circuit Judge:

In approximately 1998, [Geff] Yielding began to work as a surgical and administrative assistant for Dr. Richard Jordan, a neurosurgeon in North Little Rock, Arkansas. Dr. Jordan performed surgeries at several area hospitals, including Baptist Health Medical Center in North Little Rock ("Baptist"). Yielding was responsible for ensuring that the required equipment was present at all of Dr. Jordan's surgeries.

Jordan "Jody" Wall was a charge nurse at Baptist in 2003 and 2004. He was responsible for ordering medical supplies for Dr. Jordan's surgeries at that hospital. Yielding told Wall which supplies were needed for each scheduled surgery, and Wall ensured that the requested items were available. When Baptist did not have enough supplies on hand, Wall asked Denise Rhodes, the hospital's senior inventory coordinator, to order the needed items.

In 2002, Yielding's wife, Kelley Yielding, incorporated Advanced Neurophysiology, Inc. ("ANI"), a medical services company of which she was the sole shareholder. By 2003, Kelley had begun to work as an independent sales agent for two medical supply companies known as Orthofix and Osteotech. Orthofix sold external bone growth stimulators, which promote bone growth following surgery in patients who would otherwise have difficulty growing new bone. Osteotech sold bone allograft, which is substitute bone that is used to fill a void in a patient's bone after surgery or trauma.

Kelley Yielding marketed the two companies' products to surgeons, and received commissions on each sale. From February 2003 to October 2004, Kelley received approximately \$384,000 in commissions from Osteotech and Orthofix that were attributable to purchases by Baptist. During the same period, ANI issued twenty-two checks to Wall totaling \$54,366.08.

In November 2004, Baptist terminated Wall and Rhodes after an internal investigation revealed irregularities in the ordering of Osteotech bone and Orthofix bone growth stimulators. Baptist determined that Rhodes had placed purchasing orders for the Osteotech and Orthofix products without proper authorization, and that the hospital should not have purchased any Orthofix bone growth stimulators. Baptist also

discovered that more than one hundred pieces of bone were missing from the hospital's inventory.

On December 27, 2004, Dr. Jordan forwarded to the Yieldings an e-mail he had received from a Baptist administrator. In the e-mail, the administrator characterized the purchases of the bone growth stimulators as "very suspicious," and informed Dr. Jordan that the hospital was "continuing [its] investigation of this issue as well as the . . . missing pieces of bone."

Three days later, U.S. Bank issued a check to ANI for \$34,018.90. This was the precise amount of ANI's total payments to Wall in 2004. The check listed the remitter as Jordan Wall, and the purpose of the payment as "REPAYMENT ON LOAN." Bank records showed that on the same day, Yielding withdrew \$21,018.90 from the Yieldings' personal bank account at U.S. Bank. A receipt and currency transaction report indicated that Yielding also paid the bank \$13,000 in cash.

The Federal Bureau of Investigation opened an inquiry into the irregularities at Baptist in mid-2005. In an interview in October 2005, Wall told investigators that the Yieldings had given him a loan of "[m]aybe \$10,000," not the \$34,018.90 paid by check in December 2004. On April 14, 2006, the FBI executed search warrants at the Yieldings' home and at Dr. Jordan's office. During the search of the Yielding residence, the agents discovered a promissory note describing an interest-free loan of \$34,018.90 issued from ANI to Wall in January 2004. The note was marked as paid on December 30, 2004.

The agents also interviewed Kelley Yielding. She initially described the payments from ANI to Wall as a loan and denied that Wall had been employed by ANI. Yielding told the agents that he and his wife had given Wall a loan of approximately \$30,000, that the loan had been documented, and that Wall had repaid the loan. After the agents confronted Yielding with bank records indicating that he used his own funds to purchase Wall's check to ANI, however, Yielding stated that Wall had convinced him to pay Wall approximately \$3000 per month in exchange for Wall's promise to keep all of Kelley Yielding's supplies fully in stock. Yielding told the agents that Wall asked him to purchase a cashier's check to make it appear as if the payments to Wall had been a loan that Wall was paying back. On the same day, the FBI again interviewed Wall, who then admitted that he had received payments from the Yieldings in exchange for ordering Osteotech bone and Orthofix bone growth stimulators.

Kelley Yielding died on October 2, 2006. . . . On May 8, 2008, a grand jury indicted Yielding on forty-six counts of mail fraud, falsification of documents, and payment of kickbacks involving a federal health care program.

At trial, . . . Wall testified that Yielding had approached him and had offered to pay him in exchange for ordering the products sold by Kelley Yielding. According to Wall, Yielding gave Wall lists of items to order, and Wall then asked Rhodes to obtain the listed supplies. Wall recalled that Yielding once told him to order some bone products so that Kelley would qualify for a free vacation. In return for Wall's efforts, Yielding

gave him envelopes containing checks from ANI. Wall testified that Yielding told him to “keep it quiet,” and asked him in approximately December 2004 to sign and date a promissory note so that the note would appear to have been signed in January 2004. Wall said that Yielding also asked him to sign a cashier’s check that would make the payments from ANI to Wall look like a loan. . . .

Yielding raises several challenges to his conviction on count two for violating 18 U.S.C. § 1519, an obstruction of justice statute. Section 1519 . . . provides:

Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.

18 U.S.C. § 1519. The charge in this case was based on Yielding’s knowing falsification of a promissory note with the intent to disguise checks paid from ANI to Wall as “loans” rather than kickbacks.

Yielding’s narrowest challenge is to the district court’s jury instructions on the § 1519 charge. The district court instructed the jury as follows:

The crime of falsifying a document as charged in Count Two of the indictment, has three essential elements, which are:

One, the defendant knowingly falsified a document;

Two, the defendant did so with the intent to impede, obstruct, or influence the investigation or proper administration of any matter or in contemplation of or relation to any such matter; and

Three, the matter was within the jurisdiction of the United States Department of Health and Human Services which is an agency of the United States.

If all of these essential elements have been proved beyond a reasonable doubt as to the defendant then you must find the defendant guilty of the crime charged under Count Two; otherwise you must find the defendant not guilty of this crime under Count Two.

The United States does not have to prove that the matter be pending at the time of the obstruction, but only that the acts be taken in relation to or contemplation of any such matter or case.

Further, the United States does not have to prove that the falsifying of the document would naturally or probably result in obstruction.

In order to meet its burden, the United States need not prove that the defendant specifically knew that the matter was within the jurisdiction of a department or agency.

Yielding renews objections lodged in the district court regarding the elements of the offense. To resolve the challenges to the instructions, therefore, we must consider what proof is required to establish a violation of § 1519.

One element on which both parties agree is that the government must prove that Yielding “knowingly . . . falsifie[d] . . . any . . . document.” The falsification must be done knowingly; an unwitting falsehood will not suffice.

The element of intent is more complex. The statute provides that liability may arise in three different situations involving matters within the jurisdiction of a federal department or agency: (1) when a defendant acts directly with respect to “the investigation or proper administration of any matter,” that is, a pending matter, (2) when a defendant acts “in . . . contemplation of any such matter,” and (3) when a defendant acts “in relation to . . . any such matter.” Although the phrasing of the statute is a bit awkward, the government concedes that the prosecution must show intent to impede, obstruct, or influence the investigation or proper administration of a matter in each of these three scenarios. We think this is the better reading of the statute. The phrase “or in relation to or contemplation of any such matter” is set off by commas and follows the reference to an accused’s intent to obstruct the investigation of “any matter.” It seems to us that Congress thereby sought to extend the prohibition to situations in which the accused does not act directly with respect to a pending matter, but acts either in contemplation of a future matter or in relation to a pending matter. The statute, for example, does not allow a defendant to escape liability for shredding documents with intent to obstruct a foreseeable investigation of a matter within the jurisdiction of a federal agency just because the investigation has not yet commenced.

But we do not think Congress, in expanding the scope of § 1519 beyond actions directed to a pending matter, eliminated the need for proof of intent to impede, obstruct, or influence a federal matter. In other words, the statute does not impose liability for “knowingly . . . destroy[ing] . . . any . . . document . . . in . . . contemplation of any [federal] matter,” *without* an intent to impede, obstruct, or influence a matter. If it did, then the statute would forbid innocent conduct such as routine destruction of documents that a person consciously and in good faith determines are irrelevant to a foreseeable federal matter. We thus understand the intent element of the statute to encompass three possible scenarios: (1) a defendant acts with intent to impede, obstruct, or influence the investigation or proper administration of a federal matter, (2) a defendant, in contemplation of a federal matter, acts with intent to impede, obstruct, or influence the investigation or proper administration of the matter, and (3) a defendant, in relation to a federal matter, acts with intent to impede, obstruct, or influence the investigation or proper administration of the matter.

The parties disagree, however, about whether the intent element of § 1519 also requires what the Supreme Court has described as a “nexus” between the alleged obstructive act and the federal matter. Yielding contends that the government was required to prove not only that he intended to impede, obstruct, or influence the investigation or proper administration of a matter, but also that he knew that his actions would have the “natural and probable effect” of interfering with the investigation or proper administration of a matter. He objects that the district court erred by instructing the jury that the government need not “prove that the falsifying of the document would naturally or probably result in obstruction.” . . .

We conclude that the “nexus” requirement urged by Yielding—that the government must show the accused knew his actions were likely to affect a federal matter—does not apply to a prosecution for the knowing falsification of documents under § 1519. The text of § 1519 requires only proof that the accused knowingly committed one of several acts, including falsification of a document, and did so “with the intent to impede, obstruct, or influence the investigation or proper administration” of a federal matter. The requisite knowledge and intent can be present even if the accused lacks knowledge that he is likely to succeed in obstructing the matter. It presumably will be easier to prove that an accused intended to obstruct an investigation if the obstructive act was likely to affect the investigation. But we do not think the statute allows an accused with the requisite intent to avoid liability if he overestimated the importance of a falsified record or shredded a document for the purpose of eliminating a small but appreciable risk that the document would lead investigators to discover his wrongdoing.

The language of § 1519 is materially different from the statutes considered in *Aguilar* and *Arthur Andersen*. The former forbade “corruptly endeavor[ing]” to obstruct, and the latter prohibited “knowingly corrup[t] persua[sion].” In both cases, the Court was thus required to discern the substance of an intent requirement from statutory terms that appeared to imply one, but did not speak directly to its content. . . . But in § 1519, Congress spoke more directly to the requisite intent and described its scope more precisely. The statute includes no ambiguous phrase such as “corruptly endeavor” or “knowingly corruptly persuade” that calls for implication of an additional intent requirement. . . . We think the text of § 1519 gives fair warning that knowingly falsifying a document, in contemplation of a federal matter, with intent to impede, obstruct, or interfere with that matter may result in criminal liability, whether or not the obstruction was likely to succeed. That the accused’s intent must be wrongful is evident from the nature of the acts prohibited, such as knowing falsification of documents, and the requisite intent to influence, obstruct, or impede an investigation or proper administration of a federal matter. The jury instruction was therefore not erroneous, because § 1519 does not require a nexus of the kind articulated in *Aguilar* and *Arthur Andersen*. . . .

As of this edition, no other circuit court has refuted the holding of *Yielding* that § 1519 does not contain a nexus requirement. However, not many opinions have followed it either. See *United States v. Kernell*, 667 F.3d 746 (6th Cir. 2012) (“[T]he nexus

requirement is derived from the language of other obstruction-of-justice statutes, wording that is not found in § 1519. Congress is not required to use the same structure for all obstruction-of-justice statutes.”). Does the absence of a nexus requirement create any problems from a policy standpoint?

UNITED STATES v. YATES, 574 U.S. 528 (2015)

Justice GINSBURG announced the judgment of the Court and delivered an opinion, in which THE CHIEF JUSTICE, Justice BREYER, and Justice SOTOMAYOR join. [Justice ALITO concurred on narrower grounds; his concurrence is omitted]

John Yates, a commercial fisherman, caught undersized red grouper in federal waters in the Gulf of Mexico. To prevent federal authorities from confirming that he had harvested undersized fish, Yates ordered a crew member to toss the suspect catch into the sea. For this offense, he was charged with, and convicted of, violating 18 U.S.C. § 1519, which provides:

“Whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both.”

. . . [Yates] maintains that fish are not trapped within the term “tangible object,” as that term is used in § 1519.

Section 1519 was enacted as part of the Sarbanes–Oxley Act of 2002, 116 Stat. 745, legislation designed to protect investors and restore trust in financial markets following the collapse of Enron Corporation. A fish is no doubt an object that is tangible; fish can be seen, caught, and handled, and a catch, as this case illustrates, is vulnerable to destruction. But it would cut § 1519 loose from its financial-fraud mooring to hold that it encompasses any and all objects, whatever their size or significance, destroyed with obstructive intent. Mindful that in Sarbanes–Oxley, Congress trained its attention on corporate and accounting deception and cover-ups, we conclude that a matching construction of § 1519 is in order: A tangible object captured by § 1519, we hold, must be one used to record or preserve information.

On August 23, 2007, the Miss Katie, a commercial fishing boat, was six days into an expedition in the Gulf of Mexico. Her crew numbered three, including Yates, the captain. Engaged in a routine offshore patrol to inspect both recreational and commercial vessels, Officer John Jones of the Florida Fish and Wildlife Conservation Commission decided to board the Miss Katie to check on the vessel’s compliance with fishing rules. Although the Miss Katie was far enough from the Florida coast to be in exclusively federal waters, she was nevertheless within Officer Jones’s jurisdiction. Because he had been deputized

as a federal agent by the National Marine Fisheries Service, Officer Jones had authority to enforce federal, as well as state, fishing laws.

Upon boarding the *Miss Katie*, Officer Jones noticed three red grouper that appeared to be undersized hanging from a hook on the deck. At the time, federal conservation regulations required immediate release of red grouper less than 20 inches long. 50 C.F.R. § 622.37(d)(2)(ii) (effective April 2, 2007). Violation of those regulations is a civil offense punishable by a fine or fishing license suspension. *See* 16 U.S.C. §§ 1857(1)(A), (G), 1858(a), (g).

Suspecting that other undersized fish might be on board, Officer Jones proceeded to inspect the ship's catch, setting aside and measuring only fish that appeared to him to be shorter than 20 inches. Officer Jones ultimately determined that 72 fish fell short of the 20-inch mark. A fellow officer recorded the length of each of the undersized fish on a catch measurement verification form. With few exceptions, the measured fish were between 19 and 20 inches; three were less than 19 inches; none were less than 18.75 inches. After separating the fish measuring below 20 inches from the rest of the catch by placing them in wooden crates, Officer Jones directed Yates to leave the fish, thus segregated, in the crates until the *Miss Katie* returned to port. Before departing, Officer Jones issued Yates a citation for possession of undersized fish.

Four days later, after the *Miss Katie* had docked in Cortez, Florida, Officer Jones measured the fish contained in the wooden crates. This time, however, the measured fish, although still less than 20 inches, slightly exceeded the lengths recorded on board. Jones surmised that the fish brought to port were not the same as those he had detected during his initial inspection. Under questioning, one of the crew members admitted that, at Yates's direction, he had thrown overboard the fish Officer Jones had measured at sea, and that he and Yates had replaced the tossed grouper with fish from the rest of the catch. . . .

The Sarbanes–Oxley Act, all agree, was prompted by the exposure of Enron's massive accounting fraud and revelations that the company's outside auditor, Arthur Andersen LLP, had systematically destroyed potentially incriminating documents. The Government acknowledges that § 1519 was intended to prohibit, in particular, corporate document-shredding to hide evidence of financial wrongdoing. Prior law made it an offense to "intimidat[e], threat[e], or corruptly persuad[e] another person" to shred documents. § 1512(b) (emphasis added). Section 1519 cured a conspicuous omission by imposing liability on a person who destroys records himself. *See* S.Rep. No. 107–146, (2002) (describing § 1519 as "a new general anti shredding provision" and explaining that "certain current provisions make it a crime to persuade another person to destroy documents, but not a crime to actually destroy the same documents yourself"). The new section also expanded prior law by including within the provision's reach "any matter within the jurisdiction of any department or agency of the United States."

The ordinary meaning of an "object" that is "tangible," as stated in dictionary definitions, is "a discrete . . . thing," Webster's Third New International Dictionary (2002), that

“possess[es] physical form,” Black’s Law Dictionary (10th ed. 2014). From this premise, the Government concludes that “tangible object,” as that term appears in § 1519, covers the waterfront, including fish from the sea.

Whether a statutory term is unambiguous, however, does not turn solely on dictionary definitions of its component words. Rather, “[t]he plainness or ambiguity of statutory language is determined [not only] by reference to the language itself, [but as well by] the specific context in which that language is used, and the broader context of the statute as a whole.” *Robinson v. Shell Oil Co.* See also *Deal v. United States* (it is a “fundamental principle of statutory construction (and, indeed, of language itself) that the meaning of a word cannot be determined in isolation, but must be drawn from the context in which it is used”). Ordinarily, a word’s usage accords with its dictionary definition. In law as in life, however, the same words, placed in different contexts, sometimes mean different things. . . .

We note first § 1519’s caption: “Destruction, alteration, or falsification of records in Federal investigations and bankruptcy.” That heading conveys no suggestion that the section prohibits spoliation of any and all physical evidence, however remote from records. Neither does the title of the section of the Sarbanes–Oxley Act in which § 1519 was placed, § 802: “Criminal penalties for altering documents.” 116 Stat. 800. Furthermore, § 1520, the only other provision passed as part of § 802, is titled “Destruction of corporate audit records” and addresses only that specific subset of records and documents. While these headings are not commanding, they supply cues that Congress did not intend “tangible object” in § 1519 to sweep within its reach physical objects of every kind, including things no one would describe as records, documents, or devices closely associated with them. See *Almendarez–Torres v. United States* (“[T]he title of a statute and the heading of a section are tools available for the resolution of a doubt about the meaning of a statute.” If Congress indeed meant to make § 1519 an all-encompassing ban on the spoliation of evidence, as the dissent believes Congress did, one would have expected a clearer indication of that intent.

Section 1519’s position within Chapter 73 of Title 18 further signals that § 1519 was not intended to serve as a cross-the-board ban on the destruction of physical evidence of every kind. Congress placed § 1519 (and its companion provision § 1520) at the end of the chapter, following immediately after the pre-existing § 1516, § 1517, and § 1518, each of them prohibiting obstructive acts in specific contexts. See § 1516 (audits of recipients of federal funds); § 1517 (federal examinations of financial institutions); § 1518 (criminal investigations of federal health care offenses). See also S. Rep. No. 107–146 (observing that § 1517 and § 1518 “apply to obstruction in certain limited types of cases, such as bankruptcy fraud, examinations of financial institutions, and healthcare fraud”). . . .

The contemporaneous passage of § 1512(c)(1), which was contained in a section of the Sarbanes–Oxley Act discrete from the section embracing § 1519 and § 1520, is also instructive. Section 1512(c)(1) provides:

“(c) Whoever corruptly—

“(1) alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object’s integrity or availability for use in an official proceeding

“shall be fined under this title or imprisoned not more than 20 years, or both.”

The legislative history reveals that § 1512(c)(1) was drafted and proposed after § 1519. *See* 148 Cong. Rec. 12518 (2002). The Government argues, and Yates does not dispute, that § 1512(c)(1)’s reference to “other object” includes any and every physical object. But if § 1519’s reference to “tangible object” already included all physical objects, as the Government and the dissent contend, then Congress had no reason to enact § 1512(c)(1): Virtually any act that would violate § 1512(c)(1) no doubt would violate § 1519 as well, for § 1519 applies to “the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States . . . or in relation to or contemplation of any such matter,” not just to “an official proceeding.”

The Government acknowledges that, under its reading, § 1519 and § 1512(c)(1) “significantly overlap.” Nowhere does the Government explain what independent function § 1512(c)(1) would serve if the Government is right about the sweeping scope of § 1519. We resist a reading of § 1519 that would render superfluous an entire provision passed in proximity as part of the same Act. *See Marx v. General Revenue Corp.* (“[T]he canon against surplusage is strongest when an interpretation would render superfluous another part of the same statutory scheme.”).

The words immediately surrounding “tangible object” in § 1519—“falsifies, or makes a false entry in any record [or] document”—also cabin the contextual meaning of that term. As explained in *Gustafson v. Alloyd Co.*, we rely on the principle of *noscitur a sociis*—a word is known by the company it keeps—to “avoid ascribing to one word a meaning so broad that it is inconsistent with its accompanying words, thus giving unintended breadth to the Acts of Congress.” *See also United States v. Williams* (“a word is given more precise content by the neighboring words with which it is associated”). In *Gustafson*, we interpreted the word “communication” in § 2(10) of the Securities Act of 1933 to refer to a public communication, rather than any communication, because the word appeared in a list with other words, notably “notice, circular, [and] advertisement,” making it “apparent that the list refer[red] to documents of wide dissemination.” And we did so even though the list began with the word “any.”

The *noscitur a sociis* canon operates in a similar manner here. “Tangible object” is the last in a list of terms that begins “any record [or] document.” The term is therefore appropriately read to refer, not to any tangible object, but specifically to the subset of tangible objects involving records and documents, i.e., objects used to record or preserve information. . . .

This moderate interpretation of “tangible object” accords with the list of actions § 1519 proscribes. The section applies to anyone who “alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object” with the requisite obstructive intent. (Emphasis added.) The last two verbs, “falsif[y]” and “mak[e] a false entry in,” typically take as grammatical objects records, documents, or things used to record or preserve information, such as logbooks or hard drives. *See, e.g.,* Black’s Law Dictionary (10th ed. 2014) (defining “falsify” as “[t]o make deceptive; to counterfeit, forge, or misrepresent; esp., to tamper with (a document, record, etc.)”). It would be unnatural, for example, to describe a killer’s act of wiping his fingerprints from a gun as “falsifying” the murder weapon. But it would not be strange to refer to “falsifying” data stored on a hard drive as simply “falsifying” a hard drive. Furthermore, Congress did not include on § 1512(c)(1)’s list of prohibited actions “falsifies” or “makes a false entry in.” *See* § 1512(c)(1) (making it unlawful to “alte[r], destro[y], mutilat[e], or concea[l] a record, document, or other object” with the requisite obstructive intent). That contemporaneous omission also suggests that Congress intended “tangible object” in § 1519 to have a narrower scope than “other object” in § 1512(c)(1).

A canon related to *noscitur a sociis*, *eiusdem generis*, counsels: “Where general words follow specific words in a statutory enumeration, the general words are [usually] construed to embrace only objects similar in nature to those objects enumerated by the preceding specific words.” *Washington State Dept. of Social and Health Servs. v. Guardianship Estate of Keffeler*. . . . Had Congress intended “tangible object” in § 1519 to be interpreted so generically as to capture physical objects as dissimilar as documents and fish, Congress would have had no reason to refer specifically to “record” or “document.” The Government’s unbounded reading of “tangible object” would render those words misleading surplusage. . . . It is highly improbable that Congress would have buried a general spoliation statute covering objects of any and every kind in a provision targeting fraud in financial record-keeping. . . .

Justice KAGAN, with whom Justice SCALIA, Justice KENNEDY, and Justice THOMAS join, dissenting.

A criminal law, 18 U.S.C. § 1519, prohibits tampering with “any record, document, or tangible object” in an attempt to obstruct a federal investigation. This case raises the question whether the term “tangible object” means the same thing in § 1519 as it means in everyday language—any object capable of being touched. The answer should be easy: Yes. The term “tangible object” is broad, but clear. Throughout the U.S. Code and many States’ laws, it invariably covers physical objects of all kinds. And in § 1519, context confirms what bare text says: All the words surrounding “tangible object” show that Congress meant the term to have a wide range. That fits with Congress’s evident purpose in enacting § 1519: to punish those who alter or destroy physical evidence—any physical evidence—with the intent of thwarting federal law enforcement.

The plurality instead interprets “tangible object” to cover “only objects one can use to record or preserve information.” The concurring opinion similarly, if more vaguely, contends that “tangible object” should refer to “something similar to records or documents”—and shouldn’t include colonial farmhouses, crocodiles, or fish. In my view, conventional tools of statutory construction all lead to a more conventional result: A “tangible object” is an object that’s tangible. I would apply the statute that Congress enacted and affirm the judgment below.

While the plurality starts its analysis with § 1519’s heading (“We note first § 1519’s caption”), I would begin with § 1519’s text. When Congress has not supplied a definition, we generally give a statutory term its ordinary meaning. *See, e.g., Schindler Elevator Corp. v. United States ex rel. Kirk*. As the plurality must acknowledge, the ordinary meaning of “tangible object” is “a discrete thing that possesses physical form.” A fish is, of course, a discrete thing that possesses physical form. *See generally* Dr. Seuss, *One Fish Two Fish Red Fish Blue Fish* (1960). So the ordinary meaning of the term “tangible object” in § 1519, as no one here disputes, covers fish (including too-small red grouper).

That interpretation accords with endless uses of the term in statute and rule books as construed by courts. Dozens of federal laws and rules of procedure (and hundreds of state enactments) include the term “tangible object” or its first cousin “tangible thing”—some in association with documents, others not. . . .

That is not necessarily the end of the matter; I agree with the plurality (really, who does not?) that context matters in interpreting statutes. We do not “construe the meaning of statutory terms in a vacuum.” *Tyler v. Cain*. Rather, we interpret particular words “in their context and with a view to their place in the overall statutory scheme.” *Davis v. Michigan Dept. of Treasury*. And sometimes that means, as the plurality says, that the dictionary definition of a disputed term cannot control. *See, e.g., Bloate v. United States*. But this is not such an occasion, for here the text and its context point the same way. Stepping back from the words “tangible object” provides only further evidence that Congress said what it meant and meant what it said.

Begin with the way the surrounding words in § 1519 reinforce the breadth of the term at issue. Section 1519 refers to “any” tangible object, thus indicating (in line with that word’s plain meaning) a tangible object “of whatever kind.” Webster’s Third New International Dictionary (2002). This Court has time and again recognized that “any” has “an expansive meaning,” bringing within a statute’s reach all types of the item (here, “tangible object”) to which the law refers. *Department of Housing and Urban Development v. Rucker*; *see, e.g., Republic of Iraq v. Beatty*; *Ali v. Federal Bureau of Prisons*. And the adjacent laundry list of verbs in § 1519 (“alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry”) further shows that Congress wrote a statute with a wide scope. Those words are supposed to ensure—just as “tangible object” is meant to—that § 1519 covers the whole world of evidence-tampering, in all its prodigious variety. *See United States v. Rodgers* (rejecting a “narrow, technical

definition” of a statutory term when it “clashes strongly” with “sweeping” language in the same sentence).

Still more, “tangible object” appears as part of a three-noun phrase (including also “records” and “documents”) common to evidence-tampering laws and always understood to embrace things of all kinds. The Model Penal Code’s evidence-tampering section, drafted more than 50 years ago, similarly prohibits a person from “alter[ing], destroy[ing], conceal[ing] or remov[ing] any record, document or thing “in an effort to thwart an official investigation or proceeding. ALI, Model Penal Code § 241.7(1) (1962) (emphasis added). The Code’s commentary emphasizes that the offense described in that provision is “not limited to conduct that [alters] a written instrument.” Rather, the language extends to “any physical object.” . . .

The words “record, document, or tangible object” in § 1519 also track language in 18 U.S.C. § 1512, the federal witness-tampering law covering (as even the plurality accepts) physical evidence in all its forms. Section 1512, both in its original version (preceding § 1519) and today, repeatedly uses the phrase “record, document, or other object”—most notably, in a provision prohibiting the use of force or threat to induce another person to withhold any of those materials from an official proceeding. § 4(a) of the Victim and Witness Protection Act of 1982, 96 Stat. 1249, as amended, 18 U.S.C. § 1512(b)(2). That language, which itself likely derived from the Model Penal Code, encompasses no less the bloody knife than the incriminating letter, as all courts have for decades agreed. . . .

And legislative history, for those who care about it, puts extra icing on a cake already frosted. Section 1519, as the plurality notes, was enacted after the Enron Corporation’s collapse, as part of the Sarbanes–Oxley Act of 2002, 116 Stat. 745. But the provision began its life in a separate bill, and the drafters emphasized that Enron was “only a case study exposing the shortcomings in our current laws” relating to both “corporate and criminal” fraud. S. Rep. No. 107–146, (2002). The primary “loophole[]” Congress identified arose from limits in the part of § 1512 just described: That provision, as uniformly construed, prohibited a person from inducing another to destroy “record[s], document[s], or other object[s]”—of every type—but not from doing so himself. § 1512(b)(2). Congress (as even the plurality agrees) enacted § 1519 to close that yawning gap. But § 1519 could fully achieve that goal only if it covered all the records, documents, and objects § 1512 did, as well as all the means of tampering with them. And so § 1519 was written to do exactly that—“to apply broadly to any acts to destroy or fabricate physical evidence,” as long as performed with the requisite intent. S. Rep. No. 107–146. “When a person destroys evidence,” the drafters explained, “overly technical legal distinctions should neither hinder nor prevent prosecution.” Ah well: Congress, meet today’s Court, which here invents just such a distinction with just such an effect. *See United States v. Philadelphia Nat. Bank* (“[C]reat[ing] a large loophole in a statute designed to close a loophole” is “illogical and disrespectful of . . . congressional purpose”).

As Congress recognized in using a broad term, giving immunity to those who destroy non-documentary evidence has no sensible basis in penal policy. A person who hides a murder victim's body is no less culpable than one who burns the victim's diary. A fisherman, like John Yates, who dumps undersized fish to avoid a fine is no less blameworthy than one who shreds his vessel's catch log for the same reason. Congress thus treated both offenders in the same way. It understood, in enacting § 1519, that destroying evidence is destroying evidence, whether or not that evidence takes documentary form. . . .

I tend to think, for the reasons the plurality gives, that § 1519 is a bad law—too broad and undifferentiated, with too-high maximum penalties, which give prosecutors too much leverage and sentencers too much discretion. And I'd go further: In those ways, § 1519 is unfortunately not an outlier, but an emblem of a deeper pathology in the federal criminal code.

But whatever the wisdom or folly of § 1519, this Court does not get to rewrite the law. "Resolution of the pros and cons of whether a statute should sweep broadly or narrowly is for Congress." *Rodgers*. If judges disagree with Congress's choice, we are perfectly entitled to say so—in lectures, in law review articles, and even in dicta. But we are not entitled to replace the statute Congress enacted with an alternative of our own design.

The next case, another decision interpreting § 1519, includes more material on the relationship between obstruction and the role of lawyers, as well as on reliance on advice of counsel in the obstruction context. See if you can understand what is going on procedurally in this case and why the court reaches the issues of statutory interpretation that it does. Note that this is a single district court opinion—important for what it discusses and because there are relatively few decisions on § 1519, but not of course a generally binding decision.

UNITED STATES v. STEVENS, 771 F. Supp. 2d 556 (D. Md. 2011)

ROGER W. TITUS, District Judge:

On November 8, 2010, a grand jury for the United States District Court for the District of Maryland returned a six-Count indictment against Lauren Stevens ("Stevens"), former Vice President and Associate General Counsel of GlaxoSmithKline ("GSK"). The indictment charged Stevens with one count of obstruction of a proceeding in violation of 18 U.S.C. § 1512, one count of falsification and concealment of documents in violation of 18 U.S.C. § 1519, and four counts of making a false statement in violation of 18 U.S.C. § 1001. The charges arose out of Stevens' response to an inquiry by the United States Food and Drug Administration ("FDA") into GSK's alleged off-label promotion of the anti-depressant drug Wellbutrin SR ("Wellbutrin"). A jury trial is scheduled to begin April 5, 2011. The parties have filed multiple pretrial motions, most of which will be discussed below.

On October 9, 2002, the FDA sent a letter to GSK stating that the FDA had recently received information indicating that GSK had possibly promoted Wellbutrin for weight loss, a use not approved by the FDA. The FDA asked GSK to provide it with materials related to Wellbutrin promotional programs sponsored by GSK, including copies of all slides, videos, handouts, and other materials presented or distributed at any GSK program or activity related to Wellbutrin. Stevens was “in charge of” GSK’s “response to the FDA’s inquiry and investigation” and “led a team of lawyers and paralegals who gathered documents and information.”

The United States alleges that Stevens obstructed the FDA’s investigation by withholding and concealing documents and other information about GSK’s promotional activities for Wellbutrin, including for unapproved uses, while representing to the FDA that she had completed her response to its inquiry, and that Stevens falsified and altered documents in order to impede the FDA’s investigation of GSK. In particular, the Government alleges Stevens withheld slide sets used by speakers at GSK promotional events that promoted off-label use of Wellbutrin and withheld information regarding compensation received by attendees at promotional events. The Government alleges that Stevens signed and sent to the FDA six letters containing materially false statements regarding GSK’s promotion of Wellbutrin for off-label uses.

In responding to the FDA’s inquiry, Stevens was assisted by GSK in-house counsel and outside counsel from the law firm of King & Spalding. Stevens’ primary defense to the charges in the indictment is that she relied in good faith on the advice of counsel in responding to the FDA’s inquiry, and that such reliance negated the requisite intent to obstruct the FDA’s investigation or to make false statements.

The Government filed two pretrial motions. The first seeks to preclude Stevens from asserting good faith reliance on the advice of counsel as a defense to Count 2. The Government argues that good faith reliance on the advice of counsel is not a defense to Count 2 because 18 U.S.C. § 1519 is a general intent crime, and good faith reliance on advice of counsel is only a defense to specific intent crimes. The Government also moved in limine to exclude evidence regarding the opinions of other in-house and outside counsel that were not expressed to Stevens at the time of GSK’s response to the FDA’s inquiry, regarding whether they viewed GSK’s responses to be appropriate and not misleading. . . .

Good faith reliance on the advice of counsel is only relevant to specific intent crimes because such reliance demonstrates a defendant’s lack of the requisite intent to violate the law. *United States v. Miller* (“The reliance defense . . . is designed to refute the government’s proof that the defendant intended to commit the offense.”), *United States v. Polytarides* (“The basis for the defense of action taken on the advice of counsel is that, in relying on counsel’s advice, defendant lacked the requisite intent to violate the law.”). The United States argues that 18 U.S.C. § 1519 is a general intent crime, and therefore Stevens’ good faith reliance on advice of counsel is irrelevant to a determination of her guilt on Count 2.

Whether a conviction under § 1519 requires proof that a defendant acted with the specific intent to violate the law is a question of statutory construction. *Staples v. United States*. A close reading of the statutory language reveals that a conviction under § 1519 can only be premised on conduct that was intentional or willful. . . .

The Supreme Court's decision in *Arthur Andersen* guides this Court's interpretation of § 1519. . . .

The Supreme Court held that one could not "knowingly . . . corruptly persuad[e]" another person with intent to cause that person to withhold documents from, or alter documents for use in, an official proceeding without being "conscious of [his] wrongdoing." *Andersen*. The Court stated that "limiting criminality to persuaders conscious of their wrongdoing sensibly allows § 1512(b) to reach only those with the level of culpability usually required to impose criminal liability."

As in *Arthur Andersen*, the most natural, grammatical reading of § 1519 is one in which the word "knowingly" modifies "with intent to impede, obstruct, or influence." The mens rea of 1519 is not just "knowingly"—meaning "with awareness, understanding, or consciousness"—as the Government suggests. Rather, the mens rea is "knowingly . . . with intent to impede, obstruct, or influence," a mens rea clearly requiring consciousness of wrongdoing. One cannot be said to "knowingly . . . alter [], . . . conceal[], cover[] up, falsif[y], or make[] false entry in any record [or] document . . . with intent to impede, obstruct, or influence" an investigation or administration of a matter within the jurisdiction of a federal agency unless it is that individual's intent to do that which is wrongful. As one of our sister courts has held, though the word "corruptly" is not found in § 1519, the same evil intent embodied in § 1512 is embodied in § 1519. *United States v. Moyer*. The language "with intent to impede, obstruct, or influence" "imposes upon the § 1519 defendant the same sinister mentality which 'corruptly' requires of a § 1512(b)(2) defendant." As with 18 U.S.C. § 1512, the most reasonable reading of Section 1519 is one which imposes criminal liability only on those who were conscious of the wrongfulness of their actions. To hold otherwise would allow § 1519 to reach inherently innocent conduct, such as a lawyer's instruction to his client to withhold documents the lawyer in good faith believes are privileged. . . .

Stevens moved for disclosure of the Government's presentation to the grand jury, arguing that disclosure was warranted pursuant to Federal Rule of Criminal Procedure 6(e)(3)(E)(ii) because the Government may have failed to properly instruct the grand jury regarding the advice of counsel defense and may have failed to present critical exculpatory evidence. In response to Stevens' motion, the Government filed both a redacted and an unredacted opposition. In its unredacted opposition, filed under seal for the Court's in camera review, the Government conceded that a grand juror had asked a question about the advice of counsel defense, and that a response was given, but the Government did not disclose to the Court the nature of that response. The Court ordered the grand jury transcripts disclosed for the Court's immediate, in camera review, reviewed the transcripts, and disclosed a brief excerpt from the grand jury transcripts to

Stevens to allow for further briefing on whether the grand jury was properly instructed on the advice of counsel defense.

The excerpt disclosed by the Court read as follows:

MR. JASPERSE: Do the Grand Jurors have any legal questions for Ms. Bloom or I?

A JUROR: I have a question. Does it matter that maybe she was—that Lauren Stevens was getting direction from somebody else about how to handle this? Does it matter or is it not relevant?

MR. JASPERSE: There is something in the law called the advice of counsel defense and that is a defense that a defendant can raise, once the defendant has been charged.

There are also exceptions to the advice of counsel defense. So in other words, a person who is charged with a crime cannot simply say, Well, my lawyer said it was okay. There are various requirements, including that the purpose in getting the advice cannot be to commit a crime or to engage in fraud. Another requirement is that the person receiving the advice must provide full information, all of the information, to the attorney who is rendering the advice.

MS. BLOOM: And I think essentially if the elements of the crime are met, that the person knows that they are submitting a false statement and—what the advice of counsel defense goes to is if someone reasonably relies on someone else to believe that they are not committing a crime, but when—if you have an attorney who knowingly submits a false statement—and I think you saw some evidence—you know, would that person know that that's a crime.

So, that while it can be relevant at trial what a person knows and who else gave them advice, if you find probable cause for the elements here that the attorney Lauren Stevens reasonably knew that she was making false statements and the elements that Patrick went through, then that's sufficient to find probable cause.

Does that help?

A JUROR: Yes.

. . . Stevens argued that dismissal of the indictment was warranted because the advice of counsel instruction was incorrect, and there was grave doubt that the decision to indict was free from the substantial influence of the improper instruction. The Government argued that the grand jury was properly instructed and that even if the instruction was deficient, dismissal of the indictment was neither required nor warranted.

Though often referred to as the “advice of counsel defense,” this label is actually a misnomer. Good faith reliance on the advice of counsel, when proven, negates the element of wrongful intent of a defendant that is required for a conviction. *See United States v. Peterson* (“A good faith reliance on the advice of counsel is not a defense to securities fraud. It is simply a means of demonstrating good faith and represents possible evidence of an absence of any intent to defraud.”); *see also Oakley, Inc. v. Bugaboos* (just because the “‘advice of counsel defense’ contains the word defense . . . does not an affirmative defense make.”).

An affirmative defense is “[a] defendant’s assertion of facts and arguments that, if true, will defeat the plaintiff’s or prosecution’s claim, even if all the allegations in the complaint are true.” *Black’s Law Dictionary* (9th ed. 2009). By contrast, the advice of counsel “defense” negates the defendant’s wrongful intent, and therefore demonstrates an absence of an element of the offense—mens rea. . . .

The Court has grave doubts as to whether the decision to indict was free from the substantial influence of the improper advice of counsel instruction. *Bank of Nova Scotia*. A grand juror explicitly asked about the legal implications of Stevens’ reliance on the advice of others in responding to the FDA and whether it was relevant. The grand juror was essentially told that advice of counsel was not relevant to the decision to indict, but rather was an issue to be raised in defense at trial.

The grand juror’s question was not just any question, but rather was much akin to asking about an elephant in the room. The grand jury was well aware of the Defendant’s role as the leader of a team of lawyers and paralegals, and the question was a natural one that arose out of her status. The question went to the heart of the intent required to indict. The incorrect answer either substantially influenced the decision to indict or, at the very least, creates grave doubt as to that decision. Accordingly, dismissal of the indictment is appropriate and required in the interests of justice.

The parties differ as to whether a dismissal should be with or without prejudice. The Court has carefully reviewed the grand jury transcripts and found no evidence that the prosecutors involved engaged in “willful prosecutorial misconduct.” *United States v. Feurtado*. This is not a case in which the Government attempted to affirmatively mislead the grand jury to obtain an indictment—rather it is a case in which prosecutors simply misinstructed the grand jury on the law. However, even in the absence of willful prosecutorial misconduct, “a defendant is entitled to dismissal of an indictment . . . where actual prejudice is established.” Under these circumstances, dismissal of the indictment is necessary to allay the Court’s grave doubts about the grand jury’s decision to indict, but dismissal with prejudice is wholly inappropriate. (affirming district court’s dismissal without prejudice where government’s errors before the grand jury were unintentional, rather than the product of prosecutorial misconduct). Accordingly, the indictment shall be dismissed without prejudice to the Government’s right to seek Steven’s indictment

before a different grand jury that is appropriately instructed as to the law in conformity with this opinion.²

Problem 8-2

Walter hands a laptop to his wife Skylar and says, “I think I am going to be in trouble with the police soon. This has stuff on it I am not allowed to have. Take it to my lawyer Saul, he will know what to do with it.” Walter then runs out of the house and takes off in his car. Skylar takes the laptop to Saul’s office. Saul says he cannot say how he knows, but the laptop contains images of child pornography, the possession of which is a federal felony. Skylar gives Saul her consent when he asks if he can destroy the hard drive. Saul then destroys the hard drive. What crimes, if any, have Skylar and Saul committed and what defenses, if any, might they have?

Problem 8-3

Returning to a more recent set of obstruction issues, ones involving former President Trump, review the following indictment—which has been subject to long pretrial delays—in the “Mar-a-Lago” matter in light of all of the principles discussed in this chapter. Consider how you might attempt to defend the defendants against these charges.

SUPERSEDING INDICTMENT, UNITED STATES v. DONALD J. TRUMP, WALTINE NAUTA and CARLOS DE OLIVEIRA, No. 9:23-cr-80101-AMC (S.D. Fla. July 27, 2023)

The Grand Jury charges that:

INDICTMENT

GENERAL ALLEGATIONS

At times material to this Indictment, on or about the dates and approximate times stated below:

1. Defendant DONALD J. TRUMP was the forty-fifth President of the United States of America. He held office from January 20, 2017, until January 20, 2021. As president, TRUMP had lawful access to the most sensitive classified documents and national defense information gathered and owned by the United States government,

² The aftermath: the government reindicted Stevens on the same charge. At trial, when the government concluded its proof, the trial court dismissed the case for legally insufficient evidence and it never reached a jury.

including information from the agencies that comprise the United States Intelligence Community and the United States Department of Defense.

2. Over the course of his presidency, TRUMP gathered newspapers, press clippings, letters, notes, cards, photographs, official documents, and other materials in cardboard boxes that he kept in the White House. Among the materials TRUMP stored in his boxes were hundreds of classified documents.

3. The classified documents TRUMP stored in his boxes included information regarding defense and weapons capabilities of both the United States and foreign countries; United States nuclear programs; potential vulnerabilities of the United States and its allies to military, attack; and plans for possible retaliation in response to a foreign attack. The unauthorized disclosure of these classified documents could put at risk the national security of the United States, foreign relations, the safety of the United States military, and human sources and the continued viability of sensitive intelligence collection methods.

4. At 12:00 p.m. on January 20, 2021, TRUMP ceased to be president. As he departed the White House, TRUMP caused scores of boxes, many of which contained classified documents, to be transported to The Mar-a-Lago Club in Palm Beach, Florida, where he maintained his residence. TRUMP was not authorized to possess or retain those classified documents.

5. The Mar-a-Lago Club was an active social club, which, between January 2021 and August 2022, hosted events for tens of thousands of members and guests. After TRUMP's presidency, The Mar-a-Lago Club was not an authorized location for the storage, possession, review, display, or discussion of classified documents. Nevertheless, TRUMP stored his boxes containing classified documents in various locations at The Mar-a-Lago Club-including in a ballroom, a bathroom and shower, an office space, his bedroom, and a storage room.

6. On two occasions in 2021, TRUMP showed classified documents to others, as follows:

- a. In July 2021, at Trump National Golf Club in Bedminster, New Jersey ("The Bedminster Club"), during an audio-recorded meeting with a writer, a publisher, and two members of his staff, none of whom possessed a security clearance, TRUMP showed and described a "plan of attack" that TRUMP said was prepared for him by the Department of Defense and a senior military official. TRUMP told the individuals that the plan was "highly confidential" and "secret." TRUMP also said, "as president I could have declassified it," and, "Now I can't, you know, but this is still a secret."

- b. In August or September 2021, at The Bedminster Club, TRUMP showed a representative of his political action committee who did not possess a security clearance a classified map related to a military operation and told the representative that he should not be showing it to the representative and that the representative should not get too close.

7. On March 30, 2022, the Federal Bureau of Investigation (“FBI”) opened a criminal investigation into the unlawful retention of classified documents at The Mar-a-Lago Club. A federal grand jury investigation began the next month. The grand jury issued a subpoena requiring TRUMP to turn over all documents with classification markings. TRUMP endeavored to obstruct the FBI and grand jury investigations and conceal his continued retention of classified documents by, among other things:

- a. suggesting that his attorney falsely represent to the FBI and grand jury that TRUMP did not have documents called for by the grand jury subpoena;
- b. directing defendant WALTINE NAUTA to move boxes of documents to conceal them from TRUMP’s attorney, the FBI, and the grand jury;
- c. suggesting that his attorney hide or destroy documents called for by the grand jury subpoena;
- d. providing to the FBI and grand jury just some of the documents called for by the grand jury subpoena, while claiming that he was cooperating fully; and
- e. causing a certification to be submitted to the FBI and grand jury falsely representing that all documents called for by the grand jury subpoena had been produced-while knowing that, in fact, not all such documents had been produced.

8. As a result of TRUMP’s retention of classified documents after his presidency and refusal to return them, hundreds of classified documents were not recovered by the United States government until 2022, as follows:

- a. On January 17, nearly one year after TRUMP left office, and after months of demands by the National Archives and Records Administration for TRUMP to provide all missing presidential records, TRUMP provided only 15 boxes, which contained 197 documents with classification markings.
- b. On June 3, in response to a grand jury subpoena demanding the production of all documents with classification markings, TRUMP’s attorney provided to the FBI 38 more documents with classification markings.

- c. On August 8, pursuant to a court-authorized search warrant, the FBI recovered from TRUMP's office and a storage room at The Mar-a-Lago Club 102 more documents with classification markings.

TRUMP's Co-Conspirators

9. Defendant NAUTA was a member of the United States Navy stationed as a valet in the White House during TRUMP's presidency. Beginning in August 2021, NAUTA became an executive assistant in The Office of Donald J. Trump and served as TRUMP's personal aide or "body man." NAUTA reported to TRUMP, worked closely with TRUMP, and traveled with TRUMP.

10. Beginning in January 2022, Defendant CARLOS DE OLIVEIRA was employed as the property manager at The Mar-a-Lago Club. Prior to holding the position of property manager, DE OLIVEIRA was employed as a valet at The Mar-a-Lago Club.

The Mar-a-Lago Club

11. The Mar-a-Lago Club was located on South Ocean Boulevard in Palm Beach, Florida, and included TRUMP's residence, more than 25 guest rooms, two ballrooms, a spa, a gift store, exercise facilities, office space, and an outdoor pool and patio. As of January 2021, The Mar-a-Lago Club had hundreds of members and was staffed by more than 150 full-time, part-time, and temporary employees.

12. Between January 2021 and August 2022, The Mar-a-Lago Club hosted more than 150 social events, including weddings, movie premieres, and fundraisers that together drew tens of thousands of guests.

13. The United States Secret Service (the "Secret Service") provided protection services to TRUMP and his family after he left office, including at The Mar-a-Lago Club, but it was not responsible for the protection of TRUMP's boxes or their contents. TRUMP did not inform the Secret Service that he was storing boxes containing classified documents at The Mar-a-Lago Club.

Classified Information

14. National security information was information owned by, produced by, produced for, and under the control of the United States government. Pursuant to Executive Order 12958, signed on April 17, 1995, as amended by Executive Order 13292 on March 25, 2003, and Executive Order 13526 on December 29, 2009, national security information was classified as "TOP SECRET," "SECRET," or "CONFIDENTIAL," as follows:

- a. Information was classified as TOP SECRET if the unauthorized disclosure of that information reasonably could be expected to cause

exceptionally grave damage to the national security that the original classification authority was able to identify or describe.

- b. Information was classified as SECRET if the unauthorized disclosure of that information reasonably could be expected to cause serious damage to the national security that the original classification authority was able to identify or describe.
- c. Information was classified as CONFIDENTIAL if the unauthorized disclosure of that information reasonably could be expected to cause damage to the national security that the original classification authority was able to identify or describe.

15. The classification marking “NOFORN” stood for “Not Releasable to Foreign Nationals” and denoted that dissemination of that information was limited to United States persons.

16. Classified information related to intelligence sources, methods, and analytical processes was designated as Sensitive Compartmented Information (“SCI”). SCI was to be processed, stored, used, or discussed in an accredited Sensitive Compartmented Information Facility (“SCIF”), and only individuals with the appropriate security clearance and additional SCI permissions were authorized to have access to such national security information.

17. When the vulnerability of, or threat to, specific classified information was exceptional, and the normal criteria for determining eligibility for access to classified information were insufficient to protect the information from unauthorized disclosure, the United States could establish Special Access Programs (“SAPs”) to further protect the classified information. The number of these programs was to be kept to an absolute minimum and limited to programs in which the number of persons who ordinarily would have access would be reasonably small and commensurate with the objective of providing enhanced protection for the information involved. Only individuals with the appropriate security clearance and additional SAP permissions were authorized to have access to such national security information, which was subject to enhanced handling and storage requirements.

18. Pursuant to Executive Order 13526, information classified at any level could be lawfully accessed only by persons determined by an appropriate United States government official to be eligible for access to classified information and who had signed an approved non-disclosure agreement, who received a security clearance, and who had a “need-to-know” the classified information. After his presidency, TRUMP was not authorized to possess or retain classified documents.

19. Executive Order 13526 provided that a former president could obtain a waiver of the “need-to-know” requirement, if the agency head or senior agency official

of the agency that originated the classified information: (1) determined in writing that access was consistent with the interest of national security and (2) took appropriate steps to protect classified information from unauthorized disclosure or compromise and ensured that the information was safeguarded in a manner consistent with the order. TRUMP did not obtain any such waiver after his presidency.

20. As part of his official duties as president, TRUMP received intelligence briefings from high-level United States government officials, including briefings from the Director of the Central Intelligence Agency, the Chairman of the Joint Chiefs of Staff, senior White House officials, and a designated briefer. He regularly received a collection of classified intelligence from the United States Intelligence Community (“USIC”) known as the “President’s Daily Brief.”

21. The USIC’s mission was to collect, analyze, and deliver foreign intelligence and counterintelligence information to America’s leaders, including the president, policymakers, law enforcement, and the military, so they could make sound decisions to protect the United States. The USIC consisted of United States executive branch departments and agencies responsible for the conduct of foreign relations and the protection of national security.

22. After his presidency, TRUMP retained classified documents originated by, or implicating the equities of, multiple USIC members and other executive branch departments and agencies

23. In January 2021, as he was preparing to leave the White House, TRUMP and his White House staff, including NAUTA, packed items, including some of TRUMP’s boxes. TRUMP was personally involved in this process. TRUMP caused his boxes, containing hundreds of classified documents, to be transported from the White House to The Mar-a-Lago Club.

24. From January through March 15, 2021, some of TRUMP’s boxes were stored in The Mar-a-Lago Club’s White and Gold Ballroom, in which events and gatherings took place. TRUMP’s boxes were for a time stacked on the ballroom’s stage

25. In March 2021, NAUTA and others moved some of TRUMP’s boxes from the White and Gold Ballroom to the business center at The Mar-a-Lago Club.

26. On April 5, 2021, an employee of The Office of Donald J. Trump (“Trump Employee 1”) texted another employee of that office (“Trump Employee 2”) to ask whether TRUMP’s boxes could be moved out of the business center to make room for staff to use it as an office. Trump Employee 2 replied, “Woah!! Ok so potus specifically asked Walt for those boxes to be in the business center because they are his ‘papers.’” Later that day, Trump Employee 1 and Trump Employee 2 exchanged the following text messages:

Trump Employee 2:

We can definitely make it work if we move his papers into the lake room?

Trump Employee 1:

There is still a little room in the shower where his other stuff is. Is it only his papers he cares about? There's some other stuff in there that are not papers. Could that go to storage? Or does he want everything in there on property

Trump Employee 2:

Yes—anything that's not the beautiful mind paper boxes can definitely go to storage. Want to take a look at the space and start moving tomorrow AM?

27. After the text exchange between Trump Employee 1 and Trump Employee 2, in April 2021, some of TRUMP's boxes were moved from the business center to a bathroom and shower in The Mar-a-Lago Club's Lake Room

28. In May 2021, TRUMP directed that a storage room on the ground floor of The Mar-a-Lago Club (the "Storage Room") be cleaned out so that it could be used to store his boxes. The hallway leading to the Storage Room could be reached from multiple outside entrances, including one accessible from The Mar-a-Lago Club pool patio through a doorway that was often kept open. The Storage Room was near the liquor supply closet, linen room, lock shop, and various other rooms.

29. On June 24, 2021, TRUMP's boxes that were in the Lake Room were moved to the Storage Room. After the move, there were more than 80 boxes in the Storage Room

30. On December 7, 2021, NAUTA found several of TRUMP's boxes fallen and their contents spilled onto the floor of the Storage Room, including a document marked "SECRET//REL TO USA, FVEY," which denoted that the information in the document was releasable only to the Five Eyes intelligence alliance consisting of Australia, Canada, New Zealand, the United Kingdom, and the United States. NAUTA texted Trump Employee 2, "I opened the door and found this." . . . NAUTA also attached two photographs he took of the spill. Trump Employee 2 replied, "Oh no oh no," and "I'm sorry potus had my phone." One of the photographs NAUTA texted to Trump Employee 2 is depicted below with the visible classified information redacted. TRUMP's unlawful retention of this document is charged in Count 8 of this Superseding Indictment. . . .

TRUMP's Production of 15 Cardboard Boxes to the National Archives and Records Administration

31. Beginning in May 2021, the National Archives and Records Administration ("NARA"), which was responsible for archiving presidential records, repeatedly demanded that TRUMP turn over presidential records that he had kept after his presidency. On multiple occasions, beginning in June, NARA warned TRUMP through his representatives that if he did not comply, it would refer the matter of the missing records to the Department of Justice.

32. Between November 2021 and January 2022, NAUTA and Trump Employee 2—at TRUMP's direction—brought boxes from the Storage Room to TRUMP's residence for TRUMP to review.

33. On November 12, 2021, Trump Employee 2 provided TRUMP a photograph of his boxes in the Storage Room by taping it to one of the boxes that Trump Employee 2 had placed in TRUMP's residence. Trump Employee 2 provided TRUMP the photograph so that TRUMP could see how many of his boxes were stored in the Storage Room. . . .

34. On November 17, 2021, NAUTA texted Trump Employee 2 about the photograph Trump Employee 2 had provided to TRUMP, stating, "He mentioned about a picture of the 'boxes' he wants me to see it?" Trump Employee 2 replied, "Calling you shortly."

35. On November 25, 2021, Trump Employee 2 texted NAUTA about TRUMP's review of the contents of his boxes, asking, "Has he mentioned boxes to you? I delivered some, but I think he may need more. Could you ask if he'd like more in pine hall?" Pine Hall was an entry room in TRUMP's residence. NAUTA replied in three successive text messages:

Nothing about boxes yet

He has one he's working on in pine hall

Knocked out 2 boxes yesterday

36. On November 29, 2021, Trump Employee 2 texted NAUTA, asking, "Next you are on property (no rush) could you help me bring 4 more boxes up?". NAUTA replied, "Yes!! Of course."

37. On December 29, 2021, Trump Employee 2 texted a TRUMP representative who was in contact with NARA ("Trump Representative I"), "box answer will be wrenched out of him today, promise!" The next day, Trump Representative 1 replied in two successive text messages:

Hey—Just checking on Boxes. . . .

would love to have a number to them today

Trump Employee 2 spoke to TRUMP and then responded a few hours later in two successive text messages:

12

Is his number

38. On January 13, 2022, NAUTA texted Trump Employee 2 about TRUMP's "tracking" of boxes, stating, "He's tracking the boxes, more to follow today on whether he wants to go through more today or tomorrow." Trump Employee 2 replied, "Thank you!"

39. On January 15, 2022, NAUTA sent Trump Employee 2 four successive text messages:

One thing he asked

Was for new covers for the boxes,
for Monday m.

Morning

*can we get new box covers before
giving these to them on Monday? They
have too much writing on them..! marked too
much

Trump Employee 2 replied, "Yes, I will get that!"

40. On January 17, 2022, Trump Employee 2 and NAUTA gathered 15 boxes from TRUMP's residence, loaded the boxes in NAUTA's car, and took them to a commercial truck for delivery to NARA.

41. When interviewed by the FBI in May 2022 regarding the location and movement of boxes before the production to NARA, NAUTA made false and misleading statements . . ., including:

- a. falsely stating that he was not aware of TRUMP's boxes being brought to TRUMP's residence for his review before TRUMP provided 15 boxes to NARA in January 2022;
- b. falsely stating that he did not know how the boxes that he and Trump Employee 2 brought from TRUMP's residence to the commercial truck

for delivery to NARA on January 17, 2022, had gotten to the residence;
and

- c. when asked whether he knew where TRUMP's boxes had been stored, before they were in TRUMP's residence and whether they had been in a secure or locked location, NAUTA falsely responded, "I wish, I wish I could tell you. I don't know. I don't—I honestly just don't know."

42. When the 15 boxes that TRUMP had provided reached NARA in January 2022, NARA reviewed the contents and determined that 14 of the boxes contained documents with classification markings. Specifically, as the FBI later determined, the boxes contained 197 documents with classification markings, of which 98 were marked "SECRET," 30 were marked "TOP SECRET," and the remainder were marked "CONFIDENTIAL." Some of those documents also contained SCI and SAP markings.

43. On February 9, 2022, NARA referred the discovery of classified documents in TRUMP's boxes to the Department of Justice for investigation.

44. On March 30, 2022, the FBI opened a criminal investigation.

45. On April 26, 2022, a federal grand jury opened an investigation.

46. On May 11, 2022, the grand jury issued a subpoena (the "May 11 Subpoena") to The Office of Donald J. Trump requiring the production of all documents with classification markings in the possession, custody, or control of TRUMP or The Office of Donald J. Trump. Two attorneys representing TRUMP ("Trump Attorney 1" and "Trump Attorney 2") informed TRUMP of the May 11 Subpoena, and he authorized Trump Attorney 1 to accept service.

47. On May 22, 2022, NAUTA entered the Storage Room at 3:47 p.m. and left approximately 34 minutes later, carrying one of TRUMP's boxes.

48. On May 23, 2022, TRUMP met with Trump Attorney 1 and Trump Attorney 2 at The Mar-a-Lago Club to discuss the response to the May 11 Subpoena. Trump Attorney 1 and Trump Attorney 2 told TRUMP that they needed to search for documents that would be responsive to the subpoena and provide a certification that there had been compliance with the subpoena. TRUMP, in sum and substance, made the following statements, among others, as memorialized by Trump Attorney 1:

- a. I don't want anybody looking, I don't want anybody looking through my boxes, I really don't, I don't want you looking through my boxes.

- b. Well what if we, what happens if we just don't respond at all or don't play ball with them?
- c. Wouldn't it be better if we just told them we don't have anything here?
- d. Well look isn't it better if there are no documents?

49. While meeting with Trump Attorney 1 and Trump Attorney 2 on May 23, TRUMP, in sum and substance, told the following story, as memorialized by Trump Attorney 1:

[Attorney], he was great, he did a great job. You know what? He said, he said that it—that it was him. That he was the one who deleted all of her emails, the 30,000 emails, because they basically dealt with her scheduling and her going to the gym and her having beauty appointments. And he was great. And he, so she didn't get in any trouble because he said that he was the one who deleted them.

TRUMP related the story more than once that day.

50. On May 23, TRUMP also confirmed his understanding with Trump Attorney 1 that Trump Attorney 1 would return to The Mar-a-Lago Club on June 2 to search for any documents with classification markings to produce in response to the May 11 Subpoena. Trump Attorney 1 made it clear to TRUMP that Trump Attorney 1 would conduct the search for responsive documents by looking through TRUMP's boxes that had been transported from the White House and remained in storage at The Mar-a-Lago Club. TRUMP indicated that he wanted to be at The Mar-a-Lago Club when Trump Attorney 1 returned to review his boxes on June 2, and that TRUMP would change his summer travel plans to do so. TRUMP told Trump Attorney 2 that Trump Attorney 2 did not need to be present for the review of boxes.

51. After meeting with Trump Attorney 1 and Trump Attorney 2 on May 23, TRUMP delayed his departure from The Mar-a-Lago Club to The Bedminster Club for the summer so that he would be present at The Mar-a-Lago Club on June 2, when Trump Attorney 1 returned to review the boxes.

52. Between TRUMP's May 23 meeting with Trump Attorney 1 and Trump Attorney 2 to discuss the May 11 Subpoena, and June 2, when Trump Attorney 1 returned to The Mar-a-Lago Club to review the boxes in the Storage Room, NAUTA removed—at TRUMP's direction—a total of approximately 64 boxes from the Storage Room and brought them to TRUMP's residence, as set forth below:

- a. On May 24, 2022, between 5:30 p.m. and 5:38 p.m., NAUTA removed three boxes from the Storage Room.
- b. On May 30, 2022, at 9:08 a.m., TRUMP and NAUTA spoke by phone for approximately 30 seconds. Between 10:02 a.m. and 11:51 a.m., NAUTA removed a total of approximately 50 boxes from the Storage Room.
- c. On May 30, 2022, at 12:33 p.m., a Trump family member texted NAUTA:

Good afternoon Walt,
Happy Memorial Day!

I saw you put boxes to Potus room. Just FYI and
I will tell him as well:
Not sure how many he wants to take on Friday on the
plane. We will NOT have a room for them. Plane will
be full with luggage.
Thank you!

NAUTA replied:

Good Afternoon Ma'am [Smiley Face Emoji]
Thank you so much.

I think he wanted to pick from them. I don't imagine him
wanting to take the boxes.

He told me to put them in the room and that he
was going to talk to you about them.

- d. On June 1, 2022, beginning at 12:52 p.m., NAUTA removed approximately 11 boxes from the Storage Room.

53. On June 1, 2022, TRUMP spoke with Trump Attorney 1 by phone and asked whether Trump Attorney 1 was coming to The Mar-a-Lago Club the next day and for exactly what purpose. Trump Attorney 1 reminded TRUMP that Trump Attorney 1 was going to review the boxes that had been transported from the White House and remained in storage at The Mar-a-Lago Club so that Trump Attorney 1 could have a custodian of records certify that the May 11 subpoena had been complied with fully.

54. On June 2, 2022, the day that Trump Attorney 1 was scheduled to review TRUMP's boxes in the Storage Room, TRUMP spoke with NAUTA on the phone at 9:29 a.m. for approximately 24 seconds.

55. Later that day, between 12:33 p.m. and 12:52 p.m., NAUTA and an employee of The Mar-a-Lago Club moved approximately 30 boxes from TRUMP's residence to the Storage Room.

56. In sum, between May 23, 2022, and June 2, 2022, before Trump Attorney 1's review of TRUMP's boxes in the Storage Room, NAUTA—at TRUMP's direction—moved approximately 64 boxes from the Storage Room to TRUMP's residence and brought to the Storage Room only approximately 30 boxes. Neither TRUMP nor NAUTA informed Trump Attorney 1 of this information.

The False Certification to the FBI and the Grand Jury

57. On the afternoon of June 2, 2022, as TRUMP had been informed, Trump Attorney 1 arrived at The Mar-a-Lago Club to review TRUMP's boxes to look for documents with classification markings in response to the May 11 Subpoena. TRUMP met with Trump Attorney 1 before Trump Attorney 1 conducted the review. NAUTA escorted Trump Attorney 1 to the Storage Room.

58. Between 3:53 p.m. and 6:23 p.m., Trump Attorney 1 reviewed the contents of TRUMP's boxes in the Storage Room. Trump Attorney 1 located 38 documents with classification markings inside the boxes, which Trump Attorney 1 removed and placed in a Redweld folder. Trump Attorney 1 contacted NAUTA and asked him to bring clear duct tape to the Storage Room, which NAUTA did. Trump Attorney 1 used the clear duct tape to seal the Redweld folder with the documents with classification markings inside.

59. After Trump Attorney 1 finished sealing the Redweld folder containing the documents with classification markings that he had found inside TRUMP's boxes, NAUTA took Trump Attorney 1 to a dining room in The Mar-a-Lago Club to meet with TRUMP. After Trump Attorney 1 confirmed that he was finished with his search of the Storage Room, TRUMP asked, "Did you find anything? . . . Is it bad? Good?"

60. TRUMP and Trump Attorney 1 then discussed what to do with the Redweld folder containing documents with classification markings and whether Trump Attorney 1 should bring them to his hotel room and put them in a safe there. During that conversation, TRUMP made a plucking motion, as memorialized by Trump Attorney 1:

He made a funny motion as though—ell okay why don't you take them with you to your hotel room and if there's anything really bad in there, like, you know, pluck it out. And that was the motion that he made. He didn't say that.

61. That evening, Trump Attorney 1 contacted the Department of Justice and requested that an FBI agent meet him at The Mar-a-Lago Club the next day, June 3, so that he could turn over the documents responsive to the May 11 Subpoena.

62. Also that evening, Trump Attorney 1 contacted another TRUMP attorney (“Trump Attorney 3”) and asked her if she would come to The Mar-a-Lago Club the next morning to act as a custodian of records and sign a certification regarding the search for documents with classification markings in response to the May 11 Subpoena. Trump Attorney 3, who had no role in the review of TRUMP’s boxes in the Storage Room, agreed.

63. The next day, on June 3, 2022, at Trump Attorney 1’s request, Trump Attorney 3 signed a certification as the custodian of records for The Office of Donald J. Trump and took it to The Mar-a-Lago Club to provide it to the Department of Justice and FBI. In the certification, Trump Attorney 3—who performed no search of TRUMP’s boxes, had not reviewed the May 11 Subpoena, and had not reviewed the contents of the Redweld folder—stated, among other things, that “[b]ased upon the information that [had] been provided to” her:

- a. “A diligent search was conducted of the boxes that were moved from the White House to Florida”;
- b. “This search was conducted after receipt of the subpoena, in order to locate any and all documents that are responsive to the subpoena”; and
- c. “Any and all responsive documents accompany this certification.”

64. These statements were false because, among other reasons, TRUMP had directed NAUTA to move boxes before Trump Attorney 1’s June 2 review, so that many boxes were not searched and many documents responsive to the May 11 Subpoena could not be found—and in fact were not found—by Trump Attorney 1.

65. Shortly after Trump Attorney 3 executed the false certification, on June 3, 2022, Trump Attorney 1 and Trump Attorney 3 met at The Mar-a-Lago Club with personnel from the Department of Justice and FBI. Trump Attorney 1 and Trump Attorney 3 turned over the Redweld folder containing documents with classification markings, as well as the false certification signed by Trump Attorney 3 as custodian of records. TRUMP, who had delayed his departure from The Mar-a-Lago Club, joined Trump Attorney 1 and Trump Attorney 3 for some of the meeting. TRUMP claimed to the Department of Justice and FBI that he was “an open book.”

66. Earlier that same day, NAUTA, DE OLIVEIRA and others loaded several of TRUMP’s boxes along with other items on aircraft that flew TRUMP and his family north for the summer.

67. On June 3, 2022, when FBI agents were at The Mar-a-Lago Club to collect the documents with classification markings from Trump Attorney 1 and Trump Attorney 3, the agents observed that there were surveillance cameras located near the Storage Room.

68. On June 22, 2022, the Department of Justice emailed an attorney for TRUMP's business organization a draft grand jury subpoena requiring the production of certain security camera footage from The Mar-a-Lago Club, including footage from cameras "on ground floor (basement)," where the Storage Room was located.

69. On June 23, 2022, at 8:46 p.m., TRUMP called DE OLIVEIRA and they spoke for approximately 24 minutes.

70. On Friday, June 24, 2022, the Department of Justice emailed the attorney for TRUMP's business organization the final grand jury subpoena, which required the production of "[a]ny and all surveillance records, videos, images, photographs and/or CCTV from internal cameras" at certain locations at The Mar-a-Lago Club, including "on ground floor (basement)," from January 10, 2022, to June 24, 2022.

71. That same day, June 24, 2022, at 1:25 p.m., Trump Attorney 1 spoke with TRUMP by phone regarding the subpoena for security camera footage. At 3:44 p.m., NAUTA received a text message from a co-worker, Trump Employee 3, indicating that TRUMP wanted to see NAUTA. Less than two hours later, NAUTA—who was scheduled to travel with TRUMP to Illinois the next day—changed his travel schedule and began to make arrangements to go to Palm Beach, Florida, instead.

72. NAUTA provided inconsistent explanations to colleagues for his sudden travel to Florida. At 7:14 p.m. on June 24, he texted one person that he would not be traveling with TRUMP the next day because he had a family emergency and used "shushing" emojis; at 9:48 p.m. that night, he texted a Secret Service agent that he had to check on a family member in Florida; and after he arrived in Florida on June 25, he texted the same Secret Service agent that he was in Florida working.

73. Around the same time on June 24 that NAUTA was making his travel plans to go to Florida, NAUTA and DE OLIVEIRA contacted Trump Employee 4, who was the Director of Information Technology ("IT") at The Mar-a-Lago Club, as follows:

- a. At 5:02 p.m., NAUTA sent text messages to Trump Employee 4 asking, "Hy bro You around this weekend."
- b. At 5:05 p.m., NAUTA texted DE OLIVEIRA, asking, "Hey brother You working today?" DE OLIVEIRA responded, "Yes I just left." NAUTA then called DE OLIVEIRA and they spoke for approximately two minutes.
- c. At 5:09 p.m., Trump Employee 4 texted a response to NAUTA, "I am local. Entertaining some family that came to visit. What's up?" NAUTA responded to Trump Employee 4, "Ok, cool. No biggie just wanted to see if you where around. Enjoy bro!"

- d. At 6:56 p.m., DE OLIVEIRA texted Trump Employee 4, “Hey buddy how are you . . . Walter call me early said it was trying to get in touch with you I guess he’s coming down tomorrow I guess needs you for something.” Trump Employee 4 responded, “He reached out but he didn’t say what he wanted. I told him I was local but entertaining some family that came from NYC this weekend. He told me to no worries.”
- e. At 6:58 p.m., Trump Employee 4 texted NAUTA, “Bro, if you need me I can get away for a few. Just let me know.” NAUTA responded, “Sounds good!! Thank you.”

74. On Saturday, June 25, 2022, NAUTA traveled from Bedminster, New Jersey, to Palm Beach, Florida. Prior to NAUTA’s trip, DE OLIVEIRA told a valet at The Mar-a-Lago Club (“Trump Employee 5”) that NAUTA was coming down. DE OLIVEIRA asked Trump Employee 5 not to tell anyone that NAUTA was coming down because NAUTA wanted the trip to remain secret. DE OLIVEIRA also told Trump Employee 5 that NAUTA wanted DE OLIVEIRA to talk to Trump Employee 4 to see how long camera footage was stored.

75. Shortly after arriving in Palm Beach on the evening of June 25, NAUTA went to The Mar-a-Lago Club and met with DE OLIVEIRA at 5:46 p.m. At The Mar-a-Lago Club, NAUTA and DE OLIVEIRA went to the security guard booth where surveillance video is displayed on monitors, walked with a flashlight through the tunnel where the storage Room was located, and observed and pointed out surveillance cameras.

76. On Monday, June 27, 2022, at 9:48 a.m., DE OLIVEIRA walked to the IT office where Trump Employee 4 was working with another employee in the IT department. DE OLIVEIRA requested that Trump Employee 4 step away from the office so that DE OLIVEIRA and Trump Employee 4 could talk.

77. At 9:49 a.m., Trump Employee 4 and DE OLIVEIRA left the area of the IT office together and walked through a basement tunnel. DE OLIVEIRA took Trump Employee 4 to a small room known as an “audio closet” near the White and Gold Ballroom. Once inside the audio closet, DE OLIVEIRA and Trump Employee 4 had the following exchange:

- a. DE OLIVEIRA told Trump Employee 4 that their conversation should remain between the two of them.
- b. DE OLIVEIRA asked Trump Employee 4 how many days the server retained footage. Trump Employee 4 responded that he believed it was approximately 45 days.
- c. DE OLIVEIRA told Trump Employee 4 that “the boss” wanted the server deleted. Trump Employee 4 responded that he would not know

how to do that, and that he did not believe that he would have the rights to do that. Trump Employee 4 told DE OLIVEIRA that DE OLIVEIRA would have to reach out to another employee who was a supervisor of security for TRUMP’s business organization. DE OLIVEIRA then insisted Trump Employee 4 that “the boss” wanted the server deleted and asked, “what are we going to do?”

78. At 10:14 a.m., DE OLIVEIRA texted NAUTA, who was still in Florida, “Hey buddy are you working today?” DE OLIVEIRA then called NAUTA at 10:15 a.m., and they spoke for approximately one minute.

79. Later that day, at 1:06 p.m., NAUTA texted DE OLIVEIRA, who was at The Mar-a-Lago Club, “On my way to you.” Between 1:31 p.m. and 1:50 p.m., DE OLIVEIRA walked through the bushes on the north edge of The Mar-a-Lago-Club property to meet with NAUTA on the adjacent property; then walked back to the IT office that he had visited that morning; and then walked again through the bushes on the northern edge of The Mar-a-Lago Club property to meet with NAUTA on the adjacent property.

80. At 3:55 p.m., TRUMP called. DE OLIVEIRA and they spoke for approximately three and a half minutes.

81. In July 2022, the FBI and grand jury obtained and reviewed surveillance video from The Mar-a-Lago Club showing the movement of boxes set forth above.

82. On August 8, 2022, the FBI executed a court-authorized search warrant at The Mar- a-Lago Club. The search warrant authorized the FBI to search for and seize, among other things, all documents with classification markings.

83. During the execution of the warrant at The Mar-a-Lago Club, the FBI seized 102 documents with classification markings in TRUMP’s office and the Storage Room, as follows:

Location	Number of Documents	Classification Markings
TRUMP’s Office	27	Top Secret (6) Secret (18) Confidential (3)
Storage Room	75	Top Secret (11) Secret (36) Confidential (28)

84. Just over two weeks after the FBI discovered classified documents in the Storage Room and TRUMP’s office, on August 26, 2022, NAUTA called Trump Employee 5 and said words to the effect of, “someone just wants to make sure Carlos is good.” In response, Trump Employee 5 told NAUTA that DE OLIVEIRA was loyal and

that DE OLIVEIRA would not do anything to affect his relationship with TRUMP. That same day, at NAUTA's request, Trump Employee 5 confirmed in a Signal chat group with NAUTA and the PAC Representative that DE OLIVEIRA was loyal. That same day, TRUMP called DE OLIVEIRA and told DE OLIVEIRA that TRUMP would get DE OLIVEIRA an attorney.

COUNTS 1–32

Willful Retention of National Defense Information (18 U.S.C. § 793(e))

85. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

86. On or about the dates set forth in the table below, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendant,

DONALD J. TRUMP

having unauthorized possession of, access to, and control over documents relating to the national defense, did willfully retain the documents and fail to deliver them to the officer and employee of the United States entitled to receive them; that is—TRUMP, without authorization, retained—at The Mar-a-Lago Club documents relating to the national defense, including the following [ed: listing of documents and counts omitted]

COUNT 33

Conspiracy to Obstruct Justice (18 U.S.C. § 1512(k))

87. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

88. From on or about May 11, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP and

WALTINE NAUTA, and

CARLOS DE OLIVEIRA

did knowingly combine, conspire, confederate, and agree with each other and with others known and unknown to the grand jury, to engage in misleading conduct toward another person and corruptly persuade another person to withhold a record, document, and other object from an official proceeding, in violation of 18 U.S.C. § 1512(b)(2)(A), and to corruptly conceal a record, document, and other object from an official proceeding, in violation of 18 U.S.C. § 1512(c)(1).

The Purpose of the Conspiracy

89. The purpose of the conspiracy was for TRUMP to keep classified documents he had taken with him from the White House and to hide and conceal them from a federal grand jury.

The Manner and Means of the Conspiracy

90. The manner and means by which the defendants sought to accomplish the objects and purpose of the conspiracy included, among other things, the following:

- a. Suggesting that Trump Attorney 1 falsely represent to the FBI and grand jury that TRUMP did not have documents called for by the May 11 Subpoena;
- b. moving boxes of documents to conceal them from Trump Attorney 1, the FBI, and the grand jury;
- c. suggesting that Trump Attorney 1 hide or destroy documents called for by the May 11 Subpoena;
- d. providing to the FBI and grand jury-just some of the documents called for by the May 11 Subpoena, while TRUMP claimed he was cooperating fully;
- e. causing a false certification to be submitted to the FBI and grand jury representing that all documents with classification markings had been produced, when in fact they had not; and
- f. making false and misleading statements to the FBI.

All in violation of Title 18, United States Code, Section 1512(k).

COUNT 34

Withholding a Document or Record (18 U.S.C. §§ 1512(b)(2)(A), 2)

91. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

92. From on or about May 11, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP and

WALTINE NAUTA

did knowingly engage in misleading conduct toward another person, and knowingly corruptly persuade and attempt to persuade another person, with intent to cause and induce any person to withhold a record, document, and other object from an official proceeding; that is—(1) TRUMP attempted to persuade Trump Attorney 1 to hide and conceal documents from a federal grand jury; and (2) TRUMP and NAUTA misled Trump Attorney 1 by moving boxes that contained documents with classification markings so that Trump Attorney 1 would not find the documents and produce them to a federal grand jury.

All in violation of Title 18, United States Code, Sections 1512(b)(2)(A) and 2.

COUNT 35

Corruptly Concealing a Document or Record (18 U.S.C. §§ 1512(c)(1), 2)

93. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

94. From on or about May 11, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP and

WALTINE NAUTA

did corruptly conceal a record, document, and other object, and attempted to do so, with the intent to impair the object's integrity and availability for use in an official proceeding; that is—TRUMP and NAUTA hid and concealed boxes that contained documents with classification markings from Trump Attorney 1 so that Trump Attorney 1 would not find the documents and produce them to a federal grand jury.

All in violation of Title 18, United States Code, Sections 1512(c)(1) and 2.

COUNT 36

Concealing a Document in a Federal Investigation (18 U.S.C. §§ 1519, 2)

95. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

96. From on or about May 11, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP and

WALTINE NAUTA,

did knowingly conceal, cover up, falsify, and make a false entry in any record, document, and tangible object with the intent to impede, obstruct, and influence the investigation and proper administration of any matter within the jurisdiction of a department and agency of the United States, and in relation to and contemplation of any such matter; that is—during a federal criminal investigation being conducted by the FBI, (1) TRUMP and NAUTA hid, concealed, and covered up from the FBI TRUMP’s continued possession of documents with classification markings at The Mar-a-Lago Club; and (2) TRUMP caused a false certification to be submitted to the FBI.

All in violation of Title 18, United States Code, Sections 1519 and 2.

COUNT 37

Scheme to Conceal (18 U.S.C. §§ 1001(a)(1), 2)

97. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

98. From on or about May 11, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP and

WALTINE NAUTA

in a matter within the jurisdiction of the judicial branch and executive branch of the United States government, did knowingly and willfully falsify, conceal, and cover up by any trick, scheme, and device a material fact; that is—during a federal grand jury investigation and a federal criminal investigation being conducted by the FBI, TRUMP and NAUTA hid and concealed from the grand jury and the FBI TRUMP’s continued possession of documents with classification markings.

All in violation of Title 18, United States Code, Sections 1001(a)(1) and 2.

COUNT 38

False Statements and Representations (18 U.S.C. §§ 1001(a)(2), 2)

99. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

100. On or about June 3, 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendant,

DONALD J. TRUMP

in a matter within the jurisdiction of the judicial branch and executive branch of the United States government, did knowingly and willfully make and cause to be made a materially false, fictitious, and fraudulent statement and representation; that is—during a federal grand jury investigation and a federal criminal investigation being conducted by the FBI, TRUMP caused the following false statements and representations to be made to the grand jury and the FBI in a sworn certification executed by Trump Attorney 3:

- a. “A diligent search was conducted of the boxes that were moved from the White House to Florida”;
- b. “This search was conducted after receipt of the subpoena, in order to locate any and all documents that are responsive to the subpoena”; and
- c. “Any and all responsive documents accompany this certification.”

101. The statements and representations set forth above were false, as TRUMP knew, because TRUMP had directed that boxes be removed from the Storage Room before Trump Attorney 1 conducted the June 2, 2022 search for documents with classification markings, so that Trump Attorney 1’s search would not and did not include all of TRUMP’s boxes that were removed from the White House; Trump Attorney 1’s search would not and did not locate all documents responsive to the May 11 Subpoena; and all responsive documents were not provided to the FBI and the grand jury with the certification. In fact, after June 3, 2022, more than 100 documents with classification markings remained at The Mar-a-Lago Club until the FBI search on August 8, 2022.

All in violation of Title 18, United States Code, Sections 1001(a)(2) and 2.

COUNT 39

False Statements and Representations (18 U.S.C. § 1001(a)(2))

102. The General Allegations of this Indictment are re-alleged and fully incorporated here by reference.

103. On May 26, 2022, NAUTA participated in a voluntary interview with the FBI. During the interview, the FBI explained to NAUTA that the FBI was investigating how classified documents had been kept at The Mar-a-Lago Club, and the FBI asked NAUTA questions about the location and movement of TRUMP’s boxes before TRUMP provided 15 boxes to NARA on January 17, 2022. NAUTA was represented by counsel, and the FBI advised NAUTA that the interview was voluntary and that he could leave at any time. The FBI also advised NAUTA that it was a criminal offense to lie to the FBI. The interview was recorded.

104. On or about May 26, 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendant,

WALTINE NAUTA

in a matter within the jurisdiction of the executive branch of the United States government, did knowingly and willfully make a materially false, fictitious, and fraudulent statement and representation; that is—in a voluntary interview during a federal criminal investigation being conducted by the FBI, NAUTA was asked the following questions and gave the following false answers:

Question: Does any—are you aware of any boxes being brought to his home—his suite?

Answer: No

Question: All right. So, so to the best of your knowledge, you're saying that those boxes that you brought onto the truck, first time you ever laid eyes on them was just the day of when [Trump Employee 2] needed you to—

Answer: Correct.

Question: —to take them. Okay.

Question: In knowing that we're trying to track the life of these boxes and where they could have been kept and stored and all that kind of stuff—

Answer: Mm-hm.

Question: —do you have any information that could—that would—that could help us understand, like, where they were kept, how they were kept, were they secured, were they locked? Something that makes the intelligence community feel better about these things, you know?

Answer: I wish, I wish I could tell you. I don't know. I don't—I honestly just don't know.

Question: And what—so, so you only saw the 15 boxes, 15, 17 boxes—

Answer: Mm-hm.

Question: —the day of the move? Even—they just showed up that day?

Answer: They were in Pine Hall. [Trump Employee 2] just asked me, hey, can we move some boxes?

Question: Okay.

Answer: And I was like, okay.

Question: So, you didn't know—had no idea how they got there before?

Answer: No.

105. The . . . statements and representations above were false, as NAUTA knew, because (1) NAUTA did in fact know that the boxes in Pine Hall had come from the Storage Room, as NAUTA himself, with the assistance of Trump Employee 2, had moved the boxes from the Storage Room to Pine Hall; and (2) NAUTA had observed the boxes in and moved them to various locations at The Mar-a-Lago Club.

All in violation of Title 18, United States Code, Section 1001(a)(2).

COUNT 40

Altering, Destroy, Mutilating, or Concealing an Object (18 U.S.C. §§ 1512(b)(2)(B), 2)

106. The General Allegations of this Superseding Indictment are re-alleged and fully incorporated here by reference.

107. From on or about June 22, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP,

WALTINE NAUTA, and

CARLOS DE OLIVEIRA

did knowingly corruptly persuade and attempt to persuade another person, with intent to cause and induce any person to alter, destroy, mutilate, and conceal an object with intent to impair the object's integrity and availability for use in an official proceeding; that is—TRUMP, NAUTA, and DE OLIVEIRA requested that Trump Employee 4 delete security camera footage at The Mar-a-Lago Club to prevent the footage from being provided to a federal grand jury.

All in violation of Title 18, United States Code, Sections 1512(b)(2)(B) and 2.

COUNT 41

Corruptly Altering, Destroying, Mutilating or Concealing a Document, Record, or Other Object (18 U.S.C. §§ 1512(c)(1), 2)

108. The General Allegations of this Superseding Indictment are re-alleged and fully incorporated here by reference.

109. From on or about June 22, 2022, through in or around August 2022, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendants,

DONALD J. TRUMP,

WALTINE NAUTA, and

CARLOS DE OLIVEIRA

did corruptly alter, destroy, mutilate, and conceal a record, document and other object and attempted to do so, with the intent to impair the object's integrity and availability for use in an official proceeding; that is—TRUMP, NAUTA, and DE OLIVEIRA requested that Trump Employee 4 delete security camera footage at The Mar-a-Lago Club to prevent the footage from being provided to a federal grand jury.

All in violation of Title 18, United States Code, Sections 1512(c)(1) and 2.

COUNT 42

False Statements and Representations (18 U.S.C. § 1001(a)(2))

110. The General Allegations of this Superseding Indictment are re-alleged and fully incorporated here by reference.

111. On January 13, 2023, DE OLIVEIRA participated in a voluntary interview with the FBI at DE OLIVEIRA's residence. During the interview, the FBI explained to DE OLIVEIRA that the FBI was investigating how classified documents had been kept at The Mar-a-Lago Club, and the FBI asked DE OLIVEIRA questions about the location and movement of TRUMP's boxes and other items. DE OLIVEIRA was advised by the FBI that the interview was voluntary and that he could tell the agents to leave at any time. The FBI also advised DE OLIVEIRA that it was a criminal offense to lie to the FBI. The interview was recorded.

On or about January 13, 2023, in Palm Beach County, in the Southern District of Florida, and elsewhere, the defendant,

CARLOS DE OLIVEIRA

112. In a matter within the jurisdiction of the executive branch of the United States government, did knowingly and willfully make a materially false, fictitious, and fraudulent statement and representation; that is—in a voluntary interview during a federal criminal investigation being conducted by the FBI, DE OLIVEIRA was asked the following questions and gave the following false answers:

Question: When—after the end of the presidency, boxes arrived to Mar-a-Lago. Were you part of any group to help—

Answer: No.

Question: —unload them and move them?

Answer: No.

Question: Do you—were you—do you even know, like, or were you even there or aware that boxes were—

Answer: No.

Question: —like, all this stuff was being moved in?

Answer: Never saw anything.

Question: Okay.

Answer: Yeah. And then—

Question: Even his personal stuff, like, his clothes—

Answer: Never.

Question: —and furniture, nothing?

Answer: Never saw nothing.

Question: Okay. So you don't know where items would have been stored, as soon as he moved back to Mar-a-Lago?

Answer: No.

113. The underscored statements and representations above were false, as DE OLIVEIRA knew, because DE OLIVEIRA had personally observed and helped move TRUMP's boxes when they arrived at The Mar-a-Lago Club in January 2021.

All in violation of Title 18, United States Code, Section 1001(a)(2).

9. PERJURY AND FALSE STATEMENTS

As with obstruction of justice, perjury and false statement charges are “trans-substantive” in corporate crime. You should expect these offenses to be potentially in play any time a client or subject of an investigation testifies or speaks to the government, and therefore in virtually every investigation and prosecution—no matter what the underlying legal violation might be.

Many of the same policy issues that arise with obstruction charges are relevant with respect to perjury and false statement charges. As far as doctrine goes, perjury turns out to be narrower than most people think, while the federal false statements statute covers a much broader realm of conduct than most people would expect to be criminal.

A. Statutes

These are not as complicated as the obstruction statutes. Section 1621 is the modern version of the longstanding federal perjury statute. Section 1623 is a more recent statute intended to alter the law a bit in terms of how § 1621 had been interpreted. Section 1623 is, not surprisingly, used more often now. Section 1622 criminalizes subornation of perjury, which of course covers conduct that might be easier for a prosecutor to charge as obstruction (witness tampering) under § 1512. Section 1001 (“thousand and one,” as it is called) is the federal false statements statute.

18 U.S.C. § 1621. Perjury generally

Whoever—

(1) having taken an oath before a competent tribunal, officer, or person, in any case in which a law of the United States authorizes an oath to be administered, that he will testify, declare, depose, or certify truly, or that any written testimony, declaration, deposition, or certificate by him subscribed, is true, willfully and contrary to such oath states or subscribes any material matter which he does not believe to be true; or

(2) in any declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, United States Code, willfully subscribes as true any material matter which he does not believe to be true;

is guilty of perjury and shall, except as otherwise expressly provided by law, be fined under this title or imprisoned not more than five years, or both. This section is applicable whether the statement or subscription is made within or without the United States.

18 U.S.C. § 1622. Subornation of perjury

Whoever procures another to commit any perjury is guilty of subornation of perjury, and shall be fined under this title or imprisoned not more than five years, or both.

18 U.S.C. § 1623. False declarations before grand jury or court

(a) Whoever under oath (or in any declaration, certificate, verification, or statement under penalty of perjury as permitted under section 1746 of title 28, United States Code) in any proceeding before or ancillary to any court or grand jury of the United States knowingly makes any false material declaration or makes or uses any other information, including any book, paper, document, record, recording, or other material, knowing the same to contain any false material declaration, shall be fined under this title or imprisoned not more than five years, or both.

(b) This section is applicable whether the conduct occurred within or without the United States.

(c) An indictment or information for violation of this section alleging that, in any proceedings before or ancillary to any court or grand jury of the United States, the defendant under oath has knowingly made two or more declarations, which are inconsistent to the degree that one of them is necessarily false, need not specify which declaration is false if—

(1) each declaration was material to the point in question, and

(2) each declaration was made within the period of the statute of limitations for the offense charged under this section.

In any prosecution under this section, the falsity of a declaration set forth in the indictment or information shall be established sufficient for conviction by proof that the defendant while under oath made irreconcilably contradictory declarations material to the point in question in any proceeding before or ancillary to any court or grand jury. It shall be a defense to an indictment or information made pursuant to the first sentence of this subsection that the defendant at the time he made each declaration believed the declaration was true.

(d) Where, in the same continuous court or grand jury proceeding in which a declaration is made, the person making the declaration admits such declaration to be false, such admission shall bar prosecution under this section if, at the time the admission is made, the declaration has not substantially affected the proceeding, or it has not become manifest that such falsity has been or will be exposed.

(e) Proof beyond a reasonable doubt under this section is sufficient for conviction. It shall not be necessary that such proof be made by any particular number of witnesses or by documentary or other type of evidence.

B. Perjury

The following Supreme Court case is the classic statement of the “literal truth defense” to perjury. (“Literal truth” is not a formal affirmative defense; the issue has to do with the government’s burden of proof.) Factual precision is essential in talking about perjury

charges. Exactly how were the words false, or not necessarily false? Exactly how could/should the questioner have posed the question(s) so that a perjury charge could be brought if a witness lied?

BRONSTON v. UNITED STATES, 409 U.S. 352 (1973)

Mr. Chief Justice BURGER delivered the opinion for a unanimous Court.

We granted the writ in this case to consider a narrow but important question in the application of the federal perjury statute, 18 U.S.C. § 1621: whether a witness may be convicted of perjury for an answer, under oath, that is literally true but not responsive to the question asked and arguably misleading by negative implication.

Petitioner is the sole owner of Samuel Bronston Productions, Inc., a company that between 1958 and 1964, produced motion pictures in various European locations. For these enterprises, Bronston Productions, opened bank accounts in a number of foreign countries; in 1962, for example, it had 37 accounts in five countries. As president of Bronston Productions, petitioner supervised transactions involving the foreign bank accounts.

In June 1964, Bronston Productions, petitioned for an arrangement with creditors under Chapter XI of the Bankruptcy Act, 11 U.S.C. § 701 et seq. On June 10, 1966, a referee in bankruptcy held a § 21(a) hearing to determine, for the benefit of creditors, the extent and location of the company's assets. Petitioner's perjury conviction was founded on the answers given by him as a witness at that bankruptcy hearing, and in particular on the following colloquy with a lawyer for a creditor of Bronston Productions:

'Q. Do you have any bank accounts in Swiss banks, Mr. Bronston?

'A. No, sir.

'Q. Have you ever?

'A. The company had an account there for about six months, in Zurich.

'Q. Have you any nominees who have bank accounts in Swiss banks?

'A. No, sir.

'Q. Have you ever?

'A. No, sir.'

It is undisputed that for a period of nearly five years, between October 1959 and June 1964, petitioner had a personal bank account at the International Credit Bank in Geneva, Switzerland, into which he made deposits and upon which he drew checks totaling more than \$180,000. It is likewise undisputed that petitioner's answers were literally truthful. (a) Petitioner did not at the time of questioning have a Swiss bank account. (b) Bronston Productions, Inc., did have the account in Zurich described by petitioner. (c) Neither at

the time of questioning nor before did petitioner have nominees who had Swiss accounts. The Government's prosecution for perjury went forward on the theory that in order to mislead his questioner, petitioner answered the second question with literal truthfulness but unresponsively addressed his answer to the company's assets and not to his own—thereby implying that he had no personal Swiss bank account at the relevant time.

At petitioner's trial, the District Court instructed the jury that the 'basic issue' was whether petitioner 'spoke his true belief.' Perjury, the court stated, 'necessarily involves the state of mind of the accused' and 'essentially consists of willfully testifying to the truth of a fact which the defendant does not believe to be true'; petitioner's testimony could not be found 'willfully' false unless at the time his testimony was given petitioner 'fully understood the questions put to him but nevertheless gave false answers knowing the same to be false.' The court further instructed the jury that if petitioner did not understand the question put to him and for that reason gave an unresponsive answer, he could not be convicted of perjury. Petitioner could, however, be convicted if he gave an answer 'not literally false but when considered in the context in which it was given, nevertheless constitute(d) a false statement' . . . [T]he jury returned its verdict, finding petitioner guilty on the count of perjury before us today and not guilty on another charge not here relevant.

In the Court of Appeals, petitioner contended, as he had in post-trial motions before the District Court, that the key question was imprecise and suggestive of various interpretations. In addition, petitioner contended that he could not be convicted of perjury on the basis of testimony that was concededly truthful, however unresponsive. A divided Court of Appeals held that the question was readily susceptible of a responsive reply and that it adequately tested the defendant's belief in the veracity of his answer. The Court of Appeals further held that, '(f)or the purposes of 18 U.S.C. § 1621, an answer containing half of the truth which also constitutes a lie by negative implication, when the answer is intentionally given in place of the responsive answer called for by a proper question, is perjury.' In this Court, petitioner renews his attack on the specificity of the question asked him and the legal sufficiency of his answer to support a conviction for perjury. The problem of the ambiguity of the question is not free from doubt, but we need not reach that issue. Even assuming, as we do, that the question asked petitioner specifically focused on petitioner's personal bank accounts, we conclude that the federal perjury statute cannot be construed to sustain a conviction based on petitioner's answer.

The statute, 18 U.S.C. § 1621, substantially identical in its relevant language to its predecessors for nearly a century, is 'a federal statute enacted in an effort to keep the course of justice free from the pollution of perjury.'

There is, at the outset, a serious literal problem in applying § 1621 to petitioner's answer. The words of the statute confine the offense to the witness who 'willfully . . . states . . . any material matter which he does not believe to be true.' Beyond question, petitioner's answer to the crucial question was not responsive if we assume, as we do, that the first question was directed at personal bank accounts. There is, indeed, an implication in the

answer to the second question that there was never a personal bank account; in casual conversation this interpretation might reasonably be drawn. But we are not dealing with casual conversation and the statute does not make it a criminal act for a witness to willfully state any material matter that *implies* any material matter that he does not believe to be true.

The Government urges that the perjury statute be construed broadly to reach petitioner's answer and thereby fulfill its historic purpose of reinforcing our adversary factfinding process. We might go beyond the precise words of the statute if we thought they did not adequately express the intention of Congress, but we perceive no reason why Congress would intend the drastic sanction of a perjury prosecution to cure a testimonial mishap that could readily have been reached with a single additional question by counsel alert—as every examiner ought to be—to the incongruity of petitioner's unresponsive answer. Under the pressures and tensions of interrogation, it is not uncommon for the most earnest witnesses to give answers that are not entirely responsive. Sometimes the witness does not understand the question, or may in an excess of caution or apprehension read too much or too little into it. It should come as no surprise that a participant in a bankruptcy proceeding may have something to conceal and consciously tries to do so, or that a debtor may be embarrassed at his plight and yield information reluctantly. It is the responsibility of the lawyer to probe; testimonial interrogation, and cross-examination in particular, is a probing, prying, pressing form of inquiry. If a witness evades, it is the lawyer's responsibility to recognize the evasion and to bring the witness back to the mark, to flush out the whole truth with the tools of adversary examination.

It is no answer to say that here the jury found that petitioner intended to mislead his examiner. A jury should not be permitted to engage in conjecture whether an unresponsive answer, true and complete on its face, was intended to mislead or divert the examiner; the state of mind of the witness is relevant only to the extent that it bears on whether 'he does not believe (his answer) to be true.' To hold otherwise would be to inject a new and confusing element into the adversary testimonial system we know. Witnesses would be unsure of the extent of their responsibility for the misunderstandings and inadequacies of examiners, and might well fear having that responsibility tested by a jury under the vague rubric of 'intent to mislead' or 'perjury by implication.' The seminal modern treatment of the history of the offense concludes that one consideration of policy overshadowed all others during the years when perjury first emerged as a common-law offense: 'that the measures taken against the offense must not be so severe as to discourage witnesses from appearing or testifying.' . . .

Thus, we must read § 1621 in light of our own and the traditional Anglo-American judgment that a prosecution for perjury is not the sole, or even the primary, safeguard against errant testimony. While 'the lower federal courts have not dealt with the question often,' and while their expressions do not deal with unresponsive testimony and are not precisely in point, 'it may be said that they preponderate against the respondent's contention.' The cases support petitioner's position that the perjury statute is not to be loosely construed, nor the statute invoked simply because a wily witness succeeds in

derailing the questioner—so long as the witness speaks the literal truth. The burden is on the questioner to pin the witness down to the specific object of the questioner’s inquiry. . . .

It may well be that petitioner’s answers were not guileless but were shrewdly calculated to evade. Nevertheless, we are constrained to agree with Judge Lumbard, who dissented from the judgment of the Court of Appeals, that any special problems arising from the literally true but unresponsive answer are to be remedied through the ‘questioner’s acuity’ and not by a federal perjury prosecution.

Here is one of the most famous examples of testimony and the issue of “literal truth.”

PRESIDENT BILL CLINTON’S GRAND JURY TESTIMONY

Q: Mr. President, I want to before I go into a new subject area. . . The statement of your attorney, Mr. Bennett, at the Paul[a] Jones deposition, “counsel is fully aware. . . that Ms. Lewinsky has filed, has an affidavit which they are in possession of saying that there is no sex of any kind in any manner, shape or form, with President Clinton”? That statement was made by your attorney in front of Judge Susan Webber Wright, correct?

A: That’s correct.

Q: That statement is a completely false statement. Whether or not Mr. Bennett knew of your relationship with Ms. Lewinsky, the statement that there was “no sex of any kind in any manner, shape or form, with President Clinton,” was an utterly false statement. Is that correct?

A: It depends on what the meaning of the word “is” is. If the—if he—if “is” means is and never has been, that is not—that is one thing. If it means there is none, that was a completely true statement. But as I have testified, and I’d like to testify again, this is—it is somewhat unusual for a client to be asked about his lawyer’s statements, instead of the other way around. I was not paying a great deal of attention to this exchange. I was focusing on my own testimony.

Grand Jury Testimony of President Clinton, August 17, 1998, pg. 57–58.

“It is clear to the [House Judiciary] Committee that the President perjured himself when he said that Mr. Bennett’s statement that there was ‘no sex of any kind’ was ‘completely true’ depending on what the word ‘is’ is.”

Impeachment of William Jefferson Clinton, President of the United States, H.R. Rep. No. 105-830 (1998).

Problem 9-1

In addition to reading the material above about President Clinton's grand jury testimony, watch the relevant three-minute excerpt of his testimony, which is available here:

<http://www.youtube.com/watch?v=xHlt1W83JFU>. (Feel free, of course, to watch additional portions of the testimony available online for further context.) Under *Bronston*, is the assertion of the House Judiciary Committee in its articles of impeachment, excerpted above, correct?

The following (overblown) prosecution involving testimony in a civil forfeiture case explains materiality in the context of perjury and gives a bit more feel for "literal truth," as well as a sense of the defense argument of "ambiguous question."

UNITED STATES v. KROSS, 14 F.3d 751 (2d Cir. 1994)

FEINBERG, Circuit Judge:

Laura Kross appeals from a judgment of conviction entered in March 1993, after a jury trial in the United States District Court for the District of Vermont before Franklin S. Billings, Jr., J. Kross was indicted on five counts of making false declarations in a civil deposition in violation of 18 U.S.C. § 1623, and the jury found her guilty on three counts. . . . For the reasons set forth below, we affirm.

Earth People's Park (the Park), a 592-acre parcel of land in the extreme northeastern corner of Vermont, is owned by Earth People's Park, Inc., a California corporation (the Corporation). Since the founding of the Park in 1970, the Corporation has allowed people to come to the Park at no charge in order to live in harmony with nature. Kross resided in the Park from 1971 to 1979, when she moved to nearby Brownington, Vermont.

In 1990, the United States filed a civil forfeiture complaint against the Park pursuant to 21 U.S.C. § 881(a)(7). *United States v. Earth People's Park, Consisting of 592 Acres, More or Less, Located in Norton, Vermont, with all Appurtenances and Attachments Thereon*. The United States sought forfeiture on the grounds that the property was being used for the cultivation and distribution of marijuana. The Corporation asserted the defense of innocent ownership, claiming that it had no knowledge of illegal drug-related activity at the Park.

The Assistant United States Attorney conducting the forfeiture litigation deposed Kross in January 1991, at which time she was accompanied by an attorney representing the Corporation. The testimony of Kross at the deposition formed the basis for the three counts of the indictment (Counts III, IV and V) on which she was convicted. Count III set forth her responses to questions about her knowledge of illegal drug use in the Park, as follows:

Q: Did you ever see anyone smoking marijuana in the Park?

A: *Not to the best of my recollection. When I lived up there, I kept pretty much to myself.*

...

Q: With regard to Koslosky, Greenip and Brown and Gagliola, did you ever see them smoking marijuana in the Park?

A: *No, uh-uh.*

Q: Do you have any information as to whether they did smoke marijuana in the Park?

A: *No, nobody's ever come and said that to me.*

Count IV concerned her knowledge of marijuana cultivation in the Park:

Q: Did you ever see anyone grow marijuana on [Earth People's] Park property?

A: *No.*

Q: Even if you didn't see anyone grow it. Did you ever see anyone grow it there?

A: *No. It's a big 600 acres.*

...

Q: Did you ever have any information about [Koslosky, Greenip, Brown and Gagliola] growing marijuana in the Park?

A: *Definitely not.*

Count V concerned her prior criminal history:

Q: Have you ever been arrested?

A: *No.*

Q: Have you ever been charged by State or Federal authorities with any crime?

A: *No.*

Q: Really, I'm not asking whether you've been convicted; I'm asking whether you've been charged?

A: *No, not that I remember.*

At trial, the government presented testimony to show that Kross was aware of the use and cultivation of the marijuana by Park residents. Evidence also showed that Kross had been charged with felonies in Vermont state court in 1980 and 1990.

Kross argues that the district court erred in denying her pretrial motion to dismiss the indictment on the grounds that the information sought in the deposition was immaterial to the underlying forfeiture proceeding, that the deposition questions at issue were fundamentally ambiguous and that her statements were literally true. . . .

Kross contends that the indictment should have been dismissed because none of her allegedly false declarations were material to the civil forfeiture action. We disagree.

We have consistently held in the grand jury context that a false declaration is “material” within the meaning of § 1623 when it has “a natural effect or tendency to influence, impede or dissuade the grand jury from pursuing its investigation.” *United States v. Kiszewski* (quoting *United States v. Berardi*). We have pointed out that in a § 1623 prosecution for false declarations to a grand jury,

[m]atters arguably cumulative or collateral to the grand jury’s objective in a given case are considered for their *potential* to aid that body, not for the *probability* of assistance from a truthful answer.

United States v. Gribben. Because the grand jury’s function is investigative, materiality in that context is “broadly construed.” However, we have apparently not yet addressed the issue of materiality under § 1623 in the context of a deposition in a civil matter. The purpose of civil discovery is also investigative, and the scope of discovery includes any information that “appears reasonably calculated to lead to the discovery of admissible evidence.” Fed. R. Civ. P. 26(b)(1).

The Fifth Circuit has held that for purposes of § 1623, materiality in a civil discovery deposition is not limited to evidence admissible at trial, but includes matters properly the subject of and material to a deposition under Rule 26(b)(1). *United States v. Holley*. The Ninth and Sixth Circuits have also adapted a materiality definition under § 1623 to the civil deposition context. See *United States v. Clark*; *United States v. Adams*. But the resultant definition is considerably narrower than that of the Fifth Circuit: it requires not merely discoverability under Rule 26(b)(1), but also the tendency of the false statement itself to affect the outcome of the underlying civil suit for which the deposition was taken. See *Clark*; *Adams*.

The facts of the present case favor a broad construction of the definition of materiality similar to the approach we have already used in the grand jury context. While a government deposition in a forfeiture action under 21 U.S.C. § 881 is civil in form, forfeiture actions are predicated upon a nexus between the property and criminal activity. See *United State*. Under the circumstances of this case, we see no persuasive reason not to apply the broad standard for materiality of whether a truthful answer might reasonably

be calculated to lead to the discovery of evidence admissible at the trial of the underlying suit.

We turn now to apply this broad standard to the facts of this case. With respect to Counts III and IV, Kross maintains that she was not an agent of the Corporation. Therefore, she argues, any knowledge she may have had concerning drug use or cultivation at the Park was not attributable to the Corporation and was thus immaterial to the forfeiture proceeding against the Corporation. At the time the questions were asked, however, the government was entitled to explore her knowledge based on the theory that she was an agent. Certainly, Kross' denial of agency would not end the matter, in view of evidence that she had represented herself to the Assistant conducting the deposition as the agent of the Corporation and had acted as its agent in the past. In any case, even if Kross was not the Corporation's agent, the information sought was material in that it concerned not only her *knowledge* of drug activity at the Park, but also the *existence* of drug activity.

As to Count III, Kross further argues that the information sought was immaterial to the forfeiture suit because marijuana smoking is not a felony justifying forfeiture under Title 21. Thus, she argues, even if she had testified that she had knowledge of marijuana smoking, that would not have demonstrated that the Park was being used to facilitate the more serious narcotics crimes that could justify a forfeiture. We disagree with this reasoning. It is true that neither marijuana smoking nor knowledge thereof constitutes independent grounds for civil forfeiture. Nevertheless, evidence of marijuana smoking on Park property was material at the discovery stage of the forfeiture proceeding because such evidence might lead to evidence of cultivation or distribution of marijuana, which would justify forfeiture.

With respect to Count IV, Kross also argues that she "could reasonably have understood" the questions to refer to the time when she lived in the Park in the 1970s. Thus, she claims, her answer about marijuana cultivation was immaterial because it did not concern the drug crimes that formed the basis for the 1990 forfeiture proceeding, but rather concerned activity predating the five-year statute of limitations period for § 881 forfeiture actions. Kross' argument is unconvincing, however, because the questioner clearly asked Kross if she had "ever" seen or had information about marijuana cultivation in the Park. In addition, as the district court correctly found,

Although evidence of pre-1985 drug crimes could not legally constitute a basis for forfeiture, evidence that [the Corporation] knew of illegal pre-1985 drug activity could certainly have led to information that the [C]orporation was not an "innocent owner," as well as an inference that the [C]orporation failed to satisfy its affirmative duty to safeguard the property from further drug activity.

Furthermore, the prior marijuana cultivation, while not the basis for the forfeiture proceeding, is nonetheless relevant to discovery regarding the later cultivation that did form the basis for the proceeding.

With respect to Count V, Kross argues that the statements regarding her prior criminal history were not material because they could have produced no useful testimony. Furthermore, she argues, the Assistant United States Attorney already knew of the prior charges against her.

Turning to the latter argument first, whether the questioner knows the answer to a question is irrelevant to materiality. *Cf. United States v. Lee*. As to the usefulness of truthful responses, the 1990 charges eventually resulted in a conviction. Since Kross was convicted of welfare fraud, a crime involving “dishonesty or false statement,” evidence of the conviction might have been admissible at trial of the forfeiture action to impeach Kross’s credibility if she were a witness. Fed. R. Evid. 609(a)(2). Though matters relating to the credibility of a prospective witness might not always be material within the meaning of the perjury statute, *see United States v. Freedman*, in this case there was evidence that Kross represented herself to the prosecutor as an agent of the owner of the defendant property. In such circumstances, matters affecting her credibility were material. *Cf. United States v. Salinas* (witness’s credibility material where witness was defendant in underlying action); *United States v. Sablosky*.

Although the 1980 charges were ultimately dismissed, the charges concerned marijuana possession. Thus, truthful testimony concerning those charges might have led to evidence of other drug-related activity by Kross.

Kross contends that her statements referred to in Counts III and IV of the indictment cannot have been perjurious because the questions asked were fundamentally ambiguous. She argues that because the questions were asked in the context of other questions about the year 1975, she assumed the questions referred to marijuana smoking and cultivation in the year 1975. According to Kross, the indictment alleges that she grew marijuana sometime between 1976 and 1990 and thus fails to allege that her answer was false.

While it is true that answers to “fundamentally ambiguous” questioning may be insufficient to support a perjury conviction, *United States v. Lighte*, Kross’ argument is wholly without merit. The indictment in fact alleges that Kross knew of and participated in marijuana cultivation between 1975 and 1990. Moreover, in both instances, the questioner clearly asked Kross if she had “ever” seen anyone smoking or growing marijuana in the Park. We agree with the district court that “ever” is not an imprecise word. . . .

What should be done about the witness who avoids testifying truthfully by being deliberately evasive rather than uttering provable falsehoods? Sometimes, in such a case of what one might call “near perjury,” a prosecutor will charge the witness with obstruction of justice rather than perjury. This is a famous case in which such an effort failed. Whether you agree with this decision or not, it should be clear why a distinction needs to be maintained between the crimes of perjury and obstruction of justice, and the obstruction of justice statutes prevented from being used to prosecute “sort of perjury.”

UNITED STATES v. BONDS, 784 F.3d 582 (9th Cir. 2015) (en banc)

Per Curiam Opinion; Concurrence by Judge KOZINSKI; Concurrence by Judge N.R. SMITH; Concurrence by Judge REINHARDT; Concurrence by Judge W. FLETCHER; Dissent by Judge RAWLINSON

During a grand jury proceeding, defendant gave a rambling, non-responsive answer to a simple question. Because there is insufficient evidence that Statement C was material, defendant's conviction for obstruction of justice in violation of 18 U.S.C. § 1503 is not supported by the record. Whatever section 1503's scope may be in other circumstances, defendant's conviction here must be reversed. . . .

KOZINSKI, Circuit Judge, with whom Circuit Judges O'SCANNLAIN, GRABER, CALLAHAN and NGUYEN join, concurring:

Can a single non-responsive answer by a grand jury witness support a conviction for obstruction of justice under 18 U.S.C. § 1503?

Defendant [Barry Bonds], who was then a professional baseball player, was summoned before a grand jury and questioned for nearly three hours about his suspected use of steroids. He was subsequently charged with four counts of making false statements and one count of obstruction of justice, all based on his grand jury testimony. The jury convicted him on the obstruction count and was otherwise unable to reach a verdict.

The jury instructions identified seven of defendant's statements that the government alleged obstructed justice. The jury, however, found only one statement obstructive. That statement was referred to as Statement C at trial and is italicized in the passage below:

Q: Did Greg[, your trainer,] ever give you anything that required a syringe to inject yourself with?

A: I've only had one doctor touch me. And that's my only personal doctor. Greg, like I said, we don't get into each others' personal lives. We're friends, but I don't—we don't sit around and talk baseball, because he knows I don't want—don't come to my house talking baseball. If you want to come to my house and talk about fishing, some other stuff, we'll be good friends. You come around talking about baseball, you go on. I don't talk about his business. You know what I mean?

Q: Right.

A: That's what keeps our friendship. You know, I am sorry, but that—you know, that—I was a celebrity child, not just in baseball by my own instincts. I became a celebrity child with a famous father. I just don't get into other people's business because of my father's situation, you see.

Defendant was again asked about injectable steroids immediately following this exchange and a few other times during his testimony. He provided direct responses to the follow-up questions. For example, he was asked whether he ever “injected [him]self with anything that Greg . . . gave [him].” He responded “I’m not that talented, no.” The government believed that those answers were false but, as noted, the jury failed to convict defendant on the false statement counts. . . .

[S]ection 1503’s coverage is vast. By its literal terms, it applies to all stages of the criminal and civil justice process, not just to conduct in the courtroom but also to trial preparation, discovery and pretrial motions. Indeed, it arguably covers conduct taken in anticipation that a civil or criminal case might be filed, such as tax planning, hiding assets or talking to police. And the text of the omnibus clause, in concert with our definition of corruptly, encompasses any act that a jury might infer was intended to “influence, obstruct, or impede . . . the due administration of justice.” That’s true even if no actual obstruction occurs, because the clause’s use of “endeavors” makes “success . . . irrelevant.” See *United States v. Richardson*.

Stretched to its limits, section 1503 poses a significant hazard for everyone involved in our system of justice, because so much of what the adversary process calls for could be construed as obstruction. Did a tort plaintiff file a complaint seeking damages far in excess of what the jury ultimately awards? That could be viewed as corruptly endeavoring to “influence . . . the due administration of justice” by seeking to recover more than the claim deserves. So could any of the following behaviors that make up the bread and butter of litigation: filing an answer that denies liability for conduct that is ultimately adjudged wrongful or malicious; unsuccessfully filing (or opposing) a motion to dismiss or for summary judgment; seeking a continuance in order to inflict delay on the opposing party; frivolously taking an appeal or petitioning for certiorari—the list is endless. Witnesses would be particularly vulnerable because, as the Supreme Court has noted, “[u]nder the pressures and tensions of interrogation, it is not uncommon for the most earnest witnesses to give answers that are not entirely responsive.” *Bronston v. United States*.

Lawyers face the most pervasive threat under such a regime. Zealous advocacy sometimes calls for pushing back against an adversary’s just case and casting a despicable client in a favorable light, yet such conduct could be described as “endeavor[ing] to . . . impede . . . the due administration of justice.” Even routine advocacy provides ample occasion for stumbling into the heartland of the omnibus clause’s sweeping coverage. Oral arguments provide a ready example. One need not spend much time in one of our courtrooms to hear lawyers dancing around questions from the bench rather than giving pithy, direct answers. There is, for instance, the ever popular “but that is not this case” retort to a hypothetical, which could be construed as an effort to divert the court and thereby “influence . . . the due administration of justice.”

It is true that any such maneuver would violate section 1503 only if it were done “corruptly.” But it is equally true that we have given “corruptly” such a broad

construction that it does not meaningfully cabin the kind of conduct that is subject to prosecution. As noted, we have held that a defendant acts “corruptly,” as that term is used in section 1503, if he does so “with the purpose of obstructing justice.” *Rasheed*. In the examples above, a prosecutor could argue that a complaint was filed corruptly because it was designed to extort a nuisance settlement, or an answer was filed corruptly because its principal purpose was to pressure a needy plaintiff into an unjust settlement, or that the lawyer who parried a judicial hypothetical with “but that is not this case” was endeavoring to distract the court so it would reach a wrong result. That a jury or a judge might not buy such an argument is neither here nor there; a criminal prosecution, even one that results in an acquittal, is a life-wrenching event. Nor does an acquittal wipe clean the suspicion that a guilty defendant got off on a technicality.

We have no doubt that United States Attorneys and their Assistants would use the power to prosecute for such crimes judiciously, but that is not the point. Making everyone who participates in our justice system a potential criminal defendant for conduct that is nothing more than the ordinary tug and pull of litigation risks chilling zealous advocacy. It also gives prosecutors the immense and unreviewable power to reward friends and punish enemies by prosecuting the latter and giving the former a pass. The perception that prosecutors have such a potent weapon in their arsenal, even if never used, may well dampen the fervor with which lawyers, particularly those representing criminal defendants, will discharge their duties. The amorphous nature of the statute is also at odds with the constitutional requirement that individuals have fair notice as to what conduct may be criminal. *See United States v. JDT* (citing *Skilling v. United States*).

Because the statute sweeps so broadly, due process calls for prudential limitations on the government’s power to prosecute under it. Such a limitation already exists in our case law interpreting section 1503: the requirement of materiality. *See United States v. Thomas*. Materiality screens out many of the statute’s troubling applications by limiting convictions to those situations where an act “has a natural tendency to influence, or was capable of influencing, the decision of the decisionmaking body.” *See Kungys v. United States; Thomas*. Put another way, the government must prove beyond a reasonable doubt that the charged conduct was capable of influencing a decisionmaking person or entity—for example, by causing it to cease its investigation, pursue different avenues of inquiry or reach a different outcome. *See United States v. McKenna* (finding statement material because it could have affected the “decision-making process”); *Weinstock v. United States* (noting that, to be material, a statement “must have some weight in the process of reaching a decision”).

In weighing materiality, we consider “the intrinsic capabilities of the . . . statement itself,” rather than the statement’s actual effect on the decisionmaker, *see United States v. Serv. Deli Inc.*, and we evaluate the statement in “the context in which [it was] made,” *United States v. Rigas*; *see also United States v. McBane; Weinstock* (noting that in context, a statement was “rob[bed] . . . of any materiality—any possible influence upon the [decisionmaker] in reaching its decision”).

We start with the self-evident proposition that Statement C, standing alone, did not have the capacity to divert the government from its investigation or influence the grand jury's decision whether to indict anyone. Here it is again:

That's what keeps our friendship. You know, I am sorry, but that—you know, that—I was a celebrity child, not just in baseball by my own instincts. I became a celebrity child with a famous father. I just don't get into other people's business because of my father's situation, you see.

The statement says absolutely nothing pertinent to the subject of the grand jury's investigation. Even when paired with the question that prompted it,

Did Greg ever give you anything that required a syringe to inject yourself with?

Statement C communicates nothing of value or detriment to the investigation. Had the answer been "I'm afraid of needles," it would have been plausible to infer an unspoken denial, with the actual words serving as an explanation or elaboration. But, as given, the answer did not enlighten, obfuscate, confirm or deny anything within the scope of the question posed.

The most one can say about this statement is that it was non-responsive and thereby impeded the investigation to a small degree by wasting the grand jury's time and trying the prosecutors' patience. But real-life witness examinations, unlike those in movies and on television, invariably are littered with non-responsive and irrelevant answers. This happens when the speaker doesn't understand the question, begins to talk before thinking (lawyers do this with surprising frequency), wants to avoid giving a direct answer (ditto), or is temporizing. Courtrooms are pressure-laden environments and a certain number of non-responsive or irrelevant statements can be expected as part of the give-and-take of courtroom discourse. Because some non-responsive answers are among the road hazards of witness examination, any one such statement is not, standing alone, "capable of influencing . . . the decision of [a] decisionmaking body." *See Thomas*.

This is true even if, as the government now argues, Statement C is literally false. An irrelevant or wholly non-responsive answer says nothing germane to the subject of the investigation, whether it's true or false. For example, if a witness is asked, "Do you own a gun?" it makes no difference whether he answers "The sky is blue" or "The sky is green." That the second statement is false makes it no more likely to impede the investigation than the first.

Statement C does not, however, stand alone. It was a small portion of a much longer examination, and we must look at the record as a whole to determine whether a rational trier of fact could have found the statement capable of influencing the grand jury's investigation, in light of defendant's entire grand jury testimony. If, for example, a witness engages in a pattern of irrelevant statements, or launches into lengthy

disquisitions that are clearly designed to waste time and preclude the questioner from continuing his examination, the jury could find that the witness's behavior was capable of having some sway.

On careful review of the record, we find insufficient evidence to render Statement C material. In conducting this review, we are mindful that we must give the jury the benefit of the doubt and draw all reasonable inferences in favor of its verdict. *See Jackson v. Virginia*. At the same time, we must conduct our review with some rigor for the prudential reasons discussed above.

The government charged a total of seven statements, only one of which the jury found to be obstructive. Two of these statements (including Statement C) appear to be wholly irrelevant—verbal detours with no bearing on the proceedings. One statement is “I don’t know,” followed by a brief explanation for the lack of knowledge. The rest are direct answers that the government claimed were false, all concerning whether defendant’s trainer had provided or injected him with steroids. In the context of three hours of grand jury testimony, these six additional statements are insufficient to render the otherwise innocuous Statement C material. If this were enough to establish materiality, few witnesses or lawyers would be safe from prosecution.

N.R. SMITH, Circuit Judge, with whom Circuit Judges WARDLAW, CALLAHAN, and FRIEDLAND join, concurring:

I agree that no reasonable juror could have found Bonds guilty of violating 18 U.S.C. § 1503. . . .

Congress could not have intended § 1503 to be so broadly applied as to reach a single truthful but evasive statement such as Statement C. Our conclusion that Statement C could not have “the natural and probable effect” of impeding the grand jury’s investigative function stems from two sources: (1) the Government’s duty to clarify merely misleading or evasive testimony and (2) relevant precedent indicating that the Government must show that truthful but misleading or evasive testimony must amount to a refusal to testify before it is material. Taken together, these two sources lead to the conclusion that a single truthful but evasive or misleading statement cannot satisfy § 1503’s materiality requirement.

The Supreme Court’s decision in *Bronston v. United States* requires the conclusion that Statement C does not violate § 1503. Although *Bronston* dealt with a conviction for perjury, the Supreme Court’s language regarding the government’s duty to conduct competent and thorough questioning is illuminating. In short, “[t]he burden is on the questioner to pin the witness down to the specific object of the questioner’s inquiry.” Extending § 1503’s reach to transient evasive or misleading statements would obviate the prosecutor’s duty to thoroughly examine the witness. *Id.* (noting that competent cross-examination should be conducted “by counsel alert—as every examiner ought to be—to the incongruity of [the witness’s] unresponsive answer”). It would be contrary to the statute’s purpose to allow the government to permit an evasive or misleading

statement to go unchallenged, in the hopes of obtaining an obstruction of justice conviction later. The government is obligated to do all it can to obtain a direct statement in response to its questioning. The truth-seeking function of the grand jury may be impaired by lax questioning as much, if not more than, an inarticulate or wandering answer.

Bronston counsels that, to convict a defendant for violating § 1503, the jury must find more than that the witness uttered an evasive or misleading statement at some point during his testimony—the “natural and probable effect” of a single truthful but evasive or misleading statement is merely to prompt follow-up questions. Given this burden, Statement C did not have the natural or probable effect of interfering with the due administration of justice, because the Government had a duty to clarify any single misleading or evasive statement Bonds made.

The Supreme Court’s materiality standard reinforces *Bronston*’s core holding: we should not find liability for a single statement that is merely misleading or evasive. The judicially-created materiality requirement is a primary objective limitation on § 1503’s expansive reach. See *United States v. Thomas*. This materiality standard necessarily takes into account the context of the charged conduct, evaluating whether the misleading or evasive statement could have “the natural and probable effect of interfering with the due administrative of justice” given the entirety of a witness’s examination. *Aguilar*. The Government may not isolate a single statement, prove it misleading or evasive, and argue that the statement is material based solely on that fact.

Evasive or misleading statements are different from false statements. Instead of providing the tribunal with bad information, information that can be evaluated for its capability to influence, a misleading or evasive statement is meant to divert or slow the truth-seeking function in the first instance; it does not so much influence an investigation as divert it by depriving the question of its force. In this sense, offering evasive or misleading testimony is closely analogous to the destruction of evidence. See *United States v. Rasheed* (“the destruction or concealment of documents can fall within the prohibition of the statute” by “suppress[ing] evidence”). We should evaluate the materiality of evasive or misleading testimony the same way: for its capability to impede the investigative function of the grand jury.

The Fifth Circuit’s explanation of the materiality standard in *United States v. Griffin* is particularly persuasive precedent. A false, misleading, or evasive statement may be material, taken in the context of the entire examination, when it amounts to “a flat refusal to testify.” *United States v. Griffin*. Evasive or misleading testimony, in this light, can only obstruct the due administration of justice when it completely thwarts the investigative nature of the tribunal—when it derails the grand jury “as effectively as if [the witness] refused to answer the question at all.” The proper question is not whether a statement had the intrinsic capability to influence the grand jury, but whether the statement, viewed in the context of the witness’s testimony as a whole, “closed off entirely the avenue of inquiry being pursued by” the grand jury. *United States v. Brown*;

see also United States v. Cohn (“The blatantly evasive witness achieves th[e] effect [of impeding the gathering of relevant evidence] as surely by erecting a screen of feigned forgetfulness as one who burns files or induces a potential witness to absent himself.”).

Applying the materiality standard a single truthful but evasive or misleading statement can never be material. Our examination of Statement C—a single evasive or misleading statement—reveals why. No rational juror could have found that Statement C amounted to a refusal to testify, such that Bonds’s testimony thwarted the grand jury’s investigative function.

In summary, the “natural and probable effect” of a single true but evasive response to the government’s questioning is not to impede the grand jury but, rather, to prompt follow-up questioning. A statement that “goes off into the cosmos” merely triggers the prosecutor’s duty to pin the witness down and elicit a clear response. Indeed, that is exactly what happened in this case. Faced with a rambling response, the prosecutor restated the same question and elicited a direct, unambiguous answer from Bonds: “No.” No rational juror could conclude that Bonds refused to answer the question; it is plain in the record that Bonds gave his testimony to the grand jury. Further, this is thus not a situation in which a witness testified evasively for so long and with such persistence that the grand jury’s investigation would likely have been thwarted, as would be required for the testimony to be material. Statement C was therefore not material, and Bonds’s conviction must be reversed. . . .

C. False Statements (18 U.S.C. § 1001)

18 U.S.C. § 1001. Statements or entries generally

(a) Except as otherwise provided in this section, whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, knowingly and willfully—

- (1) falsifies, conceals, or covers up by any trick, scheme, or device a material fact;
- (2) makes any materially false, fictitious, or fraudulent statement or representation; or
- (3) makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry;

shall be fined under this title, imprisoned not more than 5 years or, if the offense involves international or domestic terrorism (as defined in section 2331), imprisoned not more than 8 years, or both. If the matter relates to an offense under chapter 109A, 109B, 110, or 117, or section 1591, then the term of imprisonment imposed under this section shall be not more than 8 years.

(b) Subsection (a) does not apply to a party to a judicial proceeding, or that party’s counsel, for statements, representations, writings or documents submitted by such party or counsel to a judge or magistrate in that proceeding.

(c) With respect to any matter within the jurisdiction of the legislative branch, subsection (a) shall apply only to—

(1) administrative matters, including a claim for payment, a matter related to the procurement of property or services, personnel or employment practices, or support services, or a document required by law, rule, or regulation to be submitted to the Congress or any office or officer within the legislative branch; or

(2) any investigation or review, conducted pursuant to the authority of any committee, subcommittee, commission or office of the Congress, consistent with applicable rules of the House or Senate.

The above statute is one of the broadest of all federal criminal prohibitions in terms of the conduct it may cover—given the vast realm of all communications between individuals and the federal government. The following case is about the jurisdictional element of § 1001. The issue is whether the defendant needs to know that the lie involves something within federal jurisdiction. The Court says no. Was this correctly decided as a matter of policy and statutory text?

UNITED STATES v. YERMIAN, 468 U.S. 63 (1984)

Justice POWELL delivered the opinion of the Court.

Respondent Esmail Yermian was convicted in the District Court of Central California on three counts of making false statements in a matter within the jurisdiction of a federal agency, in violation of § 1001. The convictions were based on false statements respondent supplied his employer in connection with a Department of Defense security questionnaire. Respondent was hired in 1979 by Gulton Industries, a defense contractor. Because respondent was to have access to classified material in the course of his employment, he was required to obtain a Department of Defense Security Clearance. To this end, Gulton's security officer asked respondent to fill out a "Worksheet For Preparation of Personnel Security Questionnaire."

In response to a question on the worksheet asking whether he had ever been charged with any violation of law, respondent failed to disclose that in 1978 he had been convicted of mail fraud, in violation of 18 U.S.C. § 1341. In describing his employment history, respondent falsely stated that he had been employed by two companies that had in fact never employed him. The Gulton security officer typed these false representations onto a form entitled "Department of Defense Personnel Security Questionnaire." Respondent reviewed the typed document for errors and signed a certification stating that his answers were "true, complete, and correct to the best of [his] knowledge" and that he understood "that any misrepresentation or false statement . . . may subject [him] to prosecution under section 1001 of the United States Criminal Code."

After witnessing respondent's signature, Gulton's security officer mailed the typed form to the Defense Industrial Security Clearance Office for processing. Government investigators subsequently discovered that respondent had submitted false statements on the security questionnaire. Confronted with this discovery, respondent acknowledged that he had responded falsely to questions regarding his criminal record and employment history. On the basis of these false statements, respondent was charged with three counts in violation of § 1001.

At trial, respondent admitted to having actual knowledge of the falsity of the statements he had submitted in response to the Department of Defense security questionnaire. He explained that he had made the false statements so that information on the security questionnaire would be consistent with similar fabrications he had submitted to Gulton in his employment application. Respondent's sole defense at trial was that he had no actual knowledge that his false statements would be transmitted to a federal agency.

Consistent with this defense, respondent requested a jury instruction requiring the Government to prove not only that he had actual knowledge that his statements were false at the time they were made, but also that he had actual knowledge that those statements were made in a matter within the jurisdiction of a federal agency. The District Court rejected that request and instead instructed the jury that the Government must prove that respondent "knew or should have known that the information was to be submitted to a government agency." . . . [T]he jury returned convictions on all three counts charged in the indictment. . . .

The only issue presented in this case is whether Congress intended the terms "knowingly and willfully" in § 1001 to modify the statute's jurisdictional language, thereby requiring the Government to prove that false statements were made with actual knowledge of federal agency jurisdiction. The issue thus presented is one of statutory interpretation. Accordingly, we turn first to the language of the statute. . . .

The statutory language requiring that knowingly false statements be made "in any matter within the jurisdiction of any department or agency of the United States" is a jurisdictional requirement. Its primary purpose is to identify the factor that makes the false statement an appropriate subject for federal concern. Jurisdictional language need not contain the same culpability requirement as other elements of the offense. Indeed, we have held that "the existence of the fact that confers federal jurisdiction need not be one in the mind of the actor at the time he perpetrates the act made criminal by the federal statute." Certainly in this case, the statutory language makes clear that Congress did not intend the terms "knowingly and willfully" to establish the standard of culpability for the jurisdictional element of § 1001. The jurisdictional language appears in a phrase separate from the prohibited conduct modified by the terms "knowingly and willfully." Any natural reading of § 1001, therefore, establishes that the terms "knowingly and willfully" modify only the making of "false, fictitious or fraudulent statements," and not the predicate circumstance that those statements be made in a matter within the jurisdiction of a federal agency.

Once this is clear, there is no basis for requiring proof that the defendant had actual knowledge of federal agency jurisdiction. The statute contains no language suggesting any additional element of intent, such as a requirement that false statements be “knowingly made in a matter within federal agency jurisdiction,” or “with the intent to deceive the Federal Government.” On its face, therefore, § 1001 requires that the Government prove that false statements were made knowingly and willfully, and it unambiguously dispenses with any requirement that the Government also prove that those statements were made with actual knowledge of federal agency jurisdiction. Respondent’s argument that the legislative history of the statute supports a contrary interpretation is unpersuasive. . . .

Respondent argues that absent proof of actual knowledge of federal agency jurisdiction, § 1001 becomes a “trap for the unwary,” imposing criminal sanctions on “wholly innocent conduct.” Whether or not respondent fairly may characterize the intentional and deliberate lies prohibited by the statute (and manifest in this case) as “wholly innocent conduct,” this argument is not sufficient to overcome the express statutory language of § 1001. . . . In the unlikely event that § 1001 could be the basis for imposing an unduly harsh result on those who intentionally make false statements to the Federal Government, it is for Congress and not this Court to amend the criminal statute.

The next case is a pivotal Supreme Court decision dealing with the treatment of an “exculpatory no” under § 1001. Is there any persuasive way to get the policy argument to line up with the argument about statutory language here?

BROGAN v. UNITED STATES, 522 U.S. 398 (1988)

Justice SCALIA delivered the opinion of the Court.

While acting as a union officer during 1987 and 1988, petitioner James Brogan accepted cash payments from JRD Management Corporation, a real estate company whose employees were represented by the union. On October 4, 1993, federal agents from the Department of Labor and the Internal Revenue Service visited petitioner at his home. The agents identified themselves and explained that they were seeking petitioner’s cooperation in an investigation of JRD and various individuals. They told petitioner that if he wished to cooperate, he should have an attorney contact the United States Attorney’s Office, and that if he could not afford an attorney, one could be appointed for him.

The agents then asked petitioner if he would answer some questions, and he agreed. One question was whether he had received any cash or gifts from JRD when he was a union officer. Petitioner’s response was “no.” At that point, the agents disclosed that a search of JRD headquarters had produced company records showing the contrary. They also told petitioner that lying to federal agents in the course of an investigation was a crime. Petitioner did not modify his answers, and the interview ended shortly thereafter.

Petitioner was indicted for accepting unlawful cash payments from an employer in violation of 29 U.S.C. §§ 186(b)(1), (a)(2) and (d)(2), and making a false statement within the jurisdiction of a federal agency in violation of 18 U.S.C. § 1001. He was . . . found guilty. . . . We granted certiorari on the issue of the “exculpatory no.” . . .

By its terms, 18 U.S.C. § 1001 covers “any” false statement—that is, a false statement “of whatever kind.” The word “no” in response to a question assuredly makes a “statement,” *see, e.g.*, Webster’s New International Dictionary (2d ed.1950) (def. 2: “That which is stated; an embodiment in words of facts or opinions”), and petitioner does not contest that his utterance was false or that it was made “knowingly and willfully.” In fact, petitioner concedes that under a “literal reading” of the statute he loses.

Petitioner asks us, however, to depart from the literal text that Congress has enacted, and to approve the doctrine adopted by many Circuits which excludes from the scope of § 1001 the “exculpatory no.” The central feature of this doctrine is that a simple denial of guilt does not come within the statute. There is considerable variation among the Circuits concerning, among other things, what degree of elaborated tale-telling carries a statement beyond simple denial. In the present case, however, the Second Circuit agreed with petitioner that his statement would constitute a “true ‘exculpatory n[o]’ as recognized in other circuits,” but aligned itself with the Fifth Circuit in categorically rejecting the doctrine.

Petitioner’s argument in support of the “exculpatory no” doctrine proceeds from the major premise that § 1001 criminalizes only those statements to Government investigators that “pervert governmental functions”; to the minor premise that simple denials of guilt to Government investigators do not pervert governmental functions; to the conclusion that § 1001 does not criminalize simple denials of guilt to Government investigators. Both premises seem to us mistaken. As to the minor: We cannot imagine how it could be true that falsely denying guilt in a Government investigation does not pervert a governmental function. Certainly the investigation of wrongdoing is a proper governmental function; and since it is the very *purpose* of an investigation to uncover the truth, any falsehood relating to the subject of the investigation perverts that function. It could be argued, perhaps, that a *disbelieved* falsehood does not pervert an investigation. But making the existence of this crime turn upon the credulousness of the federal investigator (or the persuasiveness of the liar) would be exceedingly strange; such a defense to the analogous crime of perjury is certainly unheard of. Moreover, as we shall see, the only support for the “perversion of governmental functions” limitation is a statement of this Court referring to the *possibility* (as opposed to the certainty) of perversion of function—a possibility that exists whenever investigators are told a falsehood relevant to their task.

In any event, we find no basis for the major premise that only those falsehoods that pervert governmental functions are covered by § 1001. Petitioner derives this premise from a comment we made in *United States v. Gilliland*, a case involving the predecessor to § 1001. That earlier version of the statute subjected to criminal liability “whoever

shall knowingly and willfully . . . make or cause to be made any false or fraudulent statements or representations, or make or use or cause to be made or used any false bill, receipt, voucher, roll, account, claim, certificate, affidavit, or deposition, knowing the same to contain any fraudulent or fictitious statement or entry, in any matter within the jurisdiction of any department or agency of the United States” The defendant in *Gilliland*, relying on the interpretive canon *ejusdem generis*, argued that the statute should be read to apply only to matters in which the Government has a financial or proprietary interest. In rejecting that argument, we noted that Congress had specifically amended the statute to cover “any matter within the jurisdiction of any department or agency of the United States,” thereby indicating “the congressional intent to protect the authorized functions of governmental departments and agencies from the perversion which might result from the deceptive practices described.” Petitioner would elevate this statement to a holding that § 1001 does not apply where a perversion of governmental functions does not exist. But it is not, and cannot be, our practice to restrict the unqualified language of a statute to the particular evil that Congress was trying to remedy—even assuming that it is possible to identify that evil from something other than the text of the statute itself. . . . And even the relied-upon dictum from *Gilliland* . . . acknowledges the reality that the reach of a statute often exceeds the precise evil to be eliminated. There is no inconsistency whatever between the proposition that Congress intended “to protect the authorized functions of governmental departments and agencies from the perversion which might result” and the proposition that the statute forbids *all* “the deceptive practices described.”

The second line of defense that petitioner invokes for the “exculpatory no” doctrine is inspired by the Fifth Amendment. He argues that a literal reading of § 1001 violates the “spirit” of the Fifth Amendment because it places a “cornered suspect” in the “cruel trilemma” of admitting guilt, remaining silent, or falsely denying guilt. This “trilemma” is wholly of the guilty suspect’s own making, of course. An innocent person will not find himself in a similar quandary (as one commentator has put it, the innocent person lacks even a “lemma.”). And even the honest and contrite guilty person will not regard the third prong of the “trilemma” (the blatant lie) as an available option. . . . Whether or not the predicament of the wrongdoer run to ground tugs at the heartstrings, neither the text nor the spirit of the Fifth Amendment confers a privilege to lie. “[P]roper invocation of the Fifth Amendment privilege against compulsory self-incrimination allows a witness to remain silent, but not to swear falsely.” . . .

Petitioner repeats the argument made by many supporters of the “exculpatory no,” that the doctrine is necessary to eliminate the grave risk that § 1001 will become an instrument of prosecutorial abuse. The supposed danger is that overzealous prosecutors will use this provision as a means of “piling on” offenses—sometimes punishing the denial of wrongdoing more severely than the wrongdoing itself. The objectors’ principal grievance on this score, however, lies not with the hypothetical prosecutors but with Congress itself, which has decreed the obstruction of a legitimate investigation to be a separate offense, and a serious one. It is not for us to revise that judgment. . . .

In sum, we find nothing to support the “exculpatory no” doctrine except the many Court of Appeals decisions that have embraced it. . . . Courts may not create their own limitations on legislation, no matter how alluring the policy arguments for doing so, and no matter how widely the blame may be spread. Because the plain language of § 1001 admits of no exception for an “exculpatory no,” we affirm the judgment of the Court of Appeals.

Justice GINSBURG, with whom Justice SOUTER joins, concurring in the judgment.

At the time of Brogan’s offense, § 1001 made it a felony “knowingly and willfully” to make “any false, fictitious or fraudulent statements or representations” in “any matter within the jurisdiction of any department or agency of the United States.” 18 U.S.C. § 1001 (1988 ed.). That encompassing formulation arms Government agents with authority not simply to apprehend lawbreakers, but to generate felonies, crimes of a kind that only a Government officer could prompt. . . .

[Section] 1001 may apply to encounters between agents and their targets “under extremely informal circumstances which do not sufficiently alert the person interviewed to the danger that false statements may lead to a felony conviction.” Because the questioning occurs in a noncustodial setting, the suspect is not informed of the right to remain silent. Unlike proceedings in which a false statement can be prosecuted as perjury, there may be no oath, no pause to concentrate the speaker’s mind on the importance of his or her answers. As in Brogan’s case, the target may not be informed that a false “No” is a criminal offense until *after* he speaks.

At oral argument, the Solicitor General forthrightly observed that § 1001 could even be used to “escalate completely innocent conduct into a felony.” More likely to occur, “if an investigator finds it difficult to prove some elements of a crime, she can ask questions about other elements to which she already knows the answers. If the suspect lies, she can then use the crime she has prompted as leverage or can seek prosecution for the lie as a substitute for the crime she cannot prove.” If the statute of limitations has run on an offense—as it had on four of the five payments Brogan was accused of accepting—the prosecutor can endeavor to revive the case by instructing an investigator to elicit a fresh denial of guilt. Prosecution in these circumstances is not an instance of Government “punishing the denial of wrongdoing more severely than the wrongdoing itself,” it is, instead, Government generation of a crime when the underlying suspected wrongdoing is or has become nonpunishable. It is doubtful Congress intended § 1001 to cast so large a net. . . .

The Court’s opinion does not instruct lower courts automatically to sanction prosecution or conviction under § 1001 in all instances of false denials made to criminal investigators. The Second Circuit, whose judgment the Court affirms, noted some reservations. That court left open the question whether “to violate Section 1001, a person must know that it is unlawful to make such a false statement.” And nothing . . . this Court said suggests that “the mere denial of criminal responsibility would be sufficient to prove such [knowledge].” Moreover, “a trier of fact might acquit on the ground that a denial

of guilt in circumstances indicating surprise or other lack of reflection was not the product of the requisite criminal intent,” and a jury could be instructed that it would be permissible to draw such an inference. Finally, under the statute currently in force, a false statement must be “material” to violate § 1001.

The controls now in place, however, do not meet the basic issue, *i.e.*, the sweeping generality of § 1001’s language. Thus, the prospect remains that an overzealous prosecutor or investigator aware that a person has committed some suspicious acts, but unable to make a criminal case—will create a crime by surprising the suspect, asking about those acts, and receiving a false denial. Congress alone can provide the appropriate instruction.

Lies to corporate counsel as crimes? In the 2000s, the Justice Department appeared to be experimenting with a controversial application of Section 1001 and the obstruction statutes in corporate crime investigations.

The government’s idea was that corporate employees could be charged with making false statements in a federal matter if they lied to company counsel conducting an internal investigation into criminal wrongdoing—on the theory that, under the current regime for investigating and negotiating corporate criminality, employees know that their statements to internal investigators will be provided to government agents and prosecutors and will likely influence their conduct.

Sanjay Kumar and Stephen Richards, former senior executives of New York-based Computer Associates, were indicted on this theory in 2004, based on allegedly having crafted a false story for others in the management group to provide to investigators from an outside law firm, with the hope of curtailing an investigation into accounting fraud. Kumar and Richards moved to dismiss the obstruction charges and the trial court denied their motions to dismiss, finding the legal theory sufficient to warrant trial. Kumar and Richards then pled guilty. Similarly, in 2006, the Justice Department charged Greg Singleton, a Houston-based energy trader, with obstruction of justice for lying to his employer’s own investigators in a matter involving energy price manipulation. Singleton pled guilty in the case and the obstruction issues were never litigated.

Although it appears that the Justice Department has not pressed this theory in recent years, it is not known whether the Department has threatened or warned witnesses of the possibility of the theory’s continued application. What would be the implications for the government, corporations, and individuals if the Justice Department were to press this legal theory in the future?

Problem 9-2

Consider the question of prosecutorial discretion. To take 2022 as an example, the federal government prosecuted 11 cases of perjury and 495 cases of false statements nationally. How many times would you estimate that each of these crimes was committed? How should one estimate those numbers? How might one assess whether the government is prosecuting too many, too few, or the right number of perjury and false statements cases? What criteria should prosecutors use for selecting which such cases to prosecute as criminal lies?

10. CIVIL REGULATORY ENFORCEMENT; WHISTLEBLOWING

In nearly every area of corporate crime, there is overlap between criminal liability and some form of civil regulatory enforcement, often conducted through a specialized government agency. Every prosecutor and defense attorney working a case in this field must be familiar with the civil regulations and enforcement apparatus that work alongside any relevant criminal provisions.

There is not space here to cover an array of different civil enforcement regimes (those of the EPA, FTC, FDA, DOD, FCC, FAA, and so on through Washington's alphabet soup). The purpose of this chapter is to provide a sense of the civil-criminal overlap by introducing the basic features of one of those regimes: the one governing transactions in securities, administered by the SEC.

The SEC is not a prosecutor and has no authority to bring criminal charges. It must proceed under its own statutory grants of authority. Both the Securities Act of 1933 and the Exchange Act of 1934 grant the SEC extensive civil enforcement powers. The substantive scope of those enforcement provisions extends over all violations of all provisions of the '33 and '34 acts. Of course, those prohibitions include the edicts against securities fraud covered in chapters 3 and 4—and a good deal of SEC enforcement activity is based on that substantive legal theory (fraud). Many cases are also brought to enforce the FCPA, which likewise grants the SEC enforcement powers and which we have also studied.

A. The SEC's Powers: A Brief Summary

The '33 and '34 Acts authorize the SEC to pursue enforcement action on two primary tracks, at the SEC's option:

(1) An **administrative proceeding** brought within the confines and authority of the agency itself, litigated before an administrative law judge who is employed by the Commission. These administrative proceedings are also referred to as "cease and desist proceedings."

(2) A **lawsuit** filed in United States District Court for injunctive and other relief.

As you read through the statutes below, make lists of the *remedies* that the SEC can obtain through each of these two paths. Again, those remedies don't include imprisonment, but they can be quite potent.

Perhaps the most important power the SEC has been granted by Congress is the subpoena power, as it is the power to get cases going in the first place. SEC enforcement lawyers can subpoena testimony under oath "before the Commission" (which is actually something just like a deposition that takes place in a conference room with lawyers present for both sides) as well as documents. Much of SEC practice is conducted during

this investigative phase, as government and defense counsel skirmish over the scope of subpoenas, who will be called to testify, what questions will be asked, and the like.

Importantly, in civil proceedings, there is no Fifth Amendment right to not have one's refusal to answer questions used against one. In other words, a witness can "take the Fifth" when subpoenaed to testify before the SEC in order to protect herself in potential parallel criminal proceedings, but that silence can be used as evidence against her in any SEC litigation.

Over roughly a decade prior to 2024, the defense bar had been complaining that the SEC was choosing administrative proceedings over federal court lawsuits more often than it used to, allegedly to exploit the "home court advantage" said to exist in litigating before its own administrative law judges (ALJs). Litigants and advocacy groups began pressing a variety of constitutional challenges to administrative adjudication that had the potential to upend not only SEC administrative enforcement but also forms of administrative adjudication in other federal agencies.

The Supreme Court has now ruled, in *SEC v. Jarkesy*, 144 S.Ct. 2117 (June 27, 2024), that the imposition of money penalties in administrative proceedings based on allegations of securities fraud violates the right to a jury trial under the Seventh Amendment of the Constitution. The constitutional text speaks of "suits at common law." The Court reasoned that a cause of action for money based on securities fraud laws that grew out of common law fraud doctrine, even if brought by a public enforcer under a statute, is the sort of case the Seventh Amendment was meant to cover. In the wake of *Jarkesy*, the SEC will be unable to seek money penalties in ALJ proceedings, at least if the case is based on a theory of fraud. It will be a year or more before we know how much of the SEC's administrative docket will shift to district court lawsuits and how much of it, involving non-monetary sanctions and/or non-fraud cases, will remain within the agency process.

A last introductory point about SEC enforcement procedure. The Commission long ago decided to afford defendants something called a "*Wells* notice" or a "*Wells* proceeding." Under this procedure, potential SEC defendants, unlike most potential criminal defendants, receive advance notice of charges the SEC is considering bringing. Lawyers can then file what amounts to a brief, attempting to persuade the SEC not to bring the charges. The Commissioners themselves, who must vote on every enforcement action, review defendants' *Wells* submissions along with the materials that the SEC's enforcement attorneys prepare to justify their recommendations of action.³

³ For more depth, but not too much, on SEC enforcement—which can merit a separate law school course—consider reading Chapter 15 of the most recent edition of *Understanding Securities Law* (LexisNexis) by Mark Steinberg.

B. Statutes

As discussed in Chapter 3, the '34 Act regulates the exchanges and trading markets. Its key enforcement provisions, which are the most common vehicles for SEC enforcement proceedings, are excerpted below. The '33 Act, which regulates the process of initial offerings, has similar enforcement provisions that are not provided here.

Selected Enforcement Provisions of the Securities Exchange Act of 1934

Section 21 (15 U.S.C. § 78u). Investigations and actions

- (a) Authority and discretion of Commission to investigate violations
 - (1) The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated, or, as to any act or practice, or omission to act, while associated with a member, formerly associated with a member, the rules of a registered clearing agency in which such person is a participant, or, as to any act or practice, or omission to act, while a participant, was a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm, a person associated with such a firm, or, as to any act, practice, or omission to act, while associated with such firm, a person formerly associated with such a firm, or the rules of the Municipal Securities Rulemaking Board, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this chapter, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this chapter relates . . .

- (b) Attendance of witnesses; production of records

For the purpose of any such investigation, or any other proceeding under this chapter, any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the

production of any such records may be required from any place in the United States or any State at any designated place of hearing.

- (c) Judicial enforcement of investigative power of Commission; refusal to obey subpoena; criminal sanctions

In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Commission, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than \$1,000 or to imprisonment for a term of not more than one year, or both.

- (d) Injunction proceedings; authority of court to prohibit persons from serving as officers and directors; money penalties in civil actions

- (1) Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this chapter, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any

provision of this chapter or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.

- (2) Authority of court to prohibit persons from serving as officers and directors

In any proceeding under paragraph (1) of this subsection, the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated section 78j(b) of this title or the rules or regulations thereunder from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 78l of this title or that is required to file reports pursuant to section 78o(d) of this title if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer.

- (3) Money penalties in civil actions

- (A) Authority of Commission

Whenever it shall appear to the Commission that any person has violated any provision of this chapter, the rules or regulations thereunder, or a cease-and-desist order entered by the Commission pursuant to section 78u-3 of this title, other than by committing a violation subject to a penalty pursuant to section 78u-1 of this title, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation.

- (B) Amount of penalty

- (i) First tier

The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (I) \$5,000 for a natural person or \$50,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation.

- (ii) Second tier

Notwithstanding clause (i), the amount of penalty for each such violation shall not exceed the greater of (I) \$50,000 for a natural person or \$250,000 for any other

person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in subparagraph (A) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(iii) Third tier

Notwithstanding clauses (i) and (ii), the amount of penalty for each such violation shall not exceed the greater of (I) \$100,000 for a natural person or \$500,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation, if—

(aa) the violation described in subparagraph (A) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(bb) such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons . . .

(D) Special provisions relating to a violation of a cease-and-desist order

In an action to enforce a cease-and-desist order entered by the Commission pursuant to section 78u-3 of this title, each separate violation of such order shall be a separate offense, except that in the case of a violation through a continuing failure to comply with the order, each day of the failure to comply shall be deemed a separate offense . . .

(5) Equitable relief

In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors⁴. . .

⁴ Federal courts have long held that “equitable relief” within the meaning of this statute can include an order requiring the violator to disgorge all profits gained as a result of the violation (“disgorgement”). The SEC commonly seeks this remedy. In *Kokesh v. SEC*, 137 S. Ct. 1635 (2017), the Supreme Court held that the remedy of disgorgement is a form of “penalty,” not a

Section 21C (15 U.S.C. § 78u-3). Cease-and-desist proceedings

(a) Authority of Commission

If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this chapter, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, any issuer, or any other person.

(b) Hearing

The notice instituting proceedings pursuant to subsection (a) of this section shall fix a hearing date not earlier than 30 days nor later than 60 days after service of the notice unless an earlier or a later date is set by the Commission with the consent of any respondent so served. . . .

(e) Authority to enter order requiring accounting and disgorgement

In any cease-and-desist proceeding under subsection (a) of this section, the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

(f) Authority of the Commission to prohibit persons from serving as officers or directors

In any cease-and-desist proceeding under subsection (a) of this section, the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 78j(b) of this title or the rules or regulations thereunder,

remedial sanction as the SEC argued, and is thus subject to the 5-year statute of limitations that applies to SEC actions seeking to impose penalties.

from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 78l of this title, or that is required to file reports pursuant to section 78o(d) of this title, if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.

Section 21B (15 U.S.C. § 78u-2). Civil remedies in administrative proceedings

(a) Commission authority to assess money penalties

(1) In general

In any proceeding instituted pursuant to sections 78o(b)(4), 78o(b)(6), 78o-4, 78o-5, 78o-6, 78o-7, or 78q-1 of this title against any person, the Commission or the appropriate regulatory agency may impose a civil penalty if it finds, on the record after notice and opportunity for hearing, that such penalty is in the public interest and that such person—

- (A) has willfully violated any provision of the Securities Act of 1933 [15 U.S.C.A. § 77a et seq.], the Investment Company Act of 1940 [15 U.S.C.A. § 80a-1 et seq.], the Investment Advisers Act of 1940 [15 U.S.C.A. § 80b-1 et seq.], or this chapter, or the rules or regulations thereunder, or the rules of the Municipal Securities Rulemaking Board;
- (B) has willfully aided, abetted, counseled, commanded, induced, or procured such a violation by any other person;
- (C) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission or with any other appropriate regulatory agency under this chapter, or in any proceeding before the Commission with respect to registration, any statement which was, at the time and in the light of the circumstances under which it was made, false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein; or
- (D) has failed reasonably to supervise, within the meaning of section 78o(b)(4)(E) of this title, with a view to preventing violations of the provisions of such statutes, rules and regulations, another person who commits such a violation, if such other person is subject to his supervision;

(2) Cease-and-desist proceedings

In any proceeding instituted under section 78u-3 of this title against any person, the Commission may impose a civil penalty, if the Commission

finds, on the record after notice and opportunity for hearing, that such person—

- (A) is violating or has violated any provision of this chapter, or any rule or regulation issued under this chapter; or
- (B) is or was a cause of the violation of any provision of this chapter, or any rule or regulation issued under this chapter.

(b) Maximum amount of penalty

(1) First tier

The maximum amount of penalty for each act or omission described in subsection (a) of this section shall be \$5,000 for a natural person or \$50,000 for any other person.

(2) Second tier

Notwithstanding paragraph (1), the maximum amount of penalty for each such act or omission shall be \$50,000 for a natural person or \$250,000 for any other person if the act or omission described in subsection (a) of this section involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(3) Third tier

Notwithstanding paragraphs (1) and (2), the maximum amount of penalty for each such act or omission shall be \$100,000 for a natural person or \$500,000 for any other person if—

- (A) the act or omission described in subsection (a) of this section involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and
- (B) such act or omission directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission.

(c) Determination of public interest

In considering under this section whether a penalty is in the public interest, the Commission or the appropriate regulatory agency may consider—

- (1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement;

- (2) the harm to other persons resulting either directly or indirectly from such act or omission;
 - (3) the extent to which any person was unjustly enriched, taking into account any restitution made to persons injured by such behavior;
 - (4) whether such person previously has been found by the Commission, another appropriate regulatory agency, or a self-regulatory organization to have violated the Federal securities laws, State securities laws, or the rules of a self-regulatory organization, has been enjoined by a court of competent jurisdiction from violations of such laws or rules, or has been convicted by a court of competent jurisdiction of violations of such laws or of any felony or misdemeanor described in section 78o(b)(4)(B) of this title;
 - (5) the need to deter such person and other persons from committing such acts or omissions; and
 - (6) such other matters as justice may require . . .
- (e) Authority to enter order requiring accounting and disgorgement

In any proceeding in which the Commission or the appropriate regulatory agency may impose a penalty under this section, the Commission or the appropriate regulatory agency may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection. . .

C. Parallel Proceedings

The following D.C. Circuit decision is a leading case on whether subjects of overlapping civil and criminal investigations have any way to complain about being attacked by the government on two fronts at once. See how the D.C. Circuit answers this question.

SEC v. DRESSER INDUSTRIES, INC., 628 F.2d 1368 (D.C. Cir. 1980) (en banc)

J. SKELLY WRIGHT, Chief Judge:

Dresser Industries, Inc. (Dresser) appeals from a decision of the District Court requiring obedience to a subpoena duces tecum issued by the Securities and Exchange Commission (SEC) on April 21, 1978, and denying Dresser's motion to quash the subpoena. The subpoena was issued in connection with an SEC investigation into Dresser's use of corporate funds to make what are euphemistically called "questionable foreign payments," and into the adequacy of Dresser's disclosures of such payments under the securities laws.

The principal issue facing this en banc court is whether Dresser is entitled to special protection against this SEC subpoena because of a parallel investigation into the same questionable foreign payments now being conducted by a federal grand jury under the guidance of the United States Department of Justice (Justice). Dresser argues principally that the SEC subpoena abuses the civil discovery process of the SEC for the purpose of criminal discovery and infringes the role of the grand jury in independently investigating allegations of criminal wrongdoing. . . .

Illegal and questionable corporate payments surfaced as a major public problem in late 1973, when several major scandals implicated prominent American corporations in improper use of corporate funds to influence government officials in the United States and foreign countries. The exposure of these activities disrupted public faith in the integrity of our political system and eroded international trust in the legitimacy of American corporate operations abroad. SEC investigation revealed that many corporate officials were falsifying financial records to shield questionable foreign and domestic payments from exposure to the public and even, in many cases, to corporate directors and accountants. Since the completeness and accuracy of corporate financial reporting is the cornerstone of federal regulation of the securities markets, such falsification became a matter of grave concern to the SEC.

Beginning in the spring of 1974 the SEC brought a series of injunctive actions against certain American corporations. It obtained consent decrees prohibiting future violations of the securities laws and establishing internal corporate procedures for investigation, disclosure, and prevention of illegal corporate payments. However, the problem of questionable foreign payments proved so widespread that the SEC devised a "Voluntary Disclosure Program" to encourage corporations to conduct investigations of their past conduct and make appropriate disclosures without direct SEC coercion. Participation in the Voluntary Disclosure Program would not insulate a corporation from an SEC enforcement action, but the Commission would be less likely to exercise its discretion to initiate enforcement actions against participants. The most important elements of the Voluntary Disclosure Program were (1) an independent committee of the corporation would conduct a thorough investigation into questionable foreign and domestic payments made by the corporation; (2) the committee would disclose the results of this investigation to the board of directors in full; (3) the corporation would disclose the substance of the report to the public and the SEC on Form 8-K; and (4) the corporation would issue a policy statement prohibiting future questionable and illegal payments and maintenance of false or incomplete records in connection with them. Except in "egregious cases" the SEC would not require that public disclosures include specific names, dates, and places. Rather, the disclosures might be "generic" in form. Thus companies participating in the Voluntary Disclosure Program would ordinarily be spared the consequences to their employees, property, and business that might result from public disclosure of specific instances of foreign bribery or kickbacks. However, companies participating in the Voluntary Disclosure Program had to agree to grant SEC requests for access to the final report and to the unexpurgated underlying documentations.

On January 27, 1976 an attorney and other representatives of Dresser met with members of the SEC staff to discuss a proposed filing. At the meeting Dresser agreed to conduct an internal inquiry into questionable foreign payments, in accordance with the terms of the Voluntary Disclosure Program. The next day Dresser submitted a Form 8-K describing, in generic terms, one questionable foreign payment. On November 11, 1976 Dresser filed a second Form 8-K reporting the results of the internal investigation. On February 10, 1977 the company supplemented this report with a third Form 8-K concerning a questionable payment not reported in the earlier reports. The reports concerned Dresser's foreign activities after November 1, 1973. All disclosures were in generic, not specific, terms.

As part of its general monitoring program, the SEC staff requested access to the documents underlying Dresser's report. On July 15, 1977 Dresser refused to grant such access. The company argued that allowing the staff to make notes or copies might subject its documents to public disclosure through the Freedom of Information Act. Dresser stated that such disclosure could endanger certain of its employees working abroad. During the ensuing discussions with the staff Dresser attempted to impose conditions of confidentiality upon any SEC examination of its documents, but the staff did not agree. Instead, it issued a recommendation to the Commission for a formal order of investigation in the Dresser case. This recommendation was predicated on the staff's conclusions that Dresser:

1. may have used corporate funds for non-corporate purposes;
2. may have made false and misleading statements concerning the existence of and circumstances surrounding material obligations of Dresser to certain foreign governments and to other entities; and
3. may have made false entries and caused false entries to be made upon the books and records of Dresser, and its affiliates and subsidiaries with respect to, among other things, payments to foreign government officials.

Moreover, the staff reported that Dresser's proxy soliciting materials, reports, and statements may have been misleading with respect to the potential risks involved in its conduct of business through questionable foreign payments, and may have included false statements in connection with such payments. Dresser vigorously opposed issuance of an order of investigation.

Meanwhile, the Department of Justice had established a task force on transnational payments to investigate possible criminal violations arising from illegal foreign payments. Two SEC attorneys participated in the task force. In the summer of 1977 the Justice task force requested access to SEC files on the approximately 400 companies, including Dresser, that had participated in the Voluntary Disclosure Program. Pursuant to Commission authorization the SEC staff transmitted all such files to the Justice task force in August 1977. After its preliminary investigation of the Form 8-K's submitted

by Dresser under the Voluntary Disclosure Program, Justice presented Dresser's case to a grand jury in the District of Columbia on January 25, 1978.

Before any summons or subpoena had issued in either the SEC or the grand jury investigation, Dresser filed suit in the Southern District of Texas against the SEC and Justice to enjoin any further investigation of it by either agency. While Dresser's suit was pending in the Southern District of Texas, the District of Columbia grand jury subpoenaed Dresser's documents on April 21, 1978. At roughly the same time the SEC issued a formal order of private investigation, authorizing the staff to subpoena the documents and to obtain other relevant evidence. Pursuant to that order the staff issued a subpoena duces tecum, returnable on May 4, 1978. This subpoena covered substantially the same documents and materials subpoenaed by the grand jury, and more. Dresser did not respond to the subpoena. . . .

Then, on June 30, 1978, the District Court (Flannery, J.) issued a memorandum opinion and order rejecting all of Dresser's objections to the SEC subpoena and requiring Dresser to comply with the subpoena within ten days after notice from the SEC. Rehearing was denied on July 15. This appeal followed. . . .

The civil and regulatory laws of the United States frequently overlap with the criminal laws, creating the possibility of parallel civil and criminal proceedings, either successive or simultaneous. In the absence of substantial prejudice to the rights of the parties involved, such parallel proceedings are unobjectionable under our jurisprudence. . . .

The Constitution, therefore, does not ordinarily require a stay of civil proceedings pending the outcome of criminal proceedings. Nevertheless, a court may decide in its discretion to stay civil proceedings, postpone civil discovery, or impose protective orders and conditions "when the interests of justice seem () to require such action, sometimes at the request of the prosecution, . . . sometimes at the request of the defense(.)" *United States v. Kordel*. The court must make such determinations in the light of the particular circumstances of the case.

Other than where there is specific evidence of agency bad faith or malicious governmental tactics, the strongest case for deferring civil proceedings until after completion of criminal proceedings is where a party under indictment for a serious offense is required to defend a civil or administrative action involving the same matter. The noncriminal proceeding, if not deferred, might undermine the party's Fifth Amendment privilege against self-incrimination, expand rights of criminal discovery beyond the limits of Federal Rule of Criminal Procedure 16(b), expose the basis of the defense to the prosecution in advance of criminal trial, or otherwise prejudice the case. If delay of the noncriminal proceeding would not seriously injure the public interest, a court may be justified in deferring it. . . . In some such cases, however, the courts may adequately protect the government and the private party by merely deferring civil discovery or entering an appropriate protective order. *Gordon v. FDIC*. The case at bar is a far weaker one for staying the administrative investigation. No indictment has been

returned; no Fifth Amendment privilege is threatened; Rule 16(b) has not come into effect; and the SEC subpoena does not require Dresser to reveal the basis for its defense.

The case at bar concerns enforcement of the securities laws of the United States, especially the Securities Act of 1933 ('33 Act), 48 Stat. 74, 15 U.S.C. § 77a et seq. (1976), and the Securities Exchange Act of 1934 ('34 Act), 48 Stat. 881, 15 U.S.C. § 78a et seq. (1976). These statutes explicitly empower the SEC to investigate possible infractions of the securities laws with a view to both civil and criminal enforcement, and to transmit the fruits of its investigations to Justice in the event of potential criminal proceedings. . . .

Under the same subsection of the '34 Act the SEC may “transmit such evidence as may be available concerning such acts or practices . . . to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this chapter.”

Effective enforcement of the securities laws requires that the SEC and Justice be able to investigate possible violations simultaneously. Dissemination of false or misleading information by companies to members of the investing public may distort the efficient workings of the securities markets and injure investors who rely on the accuracy and completeness of the company's public disclosures. If the SEC suspects that a company has violated the securities laws, it must be able to respond quickly: it must be able to obtain relevant information concerning the alleged violation and to seek prompt judicial redress if necessary. Similarly, Justice must act quickly if it suspects that the laws have been broken. Grand jury investigations take time, as do criminal prosecutions. If Justice moves too slowly the statute of limitations may run, witnesses may die or move away, memories may fade, or enforcement resources may be diverted. The SEC cannot always wait for Justice to complete the criminal proceedings if it is to obtain the necessary prompt civil remedy; neither can Justice always await the conclusion of the civil proceeding without endangering its criminal case. Thus we should not block parallel investigations by these agencies in the absence of “special circumstances” in which the nature of the proceedings demonstrably prejudices substantial rights of the investigated party or of the government. . . .

The investigation of Dresser based as it was on the staff's conclusion that Dresser may have engaged in conduct seriously contravening the securities laws falls squarely within the Commission's explicit investigatory authority. . . .

Since the validity of summonses or subpoenas “depend(s) ultimately on whether they were among those authorized by Congress,” *United States v. LaSalle Nat'l Bank*, we conclude that this subpoena is enforceable under the rule of that case.

Fulfillment of the SEC's civil enforcement responsibilities requires this conclusion. Unlike the IRS, which can postpone collection of taxes for the duration of parallel criminal proceedings without seriously injuring the public, the SEC must often act quickly, lest the false or incomplete statements of corporations mislead investors and infect the markets. Thus the Commission must be able to investigate possible securities

infractions and undertake civil enforcement actions even after Justice has begun a criminal investigation. For the SEC to stay its hand might well defeat its purpose. . . .

No one would suggest that the grand jurors, unassisted by accountants, lawyers, or others schooled in the arcana of corporate financial accounting, could sift through the masses of Dresser's corporate documents and arrive at a coherent picture of the company's foreign payments and disclosure practices. In this area, as in many areas of great complexity, the grand jurors are assisted guided and influenced, in fact not only by the United States Attorneys assigned to the investigation, but also by experts provided by the federal regulatory agencies with experience in the particular subject areas. This expert assistance is permitted under Rule 6(e), and it promotes the efficiency and rationality of the criminal investigative process. In this case two SEC agents have been assigned to Justice's task force on transnational payments to assist in the investigation of companies possibly involved in illegal foreign payments. There can be little doubt that the grand jury's deliberations will be influenced by the work of these SEC agents. Any additional influence that might arise as a result of enforcement of the SEC subpoena and transmittal of documents to Justice thereafter is likely to be inconsequential. . . .

We conclude that the danger that enforcement of this subpoena might infringe the role of the grand jury is too speculative and remote at this point to justify so extreme an action as denying enforcement of this subpoena.

In essence, Dresser has launched this attack on the parallel SEC and Justice proceedings in order to obtain protection against the bare SEC proceeding, which it fears will result in public disclosure of sensitive corporate documents. The prejudice Dresser claims it will suffer from the parallel nature of the proceedings is speculative and undefined if indeed Dresser would suffer any prejudice from it at all. Any entitlement to confidential treatment of its documents must arise under the laws pertaining to the SEC; the fortuity of a parallel grand jury investigation cannot expand Dresser's rights in this SEC enforcement action. . . .

Congress understands and approves of the "close working relationship" between the agencies in their investigative capacities. Since such a "close working relationship" will govern the activities of the agencies in enforcing the laws against questionable foreign payments under the new statute, it would be impractical for us to attempt to screen the agencies from each other when they are investigating the same sort of offense under the former statutes.

Congress manifestly did not intend that the SEC be forbidden to share information with Justice at this stage of the investigation. Under the panel majority's theory of the case the SEC would be foreclosed from sharing the fruits of its investigation with Justice as soon as Justice begins its own investigation through a grand jury. Only by waiting until the close of the SEC proceeding before initiating its own grand jury investigation could Justice obtain access to the evidence procured by the SEC. In view of Congress' concern that the agencies share information "at the earliest stage of any investigation in order to insure that the evidence needed for a criminal prosecution does not become stale," S.

Rep. No. 114, and that the agencies avoid “a costly duplication of effort,” H.R. Rep. No. 640, it would be unreasonable to prevent a sharing of information at this point in the investigation. . . .

In the present case the SEC plainly has a legitimate noncriminal purpose for its investigation of Dresser. It follows that the investigation is in good faith, in the absence of complicating factors. There is, therefore, no reason to impose a protective order such as that imposed by the panel majority.

Finally, we note that the panel’s modification would serve no compelling purpose, and might interfere with enforcement of the securities laws by the SEC and Justice. As the Second Circuit has said, the procedure permitting the SEC to communicate with Justice during the preliminary stages of an investigation has “significant advantages.”:

Allowing early participation in the case by the United States Attorney minimizes statute of limitations problems. The more time a United States Attorney has, the easier it is for him to become familiar with the complex facts of a securities fraud case, to prepare the case, and to present it to a grand jury before expiration of the applicable statute of limitations. Earlier initiation of criminal proceedings moreover is consistent with a defendant’s right to a speedy trial. . . .

The panel’s modification would “interfere with this commendable example of inter-agency cooperation,” to the detriment of securities law enforcement and in contravention of the will of Congress. On the other side of the balance, the panel’s concern for preserving the limitations on criminal discovery is largely irrelevant at this stage of the proceedings, as Dresser agrees. Thus this would be an inappropriate situation to impose a “prophylactic” rule against cooperation between the agencies. We believe the courts can prevent any injustice that may arise in the particular circumstances of parallel investigations in the future.

The next, more recent case, while a single district court decision, provides an example of a court finding the government to have gone far enough to have crossed the outer limit described in *Dresser Industries*.

UNITED STATES v. SCRUSHY, 366 F.Supp.2d 1134 (N.D. Ala. 2005)

BOWDRE, J., District Court Judge:

[The defendant Richard Scrushy was the former CEO of HealthSouth, a large public company based in Birmingham, Alabama which the government investigated for accounting fraud during the same era as the Enron prosecutions.]

This matter comes before the court on the Defendant’s “Motion to Suppress Defendant’s S.E.C. Deposition and for Exclusion of Tape-Recorded Conversations” filed on April 7, 2005. The Government responded on April 8, 2005. The court conducted a hearing on

this matter on April 11, 2005. For the reasons discussed below, the motion to suppress the S.E.C. deposition is GRANTED. As a consequence of the suppression of the S.E.C. testimony and the lack of any other evidence, Counts 30, 31, and 32, the perjury counts based on that testimony, will be dismissed with prejudice at the appropriate time. . . .

The Defendant filed this motion as a direct result of the trial testimony of Neil Seiden, Senior Accountant with the S.E.C. Department of Enforcement, Atlanta, given in open court on April 5, 2005. During Mr. Seiden's testimony, the defense and the court learned for the first time that the S.E.C. had cooperated with the United States Attorney's office in the taking of Mr. Scrushy's testimony in Birmingham, Alabama, on March 14, 2003. In fact, Government counsel had affirmatively represented to the court on April 5, 2005, the day of Mr. Seiden's testimony, that Mr. Scrushy's deposition had been moved from Atlanta to Birmingham at the request of Mr. Scrushy's attorneys and not because of any request from the U.S. Attorney's office. These representations proved false. The court does not believe, however, that Government counsel deliberately misrepresented the facts to the court.

Mr. Seiden testified on April 5, 2005, that Mr. Scrushy's deposition had been scheduled to take place on Friday March 14, 2003, in Atlanta, Georgia and until Wednesday, March 12—two days before the scheduled deposition—his office received a call from the U.S. Attorney's office that lasted fifteen to twenty minutes. He further testified that, as a result of this call, the location of the deposition was changed from Atlanta to Birmingham. Although Mr. Seiden testified that Mr. Scrushy's attorneys had previously requested the change, he also testified that "[t]he U.S. Attorney's office asked us—had a preference that we take Mr. Scrushy's testimony in Birmingham. . . ." This answer that revealed the U.S. Attorney's office, in fact, had input into the location of the Defendant's deposition—as defense counsel had suspected but Government counsel had explicitly denied—raised legal questions concerning the admissibility of the Defendant's S.E.C. testimony. The court recessed early and sought the guidance of legal briefs from both sides, which the court has received and reviewed, on the admissibility of that deposition.

On April 11, 2005, the court conducted a hearing on the motion where additional testimony was elicited from Mr. Seiden. Specifically, Mr. Seiden testified that on March 12, 2003, around 3:30 p.m., a conference call was held between the U.S. Attorney's office in Birmingham and the S.E.C. office in Atlanta. On the call were Mr. Seiden, Ron Crawford, and Robert Lough for the S.E.C.; George Martin and Pat Meadows from the U.S. Attorney's office; and Agent Gerry Kelly of the F.B.I.

During that call, Mr. Martin revealed to the S.E.C. investigators that Weston Smith and Bill Owens had disclosed to the U.S. Attorney's office that a massive fraud had been occurring at HealthSouth since its inception that exceeded one billion dollars and that Mr. Scrushy allegedly knew of the fraud. Mr. Seiden was then asked to be present at the subsequent interviews of Mr. Smith and Mr. Owens scheduled for that Friday. Mr. Seiden recounted that conversation saying, "And they said, well, we really want Neil to *participate* on Friday. . . . [W]e would really like Neil to sit in and *participate* in the

interviews, because we need his accounting help on this.” Mr. Seiden was requested to move the deposition of Mr. Scrushy to Birmingham so that he (Seiden) would be available to participate in the interviews. Mr. Martin or Mr. Meadows suggested that Mr. Scrushy might be more comfortable on his own turf, and more inclined to testify truthfully. Mr. Martin then stated that “if [Mr. Scrushy] lies, then he will be lying in our district.” Prior to learning about the massive accounting fraud at HealthSouth in the March 12th phone conference and the request by the U.S. Attorney’s office to move the deposition, the S.E.C.’s preference was to conduct the testimony in Atlanta, and Mr. Seiden, up to that point, knew of no reason to move the deposition to Birmingham.

The assistant U.S. attorneys requested Mr. Seiden specifically NOT to ask Mr. Scrushy about certain areas, including cash; property, plant and equipment (“PP&E”); and accounts payable. Mr. Seiden asked whether he could inquire about income statements or earnings per share and Mr. Martin told him that he could not do so.

Mr. Seiden received directions from his supervisor that he was to honor the United States Attorney’s request, and he did so. As instructed by the U.S. Attorney’s office, Mr. Seiden waited for Mr. Scrushy’s attorneys to raise again their request that his deposition be moved to Birmingham because the U.S. Attorney’s office did not want to let “them” know that the government knew about the fraud. According to Mr. Seiden, “them” referred to Mr. Scrushy and his attorneys. Mr. Seiden testified upon questioning by the court that, prior to the March 12, 2003, conversation with the U.S. Attorney’s office, that he knew of no reason to move the deposition to Birmingham as previously requested by Mr. Scrushy’s counsel. He stated that the deposition was moved because Mr. Scrushy’s counsel pointed out that the room in Atlanta was too small; the S.E.C. wanted more time to question Mr. Scrushy because of the revelation of fraud from the U.S. Attorney’s office; and because of the request from the U.S. Attorney’s office.

Prior to Mr. Scrushy’s deposition, according to Mr. Seiden, the decision had been made that Mr. Seiden would be available to participate in the interviews of Mr. Smith and Mr. Owens. Regardless of where Mr. Scrushy’s deposition was taken, Mr. Seiden testified: “I apparently was out of there one way or the other, I apparently was going to Birmingham on Thursday, one way or the other.”

At the deposition on March 14, 2003, Mr. Seiden did not advise Mr. Scrushy or his attorneys of the existence of the criminal investigation into the fraud at HealthSouth, or of Mr. Smith’s and Mr. Owens’ cooperation with the Department of Justice. Mr. Scrushy was asked a series of questions at his deposition based on information learned in the March 12th phone call. Mr. Seiden testified that, had it not been for the March 12th call from the U.S. Attorney’s office, these questions would not have been asked at this deposition.

At the conclusion of Mr. Scrushy’s deposition, Mr. Seiden and Mr. Lough went directly to the U.S. Attorney’s office. On the next day, Saturday, March 15, 2003, Mr. Seiden participated in the interview of Weston Smith, and on Sunday, March 16, he participated in the interview of Bill Owens.

The Government asserts that the SEC civil investigation and the Department of Justice criminal investigation involved different criminal conduct. However, the testimony of Mr. Seiden elicited by Government counsel reflected a serious overlap in those investigations. Both the criminal investigation and the SEC investigation concerned aspects of accounting fraud at HealthSouth. According to the Formal Order of Investigation, the SEC investigation included “any false statements or omissions in HealthSouth’s quarterly reports or press releases relating to any historical revenues or future revenues.”

The issue before this court is whether the Government departed from the proper administration of criminal justice in procuring the Defendant’s deposition testimony. The court finds that the Government clearly so departed. The civil action and the criminal investigation improperly merged on March 12, 2003, when the U.S. Attorney’s office called the S.E.C. office, gave the S.E.C. advice or “preferences” regarding the content of the deposition and its location, and recruited Neil Seiden to participate in the interviews of Bill Owens and Weston Smith in the criminal investigation.

Counsel for both sides agree on some of the basic principles of law that must guide the court in its decision. Federal courts have supervisory authority over the manner in which Federal agents exercise their power. *Rea v. United States*; *United States v. Parrott*. However, a defendant cannot succeed on a theory of a “perjury trap” when the questions relate to a *legitimate, parallel* investigation. *United States v. Waldon*. The question to which neither side could cite any controlling law is what distinguishes a legitimate, parallel investigation from an improper one. The court could find no controlling authority on this critical point. . . .

In the instant case, the Government had both notice and direct input. Mr. Seiden received explicit directions from the U.S. Attorney’s office concerning tailoring his examination of Mr. Scrushy. He was told areas to avoid to keep Mr. Scrushy in the dark regarding the criminal investigation, and Mr. Seiden specifically included questions in the examination that he would not have included had the U.S. Attorney’s office not contacted the S.E.C. and discussed the criminal investigation. Further, the deposition was moved to Birmingham at the U.S. Attorney’s request, thus changing the venue of the subsequent perjury charges from the Northern District of Georgia to the Northern District of Alabama.

The Government’s assertion that the civil testimony should not be suppressed because the taking of the civil deposition could not be imputed to law enforcement is disingenuous at best. Mr. Seiden is a member of the enforcement division of the S.E.C. His job is to enforce the laws that regulate securities. He is employed by the United States Government—the same United States Government whose Department of Justice is prosecuting this case. Further, he crossed over to the criminal investigation as a result of the phone conversation on March 12, 2003. The actions by Mr. Seiden in changing the venue of the deposition to accommodate the U.S. Attorney’s office, extending the length of the deposition, and asking additional questions that otherwise would not have

been asked after learning of the criminal investigation are properly imputed to the Government for purposes of this motion.

Despite the Government's assertions that the S.E.C. civil investigation was separate from and parallel to the Justice Department's criminal investigation, the facts belie that assertion. To be parallel, by definition, the separate investigations should be like the side-by-side train tracks that never intersect. By contrast, as of March 12, 2003, at 3:30 p.m., the S.E.C. civil investigation merged with the Justice Department criminal investigation. One of the reasons for that conference call was to recruit Mr. Seiden to participate in the criminal investigation. He was asked in that call to be present at and participate in the interviews of Mr. Smith and Mr. Owens. He, in fact, participated in those interviews that were originally scheduled for Friday, March 14—the same day as Mr. Scrushy's deposition—and that actually occurred in the two days following Mr. Scrushy's deposition. The need to have Mr. Seiden available to the Government was one of the reasons why Mr. Martin or Mr. Meadows stated the Government's "preference" that Mr. Scrushy's testimony be taken in Birmingham. . . .

When a defendant *knows* that he has been charged with a crime, or that a criminal investigation has targeted him, he can take actions to prevent the providing of information in an administrative or civil proceeding that could later be used against him in the criminal case. When a defendant does not know about the criminal investigation, the danger of prejudice increases. Failing to advise Mr. Scrushy or his attorneys about the criminal investigation of which he was a target, and that the deposition had been moved to accommodate the need of the U.S. Attorney's office to bring into the criminal investigation one of the very S.E.C. investigators who was questioning Mr. Scrushy, *and* the change of the deposition's location for venue purposes cannot be said to be in keeping with the proper administration of justice. Our justice system cannot function properly in the face of such cloak and dagger activities by those charged with upholding the integrity of the justice system. . . .

Because the Government manipulated the simultaneous investigations for its own purposes, including the transfer of Mr. Scrushy's deposition into this district for venue purposes, the court finds that the utilization of Mr. Scrushy's deposition in this case departs from the proper administration of justice. Therefore, the S.E.C. testimony must be excluded. The Government represented on the Record to the court that it has no evidence of perjury apart from Mr. Scrushy's S.E.C. deposition. As a result, the perjury counts, Counts 30, 31, and 32, of the Superseding Indictment based on that testimony will be dismissed at the appropriate time. . . .

D. SEC Settlements

The overwhelming majority of SEC enforcement actions conclude in settlements of the sort described in the following case. Should judges have any substantive role in reviewing such settlements? One influential district judge thought so, but was then reversed as you can see here.

SEC v. CITIGROUP GLOBAL MARKETS INC., 827 F. Supp. 2d 328 (S.D.N.Y. 2011)

JED S. RAKOFF, U.S.D.J.

On October 19, 2011, the U.S. Securities and Exchange Commission (the “S.E.C”) filed this lawsuit, accusing defendant Citigroup Global Markets Inc. (“Citigroup”) of a substantial securities fraud. According to the S.E.C.’s Complaint, after Citigroup realized in early 2007 that the market for mortgage-backed securities was beginning to weaken, Citigroup created a billion-dollar Fund (known as “Class v Funding III”) that allowed it to dump some dubious assets on misinformed investors. This was accomplished by Citigroup’s misrepresenting that the Fund’s assets were attractive investments rigorously selected by an independent investment adviser, whereas in fact Citigroup had arranged to include in the portfolio a substantial percentage of negatively projected assets and had then taken a short position in those very assets it had helped select. Having structured the Fund as a vehicle for unloading these dubious assets on unwitting investors, Citigroup realized net profits of around \$160 million, whereas the investors, as the S.E.C. later revealed, lost more than \$700 million.

In a parallel Complaint filed the same day against Citigroup employee Brian Stoker, *see U.S. Securities and Exchange Commission v. Brian H. Stoker*, the S.E.C. alleged that Citigroup knew in advance that it would be difficult to sell the Fund if Citigroup disclosed its intention to use it as a vehicle to unload its hand-picked set of negatively projected assets. Specifically, paragraph 25 of the Stoker Complaint alleges (in language some of which is notably missing from the Citigroup Complaint) that:

Citigroup knew it would be difficult to place the liabilities of [the Fund] if it disclosed to investors its intention to use the vehicle to short a hand-picked set of [poorly rated assets] By contrast, Citigroup knew that representing to investors that an experienced third-party investment adviser had selected the portfolio would facilitate the placement of the [Fund’s] liabilities.

Although this would appear to be tantamount to an allegation of knowing and fraudulent intent (“scienter,” in the lingo of securities law), the S.E.C, for reasons of its own, chose to charge Citigroup only with negligence, in violation of Sections 17(a)(2) and (3) of the Securities Act, 15 U.S.C. § 77q(a)(2) and (3).

Simultaneously with the filing of its Complaint against Citigroup, the S.E.C. presented to the Court for its signature a “Final Judgment As To Defendant Citigroup Global Markets Inc.” (the “Consent Judgment”), together with a Consent of Defendant Citigroup Global Markets Inc. (the “Consent”) that recited that Citigroup consented to the entry of the Consent Judgment “[w]ithout admitting or denying the allegations of the complaint. . . .” The Consent Judgment (I) “permanently restrained and enjoined” Citigroup and its agents, employees, etc., from future violations of Sections 17(a)(2) and (3) of the Securities Act, (II) required Citigroup to disgorge to the S.E.C. Citigroup’s

\$160 million in profits, plus \$30 million in interest thereon, and to pay to the S.E.C. a civil penalty in the amount of \$95 million, and (III) required Citigroup to undertake for a period of three years, subject to enforcement by the Court, certain internal measures designed to prevent recurrences of the securities fraud here perpetrated.

Upon receipt of these submissions, the Court, by Order dated October 27, 2011, put some questions to the parties concerning the proposed Consent Judgment, to which the parties responded both in writing, and orally. Since then, the Court has spent long hours trying to determine whether, in view of the substantial deference due the S.E.C. in matters of this kind, the Court can somehow approve this problematic Consent Judgment. In the end, the Court concludes that it cannot approve it, because the Court has not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgment.

The Court turns first to the standard of review. In its original Memorandum in support of the proposed Consent Judgment, filed before the case had been assigned to any judge, the S.E.C. expressly endorsed the standard of review set forth by this Court in its Bank of America decisions, i.e., “whether the proposed Consent Judgment . . . is fair, reasonable, adequate, and in the public interest.” Memorandum By Plaintiff Securities and Exchange Commission in Support of Proposed Settlement (quoting with approval *SEC v. Bank of America Corp.* (“Bank of America I”)); *see also SEC v. Bank of America Corp.* (“Bank of America II”). This was also the S.E.C.’s stated position in another, intervening proceeding before this Court, *SEC v. Vitesse Semiconductor Corp.* In its most recent filing in this case, however, the S.E.C. partly reverses its previous position and asserts that, while the Consent Judgment must still be shown to be fair, adequate, and reasonable, “the public interest . . . is not part of [the] applicable standard of judicial review.” This is erroneous. A large part of what the S.E.C. requests, in this and most other such consent judgments, is injunctive relief, both broadly, in the request for an injunction forbidding future violations, and more narrowly, in the request that the Court enforce future prophylactic measures (here, for a three-year period). The Supreme Court has repeatedly made clear, however, that a court cannot grant the extraordinary remedy of injunctive relief without considering the public interest. *See, e.g., eBay, Inc. v. MercExchange* (“According to well-established principles of equity, a plaintiff seeking a permanent injunction . . . must demonstrate . . . that the public interest would not be disserved by a permanent injunction.”). Indeed, the Court has held that “In exercising their discretion, courts should pay particular regard for the public consequences in employing the extraordinary remedy of injunction.” *Winter v. Natural Resources Defense Council, Inc.* (quoting *Weinberger v. Romero-Barcelo*). Similarly, the Second Circuit has repeatedly stated, most recently in *Salinger v. Colting*, that a court “must ensure that the public interests would not be disserved by the issuance” of an injunction.

As a fall-back, the S.E.C. suggests that, if the public interest must be taken into account, the S.E.C. is the sole determiner of what is in the public interest in regard to Consent Judgments settling S.E.C. cases. *See SEC Mem.* (citing *SEC v. Randolph*). That, again, is not the law. Although in its somewhat delphic decision in *Randolph* the Ninth Circuit

found that, on the facts of that case, there was no difference between the requirement of reasonableness and the requirement of being in the public interest, it was emphatic in upholding “the appropriateness of a requirement that the decree be in the public interest.” More pertinently, the D.C. Circuit, in *United States v. Trucking Employers, Inc.*, reaffirmed that “prior to approving a consent decree a court must satisfy itself of the settlement’s ‘overall fairness to beneficiaries and consistency with the public interest.’” *Id.* (quoting *United States v. Allegheny Ludlum Industries*). As these and similar authorities make plain, a court, while giving substantial deference to the views of an administrative body vested with authority over a particular area, must still exercise a modicum of independent judgment in determining whether the requested deployment of its injunctive powers will serve, or disserve, the public interest. Anything less would not only violate the constitutional doctrine of separation of powers but would undermine the independence that is the indispensable attribute of the federal judiciary.

As a practical matter, moreover, and as *Randolph* implies, the requirement that a consent judgment be in the public interest is not meaningfully severable from the requirements, still acknowledged by the S.E.C., that the consent judgment be fair, reasonable, and adequate; for all these requirements inform each other. For example, before the Court determines whether the proposed Consent Judgment is adequate, it must answer a preliminary question: adequate for what purpose? The answer, at least in part, is that the settlement must be adequate to ensure that the public interest is protected. *See Randolph* (“the SEC ought to always be required to serve the public interest”). The same analysis applies to the determination of the fairness of the settlement. Before the Court determines whether the settlement is fair, it must ask a preliminary question: fair to whom? As the holding of *Trucking Employers* quoted above makes plain, the answer is fair to the parties and to the public. . . .

Here, the S.E.C.’s long-standing policy—hallowed by history, but not by reason—of allowing defendants to enter into Consent Judgments without admitting or denying the underlying allegations, deprives the Court of even the most minimal assurance that the substantial injunctive relief it is being asked to impose has any basis in fact. There is little real doubt that Citigroup contests the factual allegations of the Complaint. In colloquy with the Court, counsel for Citigroup expressly reconfirmed that his client was not admitting the allegations of the Complaint. He also noted, correctly, that he was free—notwithstanding the S.E.C.’s gag order precluding Citigroup from contesting the S.E.C.’s allegations in the media—to fully contest the facts in any parallel litigation; and he strongly hinted that Citigroup would do just that.

The S.E.C., by contrast, took the position that, because Citigroup did not expressly deny the allegations, the Court, and the public, somehow knew the truth of the allegations. This is wrong as a matter of law and unpersuasive as a matter of fact. As a matter of law, an allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect. It is precisely for this reason that the Second Circuit held long ago, in *Lipsky v. Commonwealth United Corp.*, that “a consent judgment between a federal agency and a private corporation which is not the result of

an actual adjudication of any of the issues . . . cannot be used as evidence in subsequent litigation.” It follows that the allegations of the complaint that gives rise to the consent judgment are not evidence of anything either. Indeed the *Lipsky* court went so far as to hold that “neither [an S.E.C.] complaint nor reference to [such] a complaint which results in a consent judgment may properly be cited in the pleadings” in a parallel private action and must instead be stricken.

As for common experience, a consent judgment that does not involve any admissions and that results in only very modest penalties is just as frequently viewed, particularly in the business community, as a cost of doing business imposed by having to maintain a working relationship with a regulatory agency, rather than as any indication of where the real truth lies. This, indeed, is Citigroup’s position in this very case. . . .

It is harder to discern from the limited information before the Court what the S.E.C. is getting from this settlement other than a quick headline. By the S.E.C.’s own account, Citigroup is a recidivist and yet, in terms of deterrence, the \$95 million civil penalty that the Consent Judgment proposes is pocket change to any entity as large as Citigroup. While the S.E.C. claims that it is devoted, not just to the protection of investors but also to helping them recover their losses, the proposed Consent Judgment, in the form submitted to the Court, does not commit the S.E.C. to returning any of the total of \$285 million obtained from Citigroup to the defrauded investors but only suggests that the S.E.C. “may” do so. In any event, this still leaves the defrauded investors substantially short-changed. To be sure, at oral argument, the S.E.C. reaffirmed its long-standing purported support for private civil actions designed to recoup investors’ losses. But in actuality, the combination of charging Citigroup only with negligence and then permitting Citigroup to settle without either admitting or denying the allegations deals a double blow to any assistance the defrauded investors might seek to derive from the S.E.C. litigation in attempting to recoup their losses through private litigation, since private investors not only cannot bring securities claims based on negligence, *see, e.g., Ernst & Ernst v. Hochfelder*, but also cannot derive any collateral estoppel assistance from Citigroup’s non-admission/non-denial of the S.E.C.’s allegations. Nor, as noted, does the public, especially the business public, have any reason to credit those allegations, which remain entirely unproven. . . .

An application of judicial power that does not rest on facts is worse than mindless, it is inherently dangerous. The injunctive power of the judiciary is not a free-roving remedy to be invoked at the whim of a regulatory agency, even with the consent of the regulated. If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression.

Finally, in any case like this that touches on the transparency of financial markets whose gyrations have so depressed our economy and debilitated our lives, there is an overriding public interest in knowing the truth. In much of the world, propaganda reigns, and truth is confined to secretive, fearful whispers. Even in our nation, apologists for suppressing

or obscuring the truth may always be found. But the S.E.C., of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges; and if it fails to do so, this Court must not, in the name of deference or convenience, grant judicial enforcement to the agency's contrivances.

Accordingly, the Court refuses to approve the proposed Consent Judgment. Instead, the Court hereby consolidates this case with the Stoker action, adopts the Case Management Order in that action as equally applicable to the instant case, and directs the parties to be ready to try this case on July 16, 2012.

SEC v. CITIGROUP GLOBAL MARKETS, INC., 752 F.3d 285 (2d Cir. 2014)

POOLER, Circuit Judge:

The United States Securities and Exchange Commission ("S.E.C.") in conjunction with Citigroup Global Markets, Inc. ("Citigroup") appeals from the November 28, 2011 order of the United States District Court for the Southern District of New York (Rakoff, J.) refusing to approve a consent decree entered into by the parties and instead setting a trial date. . . . We now hold that the district court abused its discretion by applying an incorrect legal standard in assessing the consent decree and setting a date for trial. . . .

Our Court recognizes a "strong federal policy favoring the approval and enforcement of consent decrees." *Wang*. "To be sure, when the district judge is presented with a proposed consent judgment, he is not merely a 'rubber stamp.'" *S.E.C. v. Levine*. The district court here found it was "required, even after giving substantial deference to the views of the administrative agency, to be satisfied that it is not being used as a tool to enforce an agreement that is unfair, unreasonable, inadequate, or in contravention of the public interest." *Citigroup I*. Other district courts in our Circuit view "[t]he role of the Court in reviewing and approving proposed consent judgments in S.E.C. enforcement actions [as] 'restricted to assessing whether the settlement is fair, reasonable and adequate within the limitations Congress has imposed on the S.E.C. to recover investor losses.'" *S.E.C. v. CR Intrinsic Investors, LLC* (quoting *S.E.C. v. Cioffi*); see also *United States v. Peterson* ("A district court has the duty to determine whether a consent decree based on a proposed settlement is 'fair and reasonable.'").

The "fair, reasonable, adequate and in the public interest" standard invoked by the district court finds its origins in a variety of cases. Our Court previously held, in the context of assessing a plan for distributing the proceeds of a proposed disgorgement order, that "once the district court satisfies itself that the distribution of proceeds in a proposed S.E.C. disgorgement plan is fair and reasonable, its review is at an end." *Wang*. The Ninth Circuit—in circumstances similar to those presented here, a proposed consent decree aimed at settling an S.E.C. enforcement action—noted that "[u]nless a consent decree is unfair, inadequate, or unreasonable, it ought to be approved." *S.E.C. v. Randolph*.

Today we clarify that the proper standard for reviewing a proposed consent judgment involving an enforcement agency requires that the district court determine whether the proposed consent decree is fair and reasonable, with the additional requirement that the “public interest would not be disserved,” *eBay, Inc. v. MercExchange*, in the event that the consent decree includes injunctive relief. Absent a substantial basis in the record for concluding that the proposed consent decree does not meet these requirements, the district court is required to enter the order. . . .

A court evaluating a proposed S.E.C. consent decree for fairness and reasonableness should, at a minimum, assess (1) the basic legality of the decree, *see Benjamin v. Jacobson* (terminating existing consent decrees as required by the Prison Litigation Reform Act); (2) whether the terms of the decree, including its enforcement mechanism, are clear, *see, e.g., Angela R. ex rel. Hesselbein v. Clinton* (district court abused its discretion by approving consent decree that did not properly define the enforcement mechanisms); (3) whether the consent decree reflects a resolution of the actual claims in the complaint; and (4) whether the consent decree is tainted by improper collusion or corruption of some kind. *Cf. Kozlowski v. Coughlin* (“Before entering a consent judgment, the district court must be certain that the decree 1) springs from and serves to resolve a dispute within the court’s subject-matter jurisdiction, 2) comes within the general scope of the case made by the pleadings, and 3) furthers the objectives of the law upon which the complaint was based.” (internal quotation marks and alternations omitted)). Consent decrees vary, and depending on the decree a district court may need to make additional inquiry to ensure that the consent decree is fair and reasonable. The primary focus of the inquiry, however, should be on ensuring the consent decree is procedurally proper, using objective measures similar to the factors set out above, taking care not to infringe on the S.E.C.’s discretionary authority to settle on a particular set of terms.

It is an abuse of discretion to require, as the district court did here, that the S.E.C. establish the “truth” of the allegations against a settling party as a condition for approving the consent decrees. *Citigroup I*. Trials are primarily about the truth. Consent decrees are primarily about pragmatism. “[C]onsent decrees are normally compromises in which the parties give up something they might have won in litigation and waive their rights to litigation.” *United States v. ITT Continental Baking Co.* Thus, a consent decree “must be construed as . . . written, and not as it might have been written had the plaintiff established his factual claims and legal theories in litigation.” *United States v. Armour & Co.* Consent decrees provide parties with a means to manage risk. “The numerous factors that affect a litigant’s decision whether to compromise a case or litigate it to the end include the value of the particular proposed compromise, the perceived likelihood of obtaining a still better settlement, the prospects of coming out better, or worse, after a full trial, and the resources that would need to be expended in the attempt.” *Citigroup III*; *see also Randolph* (“Compromise is the essence of settlement. Even if the Commission’s case against [defendants] is strong, proceeding to trial would still be costly. The S.E.C.’s resources are limited, and that is why it often uses consent decrees as a means of enforcement.” (citation omitted)). These assessments are uniquely for the

litigants to make. It is not within the district court's purview to demand "cold, hard, solid facts, established either by admissions or by trials," *Citigroup I*, as to the truth of the allegations in the complaint as a condition for approving a consent decree.

As part of its review, the district court will necessarily establish that a factual basis exists for the proposed decree. In many cases, setting out the colorable claims, supported by factual averments by the S.E.C., neither admitted nor denied by the wrongdoer, will suffice to allow the district court to conduct its review. Other cases may require more of a showing, for example, if the district court's initial review of the record raises a suspicion that the consent decree was entered into as a result of improper collusion between the S.E.C. and the settling party. We need not, and do not, delineate the precise contours of the factual basis required to obtain approval for each consent decree that may pass before the court. It is enough to state that the district court here, with the benefit of copious submissions by the parties, likely had a sufficient record before it on which to determine if the proposed decree was fair and reasonable. On remand, if the district court finds it necessary, it may ask the S.E.C. and Citigroup to provide additional information sufficient to allay any concerns the district court may have regarding improper collusion between the parties. . . .

The job of determining whether the proposed S.E.C. consent decree best serves the public interest, however, rests squarely with the S.E.C., and its decision merits significant deference:

[F]ederal judges—who have no constituency—have a duty to respect legitimate policy choices made by those who do. The responsibilities for assessing the wisdom of such policy choices and resolving the struggle between competing views of the public interest are not judicial ones: "Our Constitution vests such responsibilities in the public branches."

Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc. (quoting *TVA v. Hill*); see also *In re Cuyahoga Equip. Corp.* ("Appellate courts ordinarily defer to the agency's expertise and the voluntary agreement of the parties in proposing the settlement.").

The district court correctly recognized that it was required to consider the public interest in deciding whether to grant the injunctive relief in the proposed injunction. However, the district court made no findings that the injunctive relief proposed in the consent decree would disserve the public interest, in part because it defined the public interest as "an overriding interest in knowing the truth." The district court's failure to make the proper inquiry constitutes legal error. On remand, the district court should consider whether the public interest would be disserved by entry of the consent decree. For example, a consent decree may disserve the public interest if it barred private litigants from pursuing their own claims independent of the relief obtained under the consent decree. What the district court may not do is find the public interest disserved based on its disagreement with the S.E.C.'s decisions on discretionary matters of policy, such as deciding to settle without requiring an admission of liability.

To the extent the district court withheld approval of the consent decree on the ground that it believed the S.E.C. failed to bring the proper charges against Citigroup, that constituted an abuse of discretion. In comparing the complaint filed by the S.E.C. against Citigroup with the complaint filed by the S.E.C. against Stoker, the district court noted that “[a]lthough this would appear to be tantamount to an allegation of knowing and fraudulent intent (‘*scienter*,’ in the lingo of securities law), the S.E.C., for reasons of its own, chose to charge Citigroup only with negligence, in violation of Sections 17(a)(2) and (3) of the Securities Act, 15 U.S.C. § 77q(a)(2) and (3).” The exclusive right to choose which charges to levy against a defendant rests with the S.E.C. *See, e.g., United States v. Microsoft Corp.* (“[T]he district court is not empowered to review the actions or behavior of the Department of Justice; the court is only authorized to review the decree itself.”); *see also Heckler v. Chaney* (“[A]n agency’s decision not to prosecute or enforce, whether through civil or criminal process, is a decision generally committed to an agency’s absolute discretion.”). Nor can the district court reject a consent decree on the ground that it fails to provide collateral estoppel assistance to private litigants—that simply is not the job of the courts. . . .

For the reasons given above, we vacate the November 28, 2011 order of the district court and remand this case for further proceedings in accordance with this opinion.

Problem 10-1

- (a) Make a brief chart or table that summarizes the SEC’s enforcement powers on the following dimensions: (1) who can the SEC proceed against? (2) what kinds of proceedings can the SEC bring and in what fora? (3) what sanctions can the SEC impose for securities violations?
- (b) Who has the better argument in the matter of the SEC/Citi settlement—Judge Rakoff or the Second Circuit appellate panel? If you were the Chair of the SEC (you might be one day!), how would you approach this issue? Consider, in this connection, the chart that follows this problem providing data on recent forms of SEC resolution.
- (c) What is the point of requiring an admission of wrongdoing in a civil settlement, assuming all penalties imposed are otherwise the same?

SEC Enforcement Outcomes 2010-2020

SEC ENFORCEMENT OUTCOMES (ABSOLUTE RESOLUTIONS, FY 2010-2020)						
	YEARS (2010-2015)					
	2010	2011	2012	2013	2014	2015
NEITHER ADMIT NOR DENY	45	47	33	30	38	75
ADMISSION OF GUILT	0	1	2	1	7	7
DEFENDANT PREVAILS	0	0	1	0	0	0
SEC DISMISSED CASE	1	0	1	1	1	0
OTHER	2	0	4	5	6	3

	YEARS (2016-2020)				
	2016	2017	2018	2019	2020
NEITHER ADMIT NOR DENY	85	50	66	83	53
ADMISSION OF GUILT	8	10	5	8	5
DEFENDANT PREVAILS	1	0	0	0	0
SEC DISMISSED CASE	0	1	1	0	0
OTHER	3	5	2	4	3

E. Whistleblowers and SEC Enforcement

Generally speaking, whistleblower laws in the U.S. follow one or both of two models: (1) statutory protections against employers retaliating against whistleblowers, often providing whistleblowers with a cause of action for damages in such circumstances; (2) financial rewards for whistleblowers who provide information that leads to successful enforcement recoveries. The following are prominent examples of each form of statutory regime, in the context of securities regulation.

18 U.S.C. § 1514A. Civil action to protect against retaliation in fraud cases (“Sarbanes-Oxley whistleblower protection law”)

(a) Whistleblower Protection for Employees of Publicly Traded Companies.—No company with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78f), or that is required to file reports under section 15(d) of the (15 U.S.C. 78o(d)) including any subsidiary or affiliate whose financial information is included in the consolidated financial statements of such company, or nationally recognized statistical rating organization (as defined in section 3(a) of the Securities

Exchange Act of 1934 (15 U.S.C. 78c), or any officer, employee, contractor, subcontractor, or agent of such company or nationally recognized statistical rating organization, may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of any lawful act done by the employee—

(1) to provide information, cause information to be provided, or otherwise assist in an investigation regarding any conduct which the employee reasonably believes constitutes a violation of section 1341, 1343, 1344, or 1348 [Title 18's mail, wire, and securities fraud statutes], any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders, when the information or assistance is provided to or the investigation is conducted by—

(A) a Federal regulatory or law enforcement agency;

(B) any Member of Congress or any committee of Congress; or

(C) a person with supervisory authority over the employee (or such other person working for the employer who has the authority to investigate, discover, or terminate misconduct); or

(2) to file, cause to be filed, testify, participate in, or otherwise assist in a proceeding filed or about to be filed (with any knowledge of the employer) relating to an alleged violation of section 1341, 1343, 1344, or 1348, any rule or regulation of the Securities and Exchange Commission, or any provision of Federal law relating to fraud against shareholders.

(b) Enforcement Action.—

(1) In general.—A person who alleges discharge or other discrimination by any person in violation of subsection (a) may seek relief under subsection (c), by—

(A) filing a complaint with the Secretary of Labor; or

(B) if the Secretary has not issued a final decision within 180 days of the filing of the complaint and there is no showing that such delay is due to the bad faith of the claimant, bringing an action at law or equity for de novo review in the appropriate district court of the United States, which shall have jurisdiction over such an action without regard to the amount in controversy. . . .

(c) Remedies.—

(1) In general.—An employee prevailing in any action under subsection (b)(1) shall be entitled to all relief necessary to make the employee whole.

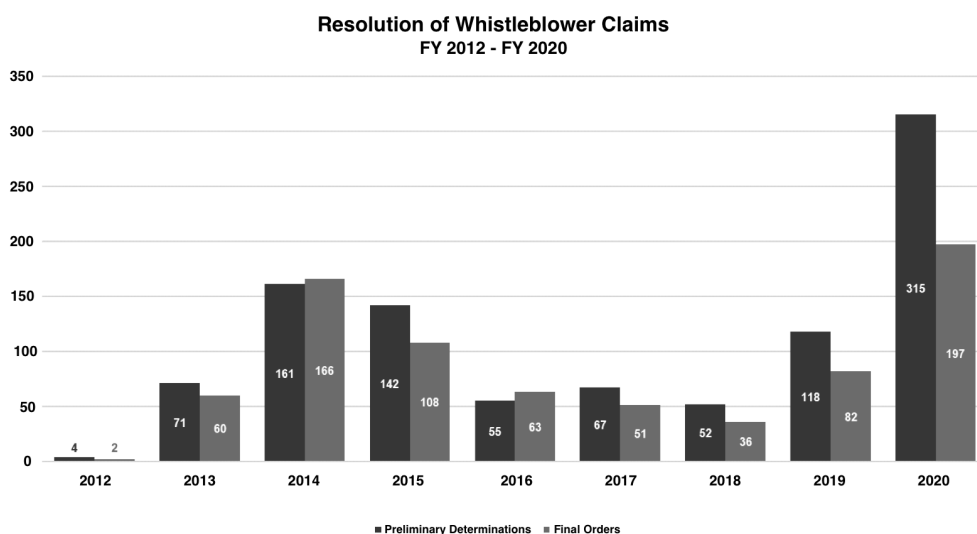
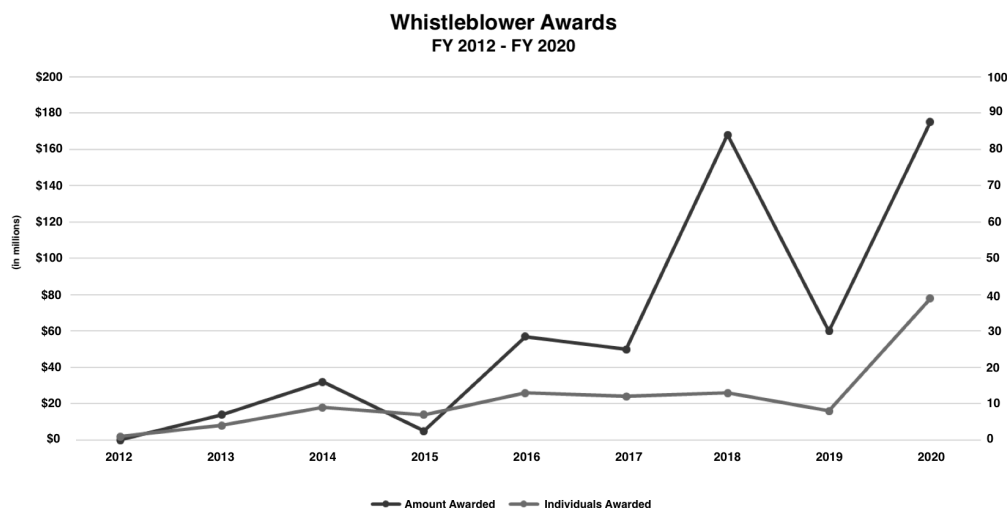
(2) Compensatory damages.—Relief for any action under paragraph (1) shall include—

- (A) reinstatement with the same seniority status that the employee would have had, but for the discrimination;
- (B) the amount of back pay, with interest; and
- (C) compensation for any special damages sustained as a result of the discrimination, including litigation costs, expert witness fees, and reasonable attorney fees. . . .

The following aspect of the 2009 Dodd-Frank legislation, enacted in the wake of the financial crisis of 2008, is potentially game-changing in the world of securities enforcement. According to an SEC's annual report (2020) on its whistleblower program:

Over the past ten years, the whistleblower program has been a critical component of the Commission's efforts to detect wrongdoing and protect investors in the marketplace, particularly where fraud is concealed or difficult to detect. Enforcement actions from whistleblower tips have resulted in more than \$2.5 billion in ordered financial remedies, including more than \$1.4 billion in disgorgement of which almost \$750 million has been, or is scheduled to be, returned to harmed investors. Recognizing the importance of rewarding meritorious whistleblowers in a timely manner, we have made efforts to streamline and substantially accelerate the evaluation of claims for whistleblower awards. These efforts paid off. Fiscal Year 2020 was a record-breaking year for the whistleblower program. The Commission issued awards totaling approximately \$175 million to 39 individuals, both greater than any other year in the program's history.

Importantly, the Division also issued substantially more preliminary determinations, which set forth its assessment of whether a claim should be approved or denied and, if approved, the proposed award amount, and final Commission orders of awards and denials. In Fiscal Year 2020, the Division issued 315 preliminary determinations, a more than 95% increase over the next highest year, and the Commission issued 197 final orders, an approximately 19% increase over the next highest year.



Criticisms of the whistleblower regime for SEC enforcement have begun to arise, in large part because the SEC has taken the position that, when it makes awards, it will not release identifying information about the conduct, people, or companies involved. The program is thus very opaque. Public information includes the amount and frequency of awards but little else. Journalists at least have begun pushing back. See John Holland, *SEC Enriches Fraudsters, Lawyers As Secrecy Shrouds Tips Program*, BLOOMBERG LAW, July 26, 2022.

As you read and analyze the statutes and regulations that make up the Dodd-Frank whistleblower regime, think about (1) who is able to take advantage of this whistleblower regime and who is not, and (2) how this regime might change incentives and processes in SEC enforcement.

15 U.S.C. § 78u–6. Securities whistleblower incentives and protection (“Dodd-Frank whistleblower law”)

(a) Definitions

In this section the following definitions shall apply:

(1) Covered judicial or administrative action

The term “covered judicial or administrative action” means any judicial or administrative action brought by the Commission under the securities laws that results in monetary sanctions exceeding \$1,000,000.

(2) Fund

The term “Fund” means the Securities and Exchange Commission Investor Protection Fund.

(3) Original information

The term “original information” means information that—

- (A) is derived from the independent knowledge or analysis of a whistleblower;
- (B) is not known to the Commission from any other source, unless the whistleblower is the original source of the information; and
- (C) is not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless the whistleblower is a source of the information.

(4) Monetary sanctions

The term “monetary sanctions”, when used with respect to any judicial or administrative action, means—

- (A) any monies, including penalties, disgorgement, and interest, ordered to be paid; and
- (B) any monies deposited into a disgorgement fund or other fund pursuant to section 308(b) of the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7246 (b)), as a result of such action or any settlement of such action.

(5) Related action

The term “related action”, when used with respect to any judicial or administrative action brought by the Commission under the securities laws, means any judicial or administrative action brought by an entity described in subclauses (I) through (IV) of subsection (h)(2)(D)(i) that is based upon the original information provided by a whistleblower pursuant to subsection (a) that led to the successful enforcement of the Commission action.

(6) Whistleblower

The term “whistleblower” means any individual who provides, or 2 or more individuals acting jointly who provide, information relating to a violation of the securities laws to the Commission, in a manner established, by rule or regulation, by the Commission.

(b) Awards

(1) In general

In any covered judicial or administrative action, or related action, the Commission, under regulations prescribed by the Commission and subject to subsection (c), shall pay an award or awards to 1 or more whistleblowers who voluntarily provided original information to the Commission that led to the successful enforcement of the covered judicial or administrative action, or related action, in an aggregate amount equal to—

- (A) not less than 10 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions; and
- (B) not more than 30 percent, in total, of what has been collected of the monetary sanctions imposed in the action or related actions. . . .

(c) Determination of amount of award; denial of award

(1) Determination of amount of award

(A) Discretion

The determination of the amount of an award made under subsection (b) shall be in the discretion of the Commission.

(B) Criteria

In determining the amount of an award made under subsection (b), the Commission—

- (i) shall take into consideration—
 - (I) the significance of the information provided by the whistleblower to the success of the covered judicial or administrative action;
 - (II) the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in a covered judicial or administrative action;
 - (III) the programmatic interest of the Commission in deterring violations of the securities laws by making awards to whistleblowers who provide information that lead to the successful enforcement of such laws; and
 - (IV) such additional relevant factors as the Commission may establish by rule or regulation; and
 - (ii) shall not take into consideration the balance of the Fund.
- (2) Denial of award

No award under subsection (b) shall be made—

 - (A) to any whistleblower who is, or was at the time the whistleblower acquired the original information submitted to the Commission, a member, officer, or employee of—
 - (i) an appropriate regulatory agency;
 - (ii) the Department of Justice;
 - (iii) a self-regulatory organization;
 - (iv) the Public Company Accounting Oversight Board; or
 - (v) a law enforcement organization;
 - (B) to any whistleblower who is convicted of a criminal violation related to the judicial or administrative action for which the whistleblower otherwise could receive an award under this section;
 - (C) to any whistleblower who gains the information through the performance of an audit of financial statements required under

the securities laws and for whom such submission would be contrary to the requirements of section 78j-1 of this title; or

- (D) to any whistleblower who fails to submit information to the Commission in such form as the Commission may, by rule, require. . . .

(f) Appeals

Any determination made under this section, including whether, to whom, or in what amount to make awards, shall be in the discretion of the Commission. Any such determination, except the determination of the amount of an award if the award was made in accordance with subsection (b), may be appealed to the appropriate court of appeals of the United States not more than 30 days after the determination is issued by the Commission. The court shall review the determination made by the Commission in accordance with section 706 of title 5. . . .

(h) Protection of whistleblowers

(1) Prohibition against retaliation

(A) In general

No employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower—

- (i) in providing information to the Commission in accordance with this section;
- (ii) in initiating, testifying in, or assisting in any investigation or judicial or administrative action of the Commission based upon or related to such information; or
- (iii) in making disclosures that are required or protected under the Sarbanes-Oxley Act of 2002 (15 U.S.C. 7201 et seq.), this chapter, including section 78j-1 (m) of this title, section 1513 (e) of title 18, and any other law, rule, or regulation subject to the jurisdiction of the Commission. . . .

(B) Enforcement

(i) Cause of action

An individual who alleges discharge or other discrimination in violation of subparagraph (A) may bring an action under this subsection in the appropriate district court of the United States for the relief provided in subparagraph (C). . . .

(C) Relief

Relief for an individual prevailing in an action brought under subparagraph (B) shall include—

(i) reinstatement with the same seniority status that the individual would have had, but for the discrimination;

(ii) 2 times the amount of back pay otherwise owed to the individual, with interest; and

(iii) compensation for litigation costs, expert witness fees, and reasonable attorneys' fees.

SEC Regulations Pursuant to Dodd-Frank Whistleblower Law

17 C.F.R. § 240.21F-4. Other definitions.

(a) Voluntary submission of information.

(1) Your submission of information is made voluntarily within the meaning of §§ 240.21F-1 through 240.21F-17 of this chapter if you provide your submission before a request, inquiry, or demand that relates to the subject matter of your submission is directed to you or anyone representing you (such as an attorney):

(i) By the Commission;

(ii) In connection with an investigation, inspection, or examination by the Public Company Accounting Oversight Board, or any self-regulatory organization; or

(iii) In connection with an investigation by Congress, any other authority of the Federal government, or a state Attorney General or securities regulatory authority.

(2) If the Commission or any of these other authorities direct a request, inquiry, or demand as described in paragraph (a)(1) of this section to you or your representative first, your submission will not be considered

voluntary, and you will not be eligible for an award, even if your response is not compelled by subpoena or other applicable law. However, your submission of information to the Commission will be considered voluntary if you voluntarily provided the same information to one of the other authorities identified above prior to receiving a request, inquiry, or demand from the Commission.

- (3) In addition, your submission will not be considered voluntary if you are required to report your original information to the Commission as a result of a pre-existing legal duty, a contractual duty that is owed to the Commission or to one of the other authorities set forth in paragraph (a)(1) of this section, or a duty that arises out of a judicial or administrative order.
- (b) Original information.
- (1) In order for your whistleblower submission to be considered original information, it must be:
 - (i) Derived from your independent knowledge or independent analysis;
 - (ii) Not already known to the Commission from any other source, unless you are the original source of the information;
 - (iii) Not exclusively derived from an allegation made in a judicial or administrative hearing, in a governmental report, hearing, audit, or investigation, or from the news media, unless you are a source of the information; and
 - (iv) Provided to the Commission for the first time after July 21, 2010 (the date of enactment of the Dodd–Frank Wall Street Reform and Consumer Protection Act).
 - (2) Independent knowledge means factual information in your possession that is not derived from publicly available sources. You may gain independent knowledge from your experiences, communications and observations in your business or social interactions.
 - (3) Independent analysis means your own analysis, whether done alone or in combination with others. Analysis means your examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.

- (4) The Commission will not consider information to be derived from your independent knowledge or independent analysis in any of the following circumstances:
- (i) If you obtained the information through a communication that was subject to the attorney-client privilege, unless disclosure of that information would otherwise be permitted by an attorney pursuant to § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise;
 - (ii) If you obtained the information in connection with the legal representation of a client on whose behalf you or your employer or firm are providing services, and you seek to use the information to make a whistleblower submission for your own benefit, unless disclosure would otherwise be permitted by an attorney pursuant to § 205.3(d)(2) of this chapter, the applicable state attorney conduct rules, or otherwise; or
 - (iii) In circumstances not covered by paragraphs (b)(4)(i) or (b)(4)(ii) of this section, if you obtained the information because you were:
 - (A) An officer, director, trustee, or partner of an entity and another person informed you of allegations of misconduct, or you learned the information in connection with the entity's processes for identifying, reporting, and addressing possible violations of law;
 - (B) An employee whose principal duties involve compliance or internal audit responsibilities, or you were employed by or otherwise associated with a firm retained to perform compliance or internal audit functions for an entity;
 - (C) Employed by or otherwise associated with a firm retained to conduct an inquiry or investigation into possible violations of law; or
 - (D) An employee of, or other person associated with, a public accounting firm, if you obtained the information through the performance of an engagement required of an independent public accountant under the Federal securities laws (other than an audit subject to § 240.21F-8(c)(4) of this chapter), and that information related to a violation by the engagement client or the client's directors, officers or other employees.

- (iv) If you obtained the information by a means or in a manner that is determined by a United States court to violate applicable Federal or state criminal law; or
- (v) Exceptions. Paragraph (b)(4)(iii) of this section shall not apply if:
 - (A) You have a reasonable basis to believe that disclosure of the information to the Commission is necessary to prevent the relevant entity from engaging in conduct that is likely to cause substantial injury to the financial interest or property of the entity or investors;
 - (B) You have a reasonable basis to believe that the relevant entity is engaging in conduct that will impede an investigation of the misconduct; or
 - (C) At least 120 days have elapsed since you provided the information to the relevant entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor, or since you received the information, if you received it under circumstances indicating that the entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or your supervisor was already aware of the information.
- (vi) If you obtained the information from a person who is subject to this section, unless the information is not excluded from that person's use pursuant to this section, or you are providing the Commission with information about possible violations involving that person.
- (5) The Commission will consider you to be an original source of the same information that we obtain from another source if the information satisfies the definition of original information and the other source obtained the information from you or your representative. In order to be considered an original source of information that the Commission receives from Congress, any other authority of the Federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, you must have voluntarily given such authorities the information within the meaning of these rules. You must establish your status as the original source of information to the Commission's satisfaction. In determining whether you are the original source of information, the Commission may seek assistance and confirmation from one of the

other authorities described above, or from another entity (including your employer), in the event that you claim to be the original source of information that an authority or another entity provided to the Commission.

- (6) If the Commission already knows some information about a matter from other sources at the time you make your submission, and you are not an original source of that information under paragraph (b)(5) of this section, the Commission will consider you an original source of any information you provide that is derived from your independent knowledge or analysis and that materially adds to the information that the Commission already possesses.
 - (7) If you provide information to the Congress, any other authority of the Federal government, a state Attorney General or securities regulatory authority, any self-regulatory organization, or the Public Company Accounting Oversight Board, or to an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law, and you, within 120 days, submit the same information to the Commission pursuant to § 240.21F-9 of this chapter, as you must do in order for you to be eligible to be considered for an award, then, for purposes of evaluating your claim to an award under §§ 240.21F-10 and 240.21F-11 of this chapter, the Commission will consider that you provided information as of the date of your original disclosure, report or submission to one of these other authorities or persons. You must establish the effective date of any prior disclosure, report, or submission, to the Commission's satisfaction. The Commission may seek assistance and confirmation from the other authority or person in making this determination.
- (c) Information that leads to successful enforcement. The Commission will consider that you provided original information that led to the successful enforcement of a judicial or administrative action in any of the following circumstances:
- (1) You gave the Commission original information that was sufficiently specific, credible, and timely to cause the staff to commence an examination, open an investigation, reopen an investigation that the Commission had closed, or to inquire concerning different conduct as part of a current examination or investigation, and the Commission brought a successful judicial or administrative action based in whole or in part on conduct that was the subject of your original information; or
 - (2) You gave the Commission original information about conduct that was already under examination or investigation by the Commission, the Congress, any other authority of the federal government, a state Attorney General or securities regulatory authority, any self-regulatory

organization, or the PCAOB (except in cases where you were an original source of this information as defined in paragraph (b)(5) of this section), and your submission significantly contributed to the success of the action.

- (3) You reported original information through an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law before or at the same time you reported them to the Commission; the entity later provided your information to the Commission, or provided results of an audit or investigation initiated in whole or in part in response to information you reported to the entity; and the information the entity provided to the Commission satisfies either paragraph (c)(1) or (c)(2) of this section. Under this paragraph (c)(3), you must also submit the same information to the Commission in accordance with the procedures set forth in § 240.21F-9 within 120 days of providing it to the entity. . . .

17 C.F.R. § 240.21F-5. Amount of award.

- (a) The determination of the amount of an award is in the discretion of the Commission.
- (b) If all of the conditions are met for a whistleblower award in connection with a Commission action or a related action, the Commission will then decide the percentage amount of the award applying the criteria set forth in § 240.21F-6 of this chapter and pursuant to the procedures set forth in §§ 240.21F-10 and 240.21F-11 of this chapter. The amount will be at least 10 percent and no more than 30 percent of the monetary sanctions that the Commission and the other authorities are able to collect. The percentage awarded in connection with a Commission action may differ from the percentage awarded in connection with a related action.
- (c) If the Commission makes awards to more than one whistleblower in connection with the same action or related action, the Commission will determine an individual percentage award for each whistleblower, but in no event will the total amount awarded to all whistleblowers in the aggregate be less than 10 percent or greater than 30 percent of the amount the Commission or the other authorities collect.

17 C.F.R. § 240.21F-6. Criteria for determining amount of award.

In exercising its discretion to determine the appropriate award percentage, the Commission may consider the following factors (and only the following factors) in relation to the facts and circumstances of each case in setting the dollar or percentage amount of the award. In the event that awards are determined for multiple whistleblowers

in connection an action, these factors will be used to determine the relative allocation of awards among the whistleblowers.

- (a) Factors that may increase the amount of a whistleblower's award. In determining whether to increase the amount of an award, the Commission will consider the following factors, which are not listed in order of importance.
 - (1) Significance of the information provided by the whistleblower. The Commission will assess the significance of the information provided by a whistleblower to the success of the Commission action or related action. In considering this factor, the Commission may take into account, among other things:
 - (i) The nature of the information provided by the whistleblower and how it related to the successful enforcement action, including whether the reliability and completeness of the information provided to the Commission by the whistleblower resulted in the conservation of Commission resources;
 - (ii) The degree to which the information provided by the whistleblower supported one or more successful claims brought in the Commission or related action.
 - (2) Assistance provided by the whistleblower. The Commission will assess the degree of assistance provided by the whistleblower and any legal representative of the whistleblower in the Commission action or related action. In considering this factor, the Commission may take into account, among other things:
 - (i) Whether the whistleblower provided ongoing, extensive, and timely cooperation and assistance by, for example, helping to explain complex transactions, interpreting key evidence, or identifying new and productive lines of inquiry;
 - (ii) The timeliness of the whistleblower's initial report to the Commission or to an internal compliance or reporting system of business organizations committing, or impacted by, the securities violations, where appropriate;
 - (iii) The resources conserved as a result of the whistleblower's assistance;
 - (iv) Whether the whistleblower appropriately encouraged or authorized others to assist the staff of the Commission who might otherwise not have participated in the investigation or related action;

- (v) The efforts undertaken by the whistleblower to remediate the harm caused by the violations, including assisting the authorities in the recovery of the fruits and instrumentalities of the violations; and
 - (vi) Any unique hardships experienced by the whistleblower as a result of his or her reporting and assisting in the enforcement action.
- (3) Law enforcement interest. The Commission will assess its programmatic interest in deterring violations of the securities laws by making awards to whistleblowers who provide information that leads to the successful enforcement of such laws. In considering this factor, the Commission may take into account, among other things:
 - (i) The degree to which an award enhances the Commission's ability to enforce the Federal securities laws and protect investors; and
 - (ii) The degree to which an award encourages the submission of high quality information from whistleblowers by appropriately rewarding whistleblowers' submission of significant information and assistance, even in cases where the monetary sanctions available for collection are limited or potential monetary sanctions were reduced or eliminated by the Commission because an entity self-reported a securities violation following the whistleblower's related internal disclosure, report, or submission.
 - (iii) Whether the subject matter of the action is a Commission priority, whether the reported misconduct involves regulated entities or fiduciaries, whether the whistleblower exposed an industry-wide practice, the type and severity of the securities violations, the age and duration of misconduct, the number of violations, and the isolated, repetitive, or ongoing nature of the violations; and
 - (iv) The dangers to investors or others presented by the underlying violations involved in the enforcement action, including the amount of harm or potential harm caused by the underlying violations, the type of harm resulting from or threatened by the underlying violations, and the number of individuals or entities harmed.
- (4) Participation in internal compliance systems. The Commission will assess whether, and the extent to which, the whistleblower and any legal

representative of the whistleblower participated in internal compliance systems. In considering this factor, the Commission may take into account, among other things:

- (i) Whether, and the extent to which, a whistleblower reported the possible securities violations through internal whistleblower, legal or compliance procedures before, or at the same time as, reporting them to the Commission; and
 - (ii) Whether, and the extent to which, a whistleblower assisted any internal investigation or inquiry concerning the reported securities violations.
- (b) Factors that may decrease the amount of a whistleblower's award. In determining whether to decrease the amount of an award, the Commission will consider the following factors, which are not listed in order of importance.
 - (1) Culpability. The Commission will assess the culpability or involvement of the whistleblower in matters associated with the Commission's action or related actions. In considering this factor, the Commission may take into account, among other things:
 - (i) The whistleblower's role in the securities violations;
 - (ii) The whistleblower's education, training, experience, and position of responsibility at the time the violations occurred;
 - (iii) Whether the whistleblower acted with scienter, both generally and in relation to others who participated in the violations;
 - (iv) Whether the whistleblower financially benefitted from the violations;
 - (v) Whether the whistleblower is a recidivist;
 - (vi) The egregiousness of the underlying fraud committed by the whistleblower; and
 - (vii) Whether the whistleblower knowingly interfered with the Commission's investigation of the violations or related enforcement actions.
 - (2) Unreasonable reporting delay. The Commission will assess whether the whistleblower unreasonably delayed reporting the securities violations. In considering this factor, the Commission may take into account, among other things:

- (i) Whether the whistleblower was aware of the relevant facts but failed to take reasonable steps to report or prevent the violations from occurring or continuing;
 - (ii) Whether the whistleblower was aware of the relevant facts but only reported them after learning about a related inquiry, investigation, or enforcement action; and
 - (iii) Whether there was a legitimate reason for the whistleblower to delay reporting the violations.
- (3) Interference with internal compliance and reporting systems. The Commission will assess, in cases where the whistleblower interacted with his or her entity's internal compliance or reporting system, whether the whistleblower undermined the integrity of such system. In considering this factor, the Commission will take into account whether there is evidence provided to the Commission that the whistleblower knowingly:
 - (i) Interfered with an entity's established legal, compliance, or audit procedures to prevent or delay detection of the reported securities violation;
 - (ii) Made any material false, fictitious, or fraudulent statements or representations that hindered an entity's efforts to detect, investigate, or remediate the reported securities violations; and
 - (iii) Provided any false writing or document knowing the writing or document contained any false, fictitious or fraudulent statements or entries that hindered an entity's efforts to detect, investigate, or remediate the reported securities violations.

As litigation relating to the SEC whistleblower program picks up—in part due to a large and active “whistleblower bar” that has been representing persons on a contingency fee basis—some case law is developing about who is covered by the Dodd-Frank regime and under what circumstances.

MURRAY v. UBS SECURITIES, LLC, 144 S.Ct. 445 (2024)

Justice SOTOMAYOR delivered the opinion of the Court.

Under the whistleblower-protection provision of the Sarbanes-Oxley Act of 2002, no covered employer may “discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of” protected whistleblowing activity. 18 U. S. C. § 1514A(a). When a whistleblower invokes this provision, he bears the initial burden of showing that his

protected activity “was a contributing factor in the unfavorable personnel action alleged in the complaint.” 49 U. S. C. § 42121(b)(2)(B)(iii). The burden then shifts to the employer to show that it “would have taken the same unfavorable personnel action in the absence of” the protected activity. § 42121(b)(2)(B)(iv).

The question before this Court is whether the phrase “discriminate against an employee . . . because of” in § 1514A(a) requires a whistleblower additionally to prove that his employer acted with “retaliatory intent.” . . .

In 2011, petitioner Trevor Murray was employed as a research strategist at securities firm UBS, within the firm's commercial mortgage-backed securities (CMBS) business. In that role, Murray was responsible for reporting on CMBS markets to current and future UBS customers. Securities and Exchange Commission (SEC) regulations required him to certify that his reports were produced independently and accurately reflected his own views. See 17 CFR § 242.501(a) (2022). Murray contends that, despite this requirement of independence, two leaders of the CMBS trading desk improperly pressured him to skew his reports to be more supportive of their business strategies, even instructing Murray to “clear [his] research articles with the desk” before publishing them.

Murray reported that conduct to his direct supervisor, Michael Schumacher, in December 2011 and again in January 2012, asserting that it was “unethical” and “illegal.” Schumacher expressed sympathy for Murray's situation but emphasized that it was “very important” that Murray not “alienate [his] internal client” (i.e., the trading desk). When Murray later informed Schumacher that the situation with the trading desk “was bad and getting worse,” as he was being left out of meetings and subjected to “constant efforts to skew [his] research,” Schumacher told him that he should just “write what the business line wanted.” Shortly after that exchange (and despite having given Murray a very strong performance review just a couple months earlier) Schumacher emailed his own supervisor and recommended that Murray “be removed from [UBS's] head count.” Schumacher recommended in the alternative that, if the CMBS trading desk wanted him, Murray could be transferred to a desk analyst position, where he would not have SEC certification responsibilities. The trading desk declined to accept Murray as a transfer, and UBS fired him in February 2012.

Murray then filed a complaint with the Department of Labor alleging that his termination violated § 1514A of Sarbanes-Oxley because he was fired in response to his internal reporting about fraud on shareholders. When the agency did not issue a final decision on his complaint within 180 days, Murray filed an action in federal court. . . .

Section 1514A's text does not reference or include a “retaliatory intent” requirement, and the provision's mandatory burden-shifting framework cannot be squared with such a requirement. While a whistleblower bringing a § 1514A claim must prove that his protected activity was a contributing factor in the unfavorable personnel action, he need not also prove that his employer acted with “retaliatory intent.” . . .

The Second Circuit and UBS both rely heavily on the word “discriminate” in § 1514A to impose a “retaliatory intent” requirement on whistleblower plaintiffs. As UBS acknowledges, the Second Circuit’s holding was “expressly predicated” on the word “discriminate.” That word, however, cannot bear the weight that both the Second Circuit and UBS place on it.

Consider the statutory text: No employer subject to Sarbanes-Oxley “may discharge, demote, suspend, threaten, harass, or in any other manner discriminate against an employee in the terms and conditions of employment because of ” the employee’s protected whistleblowing activity. § 1514A(a). To start, the placement of the word “discriminate” in the section’s catchall provision suggests that it is meant to capture other adverse employment actions that are not specifically listed, drawing meaning from the terms “discharge, demote, suspend, threaten, [and] harass” rather than imbuing those terms with a new or different meaning. Here, there is no dispute that Murray was “discharge[d],” and so it is not obvious that the “or in any other manner discriminate” clause has any relevance to his claim. According to UBS, though, “discriminate” in the catchall provision relates back to and characterizes “discharge,” such that “to be actionable, discharge must be a ‘manner’ of discriminating.” Accepting this statutory construction argument “for argument’s sake,” as this Court did in *Bostock v. Clayton County*, the question is whether the word “discriminate” inherently requires retaliatory intent. It does not.

In *Babb v. Wilkie*, this Court explained that the “normal definition” of “discrimination” is “differential treatment.” *Id.* (quoting *Jackson v. Birmingham Bd. of Ed.*;). In *Bostock*, the Court likewise observed that “discriminate” typically means simply “[t]o make a difference in treatment or favor (of one as compared with others).” (quoting Webster’s New International Dictionary (2d ed. 1954)). Prohibited discrimination occurs when an employer “intentionally treats a person worse because of” a protected characteristic. In elaborating on the meaning of “discriminate,” *Bostock* made clear that a lack of “animosity” is “irrelevant” to a claim of discrimination under Title VII.

An animus-like “retaliatory intent” requirement is simply absent from the definition of the word “discriminate.” When an employer treats someone worse—whether by firing them, demoting them, or imposing some other unfavorable change in the terms and conditions of employment—“because of” the employee’s protected whistleblowing activity, the employer violates § 1514A. It does not matter whether the employer was motivated by retaliatory animus or was motivated, for example, by the belief that the employee might be happier in a position that did not have SEC reporting requirements. . . .

Statutory context confirms that the word “discriminate” does not import a “retaliatory intent” requirement: Requiring a whistleblower to prove his employer’s retaliatory animus would ignore the statute’s mandatory burden-shifting framework. The burden-shifting framework was conspicuously absent from the Second Circuit’s opinion, and UBS now insists that the statute’s burden shifting addresses only “causation, not intent.”

Not so. Burden-shifting frameworks have long provided a mechanism for getting at intent in employment discrimination cases, and the contributing-factor burden-shifting framework is meant to be more lenient than most. . . .

The burden-shifting framework provides a means of getting at intent, and Congress here has decided that the plaintiff's burden on intent is simply to show that the protected activity was a "contributing factor in the unfavorable personnel action." 49 U.S.C. § 42121(b)(2)(B)(i); see 18 U. S. C. § 1514A(b)(2)(C) (explaining that an action brought in federal court "shall be governed by the legal burdens of proof set forth in section 42121(b)"). Once the employee makes that showing, the burden shifts to the employer to "demonstrat[e], by clear and convincing evidence, that the employer would have taken the same unfavorable personnel action in the absence of that behavior." 49 U. S. C. § 42121(b)(2)(B)(ii). . . .

To be sure, the contributing-factor framework that Congress chose here is not as protective of employers as a motivating-factor framework. That is by design. Congress has employed the contributing-factor framework in contexts where the health, safety, or well-being of the public may well depend on whistleblowers feeling empowered to come forward. This Court cannot override that policy choice by giving employers more protection than the statute itself provides. . . .

DIGITAL REALTY TRUST, INC. v. SOMERS, 138 S. Ct. 767 (2018)

Justice GINSBURG delivered the opinion of the Court.

Endeavoring to root out corporate fraud, Congress passed the Sarbanes–Oxley Act of 2002, 116 Stat. 745 (Sarbanes–Oxley), and the 2010 Dodd–Frank Wall Street Reform and Consumer Protection Act, 124 Stat. 1376 (Dodd–Frank). Both Acts shield whistleblowers from retaliation, but they differ in important respects. Most notably, Sarbanes–Oxley applies to all "employees" who report misconduct to the Securities and Exchange Commission (SEC or Commission), any other federal agency, Congress, or an internal supervisor. 18 U.S.C. § 1514A(a)(1). Dodd–Frank delineates a more circumscribed class; it defines "whistleblower" to mean a person who provides "information relating to a violation of the securities laws to the Commission." 15 U.S.C. § 78u–6(a)(6). A whistleblower so defined is eligible for an award if original information he or she provides to the SEC leads to a successful enforcement action. § 78u–6(b)–(g). And, most relevant here, a whistleblower is protected from retaliation for, *inter alia*, "making disclosures that are required or protected under" Sarbanes–Oxley, the Securities Exchange Act of 1934, the criminal anti-retaliation proscription at 18 U.S.C. § 1513(e), or any other law subject to the SEC's jurisdiction. 15 U.S.C. § 78u–6(h)(1)(A)(iii).

The question presented: Does the anti-retaliation provision of Dodd–Frank extend to an individual who has not reported a violation of the securities laws to the SEC and therefore falls outside the Act's definition of "whistleblower"? We answer that question "No": To sue under Dodd–Frank's anti-retaliation provision, a person must first

“provid[e] . . . information relating to a violation of the securities laws to the Commission.” § 78u–6(a)(6). . . .

Section 78u–6 begins by defining a “whistleblower” as “any individual who provides . . . information relating to a violation of the securities laws *to the Commission*, in a manner established, by rule or regulation, by the Commission.” § 78u–6(a)(6) (emphasis added). That definition, the statute directs, “shall apply” “[i]n this section”—*i.e.*, throughout § 78u–6. § 78u–6(a).

Section 78u–6 affords covered whistleblowers both incentives and protection. First, the section creates an award program for “whistleblowers who voluntarily provid[e] original information to the Commission that le[ads] to the successful enforcement of [a] covered judicial or administrative action.” § 78u–6(b)(1). A qualifying whistleblower is entitled to a cash award of 10 to 30 percent of the monetary sanctions collected in the enforcement action. See § 78u–6(b)(1)(A)–(B).

Second, § 78u–6(h) prohibits an employer from discharging, harassing, or otherwise discriminating against a “whistleblower” “because of any lawful act done by the whistleblower” in three situations: first, “in providing information to the Commission in accordance with [§ 78u–6],” § 78u–6(h)(1)(A)(i); second, “in initiating, testifying in, or assisting in any investigation or . . . action of the Commission based upon” information provided to the SEC in accordance with § 78u–6, § 78u–6(h)(1)(A)(ii); and third, “in making disclosures that are required or protected under” either Sarbanes–Oxley, the Securities Exchange Act of 1934, the criminal anti-retaliation prohibition at 18 U.S.C. § 1513(e), or “any other law, rule, or regulation subject to the jurisdiction of the Commission,” § 78u–6(h)(1)(A)(iii). Clause (iii), by cross-referencing Sarbanes–Oxley and other laws, protects disclosures made to a variety of individuals and entities in addition to the SEC. For example, the clause shields an employee’s reports of wrongdoing to an internal supervisor if the reports are independently safeguarded from retaliation under Sarbanes–Oxley.

The recovery procedures under the anti-retaliation provisions of Dodd–Frank and Sarbanes–Oxley differ in critical respects. First, unlike Sarbanes–Oxley, which contains an administrative-exhaustion requirement and a 180-day administrative complaint-filing deadline, *see* 18 U.S.C. § 1514A(b)(1)(A), (2)(D), Dodd–Frank permits a whistleblower to sue a current or former employer directly in federal district court, with a default limitation period of six years, *see* § 78u–6(h)(1)(B)(i), (iii)(I)(aa). Second, Dodd–Frank instructs a court to award to a prevailing plaintiff double backpay with interest, *see* § 78u–6(h)(1)(C)(ii), while Sarbanes–Oxley limits recovery to actual backpay with interest, *see* 18 U.S.C. § 1514A(c)(2)(B). Like Sarbanes–Oxley, however, Dodd–Frank authorizes reinstatement and compensation for litigation costs, expert witness fees, and reasonable attorneys’ fees. *Compare* § 78u–6(h)(1)(C)(i), (iii), *with* 18 U.S.C. § 1514A(c)(2)(A), (C).

Congress authorized the SEC “to issue such rules and regulations as may be necessary or appropriate to implement the provisions of [§ 78u–6] consistent with the purposes of

this section.” § 78u–6(j). Pursuant to this authority, the SEC published a notice of proposed rulemaking to “Implemen[t] the Whistleblower Provisions” of Dodd–Frank. 75 Fed. Reg. 70488 (2010). Proposed Rule 21F–2(a) defined a “whistleblower,” for purposes of both the award and anti-retaliation provisions of § 78u–6, as one or more individuals who “provide the Commission with information relating to a potential violation of the securities laws.” *Id.* (proposed 17 C.F.R. § 240.21F–2(a)). The proposed rule, the agency noted, “tracks the statutory definition of a ‘whistleblower’” by requiring information reporting to the SEC itself. 75 Fed. Reg. 70489.

In promulgating the final Rule, however, the agency changed course. Rule 21F–2, in finished form, contains two discrete “whistleblower” definitions. *See* 17 C.F.R. § 240.21F–2(a)–(b) (2017). For purposes of the award program, the Rule states that “[y]ou are a whistleblower if . . . you *provide the Commission* with information . . . relat[ing] to a possible violation of the Federal securities laws.” § 240.21F–2(a)(1) (emphasis added). The information must be provided to the SEC through its website or by mailing or faxing a specified form to the SEC Office of the Whistleblower § 240.21F–9(a)(1)–(2).

“For purposes of the anti-retaliation protections,” however, the Rule states that “[y]ou are a whistleblower if . . . [y]ou possess a reasonable belief that the information you are providing relates to a possible securities law violation” and “[y]ou provide that information in a manner described in” clauses (i) through (iii) of § 78u–6(h)(1)(A). 17 C.F.R. § 240.21F–2(b)(1)(i)–(ii). “The anti-retaliation protections apply,” the Rule emphasizes, “whether or not you satisfy the requirements, procedures and conditions to qualify for an award.” § 240.21F–2(b)(1)(iii). An individual may therefore gain anti-retaliation protection as a “whistleblower” under Rule 21F–2 without providing information to the SEC, so long as he or she provides information in a manner shielded by one of the anti-retaliation provision’s three clauses. For example, a report to a company supervisor would qualify if the report garners protection under the Sarbanes–Oxley anti-retaliation provision. . . .

“When a statute includes an explicit definition, we must follow that definition,” even if it varies from a term’s ordinary meaning. *Burgess v. United States*. This principle resolves the question before us.

Our charge in this review proceeding is to determine the meaning of “whistleblower” in § 78u–6(h), Dodd–Frank’s anti-retaliation provision. The definition section of the statute supplies an unequivocal answer: A “whistleblower” is “any individual who provides . . . information relating to a violation of the securities laws *to the Commission*.” § 78u–6(a)(6) (emphasis added). Leaving no doubt as to the definition’s reach, the statute instructs that the “definitio[n] shall apply” “[i]n this section,” that is, throughout § 78u–6. § 78u–6(a)(6).

The whistleblower definition operates in conjunction with the three clauses of § 78u–6(h)(1)(A) to spell out the provision’s scope. The definition first describes *who* is eligible for protection—namely, a whistleblower who provides pertinent information “to the

Commission.” § 78u–6(a)(6). The three clauses of § 78u–6(h)(1)(A) then describe what *conduct*, when engaged in by a whistleblower, is shielded from employment discrimination. *See* § 78u–6(h)(1)(A)(i)–(iii). An individual who meets both measures may invoke Dodd–Frank’s protections. But an individual who falls outside the protected category of “whistleblowers” is ineligible to seek redress under the statute, regardless of the conduct in which that individual engages. . . .

In sum, Dodd–Frank’s text and purpose leave no doubt that the term “whistleblower” in § 78u–6(h) carries the meaning set forth in the section’s definitional provision. The disposition of this case is therefore evident: Somers did not provide information “to the Commission” before his termination, § 78u–6(a)(6), so he did not qualify as a “whistleblower” at the time of the alleged retaliation. He is therefore ineligible to seek relief under § 78u–6(h). . . .

Applying the whistleblower definition as written, Somers and the Solicitor General further protest, will create “an incredibly unusual statutory scheme”: “[I]dential misconduct”—*i.e.*, retaliating against an employee for internal reporting—will “go punished or not based on the happenstance of a separate report” to the SEC, of which the wrongdoer may “not even be aware.” The upshot, the Solicitor General warns, “would [be] substantially diminish[ed] Dodd–Frank] deterrent effect.”

Overlooked in this protest is Dodd–Frank’s core objective: to prompt reporting to the SEC. In view of that precise aim, it is understandable that the statute’s retaliation protections, like its financial rewards, would be reserved for employees who have done what Dodd–Frank seeks to achieve, *i.e.*, they have placed information about unlawful activity before the Commission to aid its enforcement efforts. . . .

LIU MENG-LIN v. SIEMENS AG, 763 F.3d 175 (2d Cir. 2014)

GERARD E. LYNCH, Circuit Judge:

The Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010), includes a provision, 15 U.S.C. § 78u–6(h), that prohibits employers from retaliating against whistleblower employees who make certain protected disclosures. The instant case requires us to determine whether § 78u–6(h) protects a foreign worker employed abroad by a foreign corporation where all events related to the disclosures occurred abroad. Because (1) legislation is presumed to apply only domestically unless there is evidence Congress intended otherwise; (2) there is no indication Congress intended the whistleblower protection provision to have extraterritorial application; and (3) the facts in the complaint unequivocally demonstrate that applying the statute in this case would constitute an extraterritorial application, we conclude that the district court properly dismissed the complaint.

Plaintiff-appellant Liu Meng-Lin, a citizen and resident of Taiwan, was employed as a compliance officer for the healthcare division of Siemens China Ltd., a Chinese corporation that is a wholly owned subsidiary of defendant-appellee Siemens AG

(“Siemens”), a German corporation whose shares, at all relevant times, were listed on the New York Stock Exchange. According to his complaint, Liu discovered that Siemens employees were indirectly making improper payments to officials in North Korea and China in connection with the sale of medical equipment in those countries. Liu believed that these payments violated both company policy and U.S. anti-corruption measures. He therefore reported this conduct to his superiors through internal company procedures, including in a meeting with a high-ranking Siemens executive in Shanghai, China. Liu claims that as he sought to address these alleged violations, Siemens progressively restricted his authority as a compliance officer, demoted him, and ultimately fired him. Liu does not plead that any of the events related to his firing—the allegedly corrupt conduct, Liu’s discovery of that conduct, Liu’s efforts to address the corrupt conduct through Siemens’s internal protocols, or his subsequent mistreatment by Siemens—occurred within the territorial jurisdiction of the United States.

Two months after Siemens fired him, Liu reported the allegedly corrupt conduct to the Securities and Exchange Commission (“SEC”), charging that Siemens had violated the Foreign Corrupt Practices Act (“FCPA”). Liu then brought this action in the United States District Court for the Southern District of New York (William H. Pauley III, *Judge*), alleging that by firing him Siemens had violated the antiretaliation provision of the Dodd-Frank Act, 15 U.S.C. § 78u–6(h)(1)(A). Siemens moved to dismiss the suit for failure to state a claim, Fed. R. Civ. P. 12(b)(6), asserting two separate defects in the complaint: that the antiretaliation provision does not apply extraterritorially, and that none of Liu’s disclosures were “required or protected” by a relevant statute as the antiretaliation provision requires. The district court granted Siemens’s motion to dismiss with prejudice on both grounds, holding (1) that on the facts pled, the complaint sought an extraterritorial application of the antiretaliation provision, which does not have extraterritorial reach, and (2) that Liu’s complaint failed to establish that he had made a disclosure to the SEC that was “required or protected” by any of the specific statutes enumerated in § 78u–6(h)(1)(A)(iii).

Liu timely appealed, and upon de novo review of the district court’s grant of the motion to dismiss, *Lundy v. Catholic Health Sys. of Long Island, Inc.*, we affirm on the ground that Liu seeks an extraterritorial application of the antiretaliation provision, and that that provision does not apply extraterritorially. . . .

“[I]t is a longstanding principle of American law that legislation of Congress, unless a contrary intent appears, is meant to apply only within the territorial jurisdiction of the United States.” *Morrison v. Nat’l Austl. Bank Ltd.*, quoting *EEOC v. Arabian Am. Oil Co.* (“*Aramco*”). “This principle represents a canon of construction, or a presumption about a statute’s meaning, rather than a limit upon Congress’s power to legislate. It rests on the perception that Congress ordinarily legislates with respect to domestic, not foreign matters.” The presumption that “[w]hen a statute gives no clear indication of an extraterritorial application, it has none,” *Kiobel v. Royal Dutch Petroleum Co.*, quoting *Morrison* is rebutted only when the statute’s “text, history, and purposes . . . evince a ‘clear indication of extraterritoriality.’” *Id.* (quoting *Morrison*). Moreover, it is “well

established that generic terms like ‘any’ or ‘every’ do not rebut the presumption against extraterritoriality,” nor do “fleeting reference[s]” to possible international ramifications of an otherwise domestic statute, *Morrison*.

We have read *Morrison* to “wholeheartedly embrace[] application of the presumption against extraterritoriality, finding that ‘unless there is the affirmative intention of the Congress clearly expressed to give a statute extraterritorial effect, we must presume it is primarily concerned with domestic conditions.’” *Norex Petroleum Ltd. Access Indus., Inc.*, (quoting *Morrison*). We will “thus look for a ‘clear’ and ‘affirmative indication’ that a statute applies to conduct occurring outside the territorial jurisdiction of the United States before concluding that the presumption has been overcome.” *United States v. Weingarten*, quoting *Morrison*.

This case involves the reach of the antiretaliation provision of the Dodd-Frank Act, which directs, in relevant part, that

[n]o employer may discharge . . . or in any other manner discriminate against, a whistleblower in the terms and conditions of employment because of any lawful act done by the whistleblower . . . in making disclosures that are required or protected under the Sarbanes–Oxley Act of 2002 . . . , this chapter, . . . and any other law, rule, or regulation subject to the jurisdiction of the [Securities and Exchange] Commission.

15 U.S.C. § 78u–6(h)(1)(A). To survive Siemens’s motion to dismiss, Liu must demonstrate either (1) that the facts alleged in his complaint state a domestic application of the antiretaliation provision of the Dodd-Frank Act, or (2) that the antiretaliation provision is intended to apply extraterritorially.

The first alternative need not detain us long. We have no occasion here to define the precise boundary between domestic and extraterritorial application of this relevant provision, or to delineate the types of contacts within the United States that would render an application of the statute domestic rather than extraterritorial because this case is extraterritorial by any reasonable definition. Liu is a resident of Taiwan employed by the Chinese subsidiary of a German company; he reported to superiors in China and Germany regarding allegedly corrupt activities that took place in China, North Korea, and Hong Kong; and his employers decided, apparently in China and/or Germany, to terminate his employment. In short, the whistleblower, his employer, and the other entities involved in the alleged wrongdoing are all foreigners based abroad, and the whistleblowing, the alleged corrupt activity, and the retaliation all occurred abroad. The facts alleged in the complaint reveal essentially no contact with the United States regarding either the wrongdoing or the protected activity.

Liu attempts to avoid this conclusion by pointing to one slim connection to the United States. He argues that “Siemens voluntarily elected to have a class of its securities publicly listed on the New York Stock Exchange and thereby voluntarily subjected itself to—and undertook to comply with—United States securities laws,” including the

antiretaliation provision. Liu argues that because Siemens has securities listed on an American exchange, his case is “fundamentally distinguishable” from *Morrison*.

This argument is unavailing. *Morrison* addressed whether Australian purchasers of shares listed on an Australian stock exchange could rely on § 10(b) of the Securities Exchange Act of 1934 to sue the Australian bank that issued the shares. The Supreme Court concluded that § 10(b) did not have extraterritorial reach, but rather applied “only [to] transactions in securities listed on domestic exchanges, and domestic transactions in other securities.” *Morrison*. The Court reached this conclusion despite the fact that “[t]here [were] listed on the New York Stock Exchange . . . the [defendant bank’s] American Depositary Receipts (ADRs), which represent the right to receive a specified number of” the Australian shares. *Morrison* thus decisively refutes Liu’s contention that the United States securities laws apply extraterritorially to the actions abroad of any company that has issued United States-listed securities.

Far from helping Liu, *Morrison* establishes that where a plaintiff can point only to the fact that a defendant has listed securities on a U.S. exchange, and the complaint alleges no further meaningful relationship between the harm and those domestically listed securities, the listing of securities alone is the sort of “fleeting” connection that “cannot overcome the presumption against extraterritoriality.” See also *In re Royal Bank of Scotland Grp. PLC Sec. Litig.* (“The idea that a foreign company is subject to U.S. [s]ecurities laws everywhere it conducts foreign transactions merely because it has ‘listed’ some securities in the United States is simply contrary to the spirit of *Morrison*.”). In short, “simply alleging that some domestic conduct occurred cannot support a claim of domestic application [because] ‘[i]t is a rare case of prohibited extraterritorial application that lacks *all* contact with the territory of the United States.’” *Norex* (quoting *Morrison*).

Liu’s argument that the statute nevertheless applies to his case requires a somewhat lengthier discussion, but is equally unavailing. The support for the conclusion that the antiretaliation provision has no extraterritorial application is straightforward: there is absolutely nothing in the text of the provision, set forth above, or in the legislative history of the Dodd-Frank Act, that suggests that Congress intended the antiretaliation provision to regulate the relationships between foreign employers and their foreign employees working outside the United States. Given the presumption against extraterritoriality, and the absence of any direct evidence of a congressional intent to apply the relevant provision extraterritorially, Liu’s effort to cobble together indirect, circumstantial suggestions of extraterritorial application faces powerful headwinds.

Liu offers several arguments that the statutory language or context of the antiretaliation provision indirectly demonstrates that it is intended to have extraterritorial reach. None provides the “clear and affirmative indication,” *Weingarten*, required to overcome the presumption against extraterritoriality. First, Liu’s contention that the antiretaliation provision “contains very broad language that includes all employees” is of no avail. The plain text of the statute contains no hint that the antiretaliation provision is meant to

apply extraterritorially, but rather simply indicates that “[n]o employer” may retaliate against a whistleblower, 15 U.S.C. § 78u–6(h)(1). That is precisely the sort of “generic” language that the Supreme Court has expressly stated is insufficient to overcome the presumption against extraterritorial application. *See Kiobel*.

Liu next points to other sections of the Dodd-Frank Act that do have some extraterritorial application to argue, in effect by association, that the antiretaliation provision also should be read to have extraterritorial reach. He points to § 929P(b) of the Dodd-Frank Act, 124 Stat. at 1864–65, which, inter alia, grants district courts jurisdiction where a suit brought by the SEC or the United States government

allege[s] a violation of the antifraud provisions of [the Securities Exchange Act of 1934] involving (1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States.

15 U.S.C. § 78aa(b). Liu argues that “by specifically providing for extraterritorial jurisdiction in a related section of the statute, Congress clearly evidenced its intention to protect SEC whistleblowers located abroad.”

Liu’s argument inverts the ordinary canons of statutory interpretation. “Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.” *Russello v. United States*. There is no exception to this general rule for language effecting extraterritorial application; to the contrary, the Supreme Court has specifically cautioned against acceptance of arguments such as Liu’s: “[W]hen a statute provides for some extraterritorial application, the presumption against extraterritoriality operates to limit that provision to its terms.” *Morrison*. That limitation is founded in “Congress’ awareness of the need to make a clear statement that a statute applies” extraterritorially through “express [] legislat[ion]” that enables such application. *Aramco*. As *Morrison* observes, it would be “superfluous” for a statute to note that a particular provision applies extraterritorially if the entire statute had extraterritorial reach. Since § 929P(b) identifies a particular provision of Dodd-Frank as having such reach, the logical inference is that the antiretaliation provision, enjoying no such explicit grant of extraterritorial application, has none, a conclusion which at least one district court has also reached. *See Asadi v. G.E. Energy (USA), LLC*.

Moreover, Liu’s argument fails even on its own terms. Liu does not explain his contention that § 929P(b)’s crisply delineated jurisdictional grant is somehow “related” to the whistleblower antiretaliation provision. In § 929P(b), Congress provided the district court with limited extraterritorial jurisdiction over specific types of antifraud suits brought by governmental entities when the conduct at issue has particular types of relationships to the United States. Liu is not a governmental actor, he has not pled facts of the sort that would confer jurisdiction under § 929P(b), and he cannot argue that the

antiretaliation provision qualifies as an antifraud provision of the Securities Exchange Act. In sum, there is no colorable argument that the limited extraterritorial reach of § 929P(b) supports extraterritorial application of the antiretaliation provision in circumstances such as those alleged by Liu.

Liu next turns to the Dodd–Frank’s whistleblower bounty provision, 15 U.S.C. § 78u–6(b), to make a similar argument. The bounty provision allows the SEC, in its discretion, to make award payments to “whistleblowers who voluntarily provided original information to the Commission that led to [a] successful enforcement” action. § 78u–6(b)(1). Liu asserts that the SEC regulations which define the eligibility for a whistleblower bounty suggest that the agency conceives of the bounty as having international reach. He cites a regulation providing that “you are not eligible [for an award] if: . . . You are . . . a member, officer, or employee of a foreign government, any political subdivision, department, agency, or instrumentality of a foreign government, or any other foreign financial regulatory authority.” 17 C.F.R. § 240.21F–8(c)(2). Liu further asserts that aspects of the agency’s discussion of the bounty provision included in the promulgation of the final rule, 76 Fed. Reg. 34300–01 (June 13, 2011), offer additional support for the idea that the bounty provision is meant to have extraterritorial reach. In particular, he points to the agency’s discussion of the tax filing procedures for an award payment to a foreign national, and the agency’s decision to *avoid* making a categorical determination as to whether a whistleblower’s possible violation of foreign laws should affect the eligibility for an award. . . .

[E]ven if we assume that the regulations clearly apply the bounty program to whistleblowers located abroad and that some deference would be due such an agency interpretation, it would not follow that Congress intended the antiretaliation provision to apply similarly. As with our analysis of § 929P(b), we must restrict an indication of extraterritorial application “to its terms,” *Morrison*; a regulation addressing the bounty provision cannot be taken to support the proposition that the antiretaliation provision should apply extraterritorially. 17 C.F.R. § 240.21F–8(c)(2) does not mention the antiretaliation provision, and indeed, other SEC regulations suggest that the requirements of the antiretaliation and bounty provisions are to be considered separately. Moreover, extraterritorial application of the bounty and antiretaliation provisions have far different international ramifications. Providing rewards to persons, foreign or domestic, who supply information about lawbreaking is far less intrusive into other countries’ sovereignty than seeking to regulate the employment practices of foreign companies with respect to the foreign nationals they employ in foreign countries. Applying the antiretaliation provision in circumstances such as Liu’s would effect such an intrusion. Thus, whatever their merits, none of the arguments that the *bounty* provision is meant to have extraterritorial reach provide any support for Liu’s claim that the *antiretaliation* provision is meant to have extraterritorial reach. . . .

Problem 10-2

Now that you have examined the very different Dodd-Frank securities law whistleblower regime, reconsider the question posed in chapter 6 when the False Claims Act was discussed: Are such legal “bounty” regimes beneficial on balance? What is the optimal way to structure such regimes? Would you modify the SEC regime if you could? How?

Consider this abstract summarizing the findings in a recent paper, Alexander Platt, *The Whistleblower Industrial Complex*, 40 YALE J. REG. 688 (2023):

Although the whistleblower programs (WBPs) created by Dodd-Frank have received universal acclaim, little is known about how they actually work. Last year, the Securities and Exchange Commission (SEC) received an average of 49 whistleblower tips every workday. Success depends on sifting through this avalanche of tips to determine which ones to investigate. To date, however, the tip-sifting process has been entirely shrouded in secrecy. . . . Using a new dataset comprised of information I obtained under the Freedom of Information Act, I find (among other things) that tipsters represented by lawyers significantly outperform unrepresented ones, repeat-player lawyers outperform first-timers, and lawyers who used to work at the SEC outperform just about everybody. The upshot is that the SEC and CFTC have effectively privatized the tip-sifting function that is at the core of the WBPs. Private lawyers have likely extracted hundreds of millions of dollars in fees and expenses from these programs, with a disproportionate share going to a concentrated group of well-connected, repeat players. Unlike traditional plaintiffs’ side securities attorneys and attorneys who represent clients seeking government payments in many other contexts, private whistleblower lawyers operate free from virtually all public accountability, transparency, or regulation.

F. New Whistleblower Programs

The SEC’s general structure for its whistleblowing program under the Dodd-Frank Act has been serving as a model for other experimentation with whistleblowing incentives, which have been catching on rapidly.

In 2022, Congress enacted legislation to allow the Treasury Department to reward individuals who provide information that leads to successful money laundering enforcement actions. 31 U.S.C. § 5323. The legislation was modeled from the Dodd-Frank SEC whistleblower regime. Requirements include: (1) that Treasury brings an action resulting over \$1 million of penalties; (2) that the whistleblower’s information be “original” under a definition similar to the SEC program; and (3) that the whistleblower not be an excluded person from a number of categories similar to those the SEC program excludes. A qualifying whistleblower is eligible for an award of between 10 and 30 percent of Treasury’s recovery, at Treasury’s discretion. The legislation also includes anti-retaliation protection for whistleblowers.

In the non-statutory setting of policy making, DOJ's Criminal Division has very recently adopted the following two "pilot programs" for experimenting with encouraging persons with knowledge of certain forms of business crime to come forward in exchange for receiving (1) a non-prosecution guarantee (the U.S. Attorney's Office for the Southern District of New York has adopted a similar pilot nonprosecution program; its terms are available at https://www.justice.gov/d9/2024-05/sdny_wb_policy_effective_2-13-24.pdf); and/or (2) a financial reward consisting of a percentage of funds recovered by DOJ through its statutory forfeiture authorities.

U.S. Dep't of Justice, The Criminal Division's Pilot Program on Voluntary Self-Disclosures for Individuals (April 15, 2024)

The Department of Justice (Department) is dedicated to vigorously investigating and prosecuting federal criminal offenses, including crimes by, through, or related to corporations. Use of cooperating witnesses in investigations and prosecutions, discretionary grants of immunity, and entry into non-prosecution agreements (NPAs) in return for a person's cooperation have long been a part of the federal criminal system and are addressed by the Department's Justice Manual, *see* JM 9-27.600 *et seq.* (explaining, *inter alia*, criteria for entry of non-prosecution agreements with cooperating witnesses, including supervisory approval and that any such agreement be in the public interest); U.S.S.G. §§ 5K1.1, 5K2.16; Rule 35 of the Federal Rules of Criminal Procedure; and 18 U.S.C. §§ 6001-6003.

The prospect of an NPA may provide a strong incentive for individuals to bring to the Criminal Division's and law enforcement's attention actionable, original information about criminal conduct that might otherwise go undetected or be impossible to prove. The Criminal Division's grant of an NPA to individuals who report misconduct to law enforcement in the context of corporate and white-collar criminal offenses also may be a particularly important incentive for companies to create compliance programs that encourage robust internal reporting of complaints, that help prevent, detect, and remediate misconduct before it begins or expands, and that allow companies to report misconduct when it occurs.

This Pilot Program provides transparency regarding the circumstances in which Criminal Division prosecutors will offer NPAs to individuals who voluntarily disclose original information about certain types of criminal conduct involving corporations, fully cooperate with authorities, and pay any applicable victim compensation, restitution, forfeiture, or disgorgement, including returning any ill-gotten gains.

The Pilot Program applies to Criminal Division investigations of the offenses outlined below and applies to disclosures made on or after April 15, 2024. The Pilot Program does not modify or amend existing Department or Division policies or directives, or provisions of the Justice Manual. While the Pilot Program is in effect, the Criminal Division will collect anonymized statistical data about relevant disclosures, for the purposes of determining whether to extend, modify, or end the Pilot Program. . . .

When an individual voluntarily self-discloses original information about criminal misconduct, including the complete extent of their own role in the misconduct, fully cooperates, and satisfies the other conditions set forth below, the reporting individual will receive an NPA.

1. The disclosure must be to the Criminal Division at NPA.Pilot@usdoj.gov.
2. The reporting individual must disclose original information, meaning non-public information not previously known to the Criminal Division or to any component of the Department of Justice, and the information provided must relate to at least one of the following:
 - o Violations by financial institutions, their insiders, or agents, including schemes involving money laundering, anti-money laundering, registration of money transmitting businesses, and fraud statutes, and fraud against or compliance with financial institution regulators;
 - o Violations related to integrity of financial markets undertaken (1) by financial institutions, investment advisors, or investment funds, (2) by or through public companies or private companies with 50 or more employees, or (3) by any insiders or agents of any such entities;
 - o Violations related to foreign corruption and bribery by, through, or related to public or private companies, including violations of the Foreign Corrupt Practices Act, violations of the Foreign Extortion Prevention Act, and violations of the money laundering statutes;
 - o Violations related to health care fraud or illegal health care kickbacks committed by or through public companies or private companies with 50 or more employees;
 - o Violations by or through public or private companies with 50 or more employees related to fraud against, or the deception of, the United States in connection with federally funded contracting, where such fraud does not involve health care or illegal health care kickbacks; and
 - o Violations committed by or through public or private companies related to the payment of bribes or kickbacks to domestic public officials.
3. The disclosure must be voluntary, meaning (1) before any request, inquiry, or demand that relates to the subject matter of the submission is directed to the individual or anyone representing the individual (e.g., his or her legal representative) by the Department in connection with any investigation, or by a federal law enforcement, regulatory, or civil enforcement agency regarding the same misconduct; (2) where the individual has no preexisting obligation pursuant to an agreement in connection with a criminal prosecution or civil enforcement action to report the information to the Criminal Division, any Department component, or any federal law enforcement, regulatory, or

civil enforcement agency; and (3) in the absence of any government investigation or threat of imminent disclosure to the government or the public.

4. The disclosure must be truthful and complete, meaning it must include all information known to the individual related to any misconduct in which the individual has participated and/or of which the individual is aware, including the complete extent of the individual's own role in the misconduct, and all matters about which the Department may inquire.

5. The reporting individual must agree to fully cooperate with and be willing and able to provide substantial assistance to the Department in its investigation of related conduct and prosecution of equally or more culpable individuals or entities including, but not limited to, providing truthful and complete testimony and evidence, whether in interviews, before a grand jury, or at any trial or other court proceeding; producing documents, records, and other evidence when called upon by the Criminal Division; and, if requested, working in a proactive manner under the supervision of, and in compliance with United States law enforcement officers and agents.

6. The reporting individual must agree to forfeit or disgorge any profit from the criminal wrongdoing and pay restitution or victim compensation.

7. The reporting individual: (1) has not engaged in criminal conduct involving violence, use of force, threats, substantial patient harm, any sex offense involving fraud, force, or coercion, or relating to a minor, or any offense involving terrorism; (2) is not the Chief Executive Officer (or equivalent) or Chief Financial Officer (or equivalent) of a public or private company or is not the organizer/leader of the scheme; (3) is not an elected or appointed foreign government official; (4) is not a domestic government official at any level, including any employee of a law enforcement agency; and (5) does not have a previous felony conviction or a conviction of any kind for conduct involving fraud or dishonesty.

Separate and apart from this Pilot Program, Criminal Division prosecutors retain discretion to offer an NPA to individuals in appropriate circumstances, including where individuals come forward pursuant to the Pilot Program but the criteria above are not met in full, in accordance with the Justice Manual and Criminal Division procedures.

Department of Justice Corporate Whistleblower Awards Pilot Program (August 1, 2024)

Introduction

The Attorney General is authorized to pay "awards for information or assistance leading to a civil or criminal forfeiture." *See* 28 U.S.C. § 524(c). This document sets forth criteria that individuals must meet in order to qualify for payment of an award in the Department's discretion as part of the Department's Corporate

Whistleblower Awards Pilot Program (Corporate Whistleblower Awards Pilot Program or Pilot Program).

Whistleblowers may be eligible for an award pursuant to the Corporate Whistleblower Awards Pilot relating to one or more designated program areas that leads to forfeiture exceeding \$1,000,000 in net proceeds, as outlined below. Any award is subject to the payment considerations outlined below. Additional guidance and procedures for submitting information and making a claim for an award are also outlined here. . . .

I. Eligibility for Submission and Definitions

1. Whistleblower Award Eligibility: An individual may be eligible for a whistleblower award if, alone or jointly with other individuals, they provide the Department with original information in writing pursuant to the conditions and procedures set forth below, and that information leads to criminal or civil forfeiture exceeding \$1,000,000 in net proceeds forfeited in connection with a successful prosecution, corporate criminal resolution, or civil forfeiture action related to corporate criminal conduct in the programmatic areas outlined below.

An individual is not eligible for an award under this program if:

- a. They are a company or another type of entity. A qualifying whistleblower must be an individual.
- b. They would be eligible for an award through another U.S. government or statutory whistleblower, *qui tam*, or similar program if they had reported the same scheme that they reported under this pilot program.
- c. They are, or were at the time they acquired the original information provided to the Department, an official, employee, or contractor of the Department or any law enforcement organization or a spouse, parent, child, or sibling of an official, employee, or contractor of the Department or they resided in the same household as an official, employee, or contractor of the Department.
- d. They are, or were at the time they acquired the original information provided to the Department, an elected or appointed foreign government official.
- e. They meaningfully participated in the criminal activity they reported, including by directing, planning, initiating, or knowingly profiting from that criminal activity.
- f. In their whistleblower submission, dealings with the Department, or dealings with another authority in connection with a related action, the individual knowingly and willfully made or makes any false, fictitious, or fraudulent statement or representation, withheld or

- withholds material or significant information, or used or uses any writing or document knowing that it contains any false, fictitious, or fraudulent statement or entry with intent to mislead or otherwise hinder the Department or another authority, or otherwise interfered or interferes with or obstructed or obstructs the Department's investigation.
- g. They acquired the original information from a person: (1) who is ineligible under paragraphs (c) through (f), unless they are providing the Department with information about possible violations involving that person; or (2) with the intent to evade any provision in this document.
 - h. They provided information to the Department before the effective date of the Corporate Whistleblower Awards Pilot Program.
2. Original Information: An individual must provide, in writing, original information, meaning:
- a. Information that is derived from the individual's independent knowledge or independent analysis.
 - i. Independent knowledge means factual information in the individual's possession that is not derived from publicly available sources. The individual may gain independent knowledge from their experiences, communications, and observations in their business or social interactions.
 - ii. Independent analysis means the individual's own analysis, whether done alone or in combination with others. Analysis means the individual's examination and evaluation of information that may be publicly available, but which reveals information that is not generally known or available to the public.
 - b. Information that is non-public and previously not known to the Department. This assessment will focus on whether the information itself is original, non-public, and not previously known to the Department, regardless of whether the Department did or did not already have an investigation open related to the information provided.
 - c. Information that materially adds to the information the Department already possesses. Even if the Department already has information about a matter from other sources at the time an individual makes their submission, the Department will consider the individual an original source of any information they provide that is derived from their independent knowledge or analysis and that materially adds to the information that the Department already possesses, if they meet the other criteria for original information specified herein.

- d. Original information that an individual first reported through an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law where the entity later reported to the Department the individual's information or the results of an investigation initiated in whole or in part in response to the individual's information, provided the individual also reports their information to the Department within 120 days of reporting internally. In that situation, for purposes of evaluating the claim for an award under this Corporate Whistleblower Awards Pilot Program, the Department will deem the date the individual provided original information to the entity's internal reporting structure as the date of the individual's original disclosure to the Department.
- e. An individual's information is not original if:
 - i. They obtained the information through a communication that was subject to the attorney-client privilege, including any third parties' attorney-client privilege, unless disclosure of that information would otherwise be permitted by an attorney pursuant to the crime-fraud or other exceptions under the applicable state attorney conduct rules.
 - ii. They obtained the information in connection with the legal representation of a client on whose behalf they or their employer or firm are providing services, and they seek to use the information to make a whistleblower submission for their own benefit.
 - iii. The information they submitted is contained entirely in an allegation made in a judicial or administrative hearing, in a government report, hearing, audit, or investigation, or in the news media, unless they were a source of the information.
 - iv. They obtained the information because they were: (a) an officer, director, trustee, or partner of an entity and another person informed them of allegations of misconduct, or they learned the information in connection with the entity's processes for identifying, reporting, and addressing possible violations of law; (b) an employee whose principal duties involve compliance or internal audit responsibilities, or they were employed by or otherwise associated with a firm retained to perform compliance or internal audit functions for an entity, and the information relates to or is derived from these responsibilities or functions; (c) employed by or otherwise associated with a firm retained to conduct an inquiry or investigation into possible violations of law and the information relates to or derives from that retention; or (d) an employee of, or other person associated with, a public accounting firm, if they obtained the information through the

performance of an engagement required of an independent public accountant and that information related to a violation by the engagement client or the client's directors, officers, or other employees (*but see* (vii) below).

- v. They obtained the information or knew that the information was obtained by a means or in a manner that violates applicable federal or state criminal law.
 - vi. They obtained the information from a person who is subject to this section, unless the information is not excluded from that person's use pursuant to this section, or they are providing the Department with information about possible violations involving that person.
 - vii. However, the exceptions in Paragraph (iv) of this section shall not apply if an individual: (a) has a reasonable basis to believe that disclosure of the information to the Department is necessary to prevent the relevant individual or entity from engaging in criminal conduct that is likely to harm national security, result in crimes of violence, result in imminent harm to patients in connection with health care, or cause imminent financial or physical harm to others; (b) has a reasonable basis to believe that the relevant individual or entity is engaging in conduct that will impede an investigation of the misconduct; or (c) is someone described in (iv)(a) or (iv)(b) and at least 120 days have elapsed since they provided the information to the relevant entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or their supervisor, or since they received the information, if they received it under circumstances indicating that the entity's audit committee, chief legal officer, chief compliance officer (or their equivalents), or their supervisor was already aware of the information.
3. Subject Area: An individual's information must pertain to one of the following subject matter areas:
- a. Violations by financial institutions, their insiders, or agents, including schemes involving money laundering, anti-money laundering compliance violations, registration of money transmitting businesses, and fraud statutes, and fraud against or non-compliance with financial institution regulators.
 - b. Violations related to foreign corruption and bribery by, through, or related to companies, including violations of the Foreign Corrupt Practices Act, violations of the Foreign Extortion Prevention Act, and violations of the money laundering statutes.

- c. Violations committed by or through companies related to the payment of bribes or kickbacks to domestic public officials, including but not limited to federal, state, territorial, or local elected or appointed officials and officers or employees of any government department or agency.
 - d. Violations related to (a) federal health care offenses and related crimes involving private or other non-public health care benefit programs, where the overwhelming majority of claims are submitted to private or other non-public health care benefit programs, (b) fraud against patients, investors, and other non-governmental entities in the health care industry, where the overwhelming majority of the actual or intended loss was to patients, investors, and other non-governmental entities, and (c) any other federal violations involving conduct related to health care not covered by the Federal False Claims Act, 31 U.S.C. § 3729, *et seq.*
- 4. Voluntary: An individual's submission must be voluntary.
 - a. An individual's submission of information is voluntary if it occurs:
 - i. before any request, inquiry, or demand that relates to the subject matter of the submission is directed to the individual or anyone representing them (*e.g.*, their legal representative) by the Department in connection with any investigation, by federal law enforcement, or by a civil enforcement agency regarding the same misconduct;
 - ii. where the individual has no preexisting obligation pursuant to an agreement in connection with a criminal prosecution or civil enforcement action to report the information to the Department, any Department component, or any federal law enforcement or civil enforcement agency; and
 - iii. in the absence of any government investigation or threat of imminent disclosure to the government or the public.
 - b. An individual's submission is not voluntary if the Department directed a request, inquiry, or demand to them or their representative before their submission, even if they respond to such a request voluntarily. However, if an individual voluntarily reported original information to their employer before receiving a request, inquiry, or demand from the Department, and they reported to the Department or they responded to the Department's request within 120 days of reporting the original information to their employer, their submission will still qualify as voluntary.
- 5. Truthful and Complete: An individual must provide truthful and complete information, meaning they must provide all information of which they have knowledge related to any misconduct, including misconduct in which they

participated or of which they are aware, the complete extent of their own role, if any, in the misconduct, and all matters about which the Department may inquire.

- a. To submit to the Pilot Program and be eligible for an award, the individual or their attorney must provide their information to the Department using the Intake Form available at www.justice.gov/corporatewhistleblower and declare under penalty of perjury that the information is true and correct to the best of the individual's knowledge.
 - b. Information is not truthful and complete if the individual is involved in the misconduct but lies about, conceals, or mischaracterizes their role in the misconduct.
6. Cooperation: An individual must cooperate with the Department in its investigation of related conduct and criminal or civil actions. This includes but is not limited to providing truthful and complete testimony and evidence, whether in interviews, before a grand jury, or at any trial or other court proceeding; producing documents, records, and other evidence when called upon by the Department; and, if requested, working in a proactive manner under the supervision of, and in compliance with, United States law enforcement officers and agents.
7. Leading to Forfeiture: The information must lead to successful forfeiture exceeding \$1,000,000 in net proceeds forfeited by the Department in connection with a prosecution, corporate criminal resolution, or civil forfeiture action related to corporate criminal conduct in the programmatic areas outlined above.
 - a. There is successful forfeiture where the Department obtains a final order of forfeiture, civil judgment of forfeiture, or administrative declaration of forfeiture related to assets obtained as a result of an individual's submission, and those assets are deposited in the Assets Forfeiture Fund.
 - b. In assessing whether an individual's submission of original information led to a successful civil or criminal forfeiture, the Department will consider whether:
 - i. The individual provided the Department with original information that was sufficiently specific, credible, and timely to cause the Department to open an investigation, reopen an investigation that the Department had closed, or to inquire about different conduct as part of a current investigation, and that original information led the Department to obtain a successful forfeiture.
 - ii. The individual provided the Department with original information about conduct that was already under

investigation by the Department, and their submission significantly contributed to the successful forfeiture.

- iii. The individual reported original information through an entity's internal whistleblower, legal, or compliance procedures for reporting allegations of possible violations of law before or at the same time they reported them to the Department; the entity later provided their information to the Department, or provided results of an investigation initiated in whole or in part in response to information they reported to the entity; and the information the entity provided to the Department satisfies either paragraph (b)(i) or (b)(ii) of this section. An individual must also submit the same information to the Department within 120 days of providing it to the entity.
- c. As described below, any award is discretionary and will be based on the net proceeds of the forfeiture.
- d. If there is no successful forfeiture, no award will be available.

II. Additional Considerations for Payment of an Award

Where the information provided leads to forfeiture exceeding \$1,000,000 in total net proceeds forfeited in a successful prosecution, corporate criminal resolution, or civil forfeiture action in one of the programmatic areas of corporate enforcement described above, the whistleblower may be eligible for an award from the case as outlined below. Awards are entirely discretionary and an award is not guaranteed; however, as noted above, the Department intends, through the exercise of its discretion, to incentivize those with information about corporate criminal wrongdoing to report original information about criminal conduct that might otherwise go undetected or be difficult to prove. When assessing whether to make a discretionary award, the Department will consider the following.

1. Amount of Award. The determination of whether an individual is eligible for an award and the amount of an award is in the sole discretion of the Department.
 - a. If the Department makes awards to more than one whistleblower in connection with the same matter, the Department will determine an individual percentage award for each whistleblower, but in no event will the total amount awarded to all whistleblowers in the aggregate in each case be greater than that outlined below.
 - b. If the Department finalizes a successful forfeiture, the whistleblower(s) may be eligible for an award based on the following calculation for the matter:
 - i. An award of up to 30% of the first \$100 million in net proceeds forfeited;

- ii. An award of up to 5% of any net proceeds forfeited between \$100 million and \$500 million.
 - iii. No award on net proceeds forfeited above \$500 million.
 - c. If the Department determines in its sole discretion that an award is appropriate and none of the considerations that may decrease an award are present, there is a presumption that the Department will award a whistleblower the maximum 30% of the first \$10 million in net proceeds forfeited.
 - d. Awards, if paid, will be paid from the net proceeds of the total asset(s) forfeited in each case.
2. Payment Priority: In making awards, the Department will draw from net proceeds of the forfeiture of total asset(s) finally forfeited and deposited in the Assets Forfeiture Fund in conjunction with each successful prosecution, corporate criminal resolution, or civil forfeiture action. . . .

[Ed: the pilot program policy includes additional provisions related to criteria for determining the amount of the award and procedures for filing for an award; these are reasonably similar in form to those that apply under the SEC Dodd-Frank whistleblower program.]

Problem 10-3

Suppose you are an attorney at a law firm that sometimes represents and defends individuals concerned about potential criminal problems and that your firm also represents some such individuals in the posture of whistleblower. Nancy, a new client, comes to your office for an initial meeting and states that she works in the accounting department of a large public company and believe she has knowledge of fraud in the company's accounting practices. She asks you to explain what her options might be. How will you conduct this interview? What are the most important questions you will ask Nancy?

11. THE GRAND JURY

The grand jury is one of the most powerful tools in the federal prosecutor's arsenal. It has subpoena power, secrecy rules, court authority, *ex parte* structure, and a general solemnity that make it a very effective way to gather information, especially from people who do not want to share it.

As a matter of law, the grand jury has two functions: (1) to investigate possible criminal violations, and (2) to determine whether there is sufficient evidence to return an indictment (charge a crime). The two functions are of course closely related, since it is the power to charge that gives rise to the power to investigate.

More of corporate criminal practice occurs in the shadow of the grand jury than inside the grand jury (*i.e.*, "we can do this cooperatively or we can do it in the grand jury"). But that shadow is very important, so the practitioner must understand how things work if a matter or witness ends up, or could end up, in the grand jury. And, of course, in a contested case only the grand jury can level a charge, so there is always the possibility, however slight, that a case will fail in the grand jury and never get off the ground.

A. Statutes and Rules

The Fifth Amendment gives the right to have a charge considered and returned or rejected by a grand jury in federal court before being prosecuted for any felony. This right has not been incorporated against the states, though most states have grand juries.

Rule 6 of the Federal Rules of Criminal Procedure explains (some of) how the grand jury works and has important provisions about secrecy. Notice who and what are *not* covered by the secrecy rules.

U.S. Constitution Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Federal Rules of Criminal Procedure: Rule 6. "The Grand Jury"

(a) Summoning a Grand Jury.

(1) In General. When the public interest so requires, the court must order that one or more grand juries be summoned. A grand jury must have 16 to 23 members, and

the court must order that enough legally qualified persons be summoned to meet this requirement.

(2) Alternate Jurors. When a grand jury is selected, the court may also select alternate jurors. Alternate jurors must have the same qualifications and be selected in the same manner as any other juror. Alternate jurors replace jurors in the same sequence in which the alternates were selected. An alternate juror who replaces a juror is subject to the same challenges, takes the same oath, and has the same authority as the other jurors.

(b) Objection to the Grand Jury or to a Grand Juror.

(1) Challenges. Either the government or a defendant may challenge the grand jury on the ground that it was not lawfully drawn, summoned, or selected, and may challenge an individual juror on the ground that the juror is not legally qualified.

(2) Motion to Dismiss an Indictment. A party may move to dismiss the indictment based on an objection to the grand jury or on an individual juror's lack of legal qualification, unless the court has previously ruled on the same objection under Rule 6(b)(1). The motion to dismiss is governed by 28 U.S.C. § 1867(e). The court must not dismiss the indictment on the ground that a grand juror was not legally qualified if the record shows that at least 12 qualified jurors concurred in the indictment.

(c) Foreperson and Deputy Foreperson. The court will appoint one juror as the foreperson and another as the deputy foreperson. In the foreperson's absence, the deputy foreperson will act as the foreperson. The foreperson may administer oaths and affirmations and will sign all indictments. The foreperson—or another juror designated by the foreperson—will record the number of jurors concurring in every indictment and will file the record with the clerk, but the record may not be made public unless the court so orders.

(d) Who May Be Present.

(1) While the Grand Jury Is in Session. The following persons may be present while the grand jury is in session: attorneys for the government, the witness being questioned, interpreters when needed, and a court reporter or an operator of a recording device.

(2) During Deliberations and Voting. No person other than the jurors, and any interpreter needed to assist a hearing-impaired or speech-impaired juror, may be present while the grand jury is deliberating or voting.

(e) Recording and Disclosing the Proceedings.

(1) Recording the Proceedings. Except while the grand jury is deliberating or voting, all proceedings must be recorded by a court reporter or by a suitable recording device. But the validity of a prosecution is not affected by the

unintentional failure to make a recording. Unless the court orders otherwise, an attorney for the government will retain control of the recording, the reporter's notes, and any transcript prepared from those notes.

(2) Secrecy.

(A) No obligation of secrecy may be imposed on any person except in accordance with Rule 6(e)(2)(B).

(B) Unless these rules provide otherwise, the following persons must not disclose a matter occurring before the grand jury:

- (i)** a grand juror;
- (ii)** an interpreter;
- (iii)** a court reporter;
- (iv)** an operator of a recording device;
- (v)** a person who transcribes recorded testimony;
- (vi)** an attorney for the government; or
- (vii)** a person to whom disclosure is made under Rule 6(e)(3)(A)(ii) or (iii).

(3) Exceptions.

(A) Disclosure of a grand-jury matter—other than the grand jury's deliberations or any grand juror's vote—may be made to:

- (i)** an attorney for the government for use in performing that attorney's duty;
- (ii)** any government personnel—including those of a state, state subdivision, Indian tribe, or foreign government—that an attorney for the government considers necessary to assist in performing that attorney's duty to enforce federal criminal law; or
- (iii)** a person authorized by 18 U.S.C. § 3322.

(B) A person to whom information is disclosed under Rule 6(e)(3)(A)(ii) may use that information only to assist an attorney for the government in performing that attorney's duty to enforce federal criminal law. An attorney for the government must promptly provide the court that impaneled the grand jury with the names of all persons to whom a disclosure has been made, and must certify that the attorney has advised those persons of their obligation of secrecy under this rule.

(C) An attorney for the government may disclose any grand-jury matter to another federal grand jury.

(D) An attorney for the government may disclose any grand-jury matter involving foreign intelligence, counterintelligence (as defined in 50 U.S.C. § 401a), or foreign intelligence information (as defined in Rule 6(e)(3)(D)(iii)) to any federal law enforcement, intelligence, protective, immigration, national defense, or national security official to assist the official receiving the information in the performance of that official's duties. An attorney for the government may also disclose any grand-jury matter involving, within the United States or elsewhere, a threat of attack or other grave hostile acts of a foreign power or its agent, a threat of domestic or international sabotage or terrorism, or clandestine intelligence gathering activities by an intelligence service or network of a foreign power or by its agent, to any appropriate federal, state, state subdivision, Indian tribal, or foreign government official, for the purpose of preventing or responding to such threat or activities.

(i) Any official who receives information under Rule 6(e)(3)(D) may use the information only as necessary in the conduct of that person's official duties subject to any limitations on the unauthorized disclosure of such information. Any state, state subdivision, Indian tribal, or foreign government official who receives information under Rule 6(e)(3)(D) may use the information only in a manner consistent with any guidelines issued by the Attorney General and the Director of National Intelligence.

(ii) Within a reasonable time after disclosure is made under Rule 6(e)(3)(D), an attorney for the government must file, under seal, a notice with the court in the district where the grand jury convened stating that such information was disclosed and the departments, agencies, or entities to which the disclosure was made.

(iii) As used in Rule 6(e)(3)(D), the term "foreign intelligence information" means:

(a) information, whether or not it concerns a United States person, that relates to the ability of the United States to protect against—

- actual or potential attack or other grave hostile acts of a foreign power or its agent;
- sabotage or international terrorism by a foreign power or its agent; or
- clandestine intelligence activities by an intelligence service or network of a foreign power or by its agent; or

(b) information, whether or not it concerns a United States person, with respect to a foreign power or foreign territory that relates to—

- the national defense or the security of the United States; or
- the conduct of the foreign affairs of the United States.

(E) The court may authorize disclosure—at a time, in a manner, and subject to any other conditions that it directs—of a grand-jury matter:

(i) preliminarily to or in connection with a judicial proceeding;

(ii) at the request of a defendant who shows that a ground may exist to dismiss the indictment because of a matter that occurred before the grand jury;

(iii) at the request of the government, when sought by a foreign court or prosecutor for use in an official criminal investigation;

(iv) at the request of the government if it shows that the matter may disclose a violation of State, Indian tribal, or foreign criminal law, as long as the disclosure is to an appropriate state, state-subdivision, Indian tribal, or foreign government official for the purpose of enforcing that law; or

(v) at the request of the government if it shows that the matter may disclose a violation of military criminal law under the Uniform Code of Military Justice, as long as the disclosure is to an appropriate military official for the purpose of enforcing that law.

(F) A petition to disclose a grand-jury matter under Rule 6(e)(3)(E)(i) must be filed in the district where the grand jury convened. Unless the hearing is ex parte—as it may be when the government is the petitioner—the petitioner must serve the petition on, and the court must afford a reasonable opportunity to appear and be heard to:

(i) an attorney for the government;

(ii) the parties to the judicial proceeding; and

(iii) any other person whom the court may designate.

(G) If the petition to disclose arises out of a judicial proceeding in another district, the petitioned court must transfer the petition to the other court unless the petitioned court can reasonably determine whether disclosure is proper. If the petitioned court decides to transfer, it must send to the transferee court the material sought to be disclosed, if feasible, and a written evaluation of the need for continued grand-jury secrecy. The transferee court must afford those persons identified in Rule 6(e)(3)(F) a reasonable opportunity to appear and be heard.

(4) Sealed Indictment. The magistrate judge to whom an indictment is returned may direct that the indictment be kept secret until the defendant is in custody or has been released pending trial. The clerk must then seal the indictment, and no person may disclose the indictment's existence except as necessary to issue or execute a warrant or summons.

(5) Closed Hearing. Subject to any right to an open hearing in a contempt proceeding, the court must close any hearing to the extent necessary to prevent disclosure of a matter occurring before a grand jury.

(6) Sealed Records. Records, orders, and subpoenas relating to grand-jury proceedings must be kept under seal to the extent and as long as necessary to prevent the unauthorized disclosure of a matter occurring before a grand jury.

(7) Contempt. A knowing violation of Rule 6, or of any guidelines jointly issued by the Attorney General and the Director of National Intelligence under Rule 6, may be punished as a contempt of court.

(f) Indictment and Return. A grand jury may indict only if at least 12 jurors concur. The grand jury—or its foreperson or deputy foreperson—must return the indictment to a magistrate judge in open court. To avoid unnecessary cost or delay, the magistrate judge may take the return by video teleconference from the court where the grand jury sits. If a complaint or information is pending against the defendant and 12 jurors do not concur in the indictment, the foreperson must promptly and in writing report the lack of concurrence to the magistrate judge.

(g) Discharging the Grand Jury. A grand jury must serve until the court discharges it, but it may serve more than 18 months only if the court, having determined that an extension is in the public interest, extends the grand jury's service. An extension may be granted for no more than 6 months, except as otherwise provided by statute.

(h) Excusing a Juror. At any time, for good cause, the court may excuse a juror either temporarily or permanently, and if permanently, the court may impanel an alternate juror in place of the excused juror.

(i) "Indian Tribe" Defined. "Indian tribe" means an Indian tribe recognized by the Secretary of the Interior on a list published in the Federal Register under 25 U.S.C. § 479a-1.

B. Prosecutors and the Grand Jury

DOJ, in the following internal rules, tries to limit prosecutors in the grand jury more than the law requires. Notice the ways the DOJ does that. These guidelines recognize the powers of the grand jury and the potential for abuse that is mostly unreviewable. What kinds of abuses do these internal DOJ rules seek to prevent?

U.S. DEPARTMENT OF JUSTICE, JUSTICE MANUAL [Provisions on Grand Juries]

9-11.010. Introduction

This chapter contains the Department’s policy on grand jury practice. For a discussion of the law, and a list of resource materials on grand jury practice, see the Criminal Resource Manual.

In dealing with the grand jury, the prosecutor must always conduct himself or herself as an officer of the court whose function is to ensure that justice is done and that guilt shall not escape nor innocence suffer. The prosecutor must recognize that the grand jury is an independent body, whose functions include not only the investigation of crime and the initiation of criminal prosecution but also the protection of the citizenry from unfounded criminal charges. The prosecutor’s responsibility is to advise the grand jury on the law and to present evidence for its consideration. In discharging these responsibilities, the prosecutor must be scrupulously fair to all witnesses and must do nothing to inflame or otherwise improperly influence the grand jurors.

9-11.101. Powers and Limitations of Grand Juries—The Functions of a Grand Jury

While grand juries are sometimes described as performing accusatory and investigatory functions, the grand jury’s principal function is to determine whether or not there is probable cause to believe that one or more persons committed a certain Federal offense within the venue of the district court. Thus, it has been said that a grand jury has but two functions—to indict or, in the alternative, to return a “no-bill.” *See* Wright, *Federal Practice and Procedure*, Criminal Section 110.

At common law, a grand jury enjoyed a certain power to issue reports alleging non-criminal misconduct. A special grand jury impaneled under Title 18 U.S.C. § 3331 is authorized, on the basis of a criminal investigation (but not otherwise), to fashion a report, potentially for public release, concerning either organized crime conditions in the district or the non-criminal misconduct in office of appointed public officers or employees. This is discussed at USAM 9-11.300 and USAM 9-11.330, and the Criminal Resource Manual. *See Jenkins v. McKeithen; Hannah v. Larche*. Whether a regular grand jury enjoys a comparable authority to issue a report is a difficult and complex question. *Cf. United States v. Briggs*. The Criminal Division of the Department of Justice should be consulted before any grand jury report is initiated, whether by a regular or special grand jury. *See also* USAM 9-11.330.

9-11.120. Power of a Grand Jury Limited by Its Function

The grand jury’s power, although expansive, is limited by its function toward possible return of an indictment. *Costello v. United States*. Accordingly, the grand jury cannot be used solely to obtain additional evidence against a defendant who has already been indicted. *United States v. Woods, Hurt v. United States*. Nor can the grand jury be used solely for pre-trial discovery or trial preparation. *United States v. Star*. After indictment,

the grand jury may be used if its investigation is related to a superseding indictment of additional defendants or additional crimes by an indicted defendant. *In re Grand Jury Subpoena Duces Tecum, Dated January 2, 1985; In re Grand Jury Proceedings. . . .*

9-11.150. Subpoenaing Targets of the Investigation

A grand jury may properly subpoena a subject or a target of the investigation and question the target about his or her involvement in the crime under investigation. See *United States v. Wong; United States v. Washington; United States v. Mandujano; United States v. Dionisio*. However, in the context of particular cases such a subpoena may carry the appearance of unfairness. Because the potential for misunderstanding is great, before a known “target” (as defined in USAM 9-11.151) is subpoenaed to testify before the grand jury about his or her involvement in the crime under investigation, an effort should be made to secure the target’s voluntary appearance. If a voluntary appearance cannot be obtained, the target should be subpoenaed only after the grand jury and the United States Attorney or the responsible Assistant Attorney General have approved the subpoena. In determining whether to approve a subpoena for a “target,” careful attention will be paid to the following considerations:

- The importance to the successful conduct of the grand jury’s investigation of the testimony or other information sought;
- Whether the substance of the testimony or other information sought could be provided by other witnesses; and
- Whether the questions the prosecutor and the grand jurors intend to ask or the other information sought would be protected by a valid claim of privilege.

9-11.151. Advice of “Rights” of Grand Jury Witnesses

It is the policy of the Department of Justice to advise a grand jury witness of his or her rights if such witness is a “target” or “subject” of a grand jury investigation. See the Criminal Resource Manual at 160 for a sample target letter.

A “target” is a person as to whom the prosecutor or the grand jury has substantial evidence linking him or her to the commission of a crime and who, in the judgment of the prosecutor, is a putative defendant. An officer or employee of an organization which is a target is not automatically considered a target even if such officer’s or employee’s conduct contributed to the commission of the crime by the target organization. The same lack of automatic target status holds true for organizations which employ, or employed, an officer or employee who is a target.

A “subject” of an investigation is a person whose conduct is within the scope of the grand jury’s investigation.

The Supreme Court declined to decide whether a grand jury witness must be warned of his or her Fifth Amendment privilege against compulsory self-incrimination before the witness’s grand jury testimony can be used against the witness. See *United States v. Washington; United States v. Wong; United States v. Mandujano*. In *Mandujano* the

Court took cognizance of the fact that Federal prosecutors customarily warn “targets” of their Fifth Amendment rights before grand jury questioning begins. Similarly, in *Washington*, the Court pointed to the fact that Fifth Amendment warnings were administered as negating “any possible compulsion to self-incrimination which might otherwise exist” in the grand jury setting. *See Washington*.

Notwithstanding the lack of a clear constitutional imperative, it is the policy of the Department that an “Advice of Rights” form be appended to all grand jury subpoenas to be served on any “target” or “subject” of an investigation. *See* advice of rights below.

In addition, these “warnings” should be given by the prosecutor on the record before the grand jury and the witness should be asked to affirm that the witness understands them.

Although the Court in *Washington* held that “targets” of the grand jury’s investigation are entitled to no special warnings relative to their status as “potential defendant(s),” the Department of Justice continues its longstanding policy to advise witnesses who are known “targets” of the investigation that their conduct is being investigated for possible violation of Federal criminal law. This supplemental advice of status of the witness as a target should be repeated on the record when the target witness is advised of the matters discussed in the preceding paragraphs.

When a district court insists that the notice of rights not be appended to a grand jury subpoena, the advice of rights may be set forth in a separate letter and mailed to or handed to the witness when the subpoena is served.

Advice of Rights

- The grand jury is conducting an investigation of possible violations of Federal criminal laws involving: (State here the general subject matter of inquiry, e.g., conducting an illegal gambling business in violation of 18 U.S.C. § 1955).
- You may refuse to answer any question if a truthful answer to the question would tend to incriminate you.
- Anything that you do say may be used against you by the grand jury or in a subsequent legal proceeding.
- If you have retained counsel, the grand jury will permit you a reasonable opportunity to step outside the grand jury room to consult with counsel if you so desire.

Additional Advice to be Given to Targets: If the witness is a target, the above advice should also contain a supplemental warning that the witness’s conduct is being investigated for possible violation of federal criminal law.

9-11.152. Requests by Subjects and Targets to Testify Before the Grand Jury

It is not altogether uncommon for subjects or targets of the grand jury’s investigation, particularly in white-collar cases, to request or demand the opportunity to tell the grand jury their side of the story. While the prosecutor has no legal obligation to permit such

witnesses to testify, *United States v. Leverage Funding System, Inc.*; *United States v. Gardner*, a refusal to do so can create the appearance of unfairness. Accordingly, under normal circumstances, where no burden upon the grand jury or delay of its proceedings is involved, reasonable requests by a “subject” or “target” of an investigation, as defined above, to testify personally before the grand jury ordinarily should be given favorable consideration, provided that such witness explicitly waives his or her privilege against self-incrimination, on the record before the grand jury, and is represented by counsel or voluntarily and knowingly appears without counsel and consents to full examination under oath.

Such witnesses may wish to supplement their testimony with the testimony of others. The decision whether to accommodate such requests or to reject them after listening to the testimony of the target or the subject, or to seek statements from the suggested witnesses, is a matter left to the sound discretion of the grand jury. When passing on such requests, it must be kept in mind that the grand jury was never intended to be and is not properly either an adversary proceeding or the arbiter of guilt or innocence. *See, e.g., United States v. Calandra.*

9-11.153. Notification of Targets

When a target is not called to testify pursuant to USAM 9-11.150, and does not request to testify on his or her own motion (see USAM 9-11.152), the prosecutor, in appropriate cases, is encouraged to notify such person a reasonable time before seeking an indictment in order to afford him or her an opportunity to testify before the grand jury, subject to the conditions set forth in USAM 9-11.152. Notification would not be appropriate in routine clear cases or when such action might jeopardize the investigation or prosecution because of the likelihood of flight, destruction or fabrication of evidence, endangerment of other witnesses, undue delay or otherwise would be inconsistent with the ends of justice.

9-11.154. Advance Assertions of an Intention to Claim the Fifth Amendment Privilege Against Compulsory Self-Incrimination

A question frequently faced by Federal prosecutors is how to respond to an assertion by a prospective grand jury witness that if called to testify the witness will refuse to testify on Fifth Amendment grounds. If a “target” of the investigation and his or her attorney state in writing, signed by both, that the “target” will refuse to testify on Fifth Amendment grounds, the witness ordinarily should be excused from testifying unless the grand jury and the United States Attorney agree to insist on the appearance. In determining the desirability of insisting on the appearance of such a person, consideration should be given to the factors which justified the subpoena in the first place, i.e., the importance of the testimony or other information sought, its unavailability from other sources, and the applicability of the Fifth Amendment privilege to the likely areas of inquiry.

Some argue that unless the prosecutor is prepared to seek an order pursuant to 18 U.S.C. § 6003, the witness should be excused from testifying. However, such a broad rule would be improper and make it too convenient for witnesses to avoid testifying truthfully to their knowledge of relevant facts. Moreover, once compelled to appear, the witness may be willing and able to answer some or all of the grand jury's questions without incriminating himself or herself.

9-11.155. Notification to Targets when Target Status Ends

The United States Attorney has the discretion to notify an individual, who has been the target of a grand jury investigation, that the individual is no longer considered to be a target by the United States Attorney's Office. Such a notification should be provided only by the United States Attorney having cognizance over the grand jury investigation.

Discontinuation of target status may be appropriate when:

- The target previously has been notified by the government that he or she was a target of the investigation; and,
- The criminal investigation involving the target has been discontinued without an indictment being returned charging the target, or the government receives evidence in a continuing investigation that conclusively establishes that target status has ended as to this individual.

There may be other circumstances in which the United States Attorney may exercise discretion to provide such notification such as when government action has resulted in public knowledge of the investigation.

The United States Attorney may decline to issue such notification if the notification would adversely affect the integrity of the investigation or the grand jury process, or for other appropriate reasons. No explanation need be provided for declining such a request.

If the United States Attorney concludes that the notification is appropriate, the language of the notification may be tailored to the particular case. In a particular case, for example, the language of the notification may be drafted to preclude the target from using the notification as a "clean bill of health" or testimonial.

The delivering of such a notification to a target or the attorney for the target shall not preclude the United States Attorney's Office or the grand jury having cognizance over the investigation (or any other grand jury) from reinstituting such an investigation without notification to the target, or the attorney for the target, if, in the opinion of that or any other grand jury, or any United States Attorney's Office, circumstances warrant such a reinstitution. . . .

9-11.233. Presentation of Exculpatory Evidence

In *United States v. Williams*, the Supreme Court held that the Federal courts' supervisory powers over the grand jury did not include the power to make a rule allowing the

dismissal of an otherwise valid indictment where the prosecutor failed to introduce substantial exculpatory evidence to a grand jury. It is the policy of the Department of Justice, however, that when a prosecutor conducting a grand jury inquiry is personally aware of substantial evidence that directly negates the guilt of a subject of the investigation, the prosecutor must present or otherwise disclose such evidence to the grand jury before seeking an indictment against such a person. While a failure to follow the Department's policy should not result in dismissal of an indictment, appellate courts may refer violations of the policy to the Office of Professional Responsibility for review.

C. The Judicial Branch and the Grand Jury

The following case deals with the question of how bad things have to get for a court to actually dismiss a case because of misconduct by the government in the grand jury. Why is the scope of judicial review of such grand jury-related conduct not broader?

BANK OF NOVA SCOTIA v. UNITED STATES, 487 U.S. 250 (1988)

Justice KENNEDY delivered the opinion of the Court.

The issue presented is whether a district court may invoke its supervisory power to dismiss an indictment for prosecutorial misconduct in a grand jury investigation, where the misconduct does not prejudice the defendants.

In 1982, after a 20-month investigation conducted before two successive grand juries, eight defendants, including petitioners William A. Kilpatrick, Declan J. O'Donnell, Sheila C. Lerner, and The Bank of Nova Scotia, were indicted on 27 counts. The first 26 counts charged all defendants with conspiracy and some of them with mail and tax fraud. Count 27 charged Kilpatrick with obstruction of justice. . . .

We hold that, as a general matter, a district court may not dismiss an indictment for errors in grand jury proceedings unless such errors prejudiced the defendants.

In the exercise of its supervisory authority, a federal court "may, within limits, formulate procedural rules not specifically required by the Constitution or the Congress." *United States v. Hasting*. Nevertheless, it is well established that "[e]ven a sensible and efficient use of the supervisory power . . . is invalid if it conflicts with constitutional or statutory provisions." *Thomas v. Arn*. To allow otherwise "would confer on the judiciary discretionary power to disregard the considered limitations of the law it is charged with enforcing." *United States v. Payner*. Our previous cases have not addressed explicitly whether this rationale bars exercise of a supervisory authority where, as here, dismissal of the indictment would conflict with the harmless-error inquiry mandated by the Federal Rules of Criminal Procedure.

We now hold that a federal court may not invoke supervisory power to circumvent the harmless-error inquiry prescribed by Federal Rule of Criminal Procedure 52(a). Rule 52(a) provides that "[a]ny error, defect, irregularity or variance which does not affect substantial rights shall be disregarded." The Rule was promulgated pursuant to 18 U.S.C.

§ 687 (1946 ed.) (currently codified, as amended, at 18 U.S.C. § 3771), which invested us with authority “to prescribe, from time to time, rules of pleading, practice, and procedure with respect to any or all proceedings prior to and including verdict. . . .” Like its present-day successor, § 687 provided that after a Rule became effective “all laws in conflict therewith shall be of no further force and effect.” It follows that Rule 52 is, in every pertinent respect, as binding as any statute duly enacted by Congress, and federal courts have no more discretion to disregard the Rule’s mandate than they do to disregard constitutional or statutory provisions. The balance struck by the Rule between societal costs and the rights of the accused may not casually be overlooked “because a court has elected to analyze the question under the supervisory power.” *United States v. Payner*. . . .

Having concluded that our customary harmless-error inquiry is applicable where, as in the cases before us, a court is asked to dismiss an indictment prior to the conclusion of the trial, we turn to the standard of prejudice that courts should apply in assessing such claims. We adopt for this purpose, at least where dismissal is sought for nonconstitutional error, the standard articulated by Justice O’CONNOR in her concurring opinion in *United States v. Mechanik*. Under this standard, dismissal of the indictment is appropriate only “if it is established that the violation substantially influenced the grand jury’s decision to indict,” or if there is “grave doubt” that the decision to indict was free from the substantial influence of such violations. *United States v. Mechanik*. . . .

To be distinguished from the cases before us are a class of cases in which indictments are dismissed, without a particular assessment of the prejudicial impact of the errors in each case, because the errors are deemed fundamental. These cases may be explained as isolated exceptions to the harmless-error rule. We think, however, that an alternative and more clear explanation is that these cases are ones in which the structural protections of the grand jury have been so compromised as to render the proceedings fundamentally unfair, allowing the presumption of prejudice. *See Rose v. Clark*. These cases are exemplified by *Vasquez v. Hillery*, where we held that racial discrimination in selection of grand jurors compelled dismissal of the indictment. In addition to involving an error of constitutional magnitude, other remedies were impractical and it could be presumed that a discriminatorily selected grand jury would treat defendants unfairly. *See United States v. Mechanik*. We reached a like conclusion in *Ballard v. United States*, where women had been excluded from the grand jury. The nature of the violation allowed a presumption that the defendant was prejudiced, and any inquiry into harmless error would have required unguided speculation. Such considerations are not presented here, and we review the alleged errors to assess their influence, if any, on the grand jury’s decision to indict in the factual context of the cases before us.

Though the standard we have articulated differs from that used by the Court of Appeals, we reach the same conclusion and affirm its decision reversing the order of dismissal. We review the record to set forth the basis of our agreement with the Court of Appeals that prejudice has not been established.

The District Court found that the Government had violated Federal Rule of Criminal Procedure 6(e) by: (1) disclosing grand jury materials to Internal Revenue Service employees having civil tax enforcement responsibilities; (2) failing to give the court prompt notice of such disclosures; (3) disclosing to potential witnesses the names of targets of the investigation; and (4) instructing two grand jury witnesses, who had represented some of the defendants in a separate investigation of the same tax shelters, that they were not to reveal the substance of their testimony or that they had testified before the grand jury. The court also found that the Government had violated Federal Rule of Criminal Procedure 6(d) in allowing joint appearances by IRS agents before the grand jury for the purpose of reading transcripts to the jurors.

The District Court further concluded that one of the prosecutors improperly argued with an expert witness during a recess of the grand jury after the witness gave testimony adverse to the Government. It also held that the Government had violated the witness immunity statute, 18 U.S.C. §§ 6002, 6003, by the use of “pocket immunity” (immunity granted on representation of the prosecutor rather than by order of a judge), and that the Government caused IRS agents to mischaracterize testimony given in prior proceedings. Furthermore, the District Court found that the Government violated the Fifth Amendment by calling a number of witnesses for the sole purpose of having them assert their privilege against self-incrimination and that it had violated the Sixth Amendment by conducting postindictment interviews of several high-level employees of The Bank of Nova Scotia. Finally, the court concluded that the Government had caused IRS agents to be sworn as agents of the grand jury, thereby elevating their credibility.

As we have noted, no constitutional error occurred during the grand jury proceedings. The Court of Appeals concluded that the District Court’s findings of Sixth Amendment postindictment violations were unrelated to the grand jury’s independence and decisionmaking process because the alleged violations occurred *after* the indictment. We agree that it was improper for the District Court to cite such matters in dismissing the indictment. The Court of Appeals also found that no Fifth Amendment violation occurred as a result of the Government’s calling seven witnesses to testify despite an avowed intention to invoke their Fifth Amendment privilege. We agree that, in the circumstances of these cases, calling the witnesses was not error. The Government was not required to take at face value the unsworn assertions made by these witnesses outside the grand jury room. Once a witness invoked the privilege on the record, the prosecutors immediately ceased all questioning. Throughout the proceedings, moreover, the prosecution repeated the caution to the grand jury that it was not to draw any adverse inference from a witness’ invocation of the Fifth Amendment.

In the cases before us we do not inquire whether the grand jury’s independence was infringed. Such an infringement may result in grave doubt as to a violation’s effect on the grand jury’s decision to indict, but we did not grant certiorari to review this conclusion. We note that the Court of Appeals found that the prosecution’s conduct was not “a significant infringement on the grand jury’s ability to exercise independent judgment,” and we accept that conclusion here. Finally, we note that we are not faced

with a history of prosecutorial misconduct, spanning several cases, that is so systematic and pervasive as to raise a substantial and serious question about the fundamental fairness of the process which resulted in the indictment.

We must address, however, whether, despite the grand jury's independence, there was any misconduct by the prosecution that otherwise may have influenced substantially the grand jury's decision to indict, or whether there is grave doubt as to whether the decision to indict was so influenced. Several instances of misconduct found by the District Court—that the prosecutors manipulated the grand jury investigation to gather evidence for use in civil audits; violated the secrecy provisions of Rule 6(e) by publicly identifying the targets and the subject matter of the grand jury investigation; and imposed secrecy obligations in violation of Rule 6(e) upon grand jury witnesses—might be relevant to an allegation of a purpose or intent to abuse the grand jury process. Here, however, it is plain that these alleged breaches could not have affected the charging decision. We have no occasion to consider them further.

We are left to consider only the District Court's findings that the prosecutors: (1) fashioned and administered unauthorized "oaths" to IRS agents in violation of Rule 6(c); (2) caused the same IRS agents to "summarize" evidence falsely and to assert incorrectly that all the evidence summarized by them had been presented previously to the grand jury; (3) deliberately berated and mistreated an expert witness for the defense in the presence of some grand jurors; (4) abused its authority by providing "pocket immunity" to 23 grand jury witnesses; and (5) permitted IRS agents to appear in tandem to present evidence to the grand jury in violation of Rule 6(d). We consider each in turn.

The Government administered oaths to IRS agents, swearing them in as "agents" of the grand jury. Although the administration of such oaths to IRS agents by the Government was unauthorized, there is ample evidence that the jurors understood that the agents were aligned with the prosecutors. At various times a prosecutor referred to the agents as "my agent(s)," and, in discussions with the prosecutors, grand jurors referred to the agents as "your guys" or "your agents." There is nothing in the record to indicate that the oaths administered to the IRS agents caused their reliability or credibility to be elevated, and the effect, if any, on the grand jury's decision to indict was negligible.

The District Court found that, to the prejudice of petitioners, IRS agents gave misleading and inaccurate summaries to the grand jury just prior to the indictment. Because the record does not reveal any prosecutorial misconduct with respect to these summaries, they provide no ground for dismissing the indictment. The District Court's finding that the summaries offered by IRS agents contained evidence that had not been presented to the grand jury in prior testimony boils down to a challenge to the reliability or competence of the evidence presented to the grand jury. We have held that an indictment valid on its face is not subject to such a challenge. *United States v. Calandra*. To the extent that a challenge is made to the accuracy of the summaries, the mere fact that evidence itself is unreliable is not sufficient to require a dismissal of the indictment. See *Costello v. United States* (holding that a court may not look behind the indictment to

determine if the evidence upon which it was based is sufficient). In light of the record, the finding that the prosecutors knew the evidence to be false or misleading, or that the Government caused the agents to testify falsely, is clearly erroneous. Although the Government may have had doubts about the accuracy of certain aspects of the summaries, this is quite different from having knowledge of falsity.

The District Court found that a prosecutor was abusive to an expert defense witness during a recess and in the hearing of some grand jurors. Although the Government concedes that the treatment of the expert tax witness was improper, the witness himself testified that his testimony was unaffected by this misconduct. The prosecutors instructed the grand jury to disregard anything they may have heard in conversations between a prosecutor and a witness, and explained to the grand jury that such conversations should have no influence on its deliberations. In light of these ameliorative measures, there is nothing to indicate that the prosecutor's conduct toward this witness substantially affected the grand jury's evaluation of the testimony or its decision to indict.

The District Court found that the Government granted "pocket immunity" to 23 witnesses during the course of the grand jury proceedings. Without deciding the propriety of granting such immunity to grand jury witnesses, we conclude the conduct did not have a substantial effect on the grand jury's decision to indict, and it does not create grave doubt as to whether it affected the grand jury's decision. Some prosecutors told the grand jury that immunized witnesses retained their Fifth Amendment privilege and could refuse to testify, while other prosecutors stated that the witnesses had no Fifth Amendment privilege, but we fail to see how this could have had a substantial effect on the jury's assessment of the testimony or its decision to indict. The significant point is that the jurors were made aware that these witnesses had made a deal with the Government.

Assuming the Government had threatened to withdraw immunity from a witness in order to manipulate that witness' testimony, this might have given rise to a finding of prejudice. There is no evidence in the record, however, that would support such a finding. The Government told a witness' attorney that if the witness "testified for Mr. Kilpatrick, all bets were off." The attorney, however, ultimately concluded that the prosecution did not mean to imply that immunity would be withdrawn if his client testified for Kilpatrick, but rather that his client would be validly subject to prosecution for perjury. Although the District Court found that the Government's statement was interpreted by the witness to mean that if he testified favorably for Kilpatrick his immunity would be withdrawn, neither Judge Winner nor Judge Kane made a definitive finding that the Government improperly threatened the witness. The witness may have felt threatened by the prosecutor's statement, but his subjective fear cannot be ascribed to governmental misconduct and was, at most, a consideration bearing on the reliability of his testimony.

Finally, the Government permitted two IRS agents to appear before the grand jury at the same time for the purpose of reading transcripts. Although allowing the agents to read to the grand jury in tandem was a violation of Rule 6(d), it was not prejudicial. The agents gave no testimony of their own during the reading of the transcripts. The grand jury was instructed not to ask any questions and the agents were instructed not to answer any questions during the readings. There is no evidence that the agents' reading in tandem enhanced the credibility of the testimony or otherwise allowed the agents to exercise undue influence.

In considering the prejudicial effect of the foregoing instances of alleged misconduct, we note that these incidents occurred as isolated episodes in the course of a 20-month investigation, an investigation involving dozens of witnesses and thousands of documents. In view of this context, those violations that did occur do not, even when considered cumulatively, raise a substantial question, much less a grave doubt, as to whether they had a substantial effect on the grand jury's decision to charge.

Errors of the kind alleged in these cases can be remedied adequately by means other than dismissal. For example, a knowing violation of Rule 6 may be punished as a contempt of court. *See* Fed. Rule Crim. Proc. 6(e)(2). In addition, the court may direct a prosecutor to show cause why he should not be disciplined and request the bar or the Department of Justice to initiate disciplinary proceedings against him. The court may also chastise the prosecutor in a published opinion. Such remedies allow the court to focus on the culpable individual rather than granting a windfall to the unprejudiced defendant.

We conclude that the District Court had no authority to dismiss the indictment on the basis of prosecutorial misconduct absent a finding that petitioners were prejudiced by such misconduct. The prejudicial inquiry must focus on whether any violations had an effect on the grand jury's decision to indict. If violations did substantially influence this decision, or if there is grave doubt that the decision to indict was free from such substantial influence, the violations cannot be deemed harmless. The record will not support the conclusion that petitioners can meet this standard. The judgment of the Court of Appeals is affirmed.

This next case addresses the grand jury's subpoena power and the limited basis on which one can challenge such a subpoena and try to resist compliance.

UNITED STATES v. R. ENTERPRISES, INC., 498 U.S. 292 (1991)

Justice O'CONNOR delivered the opinion of the Court.

This case requires the Court to decide what standards apply when a party seeks to avoid compliance with a subpoena *duces tecum* issued in connection with a grand jury investigation.

Since 1986, a federal grand jury sitting in the Eastern District of Virginia has been investigating allegations of interstate transportation of obscene materials. In early 1988,

the grand jury issued a series of subpoenas to three companies—Model Magazine Distributors, Inc. (Model), R. Enterprises, Inc., and MFR Court Street Books, Inc. (MFR). Model is a New York distributor of sexually oriented paperback books, magazines, and videotapes. R. Enterprises, which distributes adult materials, and MFR, which sells books, magazines, and videotapes, are also based in New York. All three companies are wholly owned by Martin Rothstein. The grand jury subpoenas sought a variety of corporate books and records and, in Model's case, copies of 193 videotapes that Model had shipped to retailers in the Eastern District of Virginia. All three companies moved to quash the subpoenas, arguing that the subpoenas called for production of materials irrelevant to the grand jury's investigation and that the enforcement of the subpoenas would likely infringe their First Amendment rights. . . .

The grand jury occupies a unique role in our criminal justice system. It is an investigatory body charged with the responsibility of determining whether or not a crime has been committed. Unlike this Court, whose jurisdiction is predicated on a specific case or controversy, the grand jury "can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not." *United States v. Morton Salt Co.* The function of the grand jury is to inquire into all information that might possibly bear on its investigation until it has identified an offense or has satisfied itself that none has occurred. As a necessary consequence of its investigatory function, the grand jury paints with a broad brush. "A grand jury investigation 'is not fully carried out until every available clue has been run down and all witnesses examined in every proper way to find if a crime has been committed.'" *Branzburg v. Hayes*, (quoting *United States v. Stone*).

A grand jury subpoena is thus much different from a subpoena issued in the context of a prospective criminal trial, where a specific offense has been identified and a particular defendant charged. "[T]he identity of the offender, and the precise nature of the offense, if there be one, normally are developed at the conclusion of the grand jury's labors, not at the beginning." *Blair v. United States*. In short, the Government cannot be required to justify the issuance of a grand jury subpoena by presenting evidence sufficient to establish probable cause because the very purpose of requesting the information is to ascertain whether probable cause exists. See *Hale v. Henkel*.

This Court has emphasized on numerous occasions that many of the rules and restrictions that apply at a trial do not apply in grand jury proceedings. This is especially true of evidentiary restrictions. The same rules that, in an adversary hearing on the merits, may increase the likelihood of accurate determinations of guilt or innocence do not necessarily advance the mission of a grand jury, whose task is to conduct an *ex parte* investigation to determine whether or not there is probable cause to prosecute a particular defendant. In *Costello v. United States*, this Court declined to apply the rule against hearsay to grand jury proceedings. Strict observance of trial rules in the context of a grand jury's preliminary investigation "would result in interminable delay but add nothing to the assurance of a fair trial." In *United States v. Calandra*, we held that the Fourth Amendment exclusionary rule does not apply to grand jury proceedings.

Permitting witnesses to invoke the exclusionary rule would “delay and disrupt grand jury proceedings” by requiring adversary hearings on peripheral matters, and would effectively transform such proceedings into preliminary trials on the merits. The teaching of the Court’s decisions is clear: A grand jury “may compel the production of evidence or the testimony of witnesses as it considers appropriate, and its operation generally is unrestrained by the technical procedural and evidentiary rules governing the conduct of criminal trials.”

This guiding principle renders suspect the Court of Appeals’ holding that the standards announced in *Nixon* as to subpoenas issued in anticipation of trial apply equally in the grand jury context. The multifactor test announced in *Nixon* would invite procedural delays and detours while courts evaluate the relevancy and admissibility of documents sought by a particular subpoena. We have expressly stated that grand jury proceedings should be free of such delays. “Any holding that would saddle a grand jury with minitrials and preliminary showings would assuredly impede its investigation and frustrate the public’s interest in the fair and expeditious administration of the criminal laws.” *United States v. Dionisio. Accord, Calandra*. Additionally, application of the *Nixon* test in this context ignores that grand jury proceedings are subject to strict secrecy requirements. *See* Fed. Rule Crim. Proc. 6(e). Requiring the Government to explain in too much detail the particular reasons underlying a subpoena threatens to compromise “the indispensable secrecy of grand jury proceedings.” *United States v. Johnson*. Broad disclosure also affords the targets of investigation far more information about the grand jury’s internal workings than the Federal Rules of Criminal Procedure appear to contemplate.

The investigatory powers of the grand jury are nevertheless not unlimited. *See Branzburg; Calandra*. Grand juries are not licensed to engage in arbitrary fishing expeditions, nor may they select targets of investigation out of malice or an intent to harass. In this case, the focus of our inquiry is the limit imposed on a grand jury by Federal Rule of Criminal Procedure 17(c), which governs the issuance of subpoenas *duces tecum* in federal criminal proceedings. The Rule provides that “[t]he court on motion made promptly may quash or modify the subpoena if compliance would be unreasonable or oppressive.”

This standard is not self-explanatory. As we have observed, “what is reasonable depends on the context.” *New Jersey v. T.L.O.* In *Nixon*, this Court defined what is reasonable in the context of a jury trial. We determined that, in order to require production of information prior to trial, a party must make a reasonably specific request for information that would be both relevant and admissible at trial. But, for the reasons we have explained above, the *Nixon* standard does not apply in the context of grand jury proceedings. In the grand jury context, the decision as to what offense will be charged is routinely not made until after the grand jury has concluded its investigation. One simply cannot know in advance whether information sought during the investigation will be relevant and admissible in a prosecution for a particular offense.

To the extent that Rule 17(c) imposes some reasonableness limitation on grand jury subpoenas, however, our task is to define it. In doing so, we recognize that a party to whom a grand jury subpoena is issued faces a difficult situation. As a rule, grand juries do not announce publicly the subjects of their investigations. A party who desires to challenge a grand jury subpoena thus may have no conception of the Government's purpose in seeking production of the requested information. Indeed, the party will often not know whether he or she is a primary target of the investigation or merely a peripheral witness. Absent even minimal information, the subpoena recipient is likely to find it exceedingly difficult to persuade a court that "compliance would be unreasonable." As one pair of commentators has summarized it, the challenging party's "unenviable task is to seek to persuade the court that the subpoena that has been served on [him or her] could not possibly serve any investigative purpose that the grand jury could legitimately be pursuing." 1 S. Beale & W. Bryson, *Grand Jury Law and Practice* § 6:28 (1986).

Our task is to fashion an appropriate standard of reasonableness, one that gives due weight to the difficult position of subpoena recipients but does not impair the strong governmental interests in affording grand juries wide latitude, avoiding minitrials on peripheral matters, and preserving a necessary level of secrecy. We begin by reiterating that the law presumes, absent a strong showing to the contrary, that a grand jury acts within the legitimate scope of its authority. *See United States v. Mechanik* ("The grand jury proceeding is accorded a presumption of regularity, which generally may be dispelled only upon particularized proof of irregularities in the grand jury process"). *See also Hamling v. United States; United States v. Johnson*. Consequently, a grand jury subpoena issued through normal channels is presumed to be reasonable, and the burden of showing unreasonableness must be on the recipient who seeks to avoid compliance. Indeed, this result is indicated by the language of Rule 17(c), which permits a subpoena to be quashed only "on motion" and "if *compliance* would be unreasonable." To the extent that the Court of Appeals placed an initial burden on the Government, it committed error. Drawing on the principles articulated above, we conclude that where, as here, a subpoena is challenged on relevancy grounds, the motion to quash must be denied unless the district court determines that there is no reasonable possibility that the category of materials the Government seeks will produce information relevant to the general subject of the grand jury's investigation. Respondents did not challenge the subpoenas as being too indefinite nor did they claim that compliance would be overly burdensome. *See App. in In re Grand Jury 87-3 Subpoena Duces Tecum*. The Court of Appeals accordingly did not consider these aspects of the subpoenas, nor do we.

It seems unlikely, of course, that a challenging party who does not know the general subject matter of the grand jury's investigation, no matter how valid that party's claim, will be able to make the necessary showing that compliance would be unreasonable. After all, a subpoena recipient "cannot put his whole life before the court in order to show that there is no crime to be investigated," *Marston's, Inc. v. Strand*. Consequently, a court may be justified in a case where unreasonableness is alleged in requiring the Government to reveal the general subject of the grand jury's investigation before requiring the challenging party to carry its burden of persuasion. We need not resolve

this question in the present case, however, as there is no doubt that respondents knew the subject of the grand jury investigation pursuant to which the business records subpoenas were issued. In cases where the recipient of the subpoena does not know the nature of the investigation, we are confident that district courts will be able to craft appropriate procedures that balance the interests of the subpoena recipient against the strong governmental interests in maintaining secrecy, preserving investigatory flexibility, and avoiding procedural delays. For example, to ensure that subpoenas are not routinely challenged as a form of discovery, a district court may require that the Government reveal the subject of the investigation to the trial court *in camera*, so that the court may determine whether the motion to quash has a reasonable prospect for success before it discloses the subject matter to the challenging party.

Applying these principles in this case demonstrates that the District Court correctly denied respondents' motions to quash. It is undisputed that all three companies—Model, R. Enterprises, and MFR—are owned by the same person, that all do business in the same area, and that one of the three, Model, has shipped sexually explicit materials into the Eastern District of Virginia. The District Court could have concluded from these facts that there was a reasonable possibility that the business records of R. Enterprises and MFR would produce information relevant to the grand jury's investigation into the interstate transportation of obscene materials. Respondents' blanket denial of any connection to Virginia did not suffice to render the District Court's conclusion invalid. A grand jury need not accept on faith the self-serving assertions of those who may have committed criminal acts. Rather, it is entitled to determine for itself whether a crime has been committed. *See Morton Salt Co.*

Both in the District Court and in the Court of Appeals, respondents contended that these subpoenas sought records relating to First Amendment activities, and that this required the Government to demonstrate that the records were particularly relevant to its investigation. The Court of Appeals determined that the subpoenas did not satisfy Rule 17(c) and thus did not pass on the First Amendment issue. We express no view on this issue and leave it to be resolved by the Court of Appeals.

The judgment is reversed insofar as the Court of Appeals quashed the subpoenas issued to R. Enterprises and MFR, and the case is remanded for further proceedings consistent with this opinion.

The next case deals with the question of whether the prosecutor must present exculpatory evidence to the grand jury as a matter of constitutional law (as opposed to the requirements of professional or internal DOJ rules). If not, why not?

UNITED STATES v. WILLIAMS, 504 U.S. 36 (1992)

Justice SCALIA delivered the opinion of the Court.

The question presented in this case is whether a district court may dismiss an otherwise valid indictment because the Government failed to disclose to the grand jury “substantial exculpatory evidence” in its possession.

On May 4, 1988, respondent John H. Williams, Jr., a Tulsa, Oklahoma, investor, was indicted by a federal grand jury on seven counts of “knowingly mak[ing] [a] false statement or report . . . for the purpose of influencing . . . the action [of a federally insured financial institution],” in violation of 18 U.S.C. § 1014 (1988 ed., Supp. II). According to the indictment, between September 1984 and November 1985 Williams supplied four Oklahoma banks with “materially false” statements that variously overstated the value of his current assets and interest income in order to influence the banks’ actions on his loan requests.

Williams’ misrepresentation was allegedly effected through two financial statements provided to the banks, a “Market Value Balance Sheet” and a “Statement of Projected Income and Expense.” The former included as “current assets” approximately \$6 million in notes receivable from three venture capital companies. Though it contained a disclaimer that these assets were carried at cost rather than at market value, the Government asserted that listing them as “current assets”—*i.e.*, assets quickly reducible to cash—was misleading, since Williams knew that none of the venture capital companies could afford to satisfy the notes in the short term. The second document—the Statement of Projected Income and Expense—allegedly misrepresented Williams’ interest income, since it failed to reflect that the interest payments received on the notes of the venture capital companies were funded entirely by Williams’ own loans to those companies. The Statement thus falsely implied, according to the Government, that Williams was deriving interest income from “an independent outside source.”

Shortly after arraignment, the District Court granted Williams’ motion for disclosure of all exculpatory portions of the grand jury transcripts. *See Brady v. Maryland*. Upon reviewing this material, Williams demanded that the District Court dismiss the indictment, alleging that the Government had failed to fulfill its obligation under the Tenth Circuit’s prior decision in *United States v. Page* to present “substantial exculpatory evidence” to the grand jury. His contention was that evidence which the Government had chosen not to present to the grand jury—in particular, Williams’ general ledgers and tax returns, and Williams’ testimony in his contemporaneous Chapter 11 bankruptcy proceeding—disclosed that, for tax purposes and otherwise, he had regularly accounted for the “notes receivable” (and the interest on them) in a manner consistent with the Balance Sheet and the Income Statement. This, he contended, belied an intent to mislead the banks, and thus directly negated an essential element of the charged offense. . . .

Respondent does not contend that the Fifth Amendment itself obliges the prosecutor to disclose substantial exculpatory evidence in his possession to the grand jury. Instead, building on our statement that the federal courts “may, within limits, formulate procedural rules not specifically required by the Constitution or the Congress,” *United States v. Hasting*, he argues that imposition of the Tenth Circuit’s disclosure rule is supported by the courts’ “supervisory power.” We think not. *Hasting*, and the cases that rely upon the principle it expresses, deal strictly with the courts’ power to control their own procedures. See, e.g., *Jencks v. United States*; *McNabb v. United States*. That power has been applied not only to improve the truth-finding process of the trial, see, e.g., *Mesarosh v. United States*, but also to prevent parties from reaping benefit or incurring harm from violations of substantive or procedural rules (imposed by the Constitution or laws) governing matters apart from the trial itself, see, e.g., *Weeks v. United States*. Thus, *Bank of Nova Scotia v. United States*, makes clear that the supervisory power can be used to dismiss an indictment because of misconduct before the grand jury, at least where that misconduct amounts to a violation of one of those “few, clear rules which were carefully drafted and approved by this Court and by Congress to ensure the integrity of the grand jury’s functions,” *United States v. Mechanik*.

We did not hold in *Bank of Nova Scotia*, however, that the courts’ supervisory power could be used, not merely as a means of enforcing or vindicating legally compelled standards of prosecutorial conduct before the grand jury, but as a means of *prescribing* those standards of prosecutorial conduct in the first instance—just as it may be used as a means of establishing standards of prosecutorial conduct before the courts themselves. It is this latter exercise that respondent demands. Because the grand jury is an institution separate from the courts, over whose functioning the courts do not preside, we think it clear that, as a general matter at least, no such “supervisory” judicial authority exists, and that the disclosure rule applied here exceeded the Tenth Circuit’s authority.

“[R]ooted in long centuries of Anglo-American history,” *Hannah v. Larche*, the grand jury is mentioned in the Bill of Rights, but not in the body of the Constitution. It has not been textually assigned, therefore, to any of the branches described in the first three Articles. It “is a constitutional fixture in its own right.” *United States v. Chanen* (quoting *Nixon v. Sirica*). In fact the whole theory of its function is that it belongs to no branch of the institutional Government, serving as a kind of buffer or referee between the Government and the people. See *Stirone v. United States*; *Hale v. Henkel*; G. Edwards, *The Grand Jury* (1906). Although the grand jury normally operates, of course, in the courthouse and under judicial auspices, its institutional relationship with the Judicial Branch has traditionally been, so to speak, at arm’s length. Judges’ direct involvement in the functioning of the grand jury has generally been confined to the constitutive one of calling the grand jurors together and administering their oaths of office. See *United States v. Calandra*; Fed. Rule Crim. Proc. 6(a).

The grand jury’s functional independence from the Judicial Branch is evident both in the scope of its power to investigate criminal wrongdoing and in the manner in which that power is exercised. “Unlike [a] [c]ourt, whose jurisdiction is predicated upon a specific

case or controversy, the grand jury ‘can investigate merely on suspicion that the law is being violated, or even because it wants assurance that it is not.’” *United States v. R. Enterprises, Inc.* (quoting *United States v. Morton Salt Co.*). It need not identify the offender it suspects, or even “the precise nature of the offense” it is investigating. *Blair v. United States*. The grand jury requires no authorization from its constituting court to initiate an investigation, *see Hale*, nor does the prosecutor require leave of court to seek a grand jury indictment. And in its day-to-day functioning, the grand jury generally operates without the interference of a presiding judge. *See Calandra*. It swears in its own witnesses, Fed. Rule Crim. Proc. 6(c), and deliberates in total secrecy, *see United States v. Sells Engineering, Inc.*

True, the grand jury cannot compel the appearance of witnesses and the production of evidence, and must appeal to the court when such compulsion is required. *See, e.g., Brown v. United States*. And the court will refuse to lend its assistance when the compulsion the grand jury seeks would override rights accorded by the Constitution, *see, e.g., Gravel v. United States* (grand jury subpoena effectively qualified by order limiting questioning so as to preserve Speech or Debate Clause immunity), or even testimonial privileges recognized by the common law, *see In re Grand Jury Investigation of Hugle* (same with respect to privilege for confidential marital communications). Even in this setting, however, we have insisted that the grand jury remain “free to pursue its investigations unhindered by external influence or supervision so long as it does not trench upon the legitimate rights of any witness called before it.” *United States v. Dionisio*. Recognizing this tradition of independence, we have said that the Fifth Amendment’s “constitutional guarantee *presupposes* an investigative body ‘acting independently of either prosecuting attorney *or judge*’”. . . (quoting *Stirone*).

No doubt in view of the grand jury proceeding’s status as other than a constituent element of a “criminal prosecutio[n],” U.S. Const., Amdt. 6, we have said that certain constitutional protections afforded defendants in criminal proceedings have no application before that body. The Double Jeopardy Clause of the Fifth Amendment does not bar a grand jury from returning an indictment when a prior grand jury has refused to do so. *See Ex parte United States; United States v. Thompson*. We have twice suggested, though not held, that the Sixth Amendment right to counsel does not attach when an individual is summoned to appear before a grand jury, even if he is the subject of the investigation. *See United States v. Mandujano; In re Groban; see also* Fed. Rule Crim. Proc. 6(d). And although “the grand jury may not force a witness to answer questions in violation of [the Fifth Amendment’s] constitutional guarantee” against self-incrimination, *Calandra* (citing *Kastigar v. United States*), our cases suggest that an indictment obtained through the use of evidence previously obtained in violation of the privilege against self-incrimination “is nevertheless valid.” *Calandra; see Lawn v. United States; United States v. Blue*.

Given the grand jury’s operational separateness from its constituting court, it should come as no surprise that we have been reluctant to invoke the judicial supervisory power as a basis for prescribing modes of grand jury procedure. Over the years, we have

received many requests to exercise supervision over the grand jury's evidence-taking process, but we have refused them all, including some more appealing than the one presented today. In *United States v. Calandra*, a grand jury witness faced questions that were allegedly based upon physical evidence the Government had obtained through a violation of the Fourth Amendment; we rejected the proposal that the exclusionary rule be extended to grand jury proceedings, because of "the potential injury to the historic role and functions of the grand jury." In *Costello v. United States*, we declined to enforce the hearsay rule in grand jury proceedings, since that "would run counter to the whole history of the grand jury institution, in which laymen conduct their inquiries unfettered by technical rules."

These authorities suggest that any power federal courts may have to fashion, on their own initiative, rules of grand jury procedure is a very limited one, not remotely comparable to the power they maintain over their own proceedings. See *United States v. Chanen*. It certainly would not permit judicial reshaping of the grand jury institution, substantially altering the traditional relationships between the prosecutor, the constituting court, and the grand jury itself. Cf., e.g., *United States v. Payner* (supervisory power may not be applied to permit defendant to invoke third party's Fourth Amendment rights); see generally Beale, *Reconsidering Supervisory Power in Criminal Cases: Constitutional and Statutory Limits on the Authority of the Federal Courts*, 84 COLUM. L. REV. (1984). As we proceed to discuss, that would be the consequence of the proposed rule here.

Respondent argues that the Court of Appeals' rule can be justified as a sort of Fifth Amendment "common law," a necessary means of assuring the constitutional right to the judgment "of an independent and informed grand jury," *Wood v. Georgia*. Respondent makes a generalized appeal to functional notions: Judicial supervision of the quantity and quality of the evidence relied upon by the grand jury plainly facilitates, he says, the grand jury's performance of its twin historical responsibilities, i.e., bringing to trial those who may be justly accused and shielding the innocent from unfounded accusation and prosecution. See, e.g., *Stirone v. United States*. We do not agree. The rule would neither preserve nor enhance the traditional functioning of the institution that the Fifth Amendment demands. To the contrary, requiring the prosecutor to present exculpatory as well as inculpatory evidence would alter the grand jury's historical role, transforming it from an accusatory to an adjudicatory body.

It is axiomatic that the grand jury sits not to determine guilt or innocence, but to assess whether there is adequate basis for bringing a criminal charge. See *United States v. Calandra*. That has always been so; and to make the assessment it has always been thought sufficient to hear only the prosecutor's side. As Blackstone described the prevailing practice in 18th-century England, the grand jury was "only to hear evidence on behalf of the prosecution[,] for the finding of an indictment is only in the nature of an enquiry or accusation, which is afterwards to be tried and determined." 4 W. Blackstone, *Commentaries* (1769); see also 2 M. Hale, *Pleas of the Crown* (1st Am. ed. 1847). So also in the United States. According to the description of an early American

court, three years before the Fifth Amendment was ratified, it is the grand jury's function not "to enquire . . . upon what foundation [the charge may be] denied," or otherwise to try the suspect's defenses, but only to examine "upon what foundation [the charge] is made" by the prosecutor. *Respublica v. Shaffer*; see also F. Wharton, *Criminal Pleading and Practice* § 360 (8th ed. 1880). As a consequence, neither in this country nor in England has the suspect under investigation by the grand jury ever been thought to have a right to testify or to have exculpatory evidence presented. See 2 Hale; *United States ex rel. McCann v. Thompson*.

Imposing upon the prosecutor a legal obligation to present exculpatory evidence in his possession would be incompatible with this system. If a "balanced" assessment of the entire matter is the objective, surely the first thing to be done—rather than requiring the prosecutor to say what he knows in defense of the target of the investigation—is to entitle the target to tender his own defense. To require the former while denying (as we do) the latter would be quite absurd. It would also be quite pointless, since it would merely invite the target to circumnavigate the system by delivering his exculpatory evidence to the prosecutor, whereupon it would *have* to be passed on to the grand jury—unless the prosecutor is willing to take the chance that a court will not deem the evidence important enough to qualify for mandatory disclosure. See, e.g., *United States v. Law Firm of Zimmerman & Schwartz, P.C.* (duty to disclose exculpatory evidence held satisfied when prosecution tendered to the grand jury defense-provided exhibits, testimony, and explanations of the governing law). *United States v. Brown*.

Respondent acknowledges (as he must) that the "common law" of the grand jury is not violated if the *grand jury itself* chooses to hear no more evidence than that which suffices to convince it an indictment is proper. Cf. *Thompson*. Thus, had the Government offered to familiarize the grand jury in this case with the five boxes of financial statements and deposition testimony alleged to contain exculpatory information, and had the grand jury rejected the offer as pointless, respondent would presumably agree that the resulting indictment would have been valid. Respondent insists, however, that courts must require the modern prosecutor to alert the grand jury to the nature and extent of the available exculpatory evidence, because otherwise the grand jury "merely functions as an arm of the prosecution." We reject the attempt to convert a nonexistent duty of the grand jury itself into an obligation of the prosecutor. The authority of the prosecutor to seek an indictment has long been understood to be "coterminous with the authority of the grand jury to entertain [the prosecutor's] charges." *United States v. Thompson*. If the grand jury has no obligation to consider all "substantial exculpatory" evidence, we do not understand how the prosecutor can be said to have a binding obligation to present it.

There is yet another respect in which respondent's proposal not only fails to comport with, but positively contradicts, the "common law" of the Fifth Amendment grand jury. Motions to quash indictments based upon the sufficiency of the evidence relied upon by the grand jury were unheard of at common law in England, see, e.g., *People v. Restenblatt*. And the traditional American practice was described by Justice Nelson, riding circuit in 1852, as follows:

No case has been cited, nor have we been able to find any, furnishing an authority for looking into and revising the judgment of the grand jury upon the evidence, for the purpose of determining whether or not the finding was founded upon sufficient proof, or whether there was a deficiency in respect to any part of the complaint. . . . *United States v. Reed*.

We accepted Justice Nelson’s description in *Costello v. United States*, where we held that “[i]t would run counter to the whole history of the grand jury institution” to permit an indictment to be challenged “on the ground that there was inadequate or incompetent evidence before the grand jury.” And we reaffirmed this principle recently in *Bank of Nova Scotia*, where we held that “the mere fact that evidence itself is unreliable is not sufficient to require a dismissal of the indictment,” and that “a challenge to the reliability or competence of the evidence presented to the grand jury” will not be heard. It would make little sense, we think, to abstain from reviewing the evidentiary support for the grand jury’s judgment while scrutinizing the sufficiency of the prosecutor’s presentation. A complaint about the quality or adequacy of the evidence can always be recast as a complaint that the prosecutor’s presentation was “incomplete” or “misleading.” Our words in *Costello* bear repeating: Review of facially valid indictments on such grounds “would run counter to the whole history of the grand jury institution[,] [and] [n]either justice nor the concept of a fair trial requires [it].”

Echoing the reasoning of the Tenth Circuit in *United States v. Page*, respondent argues that a rule requiring the prosecutor to disclose exculpatory evidence to the grand jury would, by removing from the docket unjustified prosecutions, save valuable judicial time. That depends, we suppose, upon what the ratio would turn out to be between unjustified prosecutions eliminated and grand jury indictments challenged—for the latter as well as the former consume “valuable judicial time.” We need not pursue the matter; if there is an advantage to the proposal, Congress is free to prescribe it. For the reasons set forth above, however, we conclude that courts have no authority to prescribe such a duty pursuant to their inherent supervisory authority over their own proceedings. The judgment of the Court of Appeals is accordingly reversed, and the cause is remanded for further proceedings consistent with this opinion. . . .

Problem 11-1

- (a) You are retained to represent Shirley, who comes to your office for an initial interview. Shirley explains that she works as a trader at a medium-sized hedge fund that is privately held and is owned and operated principally by Edgar. Shirley says that she has conducted some trades in the last year, with Edgar's approval, on the basis of tips she sometimes gets from a scientist she met who works in the pharmaceutical industry. Shirley shows you a grand jury subpoena directing her to appear for testimony in two weeks and produce "any and all documents relating to trading in securities related to the pharmaceutical industry." She says, "A guy in a suit handed this to me yesterday" and starts with the question, "What is a grand jury?" Provide Shirley with the most comprehensive legal advice you can supply based upon what you have learned to this point. What are the next questions you would want to ask Shirley in order to further assist her?
- (b) A mock grand jury examination in the classroom can provide some sense of what the grand jury process is like. One or more students can be assigned as the prosecutors to question Shirley. One or more can be assigned to give testimony as Shirley. One or more can be assigned to act as Shirley's lawyer. One can be assigned to act as grand jury foreperson. In preparation, think about what you would ask as the prosecutor, how you would answer as the witness, and how you would advise the witness as her lawyer (if you are Shirley, you will of course need to fill out the facts of the trading situation a bit in your own mind so that you can answer a series of questions).

12. FIFTH AMENDMENT AND INDIVIDUALS

As is well known, the Fifth Amendment to the U.S. Constitution protects one from being made to be a witness against oneself in a criminal case. One might say that there are two major strands of law (and fact pattern) that flow from this basic idea.

One is the area of police interaction with citizens in the interrogation process. Think *Miranda* and mainly street crime. (For the skeptic, this is Fifth Amendment law for poor people who do not have lawyers, make bad decisions about talking to the police, and are often tricked or frightened into providing evidence against themselves.)

The other is the area of immunity grants and testimony before grand juries, at trial, and in other judicial and quasi-judicial contexts. It is the second strand of Fifth Amendment thinking that is most relevant to corporate crime and that this chapter will examine. (For the skeptic, this is Fifth Amendment law for well-off people who have lawyers and negotiate with the government to get something in exchange for waiving their Fifth Amendment rights.)

Why does the Constitution contain this right? What value(s) might it be designed, or interpreted, to further?

A. Constitution, Statutes, and Procedural Options

The government can do what it is not allowed to do under the Constitution as long as it follows the rules set forth in immunity statutes. The idea is that the Fifth Amendment right has been “supplanted”—i.e., not taken away but replaced in full—by the grant of immunity.

U.S. Constitution Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; **nor shall be compelled in any criminal case to be a witness against himself**, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

18 U.S.C. § 6002. Immunity generally

Whenever a witness refuses, on the basis of his privilege against self-incrimination, to testify or provide other information in a proceeding before or ancillary to—

- (1) a court or grand jury of the United States,
- (2) an agency of the United States, or

(3) either House of Congress, a joint committee of the two Houses, or a committee or a subcommittee of either House,

and the person presiding over the proceeding communicates to the witness an order issued under this title, the witness may not refuse to comply with the order on the basis of his privilege against self-incrimination; but no testimony or other information compelled under the order (or any information directly or indirectly derived from such testimony or other information) may be used against the witness in any criminal case, except a prosecution for perjury, giving a false statement, or otherwise failing to comply with the order.

18 U.S.C. § 6003. Court and grand jury proceedings

(a) In the case of any individual who has been or may be called to testify or provide other information at any proceeding before or ancillary to a court of the United States or a grand jury of the United States, the United States district court for the judicial district in which the proceeding is or may be held shall issue, in accordance with subsection (b) of this section, upon the request of the United States attorney for such district, an order requiring such individual to give testimony or provide other information which he refuses to give or provide on the basis of his privilege against self-incrimination, such order to become effective as provided in section 6002 of this title.

(b) A United States attorney may, with the approval of the Attorney General, the Deputy Attorney General, the Associate Attorney General, or any designated Assistant Attorney General or Deputy Assistant Attorney General, request an order under subsection (a) of this section when in his judgment—

(1) the testimony or other information from such individual may be necessary to the public interest; and

(2) such individual has refused or is likely to refuse to testify or provide other information on the basis of his privilege against self-incrimination.

18 U.S.C. § 6005. Congressional proceedings

(a) In the case of any individual who has been or may be called to testify or provide other information at any proceeding before or ancillary to either House of Congress, or any committee, or any subcommittee of either House, or any joint committee of the two Houses, a United States district court shall issue, in accordance with subsection (b) of this section, upon the request of a duly authorized representative of the House of Congress or the committee concerned, an order requiring such individual to give testimony or provide other information which he refuses to give or provide on the basis of his privilege against self-incrimination, such order to become effective as provided in section 6002 of this title.

(b) Before issuing an order under subsection (a) of this section, a United States district court shall find that—

(1) in the case of a proceeding before or ancillary to either House of Congress, the request for such an order has been approved by an affirmative vote of a majority of the Members present of that House;

(2) in the case of a proceeding before or ancillary to a committee or a subcommittee of either House of Congress or a joint committee of both Houses, the request for such an order has been approved by an affirmative vote of two-thirds of the members of the full committee; and

(3) ten days or more prior to the day on which the request for such an order was made, the Attorney General was served with notice of an intention to request the order.

(c) Upon application of the Attorney General, the United States district court shall defer the issuance of any order under subsection (a) of this section for such period, not longer than twenty days from the date of the request for such order, as the Attorney General may specify.

Punishment for contempt is a key part of the framework here, along with the perjury statutes which we have already examined. The idea is to empower the judicial process to acquire truthful testimony (information) by the combined effect of: (1) supplanting the Fifth Amendment right with immunity, (2) getting the witness to tell the truth by threatening perjury charges for false testimony, and (3) preventing the witness from simply refusing to testify. All three are necessary to make the investigative engine run.

18 U.S.C. § 401. Power of Court

A court of the United States shall have power to punish by fine or imprisonment, or both, at its discretion, such contempt of its authority, and none other, as—

(1) Misbehavior of any person in its presence or so near thereto as to obstruct the administration of justice;

(2) Misbehavior of any of its officers in their official transactions;

(3) Disobedience or resistance to its lawful writ, process, order, rule, decree, or command.

18 U.S.C. § 402. Contempt Constituting Crimes

Any person, corporation or association willfully disobeying any lawful writ, process, order, rule, decree, or command of any district court of the United States or any court of the District of Columbia, by doing any act or thing therein, or thereby forbidden, if the act or thing so done be of such character as to constitute also a criminal offense under any statute of the United States or under the laws of any State in which the act was

committed, shall be prosecuted for such contempt as provided in section 3691 of this title and shall be punished by a fine under this title or imprisonment, or both.

. . . in no case shall the fine to be paid to the United States exceed, in case the accused is a natural person, the sum of \$1,000, nor shall such imprisonment exceed the term of six months.

This section shall not be construed to relate to contempts committed in the presence of the court, or so near thereto as to obstruct the administration of justice, nor to contempts committed in disobedience of any lawful writ, process, order, rule, decree, or command entered in any suit or action brought or prosecuted in the name of, or on behalf of, the United States, but the same, and all other cases of contempt not specifically embraced in this section may be punished in conformity to the prevailing usages at law.

Federal Rule of Criminal Procedure 42. Criminal Contempt

(a) DISPOSITION AFTER NOTICE. Any person who commits criminal contempt may be punished for that contempt after prosecution on notice.

(1) *Notice.* The court must give the person notice in open court, in an order to show cause, or in an arrest order. The notice must:

(A) state the time and place of the trial;

(B) allow the defendant a reasonable time to prepare a defense; and

(C) state the essential facts constituting the charged criminal contempt and describe it as such.

(2) *Appointing a Prosecutor.* The court must request that the contempt be prosecuted by an attorney for the government, unless the interest of justice requires the appointment of another attorney. If the government declines the request, the court must appoint another attorney to prosecute the contempt.

(3) *Trial and Disposition.* A person being prosecuted for criminal contempt is entitled to a jury trial in any case in which federal law so provides and must be released or detained as Rule 46 provides. If the criminal contempt involves disrespect toward or criticism of a judge, that judge is disqualified from presiding at the contempt trial or hearing unless the defendant consents. Upon a finding or verdict of guilty, the court must impose the punishment.

(b) SUMMARY DISPOSITION. Notwithstanding any other provision of these rules, the court (other than a magistrate judge) may summarily punish a person who commits criminal contempt in its presence if the judge saw or heard the contemptuous conduct and so certifies; a magistrate judge may summarily punish a person as provided in 28 U.S.C. § 636(e). The contempt order must recite the facts, be signed by the judge, and be filed with the clerk.

The following is an example of an immunity order issued by a United States District Court. Pay careful attention to its language.

**IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA
UNITED STATES OF AMERICA,
Plaintiff,
v.
HUBERT ROTTEVEEL,
Defendant.**

CASE NO. 2:11-CR-00447 WBS

**ORDER PURSUANT TO 18 U.S.C. §§ 6002-6003 GRANTING IMMUNITY
AND REQUIRING TESTIMONY**

NOW, THEREFORE, IT IS ORDERED pursuant to 18 U.S.C. § 6002 that Manuel Romero give testimony or provide other information which he refuses to give or to provide information with respect to the purchase of real property and loan applications and other documentation submitted on his behalf to lending institutions with respect to the charged fraud scheme in the above-referenced case, in this case on the basis of his privilege against self-incrimination as to all matters about which he may be asked to testify in this trial.

IT IS FURTHER ORDERED that no testimony or other information compelled under this order, or any information directly or indirectly derived from such testimony or other information, shall be used against Manuel Romero in any criminal case, except that Manuel Romero shall not be exempted by this order from prosecution for perjury, giving a false statement pursuant to this order, or otherwise failing to comply with this order, and that immunity granted herein is co-extensive with 18 U.S.C. § 6002.

IT IS SO ORDERED

HON. WILLIAM B. SCHUB, United States District Judge

The foregoing constitutional and statutory regime sets up the following sequence for the well-represented individual (let's call her Agnes) who may have criminal exposure in a corporate investigation. Much of this chapter explores in greater depth how the law sets up this sequence through the combined effects of (1) the Fifth Amendment, (2) the immunity statutes, (3) the perjury, obstruction, and false statements statutes, and (4) the contempt laws. A common sequence in a corporate investigation is as follows:

1. A request from government agents or prosecutors for a voluntary interview is conveyed to Agnes through her counsel. Agreeing to answer questions in response will

effect a complete waiver of Agnes's Fifth Amendment privilege, with nothing guaranteed in return.

2. If Agnes refuses to be interviewed without protecting her rights ("invokes the Fifth"), prosecutors may offer to interview Agnes under a "proffer" agreement, which will be discussed further in chapter 16 (a proffer agreement is most commonly a prelude to a cooperation and plea agreement). This agreement would provide Agnes with immunity from direct use of her interview statements against her, but not immunity from her statements being used against her indirectly as leads to other evidence or to contradict or cross-examine Agnes at any later trial (referred to as derivative use). The proffer agreement also provides Agnes no protection against prosecution for any false statements she might make in the interview. If there is any chance that Agnes will be charged and want to contest the case at trial, an interview under such an agreement may make it impossible for her to testify effectively in her own defense.

3. If Agnes refuses to be interviewed under a proffer agreement (continues to rely on her full Fifth Amendment right), the prosecutors will have to decide whether to afford full immunity (use plus derivative use) to Agnes. This can be done by letter agreement (a contract signed by both parties) or by serving Agnes with a grand jury subpoena and then obtaining a court immunity order per the statutory procedure above. Agnes will prefer a court order if she fears prosecution in other jurisdictions because a letter agreement will bind only the prosecutor's office that signed it. Prosecutors will be very hesitant to immunize Agnes if it is early in their investigation and they are not yet sure about Agnes's level of criminal exposure. Taking testimony under derivative use immunity can make later prosecution of a witness very difficult or impossible, as we will see in this chapter.

4. If Agnes testifies or is interviewed under an immunity agreement or order, she can still be prosecuted for perjury, obstruction of justice, and false statements if she lies.

5. In a rare case (usually involving violent organized crime or intense political pressure), Agnes might refuse to testify even in the face of an immunity order. If she does so, she can be held in *civil* contempt by a judge and jailed until such time as she changes her mind and agrees to comply with the order to testify. Furthermore, Agnes can be prosecuted for *criminal* contempt and punished with prison time regardless of whether she relented during civil detention. Civil contempt is not considered punishment but rather a remedy to accomplish compliance with a court order. The act of contempt, however, is also considered a crime warranting punishment.

6. Alternatively, as will be explored in chapter 16, prosecutors with a strong case against Agnes may seek to persuade her to enter into a plea and cooperation agreement under which she would waive her Fifth Amendment privilege and agree to testify in exchange for a guarantee that she will not face any charges beyond limited ones set forth in the agreement.

B. Prosecutorial Conduct

With immunity, we again have an area of enormous prosecutorial power and freedom of decision making. Prosecutors have the ability to apply to the court for immunity, but the court has almost no discretion to deny an immunity application under the statutes, so power to grant immunity *de facto* rests with the prosecutor. Why is this power so significant?

The DOJ has provided additional guidelines for prosecutors seeking to exercise this power. Are there any factors that prosecutors should consider that are not included in the following guidelines?

U.S. DEPARTMENT OF JUSTICE, JUSTICE MANUAL (Excerpts)

9-23.140. Authority to Initiate Immunity Requests

Assistant United States Attorneys, with the approval of the United States Attorney or, in his or her absence, a supervisory Assistant United States Attorney, and Department attorneys, with the approval of an appropriate Assistant Attorney General or Deputy Assistant Attorney General of DOJ, may initiate requests to compel testimony under the use immunity statute.

9-23.210. Decision to Request Immunity—The Public Interest

Section 6003(b) of Title 18, United States Code, authorizes a United States Attorney to request immunity when, in his/her judgment, the testimony or other information that is expected to be obtained from the witness “may be necessary to the public interest.” Some of the factors that should be weighed in making this judgment include:

- A. The importance of the investigation or prosecution to effective enforcement of the criminal laws;
- B. The value of the person’s testimony or information to the investigation or prosecution;
- C. The likelihood of prompt and full compliance with a compulsion order, and the effectiveness of available sanctions if there is no such compliance;
- D. The person’s relative culpability in connection with the offense or offenses being investigated or prosecuted, and his or her criminal history;
- E. The possibility of successfully prosecuting the person prior to compelling his or her testimony;
- F. The likelihood of adverse collateral consequences to the person if he or she testifies under a compulsion order.

These factors are not intended to be all-inclusive or to require a particular decision in a particular case. They are, however, representative of the kinds of factors that should be considered when deciding whether to seek immunity.

9-23.212. Decision to Request Immunity—Conviction Prior to Compulsion

It is preferable as a matter of policy to punish offenders for their criminal conduct prior to compelling them to testify. While this is not feasible in all cases, a successful prosecution of the witness, or obtaining a plea of guilty to at least some of the charges against the witness, will avoid or mitigate arguments of co-defendants made to the court or jury that the witness “cut a deal” with the government to avoid the witness’s own conviction and punishment.

9-23.400. Authorization to Prosecute after Compulsion

After a person has testified or provided information pursuant to a compulsion order—except in the case of act-of-production immunity—an attorney for the government shall not initiate or recommend prosecution of the person for an offense or offenses first disclosed in, or closely related to, such testimony or information without the express written authorization of the Attorney General. Such requests for authorization should be sent to the Assistant Attorney General for the division that issued the letter of authority for requesting the original compulsion order.

The request to prosecute should indicate the circumstances justifying prosecution and the method by which the government will be able to establish that the evidence it will use against the witness will meet the government’s burden under *Kastigar v. United States*.

C. Immunity and the Constitution

The following foundational case explains why the immunity statutes are consistent with the Fifth Amendment right and do not violate the Constitution. In the course of doing that, the case also makes clear what the effect of statutory immunity is. The key to all of this is to understand three terms: (1) transactional immunity, (2) use immunity, and (3) derivative use immunity. In addition, pay careful attention to the Court’s discussion of its prior decision in *Murphy v. Waterfront Commission*.

KASTIGAR v. UNITED STATES, 406 U.S. 441 (1972)

Mr. Justice POWELL delivered the opinion of the Court.

This case presents the question whether the United States Government may compel testimony from an unwilling witness, who invokes the Fifth Amendment privilege against compulsory self-incrimination, by conferring on the witness immunity from use of the compelled testimony in subsequent criminal proceedings, as well as immunity from use of evidence derived from the testimony.

Petitioners were subpoenaed to appear before a United States grand jury in the Central District of California on February 4, 1971. The Government believed that petitioners were likely to assert their Fifth Amendment privilege. Prior to the scheduled appearances, the Government applied to the District Court for an order directing petitioners to answer questions and produce evidence before the grand jury under a grant of immunity conferred pursuant to 18 U.S.C. §§ 6002, 6003. Petitioners opposed issuance of the order, contending primarily that the scope of the immunity provided by the statute was not coextensive with the scope of the privilege against self-incrimination, and therefore was not sufficient to supplant the privilege and compel their testimony. The District Court rejected this contention, and ordered petitioners to appear before the grand jury and answer its questions under the grant of immunity.

Petitioners appeared but refused to answer questions, asserting their privilege against compulsory self-incrimination. They were brought before the District Court, and each persisted in his refusal to answer the grand jury's questions, notwithstanding the grant of immunity. The court found both in contempt, and committed them to the custody of the Attorney General until either they answered the grand jury's questions or the term of the grand jury expired. The Court of Appeals for the Ninth Circuit affirmed. This Court granted certiorari to resolve the important question whether testimony may be compelled by granting immunity from the use of compelled testimony and evidence derived therefrom ('use and derivative use' immunity), or whether it is necessary to grant immunity from prosecution for offenses to which compelled testimony relates ('transactional' immunity).

The power of government to compel persons to testify in court or before grand juries and other governmental agencies is firmly established in Anglo-American jurisprudence. . . . But the power to compel testimony is not absolute. There are a number of exemptions from the testimonial duty, the most important of which is the Fifth Amendment privilege against compulsory self-incrimination. The privilege reflects a complex of our fundamental values and aspirations, and marks an important advance in the development of our liberty. It can be asserted in any proceeding, civil or criminal, administrative or judicial, investigatory or adjudicatory; and it protects against any disclosures which the witness reasonably believes could be used in a criminal prosecution or could lead to other evidence that might be so used. This Court has been zealous to safeguard the values which underlie the privilege.

Immunity statutes, which have historical roots deep in Anglo-American jurisprudence, are not incompatible with these values. Rather, they seek a rational accommodation between the imperatives of the privilege and the legitimate demands of government to compel citizens to testify. The existence of these statutes reflects the importance of testimony, and the fact that many offenses are of such a character that the only persons capable of giving useful testimony are those implicated in the crime. . . . In addition, every State in the Union, as well as the District of Columbia and Puerto Rico, has one or more such statutes. . . .

Petitioners contend, first, that the Fifth Amendment's privilege against compulsory self-incrimination, which is that '(n)o person . . . shall be compelled in any criminal case to be a witness against himself,' deprives Congress of power to enact laws that compel self-incrimination, even if complete immunity from prosecution is granted prior to the compulsion of the incriminatory testimony. In other words, petitioners assert that no immunity statute, however drawn, can afford a lawful basis for compelling incriminatory testimony. They ask us to reconsider and overrule *Brown v. Walker* and *Ullmann v. United States*, decisions that uphold the constitutionality of immunity statutes.

We find no merit to this contention. . . .

Petitioners' second contention is that the scope of immunity provided by the federal witness immunity statute, 18 U.S.C. § 6002, is not coextensive with the scope of the Fifth Amendment privilege against compulsory self-incrimination, and therefore is not sufficient to supplant the privilege and compel testimony over a claim of the privilege. The statute provides that when a witness is compelled by district court order to testify over a claim of the privilege:

'the witness may not refuse to comply with the order on the basis of his privilege against self-incrimination; but no testimony or other information compelled under the order (or any information directly or indirectly derived from such testimony or other information) may be used against the witness in any criminal case, except a prosecution for perjury, giving a false statement, or otherwise failing to comply with the order.' 18 U.S.C. § 6002.

The constitutional inquiry, rooted in logic and history, as well as in the decisions of this Court, is whether the immunity granted under this statute is coextensive with the scope of the privilege. If so, petitioners' refusals to answer based on the privilege were unjustified, and the judgments of contempt were proper, for the grant of immunity has removed the dangers against which the privilege protects. If, on the other hand, the immunity granted is not as comprehensive as the protection afforded by the privilege, petitioners were justified in refusing to answer, and the judgments of contempt must be vacated.

Petitioners draw a distinction between statutes that provide transactional immunity and those that provide, as does the statute before us, immunity from use and derivative use. They contend that a statute must at a minimum grant full transactional immunity in order to be coextensive with the scope of the privilege. In support of this contention, they rely on *Counselman v. Hitchcock*, the first case in which this Court considered a constitutional challenge to an immunity statute. The statute, a reenactment of the Immunity Act of 1868, provided that no 'evidence obtained from a party or witness by means of a judicial proceeding . . . shall be given in evidence, or in any manner used against him . . . in any court of the United States . . .'

Notwithstanding a grant of immunity and order to testify under the revised 1868 Act, the witness, asserting his privilege against compulsory self-incrimination, refused to testify before a federal grand jury. He was consequently adjudged in contempt of court. On appeal, this Court construed the statute as affording a witness protection only against the use of the specific testimony compelled from him under the grant of immunity. This construction meant that the statute ‘could not, and would not, prevent the use of his testimony to search out other testimony to be used in evidence against him.’ Since the revised 1868 Act, as construed by the Court, would permit the use against the immunized witness of evidence derived from his compelled testimony, it did not protect the witness to the same extent that a claim of the privilege would protect him. Accordingly, under the principle that a grant of immunity cannot supplant the privilege, and is not sufficient to compel testimony over a claim of the privilege, unless the scope of the grant of immunity is coextensive with the scope of the privilege, the witness’ refusal to testify was held proper. In the course of its opinion, the Court made the following statement, on which petitioners heavily rely:

‘We are clearly of opinion that no statute which leaves the party or witness subject to prosecution after he answers the criminating question put to him, can have the effect of supplanting the privilege conferred by the Constitution of the United States. (The immunity statute under consideration) does not supply a complete protection from all the perils against which the constitutional prohibition was designed to guard, and is not a full substitute for that prohibition. In view of the constitutional provision, a statutory enactment, to be valid, must afford absolute immunity against future prosecution for the offence to which the question relates.’

Sixteen days after the *Counselman* decision, a new immunity bill was introduced by Senator Cullom. . . . The bill, which became the Compulsory Testimony Act of 1893, . . . removed the privilege against self-incrimination in hearings before the Interstate Commerce Commission and provided that:

‘no person shall be prosecuted or subjected to any penalty or forfeiture for or on account of any transaction, matter or thing, concerning which he may testify, or produce evidence, documentary or otherwise . . .’ Act of Feb. 11, 1893.

This transactional immunity statute became the basic form for the numerous federal immunity statutes until 1970, when, after re-examining applicable constitutional principles and the adequacy of existing law, Congress enacted the statute here under consideration. The new statute, which does not ‘afford (the) absolute immunity against future prosecution’ referred to in *Counselman*, was drafted to meet what Congress judged to be the conceptual basis of *Counselman*, as elaborated in subsequent decisions of the Court, namely, that immunity from the use of compelled testimony and evidence derived therefrom is coextensive with the scope of the privilege.

The statute's explicit proscription of the use in any criminal case of 'testimony or other information compelled under the order (or any information directly or indirectly derived from such testimony or other information)' is consonant with Fifth Amendment standards. We hold that such immunity from use and derivative use is coextensive with the scope of the privilege against self-incrimination, and therefore is sufficient to compel testimony over a claim of the privilege. While a grant of immunity must afford protection commensurate with that afforded by the privilege, it need not be broader. Transactional immunity, which accords full immunity from prosecution for the offense to which the compelled testimony relates, affords the witness considerably broader protection than does the Fifth Amendment privilege. The privilege has never been construed to mean that one who invokes it cannot subsequently be prosecuted. Its sole concern is to afford protection against being 'forced to give testimony leading to the infliction of 'penalties affixed to . . . criminal acts. "Immunity from the use of compelled testimony, as well as evidence derived directly and indirectly therefrom, affords this protection. It prohibits the prosecutorial authorities from using the compelled testimony in any respect, and it therefore insures that the testimony cannot lead to the infliction of criminal penalties on the witness.

Our holding is consistent with the conceptual basis of *Counselman*. . . .

The basis of the Court's decision was recognized in *Ullmann v. United States*, in which the Court reiterated that the *Counselman* statute was insufficient:

'because the immunity granted was incomplete, in that it merely forbade the use of the testimony given and failed to protect a witness from future prosecution based on knowledge and sources of information obtained from the compelled testimony.'

. . . In *Murphy v. Waterfront Comm'n*, the Court carefully considered immunity from use of compelled testimony and evidence derived therefrom. The *Murphy* petitioners were subpoenaed to testify at a hearing conducted by the Waterfront Commission of New York Harbor. After refusing to answer certain questions on the ground that the answers might tend to incriminate them, petitioners were granted immunity from prosecution under the laws of New Jersey and New York. They continued to refuse to testify, however, on the ground that their answers might tend to incriminate them under federal law, to which the immunity did not purport to extend. . . .

The issue before the Court in *Murphy* was whether New Jersey and New York could compel the witnesses, whom these States had immunized from prosecution under their laws, to give testimony that might then be used to convict them of a federal crime. Since New Jersey and New York had not purported to confer immunity from federal prosecution, the Court was faced with the question what limitations the Fifth Amendment privilege imposed on the prosecutorial powers of the Federal Government, a nonimmunizing sovereign. After undertaking an examination of the policies and purposes of the privilege, the Court overturned the rule that one jurisdiction within our federal structure may compel a witness to give testimony which could be used to convict

him of a crime in another jurisdiction. The Court held that the privilege protects state witnesses against incrimination under federal as well as state law, and federal witnesses against incrimination under state as well as federal law. Applying this principle to the state immunity legislation before it, the Court held the constitutional rule to be that:

‘(A) state witness may not be compelled to give testimony which may be incriminating under federal law unless the compelled testimony and its fruits cannot be used in any manner by federal officials in connection with a criminal prosecution against him. We conclude, moreover, that in order to implement this constitutional rule and accommodate the interests of the State and Federal Government in investigating and prosecuting crime, the Federal Governments must be prohibited from making any such use of compelled testimony and its fruits.’

. . . [B]oth the reasoning of the Court in *Murphy* and the result reached compel the conclusion that use and derivative-use immunity is constitutionally sufficient to compel testimony over a claim of the privilege. . . . As the *Murphy* Court noted, immunity from use and derivative use ‘leaves the witness and the Federal Government in substantially the same position as if the witness had claimed his privilege’ in the absence of a grant of immunity. . . . This protection coextensive with the privilege is the degree of protection that the Constitution requires, and is all that the Constitution requires even against the jurisdiction compelling testimony by granting immunity.

Although an analysis of prior decisions and the purpose of the Fifth Amendment privilege indicates that use and derivative-use immunity is coextensive with the privilege, we must consider additional arguments advanced by petitioners against the sufficiency of such immunity. We start from the premise, repeatedly affirmed by this Court, that an appropriately broad immunity grant is compatible with the Constitution.

Petitioners argue that use and derivative-use immunity will not adequately protect a witness from various possible incriminating uses of the compelled testimony: for example, the prosecutor or other law enforcement officials may obtain leads, names of witnesses, or other information not otherwise available that might result in a prosecution. It will be difficult and perhaps impossible, the argument goes, to identify, by testimony or cross-examination, the subtle ways in which the compelled testimony may disadvantage a witness, especially in the jurisdiction granting the immunity.

This argument presupposes that the statute’s prohibition will prove impossible to enforce. The statute provides a sweeping proscription of any use, direct or indirect, of the compelled testimony and any information derived therefrom. . . .

This total prohibition on use provides a comprehensive safeguard, barring the use of compelled testimony as an ‘investigatory lead,’ and also barring the use of any evidence obtained by focusing investigation on a witness as a result of his compelled disclosures.

A person accorded this immunity under 18 U.S.C. § 6002, and subsequently prosecuted, is not dependent for the preservation of his rights upon the integrity and good faith of the prosecuting authorities. As stated in *Murphy*:

‘Once a defendant demonstrates that he has testified, under a state grant of immunity, to matters related to the federal prosecution, the federal authorities have the burden of showing that their evidence is not tainted by establishing that they had an independent, legitimate source for the disputed evidence.’

This burden of proof, which we reaffirm as appropriate, is not limited to a negation of taint; rather, it imposes on the prosecution the affirmative duty to prove that the evidence it proposes to use is derived from a legitimate source wholly independent of the compelled testimony.

This is very substantial protection, commensurate with that resulting from invoking the privilege itself. The privilege assures that a citizen is not compelled to incriminate himself by his own testimony. It usually operates to allow a citizen to remain silent when asked a question requiring an incriminatory answer. This statute, which operates after a witness has given incriminatory testimony, affords the same protection by assuring that the compelled testimony can in no way lead to the infliction of criminal penalties. The statute, like the Fifth Amendment, grants neither pardon nor amnesty. Both the statute and the Fifth Amendment allow the government to prosecute using evidence from legitimate independent sources. . . .

We conclude that the immunity provided by 18 U.S.C. § 6002 leaves the witness and the prosecutorial authorities in substantially the same position as if the witness had claimed the Fifth Amendment privilege. The immunity therefore is coextensive with the privilege and suffices to supplant it. . . .

The “*Kastigar* burden”—what the government must prove to maintain a prosecution in the face of a motion to dismiss on the basis that the government has relied directly or indirectly on immunized testimony—is often described as “heavy.” Indeed, the burden is so heavy that prosecutors are loath to take it on and often treat derivative use immunity as functionally equivalent to transactional immunity. The next case demonstrates how heavy that burden is, and how prosecutions across international boundaries can further complicate the problem. The nature of the facts and charges will be familiar from Chapter 3.

UNITED STATES v. ALLEN, 864 F.3d 63 (2d Cir. 2017)

JOSÉ A. CABRANES, Circuit Judge:

This case—the first criminal appeal related to the London Interbank Offered Rate (“LIBOR”) to reach this (or any) Court of Appeals—presents the question, among others, whether testimony given by an individual involuntarily under the legal

compulsion of a foreign power may be used against that individual in a criminal case in an American court. As employees in the London office of Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (“Rabobank”) in the 2000s, defendants-appellants Anthony Allen and Anthony Conti (“Defendants”) played roles in that bank’s LIBOR submission process during the now-well-documented heyday of the rate’s manipulation. Allen and Conti were, for unrelated reasons, no longer employed at Rabobank by 2008 and 2009, respectively. By 2013, they were among the persons being investigated by enforcement agencies in the United Kingdom (“U.K.”) and the United States for their roles in setting LIBOR.

The U.K. enforcement agency, the Financial Conduct Authority (“FCA”), interviewed Allen and Conti (each a U.K. citizen and resident) that year, along with several of their coworkers. At these interviews, Allen and Conti were compelled to testify and given “direct use”—but not “derivative use”—immunity. In accordance with U.K. law, refusal to testify could result in imprisonment. The FCA subsequently decided to initiate an enforcement action against one of Defendants’ coworkers, Paul Robson, and, following its normal procedures, the FCA disclosed to Robson the relevant evidence against him, including the compelled testimony of Allen and Conti. Robson closely reviewed that testimony, annotating it and taking several pages of handwritten notes.

For reasons not apparent in the record, the FCA shortly thereafter dropped its case against Robson, and the Fraud Section of the United States Department of Justice (the “DOJ”) promptly took it up. Robson soon pleaded guilty and became an important cooperator, substantially assisting the DOJ with developing its case. Ultimately, Robson was the sole source of certain material information supplied to the grand jury that indicted Allen and Conti and, after being called as a trial witness by the Government, Robson provided significant testimony to the petit jury that convicted Defendants.

In October 2014, a grand jury returned an indictment charging Defendants with one count of conspiracy to commit wire fraud and bank fraud, in violation of 18 U.S.C. § 1349, as well as several counts of wire fraud, in violation 18 U.S.C. § 1343. Following a trial held in October 2015 in the United States District Court for the Southern District of New York (Jed S. Rakoff, Judge), a jury convicted on all counts. The District Court sentenced Allen principally to two years’ imprisonment and Conti to a year-and-a-day’s imprisonment. Agreeing that Defendants had raised a “substantial issue” for appeal, the District Court granted bail pending appeal. . . .

As relevant here, Rabobank was a contributor panel bank for USD LIBOR and JPY LIBOR. Allen joined Rabobank in 1998 as a cash trader and was the bank’s USD LIBOR submitter until 2005, when he became Rabobank’s Global Head of Liquidity and Finance. In that new role, which he held until being laid off when Rabobank closed its London branch in late 2008, he was responsible for supervising other cash traders. One of those cash traders was Conti, who assumed primary responsibility for USD LIBOR submissions starting in 2005 and continuing through 2009, when he quit shortly after his job was moved to Utrecht. Another cash trader, Paul Robson (whose testimony is central

to the issue before us), was primarily responsible for Rabobank's JPY LIBOR submissions during the relevant time period. Others, including Allen himself, would sometimes submit USD LIBOR rates or JPY LIBOR rates when Conti or Robson were unavailable. According to the "Final Notice" issued to Rabobank by the FCA for its LIBOR-related misconduct, "Rabobank did not explicitly have a policy in place to address LIBOR submissions procedures until 30 March 2011, and certain LIBOR-related compliance risks were not addressed until August 2012."

In addition to LIBOR submitters, Rabobank also employed derivatives traders who would regularly enter into interest rate swap agreements. It was a routine practice of these derivatives traders to submit requests to Conti and Robson (or, at times, their stand-ins) for higher or lower LIBOR submissions. The Government's theory of the case was that these trader requests were dictated by the traders' (and thus Rabobank's) interest in having LIBOR be higher or lower on particular dates based on the transactions that the trader had entered or positions they held. Allen and Conti, the Government alleged, honored those requests in lieu of making good-faith estimates of Rabobank's projected borrowing rates.

One USD derivatives trader, Lee Stewart (nicknamed the "Ambassador"), sat in the same line of desks at Rabobank's London office as did Allen and the cash traders—including Conti, the principal USD LIBOR submitter. Stewart testified at trial that he offered LIBOR requests "out loud," "in front of everyone," and never used "code" or "tr[ie]d" to hide what [he] was talking about." Robson testified that every morning before 11 a.m., Conti led, and Allen participated in, a "gather[ing]" and "discuss[ion]" of the best way to influence LIBOR, prefaced by the shout, "right, LIBOR times[!]"

By contrast, those derivatives traders located in other offices, like USD derivatives trader Christian Schluep (located in New York) or JPY derivatives trader Takayuki Yagami (located in Tokyo), would more often submit their LIBOR requests in writing. Thus there are numerous arguably incriminating written exchanges between the latter traders and the LIBOR submitters. Schluep and Conti had several exchanges regarding the setting of USD LIBOR—for example:

- On July 17, 2006, Schluep asked Conti, "IF ANY CHANCE, A HIGH 3MTH TODAY PL!" Conti replied, "[o]k matey . . . high one today."
- On October 31, 2006, Schluep sent Conti a message discussing market activity and then stated, "SMALL FAVOUR AS USUAL, LOW 2S HIGH 3S IF POSSIBLE MATEY," meaning he wanted a low two-month LIBOR and a high three-month LIBOR. Conti responded to the earlier parts of Schluep's message and added, "[w]ill do matey on the libors."
- On August 13, 2007, Schluep sent a message to Conti, requesting "HIGH 3S AND 6S PLS TODAY MATE (ESP 6MNTHS!!) IF U WOULD BE SO KIND .. [sic] GOTTA MAKE MONEY

SOMEHOW!” Conti responded simply, “cool,” to which Schluep replied, “CHEERS TC.. [sic] EVERY LITTLE HELPS!”

Schluep also had exchanges with Allen—for example:

- On October 6, 2006, Schluep sent a message to Allen stating, “HELLO SKIPPER, CAN U PUT 3S AT 37 FOR ME TOMORROW PLS. . . . MANY THANKS.” Allen replied, “NEVER IN DOUBT!”
- On November 29, 2006, Schluep sent a message to Allen asking for a “LOW 1S HIGH 3S LIBOR PLS!!!” Allen replied “OK MATE, WILL DO MY BEST SPEAK LATER.” Schluep later thanked Allen, because the submissions were “BANG ON THE MONEY!” Allen replied, “NO WORRIES” and joked that he “HAD TO WORK MY WAY OUT OF AN AMBASS HEADLOCK TO GET THOSE IN!”
- On December 1, 2006, Schluep sent a message to Allen stating, “APPRECIATE 3S GO DOWN, BUT A HIGH 3S TODAY WOULD BE NICE.” Allen responded, “I AM FAST TURNING INTO YOUR LIBOR BITCH!!!!” Schluep replied, “JUST FRIENDLY ENCOURAGEMENT THAT’S ALL, APPRECIATE THE HELP.” Allen replied, “NO WORRIES MATE, GLAD TO HELP[.]”

There were similar, if perhaps more explicit and thus arguably more incriminating, exchanges between Yagami and Robson regarding the setting of JPY LIBOR—for example:

- On September 21, 2007, Robson told Yagami that market information supported a submission of 0.85 for the one-month JPY LIBOR. Yagami asked for a higher rate, specifically 0.90. Robson agreed, even though he would “probably get a few phone calls,” telling Yagami that there were “bigger crooks in the market than us guys!”
- On March 19, 2008, Yagami told Robson “[w]e have loads of 6mth fixings today” and—conveying a request from another trader—asked Robson to submit 1.10 for the six-month yen LIBOR. Robson responded that market information supported a 1.03 submission for the six-month LIBOR but that he would submit 1.10 as asked, even though it would likely prompt “a phone call.” Robson added that it “will be quite funny to see the reaction” to his submission at Yagami’s requested rate.

Whether Allen and Conti did, in fact, accommodate trader requests by adjusting their LIBOR submissions was an issue that Defendants contested at trial. Although Allen and Conti claim they ignored the trader requests, the Government presented evidence at trial purporting to show that these trader requests were accommodated. For instance, on August 13, 2007, Schluep e-mailed Conti and said: GONNA NEED A FRICKIN HIGH

6 MTH FIX TOMORROW IF OK WITH U . . . 5.42?” The next day, Schluep sent a reminder and Allen informed another trader that the six-month LIBOR submission would be 5.42 because “i think thats [sic] what [C]hristian [Schluep] needs.” The Rabobank submission for six-month USD LIBOR that day was 5.42. . . .

Where Defendants and the Government parted ways on the facts was whether the traders’ requests were honored. While Conti did not take the stand at trial, Allen testified that he never actually accommodated such requests. On direct examination by the Government, by contrast, Robson—Rabobank’s JPY LIBOR submitter—explained that LIBOR’s lack of precision allowed him to accommodate trader requests without raising eyebrows. . . .

Moreover, Robson proffered to the Government that Conti likewise accommodated trading positions when making LIBOR submissions. And Robson was the sole source of trial and grand jury testimony that Allen specifically directed and instructed others in this scheme. . . .

The FCA’s interviews were compulsory; they were conducted under a grant of direct (but not derivative) use immunity, and a witness’s failure to testify under such terms could result in imprisonment. In order to avoid potential problems under *Kastigar*, the DOJ took care to conduct their interviews wholly independently of the FCA’s interviews and their fruits. Specifically, the FCA agreed to procedures to maintain a “wall” between its investigation and the DOJ’s investigation, including a “day one/day two” interview procedure in which the DOJ interviewed witnesses prior to the FCA. In accordance with that protocol, the FCA interviewed Robson (on January 17, 2013), Conti (on January 25, 2013), and Allen (on June 20 and 21, 2013), among others. Robson, in his compelled testimony to the FCA, denied any improper conduct at Rabobank.

In November 2013, the FCA initiated an enforcement action against Robson and, following its normal procedure, disclosed to Robson the relevant evidence against him, including the compelled testimony of Allen and Conti. Robson’s attorney instructed him to review the materials sent by the FCA in preparation for a meeting between Robson and his attorney. Robson “reviewed the materials over the course of two to three successive or nearly successive days sometime in or about November and/or December of 2013.” During this review, Robson underlined, annotated, and circled certain passages of both Allen’s and Conti’s compelled testimony. Robson also took roughly five pages of handwritten notes. Before Robson had the chance to discuss this material with his attorney, however, the FCA stayed its regulatory proceeding in favor of a criminal prosecution of Robson by the DOJ. On instruction from his lawyer, Robson placed the FCA materials in a box, put them in his attic, and did not review them further. . . .

In mid-July 2014, the DOJ first interviewed Robson at a so-called proffer session. On August 5, 2014, Robson signed a cooperation agreement and shortly thereafter pleaded guilty. At Robson’s plea hearing, the prosecutor informed the District Court that “there is . . . a chance that we would seek a superseding indictment in light of information that

has come to light from our two cooperators” and that there was “a distinct possibility” the new indictment would “involve[] other individuals.”

So it did. On October 16, 2014, the grand jury returned a superseding indictment charging two new individuals—Allen and Conti—with one count of conspiracy to commit wire fraud and bank fraud as well as several counts of wire fraud. It is not disputed that the Government’s presentation of evidence to the grand jury that indicted Defendants relied on evidence that Robson had provided. While Robson did not himself testify, the new information he gave was relayed to the grand jury through FBI Special Agent Jeffrey Weeks, who did testify. And Weeks’s testimony to the grand jury on certain matters derived exclusively from Robson. In particular, Robson was the only source for Weeks’s testimony that Allen “instructed, specifically instructed, LIBOR submitters in London to consider the positions and the requests of Rabobank traders and adjust their submissions for LIBOR and various currencies based on the means of those traders,” and that “Mr. Robson said that sitting near Mr. Conti he was aware that Mr. Conti set U.S. dollar LIBOR rates in which he considered his own positions as appropriate reason or justification for setting the rates.” . . .

At trial, the Government’s case-in-chief consisted of documentary evidence (e.g., e-mails, “instant chats,” and phone calls involving Allen, Conti, or their alleged co-conspirators) and testimony from eight witnesses, including three cooperators: Stewart, Yagami, and Robson. In addition to cross-examination of the Government’s witnesses, Allen and Conti each offered an expert witness, and Allen testified in his own defense. On November 5, 2015, the jury returned a verdict of guilty on all counts (nineteen counts, in total, for Allen and nine for Conti). . . .

In arguing that Fifth Amendment protections apply in this case, Defendants rely on our cases pertaining to foreign and cross-border law enforcement, which have consistently held that “in order to be admitted in our courts, inculpatory statements obtained overseas by foreign officials must have been made voluntarily.” In so holding, we joined our sister circuits that have considered the issue. Defendants contend that these cases are sufficient to resolve the present dispute regarding whether compulsion by a foreign power implicates the Fifth Amendment. We agree. . . .

The Supreme Court has taken care . . . to distinguish extraterritorial applications of the Fourth Amendment from those of the Self-Incrimination Clause of the Fifth Amendment. The Fourth Amendment “prohibits unreasonable searches and seizures whether or not the evidence is sought to be used in a criminal trial,” such that “a violation of the Amendment is fully accomplished at the time of an unreasonable governmental intrusion.” By contrast, in the case of the Fifth Amendment’s Self-Incrimination Clause, “a constitutional violation occurs only at trial,” even if “conduct by law enforcement officials prior to trial may ultimately impair that right.” In light of that distinction, “it naturally follows that, regardless of the origin—i.e., domestic or foreign—of a statement, it cannot be admitted at trial in the United States if the statement was ‘compelled.’”

Thus, the Self-Incrimination Clause's prohibition of the use of compelled testimony arises from the text of the Constitution itself, and directly addresses what happens in American courtrooms, in contrast to the exclusionary rules that are crafted as remedies to deter unconstitutional actions by officers in the field. Its protections therefore apply in American courtrooms even when the defendant's testimony was compelled by foreign officials.

Moreover, for much the same reasons, the Clause applies in American courtrooms even where, as here, the defendant's testimony was compelled by foreign officials lawfully—that is, pursuant to foreign legal process—in a manner that does not shock the conscience or violate fundamental fairness. The Clause flatly prohibits the use of compelled testimony and is not based on any matter of misconduct or illegality on the part of the agency applying the compulsion. . . .

The Government also asserts that a prohibition on its use in U.S. courts of testimony compelled by a foreign authority “could seriously hamper the prosecution of criminal conduct that crosses international borders.” In particular, the Government submits:

A foreign government could inadvertently scuttle prosecutions in the U.S. by compelling testimony and then making the testimony available to potential witnesses or the public. Worse yet, a hostile government bent on frustrating prosecution of a defendant would have to do no more than compel [that defendant] to testify and then publicize the substance of that testimony, unilaterally putting the United States to its heavy *Kastigar* burden.

The Government's first concern—that foreign powers could inadvertently or negligently obstruct federal prosecutions—fails to account for the fact that this risk already exists within our own constitutional structure. In our system—composed of “State and National Governments,” with the latter government further divided into separate co-equal branches—the DOJ does not control the granting or handling of witness immunity by the States or by the U.S. Congress. Similarly, and “[f]or better or for worse, we live in a world of nation-states in which our Government must be able to ‘function effectively in the company of sovereign nations.’”

We are confident the Government is able to do so. Indeed, in a March 2016 address that specifically discussed the immunity issue in this case, Leslie Caldwell, then-Assistant Attorney General for the Criminal Division, observed that

as we and our [foreign] counterparts work together more frequently and better understand our respective systems, we are having . . . conversations [about double jeopardy and Fifth Amendment protections] earlier, so that individuals are much less likely to be caught in the middle of last minute turf battles over where and by whom a prosecution should be brought.

In the present case, the Government was plainly aware from the outset—well before the FCA transmitted the Defendants’ compelled testimony to Robson—of the need for close coordination of its efforts with those of the U.K. authorities. The practical outcome of our holding today is that the risk of error in coordination falls on the U.S. Government (should it seek to prosecute foreign individuals), rather than on the subjects and targets of cross-border investigations.

As to the Government’s concerns that a hostile foreign government might hypothetically endeavor to sabotage U.S. prosecutions by immunizing a suspect and publicizing his or her testimony—that, of course, is not this case. This case raises no questions regarding the legitimacy or regularity of the procedures employed by the U.K. government or the U.K. government’s investigation more generally. We thus need only say here that should U.S. prosecutors or judges face the situation suggested by the Government, our holding today would not necessarily prevent prosecution in the United States. That is true not only if the U.S. prosecution navigated any resulting *Kastigar* issues by meeting its burden or by not using exposed witnesses. It is true for another reason as well. Specifically, should the circumstances in a particular case indicate that a foreign defendant had faced no real threat of sanctions by his foreign government for not testifying, then that defendant’s testimony might well not be considered involuntary. In short, the situation hypothesized by the Government is not before us today, and our resolution of this case on the facts that are before us leaves open the issue of foreign efforts to sabotage a U.S. prosecution.

On the other hand, the Government nowhere responds to the troubling consequences of accepting its argument. As conceded at oral argument, the Government’s rule would remove any bar to introducing compelled testimony directly in U.S. prosecutions similar to this one—as in, “Your honor, we offer Government Exhibit 1, the defendant’s compelled testimony.” To be sure, the Government did not introduce Defendants’ compelled testimony directly and appears to have generally sought in good faith to respect the principles underlying the Fifth Amendment. But it is well established that a defendant’s “preservation of his rights” does not turn “upon the integrity and good faith of the prosecuting authorities.” We cannot entertain a rule that discards the most basic Fifth Amendment right simply because prosecutors can be expected to respect its objectives generally.

The concerns that we express here are not idle. However unusual this particular prosecution may prove to be, so-called cross-border prosecutions have become more common. Such prosecutions necessarily entail intimate coordination between the United States and foreign authorities. As then-Assistant Attorney General Caldwell put it in the address to which we referred earlier, “[c]ollaboration and coordination among multiple regulators in cross-border matters is the future of major white collar criminal enforcement.” Perhaps the most striking development in cooperative conduct is the embedding of U.S. prosecutors in foreign law enforcement. According to Caldwell, the DOJ “recently placed Criminal Division prosecutors with Eurojust in The Hague and INTERPOL in France” and was “exploring the possibility of embedding prosecutors

with other foreign law enforcement as well.” In a more recent address, Acting Principal Deputy Assistant Attorney General Trevor N. McFadden announced that DOJ will be detailing one of its anti-corruption prosecutors to work at the U.K. FCA—“the first time the Criminal Division . . . will detail a prosecutor to work in a foreign regulatory agency on white collar crime issues.”

One area in particular where intimate cooperation and coordination will be needed between U.S. prosecutors and foreign authorities (or, perhaps, between U.S. prosecutors and U.S. prosecutors on detail to foreign authorities) is the securing of witness testimony. As the Government explained in a letter to the District Court in this case, “large scale economic crime conspiracies that harm U.S. markets, such as LIBOR rigging and the manipulation of the foreign exchange spot, often occur, in large part, overseas and successful prosecutions of these matters frequently rely on evidence provided by witnesses who live in foreign countries.” And as this case illustrates, foreign authorities may conduct compulsory witness interviews, including interviews of those who end up being—or are already—the targets of U.S. prosecution.

We do not presume to know exactly what this brave new world of international criminal enforcement will entail. Yet we are certain that these developments abroad need not affect the fairness of our trials at home. If as a consequence of joint investigations with foreign nations we are to hale foreign men and women into the courts of the United States to fend for their liberty we should not do so while denying them the full protection of a “trial right” we regard as “fundamental” and “absolute.”

Accordingly, we adhere to our precedent in assessing the voluntariness of inculpatory testimony compelled abroad by foreign governments. In the instant appeal, there is no question that the Defendants’ testimony was compelled and, thus, involuntary. We therefore conclude in this case that the Fifth Amendment prohibited the Government from using Defendants’ compelled testimony against them.

Kastigar . . . established a doctrine to enforce this protection. When a witness has been compelled to testify relating to matters for which he is later prosecuted, the government bears “the heavy burden of proving that all of the evidence it proposes to use was derived from legitimate independent sources.” This burden is “not limited to a negation of taint; rather, it imposes on the prosecution the affirmative duty to prove that the evidence it proposes to use is derived from a legitimate source wholly independent of the compelled testimony.” . . .

With the foregoing principles in mind, we consider whether any evidence from Robson used in Defendants’ prosecution was tainted. To be clear, there is no dispute that the Government “used” evidence from Robson: he was a key cooperator and a prominent trial witness. The less straightforward question is whether any evidence supplied by Robson (to the government, to the grand jury, or at trial) was tainted by his earlier review of the testimony of Defendants compelled in the United Kingdom under U.K. law.

Our Court apparently has never encountered the circumstance in which a government trial witness had, prior to testifying, reviewed a defendant's compelled testimony. The D.C. Circuit, however, has addressed the applicable legal standards in a pair of high-profile cases arising out of the Iran-Contra affair. In those cases, that Court held that "the use of immunized testimony by witnesses to refresh their memories, or otherwise to focus their thoughts, organize their testimony, or alter their prior or contemporaneous statements, constitutes" an impermissible use of the defendants' compelled testimony. . . .

In apparent agreement with both parties on appeal, we conclude that the legal standards set forth by the D.C. Circuit . . . are helpful here. We need not, in this case, decide whether the Government is required to demonstrate that Robson's review of Defendants' compelled testimony did not in any manner subtly "refresh his memory, focus or organize his thoughts," or in some other traceless way influence his state of mind. At a minimum, however, we agree with the D.C. Circuit that the Government is required to prove that his exposure to the compelled testimony did not shape, alter, or affect the information that he provided and that the Government used.

The most effective way to demonstrate that a witness's testimony was untainted by exposure to a defendant's immunized testimony is by demonstrating that his or her testimony was unchanged from comparable testimony given before the exposure. Thus, typically, the prosecution can meet its burden by memorializing (or "canning") the witness's testimony prior to his or her exposure.

In the present case, Robson did testify to the FCA regarding Rabobank's submission and alleged manipulation of LIBOR rates, as well as the roles of Allen and Conti, prior to Robson's exposure to Defendants' compelled testimony. But what Robson's "canned" testimony preserved is toxic to the Government's case; it omits or contradicts in material parts the testimony Robson later provided indirectly to the grand jury and directly to the petit jury. At the *Kastigar* hearing held by the District Court, Robson agreed that "the testimony that [he] gave to the [FCA] and the testimony that [he] gave before the jury in this trial were very different." For instance, Robson testified to the jury about an altercation between Stewart and Damon Robbins, an alternate submitter for USD LIBOR, on Rabobank's London desk. But Robson did not testify about this to the FCA, and the *Kastigar* hearing raised questions about whether he had even seen the incident at all or merely read about it in the compelled testimony. Far from rebutting the presumption that Robson's trial testimony was tainted, his pre-exposure testimony actually evidences such taint through its material differences with Robson's post-exposure trial testimony.

As Robson's FCA testimony hurts rather than helps its cause, the Government appears to contend on appeal that it satisfied its burden solely through Robson's "persuasive[]" testimony at the *Kastigar* hearing. We conclude, however, that Robson's testimony at the hearing falls far short of satisfying the demands of *Kastigar*. As explained below, the Government adduced, at bottom, nothing more than bare, self-serving denials from

Robson to meet its heavy burden. We hold that such conclusory denials are insufficient as a matter of law to sustain the prosecution's burden of proof under *Kastigar* in the face of materially inconsistent pre-exposure testimony. . . .

Accordingly, we hold that a bare, generalized denial of taint from a witness who has materially altered his testimony after being substantially exposed to a defendant's compelled testimony is insufficient as a matter of law to sustain the prosecution's burden of proof under *Kastigar* that that witness's testimony was derived from a wholly independent source. . . .

In sum, the Government did not, and cannot, meet its burden under *Kastigar*. We therefore conclude that the Government's use of evidence provided by Robson violated the Defendants' Fifth Amendment rights. . . .

Upon review of the trial record, we have no trouble concluding that this error was not harmless beyond a reasonable doubt. While two other cooperating witnesses testified, Robson was the unique source of particularly significant and incriminating evidence. Robson was the only LIBOR submitter to testify on behalf of the government, and he testified—contrary to the Defendants' central argument for acquittal—that, pursuant to a scheme at Rabobank, he in fact took trading positions into account when making submissions. And Robson was also the only witness the Government ever interviewed who said that Allen “directed” Rabobank's submitters to account for trading positions when setting LIBOR. Indeed, absent Robson's testimony that Allen issued “instructions” to him, Allen likely would not have been charged, much less convicted, of the nine counts relating to specific JPY LIBOR submissions, because Allen never submitted LIBOR estimates for that currency. Well aware of the substantial litigation risk under *Kastigar* of using a witness who not only had been exposed to Defendants' compelled testimony but who dramatically changed his own story after such exposure, the Government nevertheless chose to call Robson to the witness stand, underscoring the significance of his testimony to the Government's case. . . .

Accordingly, we conclude that the admission of Robson's trial testimony was not harmless. This error requires that Defendants' convictions be vacated and that they be awarded a new trial wherein any tainted statements are suppressed. Defendants also argue, however, that the use of Robson's tainted evidence, conveyed to the grand jury through Agent Weeks's testimony, requires dismissal of the indictment. We thus turn to that argument.

Our precedents establish that an indictment is subject to dismissal if it was procured on the basis of tainted evidence. . . .

Upon review of the evidence and testimony presented to the grand jury in this case, we cannot conclude beyond a reasonable doubt that the grand jury would have indicted Allen and Conti without the evidence supplied by Robson. As the District Court itself acknowledged, “material parts of [Agent Weeks's] grand jury testimony derived exclusively from Mr. Robson.” Specifically, when Agent Weeks testified that Allen was

the scheme's leader who had "instructed, specifically instructed, LIBOR submitters in London to consider the positions and the requests of Rabobank traders and adjust their submissions for LIBOR," his testimony derived exclusively from Robson's proffer. And when Agent Weeks testified that Mr. Conti "adjusted his U.S. dollar LIBOR rates . . . for his own benefit and the benefit of the other traders," he based his testimony exclusively upon Mr. Robson's proffer, telling the grand jury that "Mr. Robson said that sitting near Mr. Conti he was aware that Mr. Conti set U.S. dollar LIBOR rates in which he considered his own positions as appropriate reason or justification for setting the rates." . . .

Neither did the District Court suggest that the evidence conveyed from Robson, through Agent Weeks, to the grand jury, was harmless; instead, the District Court concluded that the Government had met its burden to prove Robson's evidence was untainted. As explained above, that conclusion was in error. Because we cannot conclude that the *Kastigar* errors before the grand jury were harmless, the indictment must be dismissed.

D. Internal Investigations and State Action Doctrine

Is it a violation of someone's Fifth Amendment right for a corporation to threaten to fire her if she doesn't answer questions? The answer turns in large part on the issue of what constitutes state action in this context for the purpose of constitutional law generally.

A foundational Supreme Court case on employment and the Fifth Amendment, which is not on all fours with the corporate investigation scenario in the private sector, is *Garrity v. New Jersey*, 385 U.S. 493 (1967). In *Garrity*, the Court held that incriminating statements by police officers, extracted by state investigators under threat of termination from the officers' local police departments if they refused to answer, and without any immunity protection, were compelled in violation of the Fifth Amendment.

The next two cases are on this point, but they are district court opinions and arguably can be limited to their facts. What *should* be the rule about the constitutionality of the talk-or-be-fired scenario?

UNITED STATES v. STEIN, 435 F. Supp. 2d 330 (S.D.N.Y. 2006)

KAPLAN, District Judge:

Our forefathers adopted an adversary system of justice—one in which no person may be convicted of a crime unless the government sustains its burden of convincing a jury beyond a reasonable doubt of a defendant's guilt. Part and parcel of that system is the principle that no one may be compelled, in a criminal case, to be a witness against one's self.

KPMG, the accounting giant, and many of its personnel found themselves under criminal investigation for their role in allegedly abusive tax shelters. An indictment, regardless of whether KPMG was guilty of anything, almost certainly would have meant the demise

of the firm—the fate met by its competitor, Arthur Andersen & Co., when it was indicted in the Enron scandal.

Although KPMG long had paid legal fees for any of its employees who were sued or charged with crimes as a result of doing their jobs, the government threatened to consider such payments as a factor weighing in favor of indicting the firm. It threatened also to consider any failure by KPMG to cause its employees to make full disclosure to the government as favoring indictment. So KPMG changed its practice regarding legal fees. It informed employees that it would pay fees, up to \$400,000, but only on the condition that they cooperate with the prosecutors. In other words, KPMG told its personnel that it would cut off payment of legal expenses of any employee who refused to talk to the government or who invoked the Fifth Amendment. And it made crystal clear that it would cut off any payments of legal fees to anyone who was indicted.

The government took full advantage. It sought interviews with many KPMG employees and encouraged KPMG to press the employees to cooperate. Indeed, it urged KPMG to tell employees to disclose any personal criminal wrongdoing. When individuals balked, the prosecutors told KPMG. In each case, KPMG reiterated its threat to cut off payment of legal fees unless the government were satisfied with the individual's cooperation. In some cases, it told the employees to cooperate with prosecutors or be fired.

The government obtained statements, commonly known as proffers, from nine KPMG employees who now are defendants here (the "Moving Defendants"). The Moving Defendants contend that their statements were coerced in violation of their Fifth Amendment privilege against self-incrimination. They move to preclude the government from using the statements or any evidence derived therefrom.

Having considered the evidence, the Court is persuaded that the government is responsible for the pressure that KPMG put on its employees. It threatened KPMG with the corporate equivalent of capital punishment. KPMG took the only course open to it. In the words of its chief legal officer, KPMG did everything it could "to be able to say at the right time and with the right audience, we're in full compliance with the Thompson Memorandum." It exerted substantial pressure on its employees to waive their constitutional rights.

In this case, not all of the statements made by the Moving Defendants to the government were coerced. Those that were, however, must be suppressed. . . .

One of the guiding principles set forth in the [DOJ] Thompson Memorandum is that "[i]n gauging the extent of the corporation's cooperation [for purposes of determining whether it should be indicted], the prosecutor may consider the corporation's willingness to identify the culprits within the corporation, including senior executives, *to make witnesses available*, to disclose the complete results of its internal investigation, and to waive attorney-client and work-product privileges." The commentary goes on to elaborate on the meaning of cooperation in relevant part by stating: "One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the

completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product protections . . .” Thus, the Thompson Memorandum makes clear that the failure of a business organization facing possible indictment to induce its personnel to submit to interviews by the government and to disclose whatever they know may be a factor weighing in favor of indictment of the entity. . . .

The KPMG lawyers made clear to prosecutors that KPMG believed that an indictment would be fatal to the organization. They said that KPMG intended to cooperate in order to save the firm and that it would not protect individual employees. Later in the meeting, Robert Bennett and Kenneth Bialkin of Skadden, Arps, Slate, Meagher & Flom, the senior lawyers representing KPMG, told the USAO that KPMG’s “common practice” had been to pay legal fees for employees in connection with legal matters arising out of their doing their jobs. Although KPMG still was checking on its legal obligations, they said, it would not pay legal fees for employees who declined to cooperate with the government, or who took the Fifth Amendment, as long as it had discretion to take that position. Mr. Bennett made clear also that KPMG would recommend to individual employees “lawyers who understand cooperation is the best way to go in this type of case.” He expressed also the view that “it [wa]s in the best interests of KPMG for its people to get attorneys that will cooperate with” the government. . . .

As noted, each of the Moving Defendants received the form letter that stated that KPMG would pay an individual’s legal fees and expenses, up to a maximum of \$400,000, on the condition that the individual “cooperate with the government and . . . be prompt, complete, and truthful.” Each subsequently made proffers to the government pursuant to the USAO’s standard proffer agreement after receiving the letter or, in one case, after having been told its substance but before receiving it. Six of the nine left KPMG before they made their statements and do not claim that they made their statements under a threat of loss of their employment. There is no evidence that Mr. Gremminger, one of the three who made a proffer while still employed by KPMG, ever was threatened with firing if he did not make a statement. The situations of the other two, Mr. Smith and Ms. Warley, were different.

Mr. Smith initially refused to make a proffer. Ms. Warley, on the other hand, made a proffer on April 21, 2004. This led to a dispute between her Texas counsel and the USAO in which the attorney demanded agreement by the government with a number of conditions as a prerequisite to a further session.

On May 18, 2004, AUSA Weddle informed Skadden that (1) Mr. Smith had refused to meet with the government and (2) although Ms. Warley had met with prosecutors once, she had refused to meet again except on conditions unacceptable to the USAO. Within days, Eugene O’Kelly, then chairman of KPMG, told Mr. Smith that he understood that “there were concerns about whether [Mr. Smith] was cooperating with the investigation” and told Mr. Smith that “he did not want [him] to put [Mr. O’Kelly] in a position where he was forced to take action against” him. Mr. Smith quite reasonably interpreted this comment as meaning that KPMG would fire him if he did not proffer to the government.

On May 28, 2004, promptly after the O’Kelly-Smith conversation, Skadden forwarded copies of Mr. Weddle’s letter to counsel for Smith and Warley. The cover letters stated in relevant part:

“Absent an indication within the next ten business days from the government that your client no longer refuses to meet with the government pursuant to its standard proffer agreement, KPMG will cease payment of [the client’s legal] fees.

“Finally, please note that KPMG will view continued non-cooperation as a basis for disciplinary action, including expulsion from the Firm.”

Shortly after this threat, Mr. Smith—acting against the advice of his attorney and in order to keep his job—changed his position. He entered into the USAO’s standard proffer agreement on June 16, 2004 and met with prosecutors on that date, June 17, and November 23, 2004.

The record does not fully disclose what transpired next between Ms. Warley and the USAO. In any event, she returned for a second proffer session on October 19, 2004 that lasted less than twenty minutes. Ms. Warley’s counsel advised the government that Ms. Warley believed that certain Texas statutes precluded her from voluntarily revealing client information without the clients’ permission and asked for a grand jury subpoena, compliance with which would be mandatory. The government obliged, but the USAO then terminated the proffer session despite Ms. Warley’s request to continue. A few days later, Ms. Warley appeared before the grand jury but invoked the Fifth Amendment.

On November 10, 2004, Mr. Weddle again wrote to Skadden, informing it that “notwithstanding [Ms. Warley’s] counsel’s representations that she would cooperate with the investigation, [she] continues to refuse to cooperate.” On November 15, 2004, Skadden forwarded the government’s letter to Ms. Warley’s counsel and advised him that KPMG had ceased payment of her legal fees, effective November 10, 2004. It added:

“In addition, absent an indication from the government within the next ten business days that your client no longer refuses to cooperate with the investigation, KPMG will consider additional actions, including Ms. Warley’s separation from the Firm.”

In the end, Ms. Warley’s counsel disputed the claim that she had not cooperated, but she nevertheless was terminated by KPMG. Subsequent negotiations between Ms. Warley’s counsel and the government concerning a further proffer were not successful.

In sum, then, all of the proffers followed KPMG’s conditioning of the payment of attorneys’ fees on employees’ cooperation with the government. In addition, Mr. Smith’s proffer and that of Ms. Warley on October 19, 2004 both followed explicit threats of employment termination.

KPMG repeatedly claimed that there was a direct causal connection between its actions and the proffers by some of its employees.

In a November 2, 2004 letter to the USAO, which obviously was intended to demonstrate that KPMG should not be indicted because, among other things, it had cooperated with the government, Skadden wrote:

“KPMG has repeatedly directed all current and former personnel to cooperate with the investigation and has conditioned payment of attorney’s fees upon prompt, complete, and truthful cooperation with the government’s inquiry. Whenever your Office has notified us that individuals have not rendered prompt, complete, and truthful cooperation, KPMG has promptly and without question encouraged them to cooperate and threatened to cease payment of their attorney fees and (if applicable) to take personnel action, including termination. *In certain instances, KPMG’s action has led previously non-cooperating individuals to meet with your Office.* In other instances, KPMG has ceased payment of fees and expenses.”

At later meetings, and in a so-called “White Paper” that argued against indictment of the firm, Mr. Bennett “noted that KPMG had ‘hinged attorneys fees on whether people would talk to [the government]’” and “that KPMG had cut off fees for several individuals for non-cooperation and had terminated two partners for non-cooperation,” including for “*asserting . . . [the] 5th Amendment right not to testify.*” A memorandum of a June 13, 2005 meeting with the DOJ discloses that Mr. Bennett argued that “We [KPMG] said we’d pressure—although we didn’t use that word—our employees to cooperate” and when employees did not cooperate, “Justin [AUSA Weddle] or Stan [AUSA Okula] would tell us,” and the firm then cut off fee payments and/or fired the individual. Indeed, KPMG’s final submission to the DOJ argued that it had fully cooperated by, among other things, “pressuring current and former personnel to cooperate fully with the investigation.” . . .

The Fifth Amendment provides in relevant part that “No person . . . shall be compelled in any criminal case to be a witness against himself.” An individual claiming a violation of the privilege against self-incrimination must prove that the statement sought to be suppressed was a product of compulsion by or attributable to the government. . . .

It no longer may be doubted that economic coercion to secure a waiver of the privilege against self-incrimination, where it is attributable to the government, violates the Fifth Amendment if the pressure is sufficient to “deprive[] [the accused] of his ‘free choice to admit, to deny, or to refuse to answer.’” The point is well illustrated by *Garrity v. New Jersey*, where the Supreme Court held that statements obtained from police officers in circumstances in which a state statute would have required the termination of their employment had they declined to answer were involuntary and therefore inadmissible against them in a criminal trial. So one may not exclude the possibility that KPMG’s conditioning of the payment of legal fees upon cooperating with the prosecutors,

assuming it was attributable to the government, left these defendants with no choice but to talk. Yet that is only the beginning of the discussion. . . .

Prospective criminal defendants often make so-called queen for a day proffers to prosecutors, and they do so for several reasons. As the Moving Defendants concede, some do so in the hope of obtaining a cooperation agreement. Some do so in efforts to negotiate pleas. And some do so in the hope of persuading the government not to indict at all. Thus, the fact that most of these defendants made proffers after KPMG conditioned the continued payment of their legal fees on their cooperating with the government in and of itself sheds little light on whether their statements were coerced. In other words, the fact that these defendants proffered *after* KPMG conditioned payment of their legal fees on cooperation does not mean that they proffered, even in part, *because* KPMG so conditioned payment. To illustrate the point, Mr. Watson acknowledges that he proffered on the first of several occasions voluntarily because he hoped to persuade the USAO that he should not have been prosecuted.

In consequence, *Garrity* does not require the result the Moving Defendants advocate. While it stands for the proposition that the coerced nature of a statement sometimes may be apparent on undisputed facts, it does not support the Moving Defendants' argument that the existence of an objectively coercive influence alone is sufficient to warrant suppression, even where other evidence or common sense suggests that the statement at issue in fact was voluntary. . . .

The situations of Mr. Smith and, with respect to all but the first of their proffers, Mr. Watson and Ms. Warley are quite different. Mr. Watson submitted a declaration asserting that he decided to proffer on the second and third occasions only because of the pressure placed upon him by KPMG. Although Mr. Smith and Ms. Warley did not submit affidavits addressing the issue of voluntariness, there was more than sufficient evidence to raise an issue of fact on that point. In consequence, the Court held an evidentiary hearing on the issue of coercion of these statements.

The evidence that Mr. Smith's proffers all were coerced is compelling. After he received the March 11, 2004 letter, the government requested that he proffer. Despite KPMG's insistence on cooperation and its having conditioned the payment of legal fees upon compliance with that request, he refused. In May, however, the government reported his refusal to KPMG. Mr. O'Kelly implicitly but unmistakably threatened to fire him if he did not fall into line. The threat was made explicit by Skadden on May 28, 2004. Mr. Smith, whose family was entirely dependent upon him for support, rejected his attorney's advice and agreed to proffer in order to save his job.

The government argues that Mr. Smith's decision was not a product of the government's pressure on KPMG, arguing that he previously had made statements to government bodies or otherwise represented the firm vis-a-vis government agencies and concerned clients because he, as a very senior company official, and KPMG had a "unity of interest." But this contention is not persuasive.

To be sure, Mr. Smith, as vice chair of the firm, took a prominent position in attempting to deal with a host of matters related to the tax shelters at issue in this case. He was involved, to varying degrees, with the IRS promoter audit, the SEC independence investigation, the DOJ summons enforcement proceeding, and other matters and testified before the Senate. The government may well be correct that his position would have been in jeopardy if he had refused to engage in these activities. But that does not get the government where it wants to go.

To begin with, the question here is whether the statements Mr. Smith made to the USAO after KPMG conditioned payment of his legal fees on his cooperation and explicitly threatened to fire him if he did not waive his constitutional rights and proffer were coerced. That other statements also might have been coerced by fear of loss of his job is beside the point.

Second, there is a world of difference between the prior statements and activities and those in question here. The former occurred in circumstances in which only KPMG's interests were immediately at stake, not Mr. Smith's personal liberty. Once the criminal referral was made and the USAO sent Mr. Smith a subject letter, the personal stakes for him changed dramatically. In consequence, even assuming *arguendo* that Mr. Smith voluntarily took some risks for the firm before he became the subject of a criminal investigation, the suggestion that he voluntarily ran the risk to his own freedom that was entailed in submitting to questions from prosecutors would lack force.

Finally, the question ultimately is one of credibility. The Court credits Mr. Smith's testimony and finds that he made the statements at the proffer sessions because KPMG threatened to fire him and cut off payment of his legal fees if he did not. The statements were coerced.

Mr. Watson is a young man who joined KPMG in 1992 as a staff accountant, became a non-equity partner in 1997, an equity partner in October 2001, and left the firm in July 2002. He subsequently pursued two business ventures that failed and has been unemployed for nearly a year.

In the spring of 2004, his net worth was about \$320,000, of which about a third was the equity in his personal residence. He received a subject letter from the USAO shortly after March 15, 2004 followed quickly by the KPMG form letter that said it would pay his legal expenses in connection with the investigation, up to \$400,000, provided he cooperated with the government.

Mr. Watson had been a witness before the Senate subcommittee in November 2003. He understood that the Senate staff viewed him as a whistleblower and that he had nothing to fear. He soon learned, however, that the USAO viewed him differently. Nevertheless, after receiving the subject letter, he asked his attorneys to reach out to the government and to offer to speak to them, which he did for the first time on April 1, 2004. He did so voluntarily because he "felt that the government misunderstood [his] involvement . . .

and that if [he] went in, [he] could clear up that misunderstanding and convince them not to indict [him].”

Mr. Watson was greatly disappointed by his reception at the USAO. He left the meeting thinking that it had gone “very poorly” and “felt sick about it.” After consulting with counsel, he concluded that he “did not want to return for . . . further proffer sessions.” Nevertheless, he returned for two subsequent proffer sessions. He testified that he did so because he could not afford to pay for what he regarded as an adequate defense and felt compelled to return in order to avoid KPMG cutting off payment of his legal fees.

The government has sought to suggest that Mr. Watson returned for the second and third proffer sessions in order to explore the possibility of a cooperation agreement or some other negotiated arrangement that would limit his criminal exposure. But the argument ultimately is not persuasive on the critical point in issue, which is whether he returned voluntarily.

Having considered the evidence and observed Mr. Watson on the stand, the Court credits his testimony that he returned for the second and third proffer sessions only because he felt compelled to do so by KPMG’s having conditioned payment of his legal fees on his cooperating with the prosecutors. Once he returned for those sessions, he no doubt sought to achieve the best possible outcome. But that does not undercut the conclusion that KPMG coerced his appearance by conditioning payment of his legal fees on his appearance and cooperation. Moreover, given Mr. Watson’s financial situation, the Court finds that KPMG’s condition left him with no practical choice but to cooperate.

The Court recognizes that the criminal process often requires defendants and prospective defendants to make hard choices among unpalatable alternatives and that there often is nothing wrong with this. What distinguishes this case is that the government here coerced KPMG to apply pressure to Mr. Watson and other individual defendants in order to secure waivers of constitutional rights that the government itself could not obtain. That goes beyond the bounds of appropriate government action. . . .

This is not the end of the analysis. The Fifth Amendment “restricts only governmental conduct, and will constrain a private entity only insofar as its actions are found to be ‘fairly attributable’ to the government.” Accordingly, defendants Smith and Watson are entitled to suppression only if the actions of KPMG in coercing the statements in question are fairly attributable to the government.

As the Supreme Court has explained, action by a private entity is “fairly attributable” to the government where “there is a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself.” Such a nexus exists either “(1) where the state ‘has exercised coercive power [over a private decision] or has provided such significant encouragement, either overt or covert, that the choice [by the private actor] must in law be deemed to be that of the State;’ or (2) where ‘the private entity has exercised powers that are traditionally the exclusive prerogative of the State.’” In other words, state action

will be found where the government commands or significantly encourages a private entity to take the specific action alleged to violate the Fifth Amendment, as well as where the government is “entwined” in the management or control of specific conduct at issue. . . .

Here, the government quite deliberately precipitated KPMG’s use of economic threats to coerce the proffer statements in question. “KPMG’s decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO.” The Thompson Memorandum, moreover, made it clear that a company’s failure to ensure that its employees disclose whatever they knew, regardless of their individual rights and concerns, might weigh in favor of indicting the company. The USAO knew that KPMG would apply additional pressure, beyond the threatened cut-off of legal fees, to “uncooperative” employees. Indeed, it reported them to KPMG in circumstances in which there was no conceivable reason for doing so except to facilitate the firing threats that ensued. . . .

The ultimate question here is whether “the state ‘has exercised coercive power [over a private decision] or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State.’” This Court finds that the government, both through the Thompson Memorandum and the actions of the USAO, quite deliberately coerced, and in any case significantly encouraged, KPMG to pressure its employees to surrender their Fifth Amendment rights. There is a clear nexus between the government “and the *specific* conduct of which” the Moving Defendants complain. KPMG’s actions in this regard are “fairly attributable” to the United States. . . .

In this case, the pressure that was exerted on the Moving Defendants was a product of intentional government action. The government brandished a big stick—it threatened to indict KPMG. And it held out a very large carrot. It offered KPMG the hope of avoiding the fate of Arthur Andersen if KPMG could deliver to the USAO employees who would talk, notwithstanding their constitutional right to remain silent, and strip those employees of economic means of defending themselves. In two instances, that pressure resulted in statements that otherwise would not have been made. In seven, the evidence does not warrant that conclusion. The coerced statements and their fruits must be suppressed.

UNITED STATES v. CONNOLLY, 2019 WL 2120523 (S.D.N.Y. May 2, 2019)

COLLEEN McMAHON, Chief Judge:

[Gavin] Black moves for relief under *United States v. Kastigar*, on the basis that statements obtained by his employer, Deutsche Bank AG (“Deutsche Bank”), in the course of what purported to be an internal investigation into the possible manipulation of the London Inter-Bank Offered Rate (“LIBOR”), are fairly attributable to the Government within the meaning of *Garrity v. New Jersey*

Black has made a rather convincing showing that Deutsche Bank and its outside counsel, Paul Weiss, Rifkind, Wharton & Garrison LLP (“Paul Weiss”), were *de facto* the Government for *Garrity* purposes; more important, the Government has made an utterly unpersuasive case in rebuttal. There remain holes in the record, however, and a full-bore *Garrity* hearing would be a fascinating exercise—especially because there are profound implications if the Government, as has been suggested elsewhere, is routinely outsourcing its investigations into complex financial matters to the targets of those investigations, who are in a uniquely coercive position *vis-à-vis* potential targets of criminal activity. The Court is deeply troubled by this issue.

But the Court is not eager to put the parties through a purely academic exercise. And in this case, holding a *Garrity* hearing would be a purely academic exercise because, even if Deutsche bank and Paul Weiss were agents of the Government, Black’s *Kastigar* rights were not violated. The motion is, therefore, denied. . . .

In or about October 2008, the United States Commodity Futures Trading Commission (“CFTC”) opened an investigation into LIBOR manipulation by two financial services firms—Barclays PLC (“Barclays”) and UBS Group AG (“UBS”)—both of which were LIBOR panel submitting banks.

In 2010, the Government started looking at another LIBOR panel member, Deutsche Bank. The United States Securities and Exchange Commission (“SEC”) was the first federal agency to open an investigation into Deutsche Bank’s role in LIBOR manipulation. The Bank retained Paul Weiss sometime in “early 2010” to respond to the SEC’s inquiry.

On April 19, 2010, the CFTC sent a letter to Deutsche Bank’s General Counsel for the Americas, Joseph Polizzotto, stating that it, too, intended to look into whether Deutsche Bank had submitted false or misleading LIBOR reports. The CFTC advised Deutsche Bank that it “expect[ed]” the Bank to “cooperate fully” with its investigation. It then went on to explain exactly what cooperation would look like:

Accordingly, the Division requests that Deutsche Bank Securities Inc. (and its parent, subsidiaries, affiliates and divisions, collectively referred to as “Deutsche Bank”) voluntarily conduct by external counsel a fall review of Deutsche Bank’s U.S. Dollar LIBOR reporting for the relevant time period, and report on an on-going basis the results of that review to the Division, with the review to be completed by no later than September 1, 2010. Further, the Division requests that Deutsche Bank certify that it was in compliance with the Act and Regulations with respect to its reporting of LIBOR and related trading.

Appended to the CFTC’s letter was a CFTC Enforcement Advisory Memorandum titled “Cooperation Factors in Enforcement Division Sanction Recommendations.” This memorandum stated that a corporate cooperator might receive cooperation credit if,

among other things, it “utilize[s] all available means to [] make employee testimony or other relevant corporate documents available in a timely manner.” It also noted that the quality of a corporation’s cooperation might depend upon whether the company “avoid[ed] entering into joint defense agreements with counsel for employees[.]”

Deutsche Bank expanded Paul Weiss’s representation to include conducting the so-called “voluntary” investigation that was demanded (not requested) by the CFTC. According to Walter Ricciardi, the Paul Weiss partner who headed the Bank’s internal investigation into LIBOR from its inception until January 2013, there was nothing “voluntary” about the investigation that followed the CFTC letter; given the draconian consequences that would likely ensue if it did not accept the agency’s invitation, Deutsche Bank’s only choice was about its “level of cooperation” with the Government, not about whether to cooperate. Accordingly, Deutsche Bank immediately decided that it would go all-in with cooperation.

On the record presently before the Court, it is clear enough that, for five years, Deutsche Bank and its outside counsel coordinated extensively with the three Government agencies—the SEC, the CFTC, and eventually the United States Department of Justice (“DOJ”)—that were looking into possible LIBOR manipulation. Indeed, it is apparent that the Government was kept abreast of developments on a regular basis, and that the federal agencies gave considerable direction to the investigating Paul Weiss attorneys, both about what to do and about how to do it. The issue raised by Black’s motion is just exactly how much the investigation conducted by Paul Weiss was a substitute for investigative efforts by Government attorneys.

In the early days of the CFTC’s investigation, counsel for Deutsche Bank and the CFTC held a series of telephone meetings during which they laid out the framework for the Bank’s initial investigatory steps. The CFTC proposed, and Deutsche Bank expressly agreed, to take certain immediate actions, including specifically, “Interview[ing] [] all relevant Bank staff, including those who had knowledge/approval/over sight of, input on or discussions regarding the setting and submission of the Bank’s LIBOR[.]”

In a letter “set[ting] forth” the actions Deutsche Bank had “agreed” to undertake, the CFTC also conveyed the Government’s expectation that counsel would regularly provide updates on its internal investigation:

[A]s we discussed, the CFTC and the SEC further envision regular updates, initially occurring weekly, from Counsel concerning the status and progress of the internal investigation, These updates will include simultaneous productions of responsive documents and information uncovered in the internal investigation.

The Court will assume that the CFTC and SEC received the weekly reports demanded in the July 14, 2010 letter, especially since Ricciardi testified that, while he did not recall

the CFTC’s specific request for ongoing updates, he “probably didn’t pay much attention to it because that’s just the standard way it’s always done.”

At the same time that the CFTC opened its investigation, the DOJ submitted an “Access Request Letter” to the CFTC, asking it to provide DOJ with all documents it obtained as part of its investigation into LIBOR manipulation generally. As a result of this access request letter, DOJ ultimately “received [from CFTC] hundreds of thousands of documents throughout the course of its investigation of Deutsche Bank[.]”

On November 4, 2010, Paul Weiss lawyers and representatives of Deutsche Bank’s legal department met in person with CFTC representatives in order to provide a summary of the Bank’s investigation to date. Prior to that meeting, Paul Weiss lawyers had conducted telephone interviews with several people at Deutsche Bank who ended up being part of this case, including James King and Michael Curtler (both of whom eventually testified at Black’s trial). They had also interviewed David Nicholls, an individual who oversaw Deutsche Bank’s global finance and currency forward-trading desks horn London.

At the November 4 meeting, the CFTC “asked” (*i.e.*, instructed) Paul Weiss to “interview King, Curtler, and Nicholls again, this time in person, before Thanksgiving, *and that at the same time, to the extent [Paul Weiss] learn[s] that King or Curtler regularly interact with or obtain information from others, on the same desk or other desks, [Paul Weiss] interview those individuals as well[.]*”) Deutsche Bank identified Gavin Black as an individual who fell within the parameters of the Government’s interview request. The Government concedes “for the purposes of this motion” that the “certain employees” it expected Paul Weiss to interview included Gavin Black.

Paul Weiss lawyers, acting on behalf of Deutsche Bank, interviewed Black on November 22, 2010. Black did not have discretion to refuse to talk to the investigative team. Deutsche Bank’s employee policy, titled “Global Compliance Core Principles,” provides that an employee “*must* fully cooperate with Compliance and other appropriate Deutsche Bank departments (*e.g.*, Legal, Group Audit, etc.) handling internal and external examinations, investigations and other reviews involving Deutsche Bank, its customers and other related company activities.” Although the policy did not explicitly provide for termination if employees did not comply—it only states, “Employees who violate Deutsche Bank’s policies *may* be subject to disciplinary action up to and including termination of employment[.]”—Ricciardi testified, credibly, that any employee who did not cooperate with the investigation would have lost his job. Moreover, Black himself has submitted a declaration in which he avers that “[he] did not believe that [he] had any choice but to agree to meet with Paul Weiss lawyers and answer their questions [,]” and that, “had [he] refused to do so, it would have resulted in [his] termination from Deutsche Bank.” In light of Ricciardi’s testimony, Black’s subjective understanding is what any reasonable employee of Deutsche Bank would have understood.

As the Paul Weiss investigation continued, Deutsche Bank representatives and counsel continued to update the Government about their findings and coordinate next steps, as

to Black and others. The Government gave Deutsche Bank/Paul Weiss marching orders during these meetings. For example, on December 4, 2014, a Government official directed Roberto Finzi, a Paul Weiss partner, to “approach [an employee] interview as if he were a prosecutor”—a request with which Finzi complied by giving his “word.” It is not clear whether the Government followed a similar protocol with respect to some or all of Paul Weiss’s earlier interviews of Deutsche Bank employees. Other evidence indicates that the UK FCA—which was conducting a LIBOR investigation of its own—required Paul Weiss to provide it with an “interview plan and a list of documents” before it was permitted to interview another Deutsche Bank employee.

Nonetheless, the Court has only a limited picture of Black’s interactions with Paul Weiss and Deutsche Bank. It knows even less about the Government’s role in those interactions.

Paul Weiss lawyers interviewed Black a second time on August 25, 2011 and a third time on June 19, 2012. Black was not represented by counsel at either of these interviews—just as he had not been represented at the November 22, 2010 interview. Nor does it appear that he was provided with any advance information about what to prepare (or be prepared for) at these interviews. He was given standard *Upjohn* warnings at all interviews.⁵

. . . After the Bank interviewed Black for the third time in 2012, its lawyers met with the Government in person to provide a “download,” meaning an exhaustive summary, of Black’s statements to Paul Weiss attorneys. Government notes from the “download” meeting corroborate the version of events that Ricciardi subsequently provided to the Government, *viz.*, that Black’s interviews with Paul Weiss largely consisted of his denying any wrongdoing. They also reflect some willingness by Paul Weiss to help the Government investigate Black, should it ever come to that point:

Gavin, if you choose to interview him, may recall only one or two e-mails presented before him; beyond that he does not recall any email exchanges. He will be exceptionally clear and straightforward with his answers. That said, he does not recall communication entirely. At best 3–4 occasions, which the emails may cover, are recalled. [O]ne

⁵ An “*Upjohn* warning” is the notice an attorney (in-house or outside counsel) provides a company employee to inform her that the attorney represents only the company and not the employee individually. An attorney cautions a company employee with an *Upjohn* warning when the company is involved in litigation or conducting an internal investigation. Providing an employee with an *Upjohn* warning should make it clear that:

- The attorney-client privilege over communications between the attorney and the employee belongs solely to, and is controlled by, the company.
- The company may choose to waive the privilege and disclose what the employee tells the attorney to a government agency or any other third party.

The term originated with *Upjohn Co. v. United States*, 449 U.S. 383 (1981), in which the Supreme Court held that the attorney-client privilege is preserved between the company and its attorney when its attorney communicates with the company’s employees, despite the rule that communications with third parties constitute a waiver of the attorney-client privilege.

communication where a setter asks: “Any Requests” Black would not interpret this to be soliciting a LIBOR request at that time, nor would he see anything wrong with that statement today. There is no nefarious meaning behind it, he would say.

According to Black’s counsel, the Government ultimately used the information it learned from this “download” meeting to question Black during his proffer session, which took place in London on October 1, 2013—long after Deutsche Bank, through Paul Weiss, had interviewed Black and then relayed his statements to the Government.

On September 9, 2014, as the Bank’s internal investigation was drawing to a close, Deutsche Bank’s counsel sought the Government’s “permission” to interview Gavin Black, who still worked at the Bank, for a fourth time—which is to say, Deutsche Bank *asked the Government for “permission” to interview its own employee*. The Government asserts in its brief that Paul Weiss interviewed Gavin Black on December 4, 2014, at which interview Black was represented by counsel. While the Government does not provide a citation to the record to support this assertion, and the Court has not located other evidence to corroborate this assertion, it will accept the Government’s representation.

On January 21, 2015, Paul Weiss submitted a report, known colloquially as the Paul Weiss “White Paper,” summarizing the findings of its LIBOR investigation and laying out a roadmap of the case against Deutsche Bank and various individuals who worked for the Bank.

Among other things, the White Paper provides an exhaustive overview of the Bank’s substantial cooperation with the Government during its LIBOR investigation. During the course of Deutsche Bank’s nearly five-year internal investigation, Paul Weiss lawyers conducted nearly 200 interviews of more than fifty Bank employees—including, of course, of Black—and shared the results of these interviews with the Government. In addition to conducting interviews, Paul Weiss extracted and reviewed 158 million electronic documents, as well as listened to 850,000 audio files, or over hundreds of thousands of hours of audio tapes. . . .

When all was said and done, the LIBOR investigation was the largest and most expensive internal investigation in the respective histories of both Deutsche Bank and Paul Weiss.

But the investigation was a conspicuous success for Deutsche Bank. On April 23, 2015, Deutsche Bank entered into a deferred prosecution agreement (“DPA”) with DOJ, under which Deutsche Bank agreed to (i) pay \$ 775 million in criminal penalties; (ii) continue cooperating with the Government in its ongoing investigation; and (iii) retain a corporate monitor for the three-year term of the agreement. In addition, one of Deutsche Bank’s subsidiaries, Deutsche Bank Group Services (UK) Limited, agreed to plead guilty to one count of wire fraud and pay its own fine. . . .

One critically important issue is just what the Government was doing during the five years between the sending of the CFTC's April 2010 letter and Deutsche Bank's eventual entry into a DPA with DOJ on April 23, 2015. Did the Government conduct a substantive parallel investigation to the "internal" investigation at Deutsche Bank, or did it simply give direction to Deutsche Bank/Paul Weiss, take the results of their labor (which appears to have been fully disclosed to Government lawyers), and save itself the trouble of doing its own work?

On the record presently before it, the Court would have to conclude the latter. The Government—which has never treated this matter with the seriousness it deserves—did not provide the Court with much information about any independent investigative activities it may have undertaken during those years. Indeed, it has declared that it has no need to do so.

The Government—first the SEC on April 4, 2010, then the DOJ on June 27, 2011—subpoenaed Deutsche Bank for documents. However, the Government does not appear to have interviewed any witnesses from Deutsche Bank—at least, not until after Paul Weiss interviewed those witnesses and passed information gleaned from those interviews on to the Government—or taken any investigative depositions, or reviewed anything that had not first passed through the maw of Paul Weiss's five-year, \$10 million investigative machine and been fully digested for the Government by the target of the investigation. . . . It is hard not to conclude that the Government did not conduct a single interview of its own without first using a road map that Paul Weiss provided—illuminating just how the Government should "investigate" the case against certain Deutsche Bank employees, including Black. . . .

The Fifth Amendment provides in relevant part, "No person . . . shall be compelled in any criminal case to be a witness against himself." U.S. Const. amend. V. An individual claiming a violation of the privilege against self-incrimination must prove that the statements at issue were both the product of coercion and attributable to the government.

In *Garrity*, the Supreme Court held that the statements obtained from police officers under threat of termination of employment were involuntary and therefore inadmissible against them in a criminal trial. Justice William O. Douglas, writing for the majority, reasoned that the "fear of being discharged under [New Jersey's public employment forfeiture statute] for refusal to answer on the one hand and the fear of self-incrimination on the other hand was 'a choice between the rock and the whirlpool,'" *id.* (quoting *Stevens v. Marks*). Subjecting employees to that Hobson's choice violates the Constitution.

While *Garrity* involved the conduct of a government employer, the *Garrity* rule applies with equal vigor to private conduct where the actions of a private employer in obtaining statements are "fairly attributable to the government." *United States v. Stein* ("*Stein I*"). Private conduct is attributed to the government when "there is a sufficiently close nexus between the state and the challenged action." *Blum v. Yaretsky*; *Stein II*.

As the Second Circuit explained in *Stein II*, a close nexus of state action exists between a private entity and the state when a governmental actor (i) exercises coercive power; (ii) is entwined in the management or control of the private actor; (iii) provides the private action with significant encouragement, either over or covert; (iv) engages in a joint activity in which the private actor is a willful participant; (v) delegates a public function to the private actor; or (vi) entwines the private actor in governmental policies.

It is not enough, however, that there be a close nexus between the state and the actions undertaken by a private entity; the Government must influence the specific conduct of which the party complains. The “controlling factor” is not whether the state directed the constitutionally prohibited conduct, but whether the state “involved itself in the use of a substantial economic threat to coerce a person into furnishing an incriminating statement.” *United States ex rel. Sanney v. Montanye*. The defendant bears the initial burden of showing that his interview statements are subject to *Garrity* protection. . . .

The record, which is limited (the responsibility for which falls squarely on the Government), contains compelling evidence that Deutsche Bank’s investigation is fairly attributable to the Government. Among other things, it suggests that the Government directed Deutsche Bank to investigate Gavin Black on its behalf. The Bank’s first interview of Black was conducted at the behest of the Government. Although there is no evidence either way about whether the fruits of that interview were shared with the Government agencies investigating Deutsche Bank, it is plausible—if not likely—that they did, since the record reflects that Paul Weiss was eager to share information about Black’s subsequent two interviews. Record evidence also establishes that, as Deutsche Bank’s investigation progressed, the Government continued to discuss Black by name in meetings with Bank investigators. All of this occurred well before any representative of the Government made any effort to speak with Black; that did not occur until the fall of 2013, three and a half years after Deutsche Bank’s “internal” investigation began.

Of course, it is not enough under *Garrity* that Deutsche Bank’s investigation was *generally* fairly attributable to the Government. The Bank’s interviews of Black must have been Government-engineered interviews. The evidence certainly points in that direction. There is no evidence suggesting that Black’s interviews were conducted on some different footing than were the interviews of other Deutsche Bank employees. During the period when Paul Weiss conducted the first three (of four) interviews of Black, the Government told Deutsche Bank whom to interview and when. It told Deutsche Bank to interview Gavin Black. Moreover, even as late as 2014—when the investigation was in its fourth year—the Government was still directing Paul Weiss’s activities. When Paul Weiss wanted to interview Gavin Black on September 9, 2014, it sought the Government’s permission to do so. And the Government did not simply give permission; it directed an experienced Paul Weiss partner and former Assistant U.S. Attorney for the Southern District of New York on the precise manner in which he should ask his questions. For its part, rather than simply producing documents and providing interview summaries, Paul Weiss, in full (and understandable) aid of its client’s (*i.e.*, Deutsche Bank’s) interests, digested the vast information it collected,

highlighted the most important nuggets, and shared a blueprint for what prosecutors should expect should they finally interview Black on their own. Not surprisingly, when it came time to resolve its case against Deutsche Bank, the Government credited Paul Weiss for its extensive support of its own investigative efforts.

The only conclusion one can draw from this evidence is that, rather than conduct its own investigation, the Government outsourced the important developmental stage of its investigation to Deutsche Bank—the original target of that investigation—and then built its own “investigation” into specific employees, such as Gavin Black, on a very firm foundation constructed for it by the Bank and its lawyers. This was no ordinary “outside” investigation. Deutsche Bank did not respond to the Government’s subpoenas by turning over documents without comment, and its employees were not subjected to government or regulatory depositions on notice, at which they were defended by company counsel. Indeed, Deutsche Bank did the opposite—it effectively deposed their employees by company counsel and then turned over the resulting questions and answers to the investigating agencies. . . .

Having declined to offer much by way of evidence, the Government falls back on strained legal and policy arguments that are not just unconvincing, but unworthy.

The Government (repeatedly) argues, for example, that Deutsche Bank could not have shared a close enough nexus with the Government, because its fiduciary duty diverged from the Government’s, in that Deutsche Bank—as a public company—owed its duty to shareholders, and Paul Weiss—as counsel to Deutsche Bank—owed a duty of loyalty to its client. It is hard to take this argument seriously.

The Second Circuit noted in *Stein II* that, “The threat of [ruinous indictment] brings significant pressure to bear on corporations, and that threat ‘provides a sufficient nexus’ between a private entity’s employment decision at the government’s behest and the government itself.” See *Stein II* (citing Lisa Kern Griffin, *Compelled Cooperation and the New Corporate Criminal Procedure*, 82 N.Y.U. L. Rev. (2007)). According to Ricciardi, Deutsche Bank was facing the threat of ruin, such that the only “choice” facing Deutsche Bank when it received the CFTC’s letter was the “level of cooperation” it would provide to the Government—because not cooperating was not an option. Viewed in that light, the CFTC’s request that Deutsche Bank conduct a “voluntary” investigation was a classic “Godfather offer”—one that could not be refused. And Deutsche Bank’s interest in cooperating was perfectly aligned with the Government’s interest in outsourcing its investigative functions (if that is indeed what occurred in this case). This massive amount of pressure is highly relevant to any assessment of the sufficiency of the nexus between the Government and Deutsche Bank’s “internal” investigation. . . .

Finally, the Government urges that the Court must not conclude that there was a sufficiently close nexus between it and Deutsche Bank, because doing so will hamper law enforcement by curtailing the Government’s ability to encourage cooperation, which will prove a bad idea as a matter of policy.

The Court does not doubt that it saves the Government considerable time and precious resources to permit counsel for the target of an investigation to do the heavy lifting of ferreting out the truth—especially in a case like this one, which is so large, technical, and complicated. But this is a court of law, not a court of policy. The Court is not concerned with whether the outsourcing of investigations to private parties makes life easier for the Government or for the taxpayers; it is concerned with the protection of the defendant’s constitutional right against self-incrimination, and so with the constitutional implications, if any, of such outsourcing. That concern trumps the Government’s interest in convenience.

In conclusion, given the Government’s deliberate choice not to create a record that would allow for a contrary finding, the record presently before the Court establishes that the Government violated *Garrity*, because Deutsche Bank’s interviews of Gavin Black, for which he was compelled to sit under threat of termination, are fairly attributable to the Government. . . .

As stated earlier, the Fifth Amendment prevents the Government from making any use, direct or indirect, of a defendant’s compelled statements. The Government must affirmatively prove by a preponderance of the evidence that the evidence it “used” was derived from a source that was “wholly independent” of Black’s compelled testimony. Prohibited “uses” of compelled testimony include “obtaining [an] indictment” based on tainted evidence, *Hubbell*; “preparing [the Government’s case for trial;” and presenting tainted evidence to the grand jury. *Poindexter*. *Kastigar* does not, however, encompass “merely tangential” non-evidentiary uses of compelled testimony, *Riveccio*, such as evidence that does not “influence[] the [G]overnment’s decision to pursue its line of investigation.” *Nanni*.

None of Black’s interview statements was introduced into evidence at his trial. In fact, the Government, in view of the looming *Garrity/Kastigar* issue, declined to call Ricciardi as a prosecution witness at the last possible moment—which it initially planned to do for the sole and exclusive purpose of getting Black’s false denials before the jury, so the Government could argue that they were completely at odds with the literal text of his emails and chats.

Nor did the Government make indirect use Black’s false exculpatory statements at trial. There is not a single item of trial evidence that would not have come in but for Black’s interview statements to Paul Weiss. Black does not identify, and the Court cannot find, a single question that was asked that otherwise would not have been asked. . . .

The Government thus did not violate *Kastigar* at Black’s trial.

The Government also did not make direct or indirect use of any of Black’s interview statements before the grand jury. As found in the Court’s Order Denying the Pretrial Motion of Defendant Gavin Black to Dismiss the Indictment for Alleged Violations of *Kastigar*, dated May 29, 2018, the Government identifies an independent source other

than Black’s interviews (whether with the UK FCA or with Paul Weiss) for everything that FBI Special Agent Jeffrey Weeks (the only grand jury witness) presented to the grand jury—either in the form of documents, cooperators, or information received from Deutsche Bank. Indeed, in connection with the Court’s prior *Kastigar* opinion, the Court reviewed the Government’s alternative source material for *every line* of grand jury testimony; all were accounted for, and none derived, directly or indirectly, from Black. . . .

Even assuming that the Government violated *Kastigar*, any such *Kastigar* violation would constitute harmless error. . . .

The Government has persuaded the Court that any improper use of Black’s compelled statements was harmless. As should be readily clear to the parties by now, the Court having sat through a lengthy trial and reviewed the evidence on numerous occasions—does not doubt that Black would have been indicted and convicted even if Paul Weiss lawyers had never spoken to him. The evidence that the Government obtained against Black from its many independent sources was overwhelming.

Problem 12-1

Both *Stein* and *Connolly* found state action, but the cases ultimately had very different outcomes. What are the key factual differences that resulted in the coerced statements in *Stein* being granted use immunity (perhaps even derivative use immunity?), yet the statements in *Connolly* were still admissible?

Individual corporate employees prosecuted following corporate efforts to cooperate with the DOJ continue to press Fifth Amendment arguments to attempt to suppress evidence in their own cases in the form of statements made during internal investigations. In *United States v. Coburn*, Civ. No. 2:19-cr-00120 (KM) (D.N.J. July 20, 2023), two former employees of Cognizant Corporation facing prosecution moved to suppress statements taken from them in the course of Cognizant’s internal investigation into FCPA violations. It was established and known at Cognizant that employees who refused to cooperate with the company’s investigations would be subject to termination.

The court in *Coburn* denied the defendants’ motions on the basis that Cognizant had conducted some of the interviews even before it self-disclosed the FCPA matter to DOJ, and that one interview conducted after Cognizant began to cooperate with DOJ was not managed or directed in any way by DOJ. The mere existence of DOJ’s incentives to Cognizant to investigate and share the results to obtain reduced penalties, the court said, was not enough to establish that Cognizant’s questioning of the defendant employees was state action. In addition, the court said, Cognizant had reasons to conduct a thorough investigation apart from its desire to secure leniency from the DOJ. It seems likely that, more than *Stein* and *Connolly*, the *Coburn* decision (and its facts) will be pointed to by prosecutors as guidance for how to avoid later Fifth Amendment issues while negotiating for the fruits of corporate internal investigations.

Here is a civil lawsuit in which fired employees tried to get mileage out of the same reasoning pursued in the above district court opinions. The Second Circuit opinion here, however, suggests that the *Stein* and *Connolly* reasoning might be limited to certain kinds of facts.

GILMAN v. MARSH & McLENNAN COS., INC., 826 F.3d 69 (2d Cir. 2016)

DENNIS JACOBS, Circuit Judge:

Faced with the prospect of criminal indictment premised on the actions of two employees, a company demanded that those employees explain themselves under the threat of termination. They refused, were fired, and in this suit seek to recover employment benefits they lost by termination. . . .

In April 2004, the New York Attorney General (the “AG”) began investigating “contingent commission” arrangements by which insurance brokers were thought to be steering clients to particular insurance carriers. Marsh, as one of the brokers under investigation, retained outside counsel, Davis Polk & Wardwell LLP, to conduct an internal investigation of the AG’s allegations. The internal investigation included interviews with Gilman and McNenney in the spring and summer of 2004.

The focus of the AG investigation shifted, in September 2004, to an alleged bid-rigging scheme involving Marsh and several insurance carriers. On October 13, 2004, two individuals at American International Group, Inc. (“AIG”) pleaded guilty to felony complaints charging them with participation in a bid-rigging scheme with Marsh. In the allocution of one of the AIG employees, Gilman and McNenney were identified as co-conspirators. The next day, the AG filed a civil complaint against Marsh for alleged fraudulent business practices and antitrust violations.

The fallout from the civil complaint was swift and severe. Marsh’s stock price plunged, a raft of private civil suits were filed, and Marsh’s directors, clients, and shareholders demanded answers to the bid-rigging allegations. Marsh responded by expanding the ongoing internal investigation; on October 19, 2004, Marsh suspended Gilman and McNenney (with pay). More or less at the same time, Marsh’s counsel asked Gilman and McNenney to sit for interviews and warned that failure to comply would result in termination. Gilman was asked to interview with a lawyer from Davis Polk as soon as possible. McNenney alleges that he was asked to submit to an interview with a lawyer from the AG and that he was told to do so without presence of counsel. (Marsh vigorously denies that McNenney was asked to interview with the AG, let alone to do so without counsel.)

On October 25, 2004, the CEO of Marsh’s parent company resigned and was replaced by Michael Cherkasky. The same day, Cherkasky met with Eliot Spitzer, then-Attorney General of New York, to discuss the investigation. Gilman and McNenney contend that the upshot of the meeting was that the AG would forgo criminal prosecution of Marsh itself in exchange for its cooperation with the AG’s investigation, including waivers of

attorney-client privilege and work-product immunity for information developed in the (expanding) internal investigation. That day, an AG press release announced that a civil proceeding would suffice to punish and reform Marsh, and that criminal prosecutions arising out of the alleged bid-rigging scheme would be limited to individuals. This press release was widely understood to mean the AG would indict Gilman and McNenney—as it eventually did.

By the time of the October 25 meeting and agreement between Cherkasky and Spitzer, neither Gilman nor McNenney had complied with Marsh's counsel's requests that they sit for interviews. On October 27, 2004, McNenney's attorney conveyed McNenney's refusal to Davis Polk; Marsh fired him the next day. On October 28, 2004, Gilman's attorney scheduled an interview for his client on November 2. But on November 1, 2004, Gilman submitted paperwork purporting to effectuate an early retirement; later that day, his attorney conveyed Gilman's refusal to be interviewed. Marsh fired Gilman the next day, and did not accept Gilman's purported retirement.

As Marsh employees, Gilman and McNenney were eligible for some valuable employment benefits. Under Marsh's Stock Award Plans, they received grants of stock options, stock bonus units, and/or deferred stock units, some of which they could have been entitled to upon termination if (for example) they had retired or were fired without cause. If, however, they were terminated "for cause," any unvested stock benefits were forfeited. Under Marsh's ERISA-governed Severance Pay Plan, Gilman and McNenney were entitled to severance if, *inter alia*, they remained in good standing with Marsh on their last day of work and if their employment terminated (i) because they lacked job skills, or (ii) in connection with a restructuring, or (iii) because Marsh had eliminated their position. An otherwise-eligible employee whose employment was terminated "for cause" was not entitled to severance. Marsh took the position that it fired Gilman and McNenney "for cause," and denied them unvested, deferred compensation as well as severance.

As relevant here, Gilman and McNenney sued Marsh to obtain the lost employment benefits, alleging violations of ERISA, breach of contract, and breach of the implied covenant of good faith and fair dealing. The district court granted summary judgment in favor of Marsh, concluding that the interview requests were reasonable, that Gilman's and McNenney's refusal to sit for interviews gave Marsh cause for termination, that Marsh did in fact fire them for cause (and did not breach the implied covenant), and that Gilman's purported retirement was ineffective. Gilman and McNenney appeal. . . .

The first question is whether the demand that Gilman and McNenney submit to interviews was reasonable as a matter of law. If so, Marsh had cause to fire them and deny them employment benefits. If not, Gilman's and McNenney's claims against Marsh for benefits should have withstood summary judgment. We conclude that the interview demands were reasonable as a matter of law because at the time they were made, Gilman and McNenney were Marsh employees who had been implicated in an alleged criminal conspiracy for acts that were within the scope of employment and that imperiled the

company. The second question is whether there is a triable issue of fact as to whether Marsh fired them for cause. We conclude that there is not and reject the argument that Gilman and McNenny were let go routinely as part of a reduction in force and the argument that Gilman could not be fired because he had preemptively resigned. Finally, we reject Gilman's and McNenny's contention that, in light of Marsh's cooperation with the AG, Marsh's requirement that they answer potentially incriminating questions amounted to state action, and was thus unreasonable. Accordingly, Marsh had cause to fire them, as it did, and Gilman and McNenny are entitled to none of the employment benefits they seek.

Under Delaware law, which governs Marsh's employment contracts with Gilman and McNenny, "cause" for termination includes the refusal to "obey a direct, unequivocal, reasonable order of the employer." *Unemployment Ins. Appeal Bd. v. Martin*. Gilman and McNenny do not dispute that Marsh's orders that they sit for interviews were direct and unequivocal. So the decisive issue is whether the orders were reasonable.

When Gilman and McNenny were named as co-conspirators in a criminal bid-rigging scheme for their conduct *as Marsh employees*, it was obvious (as Gilman and McNenny themselves affirmatively argue) that the AG intended to prosecute them criminally. At that time, Marsh had sufficient basis to act on the allegations, made under oath in open court, and would have had cause to terminate Gilman and McNenny, regardless of the ultimate resolution of the allegations. . . . If Marsh had indeed fired them then, it would have been for cause, and Gilman and McNenny would for that reason have been ineligible for the employment benefits they currently seek. It is difficult to see how their claims for benefits improved because Marsh instead gave them the chance to explain themselves, and they refused to comply.

Marsh was presumptively entitled to seek information from its own employees about suspicions of on-the-job criminal conduct. Marsh could take measures to protect its standing with investors, clients, employees, and regulators. Marsh also had a duty to its shareholders to investigate any potentially criminal conduct by its employees that could harm the company. And as corporate officers, Gilman and McNenny had a duty to Marsh to disclose information they had about the AG's allegations.

Marsh's demands placed Gilman and McNenny in the tough position of choosing between employment and incrimination (assuming of course the truth of the allegations). But though Gilman and McNenny "may have possessed the personal rights to [not sit for interviews], that does not immunize [them] from all collateral consequences that come from [those] act[s]," including leaving Marsh "with no practical option other than to remove [them]." *Hollinger Int'l, Inc. v. Black*. "[T]here would be a complete breakdown in the regulation of many areas of business if employers did not carry most of the load of keeping their employees in line and have the sanction of discharge for refusal to answer what is essential to that end." *United States v. Solomon*. Marsh had to use the "sanction of discharge for refusal to answer," because in the absence of an exculpatory explanation, Marsh needed to assume the worst: that the bid-rigging

allegations were true and that Marsh was vicariously liable for their criminal conduct. . . .

Given the circumstances, Marsh's demand that Gilman and McNenney explain themselves in an interview under the penalty of termination was unassailable, even routine. It did what any other company would do, and (arguably) what any company should do. Marsh's interview demands were reasonable and it had cause to fire Gilman and McNenney for refusing to comply. . . .

Gilman and McNenney argue that Marsh's interview demands constitute state action that infringed their right against self-incrimination. This is "the legal equivalent of the 'Hail Mary pass' in football." *In re Lionel Corp.* They advance the following argument: if Marsh's request that Gilman and McNenney sit for interviews under the penalty of termination is deemed state action (because of Marsh's cooperation with the AG), and if that demand and threat violated their Fifth Amendment right, then Marsh's request was unreasonable as a matter of law, and their refusal to comply with the interview demands cannot support their loss of benefits.

The claim that Marsh was a state actor leans heavily on *United States v. Stein*; but *Stein* cannot support that weight. . . . The government's influence in *Stein* was "overwhelming" in several respects: KPMG's "survival depended on its role in a joint project with the government to advance government prosecutions;" "the government forced KPMG to adopt its constricted Fees Policy;" the government "intervened in KPMG's decisionmaking;" the prosecutors "steered KPMG toward their preferred fee advancement policy and then supervised its application in individual cases;" and "absent the prosecutors' involvement . . . KPMG would not have changed its longstanding fee advancement policy." Since the government steered KPMG to adopt a policy it otherwise would not have adopted, and then supervised KPMG's implementation of that policy, KPMG's conduct was found to constitute state action.

. . . Marsh had good institutional reasons for requiring Gilman and McNenney to sit for interviews or else lose their jobs: the company's stock price was sinking and its clients, directors, investors, and regulators were demanding answers about the allegations. There is no evidence that the AG "forced" Marsh to demand interviews, "intervened" in Marsh's decisionmaking, "steered" Marsh to request interviews, or "supervised" the interview requests. Nor is there evidence that the nature and scope of the pending interviews were framed by the government, or changed after Cherkasky's October 25 meeting with Spitzer. The expansion of Marsh's internal investigation was precipitated by allegations advanced by the government, but it is not a measure it would have forgone "but for" the AG's influence.

Even if, as McNenney contends, Davis Polk sought to interview him without counsel and with the AG present, that request occurred well before October 25, and McNenney adduced no evidence that Marsh's request for an interview arose out of pressure or coercion from the AG. And Marsh, which already had cause to fire McNenney, could

presumably put additional conditions on its interview request anyway, as it still gave McNenney fundamentally the same choice to explain himself or be fired.

Gilman and McNenney invite us to consider that the occasion for the corporate investigation was a criminal initiative by government, and that a likely use of the internal investigation was that Marsh would offer up its findings (together with the employees' testimony) in the nature of a sacrifice to an angry prosecutor. No doubt, Marsh was compelled by circumstances to conduct an investigation (with expectation that any privileges attached to it would be waived) and that one mighty circumstance was a possible prosecution of the firm. But in the ordinary course, allegations of serious wrongdoing would provoke such an investigation, whether or not the allegations were made by prosecutors and whether or not the company itself was at risk of prosecution. The interests of prudent directors alone would justify or compel such a measure. *Stein* is properly distinguished because (among other things) KPMG had no institutional interest in stripping its employees of their chosen defense counsel and KPMG was forced to abandon a longstanding policy that it had decided to continue; it was therefore found that government compulsion was the "but for" reason for the new Fees Policy. . . .

Gilman and McNenney urge that we adopt, in effect, this categorical rule: acts that are taken by a private company in response to government action, and that have as one goal obtaining better treatment from the government, amount to state action. But a company is not prohibited from cooperating, and typically has supremely reasonable, independent interests for conducting an internal investigation and for cooperating with a governmental investigation, even when employees suspected of crime end up jettisoned. A rule that deems all such companies to be government actors would be incompatible with corporate governance and modern regulation.

Problem 12-2

Recall Shirley, the hedge fund trader from the problems in Chapter 11, who walked into your office with the grand jury subpoena. Return to that initial office meeting with her again. Provide the (much more robust) advice and explanation to Shirley that you would now give at that first meeting in light of what you have learned from the materials in this chapter.

Problem 12-3

You represent a corporation under investigation for securities fraud. In an effort to obtain a non-prosecution agreement, you advise the corporation to cooperate with the DOJ and conduct a thorough internal investigation. Some of the corporation's employees may be individually implicated in the fraud and are hesitant to speak with investigators. How would you advise the corporation to proceed with its investigation, balancing your obligation to your client (the corporation) and the Fifth Amendment rights of the employees?

13. FOURTH AND FIFTH AMENDMENTS AND DOCUMENTS

This chapter covers one of the subtlest and hardest topics in constitutional criminal procedure, so ambitions should be kept reasonable here. Look to come away with an awareness of what the issue(s) are, a sense of why they are hard, and an idea of how to think harder and read more about them if you encounter them in practice. The good news, at least for the student, is that the law turns out to provide only very limited means to resist production of documents to government authorities and thus the issues here can be summarily dispensed with in the vast majority of situations.

Firms have no Fifth Amendment right to not talk. Companies cannot speak, of course, and their employees have only their own individual Fifth Amendment rights, not any right on behalf of their employers. The remaining issue, then, is what to do about documents, which is what firms would really like to protect (and is kind of how they “speak”). Are documents protected by the Fifth Amendment in any way? By the Fourth Amendment? By some combination of the two?

As you work through the sequence of cases in this chapter, you will see that firms have no constitutional right to resist production of evidence. But individuals have, as part of their own Fifth Amendment rights, the right to not have “the act of production” used against them—in *some* circumstances (sigh). You have to carefully track the Supreme Court’s reasoning on this, and it is one of those areas where seeing how the doctrine developed over time makes it easier to understand the most recent decisions. Before proceeding into the case law, refresh your memory of the text of the Fourth and Fifth Amendments below.

U.S. Constitution Amendment IV

The right of the people to be secure in their persons, houses, papers, and effects, against **unreasonable searches and seizures**, shall not be violated, and **no warrants shall issue, but upon probable cause**, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

U.S. Constitution Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a grand jury, except in cases arising in the land or naval forces, or in the militia, when in actual service in time of war or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be **compelled in any criminal case to be a witness against himself**, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

A. *Boyd: The Road Not Taken*

The first case in our sequence seems to say that the Fourth and Fifth Amendments give a person the right to resist obeying what is, in essence, a regular subpoena for documents. As you will see, *Boyd* did not last, but it is an enlightening thought experiment to consider what corporate enforcement would look like now had *Boyd* remained law.

BOYD v. UNITED STATES, 116 U.S. 616 (1886)

BRADLEY, J.

This was an information filed by the district attorney of the United States in the district court for the Southern district of New York, in July, 1884, in a cause of seizure and forfeiture of property, against 35 cases of plate glass, seized by the collector as forfeited to the United States, under the twelfth section of the ‘Act to amend the customs revenue laws,’ etc., passed June 22, 1874, (18 St. 186.) It is declared by that section that any owner, importer, consignee, etc., who shall, with intent to defraud the revenue, make, or attempt to make, any entry of imported merchandise, by means of any fraudulent or false invoice, affidavit, letter, or paper, or by means of any false statement, written or verbal, or who shall be guilty of any willful act or omission, by means whereof the United States shall be deprived of the lawful duties, or any portion thereof, accruing upon the merchandise, or any portion thereof, embraced or referred to in such invoice, affidavit, letter, paper, or statement, or affected by such act or omission, shall for each offense be fined in any sum not exceeding \$5,000 nor less than \$50, or be imprisoned for any time not exceeding two years, or both; and, in addition to such fine, such merchandise shall be forfeited.

The charge was that the goods in question were imported into the United States to the port of New York, subject to the payment of duties; and that the owners or agents of said merchandise, or other person unknown, committed the alleged fraud, which was described in the words of the statute. The plaintiffs in error entered a claim for the goods, and pleaded that they did not become forfeited in manner and form as alleged. On the trial of the cause it became important to show the quantity and value of the glass contained in 29 cases previously imported. To do this the district attorney offered in evidence an order made by the district judge under the fifth section of the same act of June 22, 1874, directing notice under seal of the court to be given to the claimants, requiring them to produce the invoice of the 29 cases. The claimants, in obedience to the notice, but objecting to its validity and to the constitutionality of the law, produced the invoice; and when it was offered in evidence by the district attorney they objected to its reception on the ground that, in a suit for forfeiture, no evidence can be compelled from the claimants themselves, and also that the statute, so far as it compels production of evidence to be used against the claimants, is unconstitutional and void. The evidence being received, and the trial closed, the jury found a verdict for the United States, condemning the 35 cases of glass which were seized, and judgment of forfeiture was given. This judgment was affirmed by the circuit court, and the decision of that court is now here for review. . . .

The principal question, however, remains to be considered. Is a search and seizure, or, what is equivalent thereto, a compulsory production of a man's private papers, to be used in evidence against him in a proceeding to forfeit his property for alleged fraud against the revenue laws-is such a proceeding for such a purpose an '*unreasonable* search and seizure' within the meaning of the fourth amendment of the constitution? or is it a legitimate proceeding? It is contended by the counsel for the government, that it is a legitimate proceeding, sanctioned by long usage, and the authority of judicial decision. No doubt long usage, acquiesced in by the courts, goes a long way to prove that there is some plausible ground or reason for it in the law, or in the historical facts which have imposed a particular construction of the law favorable to such usage. It is a maxim that, *consuetudo est optimus interpret legum*; and another maxim that, *contemporanea expositio est optima et fortissima in lege*. But we do not find any long usage or any contemporary construction of the constitution, which would justify any of the acts of congress now under consideration. As before stated, the act of 1863 was the first act in this country, and we might say, either in this country or in England, so far as we have been able to ascertain, which authorized the search and seizure of a man's private papers, or the compulsory production of them, for the purpose of using them in evidence against him in a criminal case, or in a proceeding to enforce the forfeiture of his property. Even the act under which the obnoxious writs of assistance were issued did not go as far as this, but only authorized the examination of ships and vessels, and persons found therein, for the purpose of finding goods prohibited to be imported or exported, or on which the duties were not paid, and to enter into and search any suspected vaults, cellars, or warehouses for such goods. The search for and seizure of stolen or forfeited goods, or goods liable to duties and concealed to avoid the payment thereof, are totally different things from a search for and seizure of a man's private books and papers for the purpose of obtaining information therein contained, or of using them as evidence against him. The two things differ *toto coelo*. In the one case, the government is entitled to the possession of the property; in the other it is not. The seizure of stolen goods is authorized by the common law; and the seizure of goods forfeited for a breach of the revenue laws, or concealed to avoid the duties payable on them, has been authorized by English statutes for at least two centuries past; and the like seizures have been authorized by our own revenue acts from the commencement of the government.

The first statute passed by congress to regulate the collection of duties, the act of July 31, 1789, (1 St. 43,) contains provisions to this effect. As this act was passed by the same congress which proposed for adoption the original amendments to the constitution, it is clear that the members of that body did not regard searches and seizures of this kind as 'unreasonable,' and they are not embraced within the prohibition of the amendment. So, also, the supervision authorized to be exercised by officers of the revenue over the manufacture or custody of excisable articles, and the entries thereof in books required by law to be kept for their inspection, are necessarily excepted out of the category of unreasonable searches and seizures. So, also, the laws which provide for the search and seizure of articles and things which it is unlawful for a person to have in his possession for the purpose of issue or disposition, such as counterfeit coin, lottery tickets,

implements of gambling, etc., are not within this category. *Com. v. Dana*. Many other things of this character might be enumerated. The entry upon premises, made by a sheriff or other officer of the law, for the purpose of seizing goods and chattels by virtue of a judicial writ, such as an attachment, a sequestration, or an execution, is not within the prohibition of the fourth or fifth amendment, or any other clause of the constitution; nor is the examination of a defendant under oath after an ineffectual execution, for the purpose of discovering secreted property or credits, to be applied to the payment of a judgment against him, obnoxious to those amendments. But, when examined with care, it is manifest that there is a total unlikeness of these official acts and proceedings to that which is now under consideration. In the case of stolen goods, the owner from whom they were stolen is entitled to their possession, and in the case of excisable or dutiable articles, the government has an interest in them for the payment of the duties thereon, and until such duties are paid has a right to keep them under observation, or to pursue and drag them from concealment; and in the case of goods seized on attachment or execution, the creditor is entitled to their seizure in satisfaction of his debt; and the examination of a defendant under oath to obtain a discovery of concealed property or credits is a proceeding merely civil to effect the ends of justice, and is no more than what the court of chancery would direct on a bill for discovery. Whereas, by the proceeding now under consideration, the court attempts to extort from the party his private books and papers to make him liable for a penalty or to forfeit his property.

In order to ascertain the nature of the proceedings intended by the fourth amendment to the constitution under the terms ‘unreasonable searches and seizures,’ it is only necessary to recall the contemporary or then recent history of the controversies on the subject, both in this country and in England. The practice had obtained in the colonies of issuing writs of assistance to the revenue officers, empowering them, in their discretion, to search suspected places for smuggled goods, which James Otis pronounced ‘the worst instrument of arbitrary power, the most destructive of English liberty and the fundamental principles of law, that ever was found in an English law book;’ since they placed ‘the liberty of every man in the hands of every petty officer.’ This was in February, 1761, in Boston, and the famous debate in which it occurred was perhaps the most prominent event which inaugurated the resistance of the colonies to the oppressions of the mother country.

‘Then and there,’ said John Adams, ‘then and there was the first scene of the first act of opposition to the arbitrary claims of Great Britain. Then and there the child Independence was born.’ These things, and the events which took place in England immediately following the argument about writs of assistance in Boston, were fresh in the memories of those who achieved our independence and established our form of government. In the period from 1762, when the *North Briton* was started by John Wilkes, to April, 1766, when the house of commons passed resolutions condemnatory of general warrants, whether for the seizure of persons or papers, occurred the bitter controversy between the English government and Wilkes, in which the latter appeared as the champion of popular rights, and was, indeed, the pioneer in the contest which resulted in the abolition of some grievous abuses which had gradually crept into the

administration of public affairs. Prominent and principal among these was the practice of issuing general warrants by the secretary of state, for searching private houses for the discovery and seizure of books and papers that might be used to convict their owner of the charge of libel. Certain numbers of the *North Briton*, particularly No. 45, had been very bold in denunciation of the government, and were esteemed heinously libelous. By authority of the secretary's warrant Wilkes' house was searched, and his papers were indiscriminately seized. For this outrage he sued the perpetrators and obtained a verdict of £1,000 against Wood, one of the party who made the search, and £4,000 against Lord Halifax, the secretary of state, who issued the warrant. The case, however, which will always be celebrated as being the occasion of Lord CAMDEN'S memorable discussion of the subject, was that of *Entick v. Carrington and Three Other King's Messengers*, reported at length in 19 How. St. Tr 1029. The action was trespass for entering the plaintiff's dwelling-house in November, 1762, and breaking open his desks, boxes, etc., and searching and examining his papers. The jury rendered a special verdict, and the case was twice solemnly argued at the bar. Lord CAMDEN pronounced the judgment of the court in Michaelmas term, 1765, and the law, as expounded by him, has been regarded as settled from that time to this, and his great judgment on that occasion is considered as one of the landmarks of English liberty. It was welcomed and applauded by the lovers of liberty in the colonies as well as in the mother country. It is regarded as one of the permanent monuments of the British constitution, and is quoted as such by the English authorities on that subject down to the present time.

As every American statesman, during our revolutionary and formative period as a nation, was undoubtedly familiar with this monument of English freedom, and considered it as the true and ultimate expression of constitutional law, it may be confidently asserted that its propositions were in the minds of those who framed the fourth amendment to the constitution, and were considered as sufficiently explanatory of what was meant by unreasonable searches and seizures. . . .

It is not the breaking of his doors, and the rummaging of his drawers, that constitutes the essence of the offense; but it is the invasion of his indefeasible right of personal security, personal liberty, and private property, where that right has never been forfeited by his conviction of some public offense[. I]t is the invasion of this sacred right which underlies and constitutes the essence of Lord CAMDEN's judgment. Breaking into a house and opening boxes and drawers are circumstances of aggravation; but any forcible and compulsory extortion of a man's own testimony, or of his private papers to be used as evidence to convict him of crime, or to forfeit his goods, is within the condemnation of that judgment. In this regard the fourth and fifth amendments run almost into each other. . . .

We have already noticed the intimate relation between the two amendments. They throw great light on each other. For the 'unreasonable searches and seizures' condemned in the fourth amendment are almost always made for the purpose of compelling a man to give evidence against himself, which in criminal cases is condemned in the fifth amendment; and compelling a man 'in a criminal case to be a witness against himself,' which is

condemned in the fifth amendment, throws light on the question as to what is an 'unreasonable search and seizure' within the meaning of the fourth amendment. And we have been unable to perceive that the seizure of a man's private books and papers to be used in evidence against him is substantially different from compelling him to be a witness against himself. We think it is within the clear intent and meaning of those terms. We are also clearly of opinion that proceedings instituted for the purpose of declaring the forfeiture of a man's property by reason of offenses committed by him, though they may be civil in form, are in their nature criminal. In this very case the ground of forfeiture, as declared in the twelfth section of the act of 1874, on which the information is based, consists of certain acts of fraud committed against the public revenue in relation to imported merchandise, which are made criminal by the statute; and it is declared, that the offender shall be fined not exceeding \$5,000, nor less than \$50, or be imprisoned not exceeding two years, or both; and in addition to such fine such merchandise shall be forfeited. These are the penalties affixed to the criminal acts, the forfeiture sought by this suit being one of them. If an indictment had been presented against the claimants, upon conviction the forfeiture of the goods could have been included in the judgment. If the government prosecutor elects to waive an indictment, and to file a civil information against the claimants—that is, civil in form—can he by this device take from the proceeding its criminal aspect and deprive the claimants of their immunities as citizens, and extort from them a production of their private papers, or, as an alternative, a confession of guilt? This cannot be. The information, though technically a civil proceeding, is in substance and effect a criminal one. . . .

We think that the notice to produce the invoice in this case, the order by virtue of which it was issued, and the law which authorized the order, were unconstitutional and void, and that the inspection by the district attorney of said invoice, when produced in obedience to said notice, and its admission in evidence by the court, were erroneous and unconstitutional proceedings. We are of opinion, therefore, that the judgment of the circuit court should be reversed, and the cause remanded, with directions to award a new trial; and it is so ordered. . . .

The next case begins to chip away at *Boyd* and clarifies a great deal the question of what Fifth and Fourth Amendment rights corporations possess, if any. Notice the gap between *Boyd* (1886) and *Hale* (1906) and think about general developments in U.S. history during that time that may explain the shift in jurisprudence.

HALE v. HENKEL, 201 U.S. 43 (1906)

Mr. Justice Brown delivered the opinion of the court.

[The basic facts of this case are as follows: A corporation was served a subpoena for records to prove a Sherman Act violation. Hale, an employee of the corporation and the Appellant in this action, refused to produce the documents and was held in contempt.]

. . . Appellant also invokes the protection of the 5th Amendment to the Constitution, which declares that no person ‘shall be compelled in any criminal case to be a witness against himself,’ and in reply to various questions put to him he declined to answer, on the ground that he would thereby incriminate himself. . . .

But it is further insisted that, while the immunity statute may protect individual witnesses, it would not protect the corporation of which appellant was the agent and representative. This is true, but the answer is that it was not designed to do so. The right of a person under the 5th Amendment to refuse to incriminate himself is purely a personal privilege of the witness. It was never intended to permit him to plead the fact that some third person might be incriminated by his testimony, even though he were the agent of such person. A privilege so extensive might be used to put a stop to the examination of every witness who was called upon to testify before the grand jury with regard to the doings or business of his principal, whether such principal were an individual or a corporation. The question whether a corporation is a ‘person’ within the meaning of this amendment really does not arise, except, perhaps, where a corporation is called upon to answer a bill of discovery, since it can only be heard by oral evidence in the person of some one of its agents or employees. The amendment is limited to a person who shall be compelled in any criminal case to be a witness against *himself*; and if he cannot set up the privilege of a third person, he certainly cannot set up the privilege of a corporation. As the combination or conspiracies provided against by the Sherman antitrust act can ordinarily be proved only by the testimony of parties thereto, in the person of their agents or employees, the privilege claimed would practically nullify the whole act of Congress. Of what use would it be for the legislature to declare these combinations unlawful if the judicial power may close the door of access to every available source of information upon the subject? Indeed, so strict is the rule that the privilege is a personal one that it has been held in some cases that counsel will not be allowed to make the objection. We hold that the questions should have been answered.

The second branch of the case relates to the nonproduction by the witness of the books and papers called for by the *subpoena duces tecum*. The witness put his refusal on the ground, first, that it was impossible for him to collect them within the time allowed; second, because he was advised by counsel that, under the circumstances, he was under no obligation to produce them; and finally, because they might tend to incriminate him.

Had the witness relied solely upon the first ground, doubtless the court would have given him the necessary time. The last ground we have already held untenable. While the second ground does not set forth with technical accuracy the real reason for declining to produce them, the witness could not be expected to speak with legal exactness, and we think is entitled to assert that the subpoena was an infringement upon the 4th Amendment to the Constitution, which declares that ‘the right of the people to be secure in their persons, houses, paper, and effects, against unreasonable searches and seizures, shall not be violated, and no warrants shall issue but upon probable cause, supported by oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.’ . . .

Having already held that, by reason of the immunity act of 1903, the witness could not avail himself of the 5th Amendment it follows that he cannot set up that amendment as against the production of the books and papers, since, in respect to these, he would also be protected by the immunity act. We think it quite clear that the search and seizure clause of the 4th Amendment was not intended to interfere with the power of courts to compel, through a *subpoena duces tecum*, the production, upon a trial in court, of documentary evidence. As remarked in *Summers v. Moseley*, it would be 'utterly impossible to carry on the administration of justice' without this writ. . . .

If, whenever an officer or employee of a corporation were summoned before a grand jury as a witness he could refuse to produce the books and documents of such corporation, upon the ground that they would incriminate the corporation itself, it would result in the failure of a large number of cases where the illegal combination was determinable only upon the examination of such papers. Conceding that the witness was an officer of the corporation under investigation, and that he was entitled to assert the rights of corporation with respect to the production of its books and papers, we are of the opinion that there is a clear distinction in this particular between an individual and a corporation, and that the latter has no right to refuse to submit its books and papers for an examination at the suit of the state. The individual may stand upon his constitutional rights as a citizen. He is entitled to carry on his private business in his own way. His power to contract is unlimited. He owes no duty to the state or to his neighbors to divulge his business, or to open his doors to an investigation, so far as it may tend to criminate him. He owes no such duty to the state, since he receives nothing therefrom, beyond the protection of his life and property. His rights are such as existed by the law of the land long antecedent to the organization of the state, and can only be taken from him by due process of law, and in accordance with the Constitution. Among his rights are a refusal to incriminate himself, and the immunity of himself and his property from arrest or seizure except under a warrant of the law. He owes nothing to the public so long as he does not trespass upon their rights.

Upon the other hand, the corporation is a creature of the state. It is presumed to be incorporated for the benefit of the public. It receives certain special privileges and franchises, and holds them subject to the laws of the state and the limitations of its charter. Its powers are limited by law. It can make no contract not authorized by its charter. Its rights to act as a corporation are only preserved to it so long as it obeys the laws of its creation. There is a reserved right in the legislature to investigate its contracts and find out whether it has exceeded its powers. It would be a strange anomaly to hold that a state, having chartered a corporation to make use of certain franchises, could not, in the exercise of its sovereignty, inquire how these franchises had been employed, and whether they had been abused, and demand the production of the corporate books and papers for that purpose. The defense amounts to this: That an officer of a corporation which is charged with a criminal violation of the statute, may plead the criminality of such corporation as a refusal to produce its books. To state this proposition is to answer it. While an individual may lawfully refuse to answer incriminating questions unless protected by an immunity statute, it does not follow that a corporation, vested with

special privileges and franchises, may refuse to show its hand when charged with an abuse of such privileges.

It is true that the corporation in this case was chartered under the laws of New Jersey, and that it receives its franchise from the legislature of that state; but such franchises, so far as they involve questions of interstate commerce, must also be exercised in subordination to the power of Congress to regulate such commerce, and in respect to this the general government may also assert a sovereign authority to ascertain whether such franchises have been exercised in a lawful manner, with a due regard to its own laws. Being subject to this dual sovereignty, the general government possesses the same right to see that its own laws are respected as the state would have with respect to the special franchises vested in it by the laws of the state. The powers of the general government in this particular in the vindication of its own laws are the same as if the corporation had been created by an act of Congress. It is not intended to intimate, however, that it has a general visitatorial power over the state corporations.

Although, for the reasons above stated, we are of the opinion that an officer of a corporation which is charged with a violation of a statute of the state of its creation, or of an act of Congress passed in the exercise of its constitutional powers, cannot refuse to produce the books and papers of such corporation, we do not wish to be understood as holding that a corporation is not entitled to immunity, under the 4th Amendment, against *unreasonable* searches and seizures. A corporation is, after all, but an association of individuals under an assumed name and with a distinct legal entity. In organizing itself as a collective body it waives no constitutional immunities appropriate to such body. Its property cannot be taken without compensation. It can only be proceeded against by due process of law, and is protected, under the 14th Amendment, against unlawful discrimination. Corporations are a necessary feature of modern business activity, and their aggregated capital has become the source of nearly all great enterprises.

We are also of opinion that an order for the production of books and papers may constitute an unreasonable search and seizure within the 4th Amendment. While a search ordinarily implies a quest by an officer of the law, and a seizure contemplates a forcible dispossession of the owner, still, as was held in the *Boyd Case*, the substance of the offense is the compulsory production of private papers, whether under a search warrant or a *subpoena duces tecum*, against which the person, be he individual or corporation, is entitled to protection.

B. The Modern Fifth Amendment and the “Testimonial Act of Production”

The next case, *Fisher*, is a bit more complicated because the attorney-client privilege is also involved, but here the modern Supreme Court works out what the Fifth Amendment privilege really is as it concerns pre-existing documents: It is individual and it involves the act of production. While the case is a short run defeat for those resisting subpoenas, it ultimately leaves them with some potential basis to object to production.

FISHER v. UNITED STATES, 425 U.S. 391 (1976)

MR. JUSTICE WHITE delivered the opinion of the Court.

In these two cases we are called upon to decide whether a summons directing an attorney to produce documents delivered to him by his client in connection with the attorney-client relationship is enforceable over claims that the documents were constitutionally immune from summons in the hands of the client and retained that immunity in the hands of the attorney.

In each case, an Internal Revenue agent visited the taxpayer or taxpayers and interviewed them in connection with an investigation of possible civil or criminal liability under the federal income tax laws. Shortly after the interviews—one day later in No. 74-611 and a week or two later in No. 74-18—the taxpayers obtained from their respective accountants certain documents relating to the preparation by the accountants of their tax returns. Shortly after obtaining the documents—later the same day in No. 74-611 and a few weeks later in No. 74-18—the taxpayers transferred the documents to their lawyers—respondent Kasmir and petitioner Fisher, respectively—each of whom was retained to assist the taxpayer in connection with the investigation. Upon learning of the whereabouts of the documents, the Internal Revenue Service served summonses on the attorneys directing them to produce documents listed therein. . . .

All of the parties in these cases and the Court of Appeals for the Fifth Circuit have concurred in the proposition that if the Fifth Amendment would have excused a taxpayer from turning over the accountant's papers had he possessed them, the attorney to whom they are delivered for the purpose of obtaining legal advice should also be immune from subpoena. Although we agree with this proposition for the reasons set forth in Part III, *infra*, we are convinced that, under our decision in *Couch v. United States*, it is not the taxpayer's Fifth Amendment privilege that would excuse the attorney from production. The relevant part of that Amendment provides: "No person . . . shall be compelled in any criminal case to be a witness against himself."

The taxpayer's privilege under this Amendment is not violated by enforcement of the summonses involved in these cases because enforcement against a taxpayer's lawyer would not "compel" the taxpayer to do anything—and certainly would not compel him to be a "witness" against himself. The Court has held repeatedly that the Fifth Amendment is limited to prohibiting the use of "physical or moral compulsion" exerted on the person asserting the privilege. In *Couch v. United States*, we recently ruled that the Fifth Amendment rights of a taxpayer were not violated by the enforcement of a documentary summons directed to her accountant and requiring production of the taxpayer's own records in the possession of the accountant. We did so on the ground that in such a case "the ingredient of personal compulsion against an accused is lacking."

Here, the taxpayers are compelled to do no more than was the taxpayer in *Couch*. The taxpayers' Fifth Amendment privilege is therefore not violated by enforcement of the summonses directed toward their attorneys. This is true whether or not the Amendment

would have barred a subpoena directing the taxpayer to produce the documents while they were in his hands. . . .

Respondents in No. 74-611 and petitioners in No. 74-18 argue, and the Court of Appeals for the Fifth Circuit apparently agreed, that if the summons was enforced, the taxpayer's Fifth Amendment privilege would be, but should not be, lost solely because they gave their documents to their lawyers in order to obtain legal advice. But this misconceives the nature of the constitutional privilege. The Amendment protects a person from being compelled to be a witness against himself. Here, the taxpayers retained any privilege they ever had not to be compelled to testify against themselves and not to be compelled themselves to produce private papers in their possession. This personal privilege was in no way decreased by the transfer. It is simply that by reason of the transfer of the documents to the attorneys, those papers may be subpoenaed without compulsion on the taxpayer. The protection of the Fifth Amendment is therefore not available. "A party is privileged from producing evidence but not from its production." *Johnson v. United States*. The Court of Appeals for the Fifth Circuit suggested that because legally and ethically the attorney was required to respect the confidences of his client, the latter had a reasonable expectation of privacy for the records in the hands of the attorney and therefore did not forfeit his Fifth Amendment privilege with respect to the records by transferring them in order to obtain legal advice. It is true that the Court has often stated that one of the several purposes served by the constitutional privilege against compelled testimonial self-incrimination is that of protecting personal privacy. But the Court has never suggested that every invasion of privacy violates the privilege. Within the limits imposed by the language of the Fifth Amendment, which we necessarily observe, the privilege truly serves privacy interests; but the Court has never on any ground, personal privacy included, applied the Fifth Amendment to prevent the otherwise proper acquisition or use of evidence which, in the Court's view, did not involve compelled testimonial self-incrimination of some sort.

The proposition that the Fifth Amendment protects private information obtained without compelling self-incriminating testimony is contrary to the clear statements of this Court that under appropriate safeguards private incriminating statements of an accused may be overheard and used in evidence, if they are not compelled at the time they were uttered, and that disclosure of private information may be compelled if immunity removes the risk of incrimination. If the Fifth Amendment protected generally against the obtaining of private information from a man's mouth or pen or house, its protections would presumably not be lifted by probable cause and a warrant or by immunity. The privacy invasion is not mitigated by immunity; and the Fifth Amendment's strictures, unlike the Fourth's, are not removed by showing reasonableness. The Framers addressed the subject of personal privacy directly in the Fourth Amendment. They struck a balance so that when the State's reason to believe incriminating evidence will be found becomes sufficiently great, the invasion of privacy becomes justified and a warrant to search and seize will issue. They did not seek in still another Amendment—the Fifth—to achieve a general protection of privacy but to deal with the more specific issue of compelled self-incrimination. We cannot cut the Fifth Amendment completely loose from the moorings

of its language, and make it serve as a general protector of privacy—a word not mentioned in its text and a concept directly addressed in the Fourth Amendment. We adhere to the view that the Fifth Amendment protects against “compelled self-incrimination, not [the disclosure of] private information.” *United States v. Nobles*. Insofar as private information not obtained through compelled self-incriminating testimony is legally protected, its protection stems from other sources—the Fourth Amendment’s protection against seizures without warrant or probable cause and against subpoenas which suffer from “too much indefiniteness or breadth in the things required to be ‘particularly described,’” *Oklahoma Press Pub. Co. v. Walling*, the First Amendment, or evidentiary privileges such as the attorney-client privilege.

Our above holding is that compelled production of documents from an attorney does not implicate whatever Fifth Amendment privilege the taxpayer might have enjoyed from being compelled to produce them himself. The taxpayers in these cases, however, have from the outset consistently urged that they should not be forced to expose otherwise protected documents to summons simply because they have sought legal advice and turned the papers over to their attorneys. The Government appears to agree unqualifiedly. The difficulty is that the taxpayers have erroneously relied on the Fifth Amendment without urging the attorney-client privilege in so many words. They have nevertheless invoked the relevant body of law and policies that govern the attorney-client privilege. In this posture of the case, we feel obliged to inquire whether the attorney-client privilege applies to documents in the hands of an attorney which would have been privileged in the hands of the client by reason of the Fifth Amendment.

Confidential disclosures by a client to an attorney made in order to obtain legal assistance are privileged. The purpose of the privilege is to encourage clients to make full disclosure to their attorneys. As a practical matter, if the client knows that damaging information could more readily be obtained from the attorney following disclosure than from himself in the absence of disclosure, the client would be reluctant to confide in his lawyer and it would be difficult to obtain fully informed legal advice. However, since the privilege has the effect of withholding relevant information from the factfinder, it applies only where necessary to achieve its purpose. Accordingly it protects only those disclosures—necessary to obtain informed legal advice—which might not have been made absent the privilege. This Court and the lower courts have thus uniformly held that pre-existing documents which could have been obtained by court process from the client when he was in possession may also be obtained from the attorney by similar process following transfer by client in order to obtain more informed legal advice. The purpose of the privilege requires no broader rule. Pre-existing documents obtainable from the client are not appreciably easier to obtain from the attorney after transfer to him. Thus, even absent the attorney-client privilege, clients will not be discouraged from disclosing the documents to the attorney, and their ability to obtain informed legal advice will remain unfettered. It is otherwise if the documents are not obtainable by subpoena duces tecum or summons while in the exclusive possession of the client, for the client will then be reluctant to transfer possession to the lawyer unless the documents are also privileged in the latter’s hands. Where the transfer is made for the purpose of obtaining legal advice,

the purposes of the attorney-client privilege would be defeated unless the privilege is applicable. “It follows, then, that when the client himself would be privileged from production of the document, either as a party at common law . . . or as exempt from self-incrimination, the attorney having possession of the document is not bound to produce.” 8 Wigmore § 2307. Lower courts have so held. This proposition was accepted by the Court of Appeals for the Fifth Circuit below, is asserted by petitioners in No. 74-18 and respondents in No. 74-611, and was conceded by the Government in its brief and at oral argument. Where the transfer to the attorney is for the purpose of obtaining legal advice, we agree with it.

Since each taxpayer transferred possession of the documents in question from himself to his attorney, in order to obtain legal assistance in the tax investigations in question, the papers, if unobtainable by summons from the client, are unobtainable by summons directed to the attorney by reason of the attorney-client privilege. We accordingly proceed to the question whether the documents could have been obtained by summons addressed to the taxpayer while the documents were in his possession. The only bar to enforcement of such summons asserted by the parties or the courts below is the Fifth Amendment’s privilege against self-incrimination.

The proposition that the Fifth Amendment prevents compelled production of documents over objection that such production might incriminate stems from *Boyd v. United States*. . . .

Among its several pronouncements, *Boyd* was understood to declare that the seizure, under warrant or otherwise, of any purely evidentiary materials violated the Fourth Amendment and that the Fifth Amendment rendered these seized materials inadmissible. That rule applied to documents as well as to other evidentiary items—“[t]here is no special sanctity in papers, as distinguished from other forms of property, to render them immune from search and seizure, if only they fall within the scope of the principles of the cases in which other property may be seized. . . .” *Gouled v. United States*. Private papers taken from the taxpayer, like other “mere evidence,” could not be used against the accused over his Fourth and Fifth Amendment objections. Several of *Boyd*’s express or implicit declarations have not stood the test of time. The application of the Fourth Amendment to subpoenas was limited by *Hale v. Henkel*, and more recent cases. Purely evidentiary (but “nontestimonial”) materials, as well as contraband and fruits and instrumentalities of crime, may now be searched for and seized under proper circumstances. Also, any notion that “testimonial” evidence may never be seized and used in evidence is inconsistent with *Katz v. United States*, approving the seizure under appropriate circumstances of conversations of a person suspected of crime.

It is also clear that the Fifth Amendment does not independently proscribe the compelled production of every sort of incriminating evidence but applies only when the accused is compelled to make a testimonial communication that is incriminating. We have, accordingly, declined to extend the protection of the privilege to the giving of blood samples, *Schmerber v. California*; to the giving of handwriting exemplars, *Gilbert v.*

California; voice exemplars, *United States v. Wade*; or the donning of a blouse worn by the perpetrator, *Holt v. United States*. Furthermore, despite *Boyd*, neither a partnership nor the individual partners are shielded from compelled production of partnership records on self-incrimination grounds. *Bellis v. United States*. It would appear that under that case the precise claim sustained in *Boyd* would now be rejected for reasons not there considered.

The pronouncement in *Boyd* that a person may not be forced to produce his private papers has nonetheless often appeared as dictum in later opinions of this Court. To the extent, however, that the rule against compelling production of private papers rested on the proposition that seizures of or subpoenas for “mere evidence,” including documents, violated the Fourth Amendment and therefore also transgressed the Fifth, the foundations for the rule have been washed away. In consequence, the prohibition against forcing the production of private papers has long been a rule searching for a rationale consistent with the proscriptions of the Fifth Amendment against compelling a person to give “testimony” that incriminates him. Accordingly, we turn to the question of what, if any, incriminating testimony within the Fifth Amendment’s protection, is compelled by a documentary summons. A subpoena served on a taxpayer requiring him to produce an accountant’s workpapers in his possession without doubt involves substantial compulsion. But it does not compel oral testimony; nor would it ordinarily compel the taxpayer to restate, repeat, or affirm the truth of the contents of the documents sought. Therefore, the Fifth Amendment would not be violated by the fact alone that the papers on their face might incriminate the taxpayer, for the privilege protects a person only against being incriminated by his own compelled testimonial communications. The accountant’s workpapers are not the taxpayer’s. They were not prepared by the taxpayer, and they contain no testimonial declarations by him. Furthermore, as far as this record demonstrates, the preparation of all of the papers sought in these cases was wholly voluntary, and they cannot be said to contain compelled testimonial evidence, either of the taxpayers or of anyone else. The taxpayer cannot avoid compliance with the subpoena merely by asserting that the item of evidence which he is required to produce contains incriminating writing, whether his own or that of someone else.

The act of producing evidence in response to a subpoena nevertheless has communicative aspects of its own, wholly aside from the contents of the papers produced. Compliance with the subpoena tacitly concedes the existence of the papers demanded and their possession or control by the taxpayer. It also would indicate the taxpayer’s belief that the papers are those described in the subpoena. The elements of compulsion are clearly present, but the more difficult issues are whether the tacit averments of the taxpayer are both “testimonial” and “incriminating” for purposes of applying the Fifth Amendment. These questions perhaps do not lend themselves to categorical answers; their resolution may instead depend on the facts and circumstances of particular cases or classes thereof. In light of the records now before us, we are confident that however incriminating the contents of the accountant’s workpapers might be, the act of producing them—the only thing which the taxpayer is compelled to do—would not itself involve testimonial self-incrimination.

It is doubtful that implicitly admitting the existence and possession of the papers rises to the level of testimony within the protection of the Fifth Amendment. The papers belong to the accountant, were prepared by him, and are the kind usually prepared by an accountant working on the tax returns of his client. Surely the Government is in no way relying on the “truth-telling” of the taxpayer to prove the existence of or his access to the documents. The existence and location of the papers are a foregone conclusion and the taxpayer adds little or nothing to the sum total of the Government’s information by conceding that he in fact has the papers. Under these circumstances by enforcement of the summons “no constitutional rights are touched. The question is not of testimony but of surrender.” *In re Harris*. When an accused is required to submit a handwriting exemplar he admits his ability to write and impliedly asserts that the exemplar is his writing. But in common experience, the first would be a near truism and the latter self-evident. In any event, although the exemplar may be incriminating to the accused and although he is compelled to furnish it, his Fifth Amendment privilege is not violated because nothing he has said or done is deemed to be sufficiently testimonial for purposes of the privilege. This Court has also time and again allowed subpoenas against the custodian of corporate documents or those belonging to other collective entities such as unions and partnerships and those of bankrupt businesses over claims that the documents will incriminate the custodian despite the fact that producing the documents tacitly admits their existence and their location in the hands of their possessor. The existence and possession or control of the subpoenaed documents being no more in issue here than in the above cases, the summons is equally enforceable.

Moreover, assuming that these aspects of producing the accountant’s papers have some minimal testimonial significance, surely it is not illegal to seek accounting help in connection with one’s tax returns or for the accountant to prepare workpapers and deliver them to the taxpayer. At this juncture, we are quite unprepared to hold that either the fact of existence of the papers or of their possession by the taxpayer poses any realistic threat of incrimination to the taxpayer.

As for the possibility that responding to the subpoena would authenticate the workpapers, production would express nothing more than the taxpayer’s belief that the papers are those described in the subpoena. The taxpayer would be no more competent to authenticate the accountant’s workpapers or reports by producing them than he would be to authenticate them if testifying orally. The taxpayer did not prepare the papers and could not vouch for their accuracy. The documents would not be admissible in evidence against the taxpayer without authenticating testimony. Without more, responding to the subpoena in the circumstances before us would not appear to represent a substantial threat of self-incrimination. Moreover, in *Wilson v. United States*, the custodian of corporate, union or partnership books or those of a bankrupt business was ordered to respond to a subpoena for the business’ books even though doing so involved a “representation that the documents produced are those demanded by the subpoena,” *Curcio v. United States*.

Whether the Fifth Amendment would shield the taxpayer from producing his own tax records in his possession is a question not involved here; for the papers demanded here are not his “private papers,” *see Boyd v. United States*. We do hold that compliance with a summons directing the taxpayer to produce the accountant’s documents involved in these cases would involve no incriminating testimony within the protection of the Fifth Amendment. . . .

Because *Fisher* is unusually tricky, let us recap:

- (1) The client gives his accounting and tax records to his lawyer;
- (2) The government subpoenas the documents from the lawyer;
- (3) The lawyer raises the attorney-client privilege as a shield to production of the records;
- (4) Under the instrumental policy rationale supporting the attorney-client privilege, the privilege applies to the documents only if *not* shielding such documents with the privilege would cause a client to hesitate to share such records with his lawyer;
- (5) The client would not hesitate to share such documents with his lawyer if, in any event, the client could not protect them by keeping them in his own possession;
- (6) Therefore, to decide whether the privilege applies to the documents, it is necessary to decide whether the client could resist production of the documents if instead he retained possession of them;
- (7) The client could not object to production of the documents on the grounds that their contents are protected by the Fifth Amendment because there is no Fifth Amendment right with respect to the contents of documents the government does not compel one to create;
- (8) However, the client does have a Fifth Amendment right with respect to the act of producing the documents, if that act itself could incriminate the client by authenticating the documents or conceding their existence for government investigators;
- (9) The existence of these tax records was sufficiently known to the government, and the accountant could have been used to authenticate them, so nothing about the client’s act of production would have incriminated the client;
- (10) Because the client could not have resisted production of the documents had he retained them, the attorney-client privilege need not apply to the documents when possessed by the lawyer: the availability of the privilege would not influence, one way or the other, a client’s decision whether to retain such documents or share them with a lawyer.

To summarize the key takeaways from *Fisher*: An individual cannot raise a Fifth Amendment objection to someone else’s testimony or production. Furthermore, the Fifth Amendment does not protect against the compelled production of incriminating

evidence, only against incriminating testimonial communication. Whether the “act of production” itself constitutes a testimonial communication depends on the facts and circumstances. If the government is relying on the “truth-telling” of the individual to prove the existence of or access to documents, then the act of production may be testimonial.

The following case further clarifies the meaning of *Fisher*.

UNITED STATES v. DOE, 465 U.S. 605 (1984)

Justice POWELL delivered the opinion of the Court.

This case presents the issue whether, and to what extent, the Fifth Amendment privilege against compelled self-incrimination applies to the business records of a sole proprietorship.

Respondent is the owner of several sole proprietorships. In late 1980, a grand jury, during the course of an investigation of corruption in the awarding of county and municipal contracts, served five subpoenas on respondent. The first two demanded the production of the telephone records of several of respondent’s companies and all records pertaining to four bank accounts of respondent and his companies. The subpoenas were limited to the period between January 1, 1977 and the dates of the subpoenas. The third subpoena demanded the production of a list of virtually all the business records of one of respondent’s companies for the period between January 1, 1976, and the date of the subpoena. The fourth subpoena sought production of a similar list of business records belonging to another company. The final subpoena demanded production of all bank statements and cancelled checks of two of respondent’s companies that had accounts at a bank in the Grand Cayman Islands.

Respondent filed a motion in federal district court seeking to quash the subpoenas. The District Court for the District of New Jersey granted his motion except with respect to those documents and records required by law to be kept or disclosed to a public agency. In reaching its decision, the District Court noted that the Government had conceded that the materials sought in the subpoena were or might be incriminating. The court stated that, therefore, “the relevant inquiry is . . . whether the act of producing the documents has communicative aspects which warrant Fifth Amendment protection.” . The court found that the act of production would compel respondent to “admit that the records exist, that they are in his possession, and that they are authentic.” While not ruling out the possibility that the Government could devise a way to ensure that the act of turning over the documents would not incriminate respondent, the court held that the Government had not made such a showing. . . .

The Court in *Fisher* expressly declined to reach the question whether the Fifth Amendment privilege protects the contents of an individual’s tax records in his possession. The rationale underlying our holding in that case is, however, persuasive here. As we noted in *Fisher*, the Fifth Amendment protects the person asserting the

privilege only from compelled self-incrimination. Where the preparation of business records is voluntary, no compulsion is present. A subpoena that demands production of documents “does not compel oral testimony; nor would it ordinarily compel the taxpayer to restate, repeat, or affirm the truth of the contents of the documents sought.” . . .

[*Fisher*’s] reasoning applies with equal force here. Respondent does not contend that he prepared the documents involuntarily or that the subpoena would force him to restate, repeat, or affirm the truth of their contents. The fact that the records are in respondent’s possession is irrelevant to the determination of whether the creation of the records was compelled. We therefore hold that the contents of those records are not privileged.

Although the contents of a document may not be privileged, the act of producing the document may be. A government subpoena compels the holder of the document to perform an act that may have testimonial aspects and an incriminating effect. . . .

In *Fisher*, the Court explored the effect that the act of production would have on the taxpayer and determined that the act of production would have only minimal testimonial value and would not operate to incriminate the taxpayer. Unlike the Court in *Fisher*, we have the explicit finding of the District Court that the act of producing the documents would involve testimonial self-incrimination. The Court of Appeals agreed. The District Court’s finding essentially rests on its determination of factual issues. Therefore, we will not overturn that finding unless it has no support in the record. Traditionally, we also have been reluctant to disturb findings of fact in which two courts below have concurred. We therefore decline to overturn the finding of the District Court in this regard, where, as here, it has been affirmed by the Court of Appeals. . . .

We conclude that the Court of Appeals erred in holding that the contents of the subpoenaed documents were privileged under the Fifth Amendment. The act of producing the documents at issue in this case is privileged and cannot be compelled without a statutory grant of use immunity pursuant to 18 U.S.C. §§ 6002 and 6003. The judgment of the Court of Appeals is, therefore, affirmed in part, reversed in part, and the case is remanded to the District Court for further proceedings in accordance with this decision.

Justice O’CONNOR, concurring.

I concur in both the result and reasoning of Justice Powell’s opinion for the Court. I write separately, however, just to make explicit what is implicit in the analysis of that opinion: that the Fifth Amendment provides absolutely no protection for the contents of private papers of any kind. The notion that the Fifth Amendment protects the privacy of papers originated in *Boyd v. United States*, but our decision in *Fisher v. United States*, sounded the death-knell for *Boyd*. “Several of *Boyd*’s express or implicit declarations [had] not stood the test of time[,]” and its privacy of papers concept “had long been a rule searching for a rationale. . . .” Today’s decision puts a long-overdue end to that fruitless search. . . .

Note that a few years later, in *Braswell v. United States*, 487 U.S. 99 (1988), the Supreme Court held that although individuals have the rights described in *Fisher* and *Doe*, they can still be made to produce and authenticate documents in their capacity as *records custodians* for firms. However, what they do in that custodial capacity cannot be used against them in any individual prosecution.

The following case is the most recent Supreme Court word on all of this. It is not an easy case, but it is the clearest statement we have on when the use of a person's "act of production" against them violates the person's Fifth Amendment rights.

Immunity and *Kastigar* were covered in the last chapter, so it should make sense to you now how the Fifth Amendment analysis works structurally, even if this case leaves open some issues about exactly when the "act of production" privilege will apply. As you read, carefully follow the procedural steps taken with regards to this man, Hubbell.

UNITED STATES v. HUBBELL, 530 U.S. 27 (2000)

JUSTICE STEVENS delivered the opinion of the Court.

The two questions presented concern the scope of a witness' protection against compelled self-incrimination: (1) whether the Fifth Amendment privilege protects a witness from being compelled to disclose the existence of incriminating documents that the Government is unable to describe with reasonable particularity; and (2) if the witness produces such documents pursuant to a grant of immunity, whether 18 U.S.C. § 6002 prevents the Government from using them to prepare criminal charges against him.

This proceeding arises out of the second prosecution of respondent, Webster Hubbell, commenced by the Independent Counsel appointed in August 1994 to investigate possible violations of federal law relating to the Whitewater Development Corporation. The first prosecution was terminated pursuant to a plea bargain. In December 1994, respondent pleaded guilty to charges of mail fraud and tax evasion arising out of his billing practices as a member of an Arkansas law firm from 1989 to 1992, and was sentenced to 21 months in prison. In the plea agreement, respondent promised to provide the Independent Counsel with "full, complete, accurate, and truthful information" about matters relating to the Whitewater investigation.

The second prosecution resulted from the Independent Counsel's attempt to determine whether respondent had violated that promise. In October 1996, while respondent was incarcerated, the Independent Counsel served him with a subpoena *duces tecum* calling for the production of 11 categories of documents before a grand jury sitting in Little Rock, Arkansas. On November 19, he appeared before the grand jury and invoked his Fifth Amendment privilege against self-incrimination. In response to questioning by the prosecutor, respondent initially refused "to state whether there are documents within my possession, custody, or control responsive to the Subpoena." Thereafter, the prosecutor produced an order, which had previously been obtained from the District Court pursuant

to 18 U.S.C. § 6003(a), directing him to respond to the subpoena and granting him immunity “to the extent allowed by law.” Respondent then produced 13,120 pages of documents and records and responded to a series of questions that established that those were all of the documents in his custody or control that were responsive to the commands in the subpoena, with the exception of a few documents he claimed were shielded by the attorney-client and attorney work-product privileges.

The contents of the documents produced by respondent provided the Independent Counsel with the information that led to this second prosecution. On April 30, 1998, a grand jury in the District of Columbia returned a 10-count indictment charging respondent with various tax-related crimes and mail and wire fraud. The District Court dismissed the indictment relying, in part, on the ground that the Independent Counsel’s use of the subpoenaed documents violated § 6002 because all of the evidence he would offer against respondent at trial derived either directly or indirectly from the testimonial aspects of respondent’s immunized act of producing those documents. Noting that the Independent Counsel had admitted that he was not investigating tax-related issues when he issued the subpoena, and that he had “learned about the unreported income and other crimes from studying the records’ contents,” the District Court characterized the subpoena as “the quintessential fishing expedition.”

The Court of Appeals vacated the judgment and remanded for further proceedings. The majority concluded that the District Court had incorrectly relied on the fact that the Independent Counsel did not have prior knowledge of the contents of the subpoenaed documents. The question the District Court should have addressed was the extent of the Government’s independent knowledge of the documents’ existence and authenticity, and of respondent’s possession or control of them. . . .

In the opinion of the dissenting judge, the majority failed to give full effect to the distinction between the contents of the documents and the limited testimonial significance of the act of producing them. In his view, as long as the prosecutor could make use of information contained in the documents or derived therefrom without any reference to the fact that respondent had produced them in response to a subpoena, there would be no improper use of the testimonial aspect of the immunized act of production. In other words, the constitutional privilege and the statute conferring use immunity would only shield the witness from the use of any information resulting from his subpoena response “beyond what the prosecutor would receive if the documents appeared in the grand jury room or in his office unsolicited and unmarked, like manna from heaven.”

On remand, the Independent Counsel acknowledged that he could not satisfy the “reasonable particularity” standard prescribed by the Court of Appeals and entered into a conditional plea agreement with respondent. In essence, the agreement provides for the dismissal of the charges unless this Court’s disposition of the case makes it reasonably likely that respondent’s “act of production immunity” would not pose a significant bar to his prosecution. The case is not moot, however, because the agreement

also provides for the entry of a guilty plea and a sentence that will not include incarceration if we should reverse and issue an opinion that is sufficiently favorable to the Government to satisfy that condition. Despite that agreement, we granted the Independent Counsel's petition for a writ of certiorari in order to determine the precise scope of a grant of immunity with respect to the production of documents in response to a subpoena. We now affirm.

It is useful to preface our analysis of the constitutional issue with a restatement of certain propositions that are not in dispute. The term "privilege against self-incrimination" is not an entirely accurate description of a person's constitutional protection against being "compelled in any criminal case to be a witness against himself."

The word "witness" in the constitutional text limits the relevant category of compelled incriminating communications to those that are "testimonial" in character. As Justice Holmes observed, there is a significant difference between the use of compulsion to extort communications from a defendant and compelling a person to engage in conduct that may be incriminating. Thus, even though the act may provide incriminating evidence, a criminal suspect may be compelled to put on a shirt, to provide a blood sample or handwriting exemplar, or to make a recording of his voice. The act of exhibiting such physical characteristics is not the same as a sworn communication by a witness that relates either express or implied assertions of fact or belief. Similarly, the fact that incriminating evidence may be the byproduct of obedience to a regulatory requirement, such as filing an income tax return, maintaining required records, or reporting an accident, does not clothe such required conduct with the testimonial privilege.

More relevant to this case is the settled proposition that a person may be required to produce specific documents even though they contain incriminating assertions of fact or belief because the creation of those documents was not "compelled" within the meaning of the privilege. . . .

On the other hand, we have also made it clear that the act of producing documents in response to a subpoena may have a compelled testimonial aspect. We have held that "the act of production" itself may implicitly communicate "statements of fact." By "producing documents in compliance with a subpoena, the witness would admit that the papers existed, were in his possession or control, and were authentic." Moreover, as was true in this case, when the custodian of documents responds to a subpoena, he may be compelled to take the witness stand and answer questions designed to determine whether he has produced everything demanded by the subpoena. The answers to those questions, as well as the act of production itself, may certainly communicate information about the existence, custody, and authenticity of the documents. Whether the constitutional privilege protects the answers to such questions, or protects the act of production itself, is a question that is distinct from the question whether the unprotected contents of the documents themselves are incriminating.

Finally, the phrase “in any criminal case” in the text of the Fifth Amendment might have been read to limit its coverage to compelled testimony that is used against the defendant in the trial itself. It has, however, long been settled that its protection encompasses compelled statements that lead to the discovery of incriminating evidence even though the statements themselves are not incriminating and are not introduced into evidence. Thus, a half-century ago we held that a trial judge had erroneously rejected a defendant’s claim of privilege on the ground that his answer to the pending question would not itself constitute evidence of the charged offense. As we explained: “The privilege afforded not only extends to answers that would in themselves support a conviction under a federal criminal statute but likewise embraces those which would furnish a link in the chain of evidence needed to prosecute the claimant for a federal crime.” *Hoffman v. United States*. Compelled testimony that communicates information that may “lead to incriminating evidence” is privileged even if the information itself is not inculpatory. It is the Fifth Amendment’s protection against the prosecutor’s use of incriminating information derived directly or indirectly from the compelled testimony of the respondent that is of primary relevance in this case. . . .

The Government correctly emphasizes that the testimonial aspect of a response to a subpoena *duces tecum* does nothing more than establish the existence, authenticity, and custody of items that are produced. We assume that the Government is also entirely correct in its submission that it would not have to advert to respondent’s act of production in order to prove the existence, authenticity, or custody of any documents that it might offer in evidence at a criminal trial; indeed, the Government disclaims any need to introduce any of the documents produced by respondent into evidence in order to prove the charges against him. It follows, according to the Government, that it has no intention of making improper “use” of respondent’s compelled testimony.

The question, however, is not whether the response to the subpoena may be introduced into evidence at his criminal trial. That would surely be a prohibited “use” of the immunized act of production. But the fact that the Government intends no such use of the act of production leaves open the separate question whether it has already made “derivative use” of the testimonial aspect of that act in obtaining the indictment against respondent and in preparing its case for trial. It clearly has.

It is apparent from the text of the subpoena itself that the prosecutor needed respondent’s assistance both to identify potential sources of information and to produce those sources. Given the breadth of the description of the 11 categories of documents called for by the subpoena, the collection and production of the materials demanded was tantamount to answering a series of interrogatories asking a witness to disclose the existence and location of particular documents fitting certain broad descriptions. The assembly of literally hundreds of pages of material in response to a request for “any and all documents reflecting, referring, or relating to any direct or indirect sources of money or other things of value received by or provided to” an individual or members of his family during a 3-year period is the functional equivalent of the preparation of an answer to either a detailed written interrogatory or a series of oral questions at a discovery

deposition. Entirely apart from the contents of the 13,120 pages of materials that respondent produced in this case, it is undeniable that providing a catalog of existing documents fitting within any of the 11 broadly worded subpoena categories could provide a prosecutor with a “lead to incriminating evidence,” or “a link in the chain of evidence needed to prosecute.”

Indeed, the record makes it clear that that is what happened in this case. The documents were produced before a grand jury sitting in the Eastern District of Arkansas in aid of the Independent Counsel’s attempt to determine whether respondent had violated a commitment in his first plea agreement. The use of those sources of information eventually led to the return of an indictment by a grand jury sitting in the District of Columbia for offenses that apparently are unrelated to that plea agreement. What the District Court characterized as a “fishing expedition” did produce a fish, but not the one that the Independent Counsel expected to hook. It is abundantly clear that the testimonial aspect of respondent’s act of producing subpoenaed documents was the first step in a chain of evidence that led to this prosecution. The documents did not magically appear in the prosecutor’s office like “manna from heaven.” They arrived there only after respondent asserted his constitutional privilege, received a grant of immunity, and—under the compulsion of the District Court’s order—took the mental and physical steps necessary to provide the prosecutor with an accurate inventory of the many sources of potentially incriminating evidence sought by the subpoena. It was only through respondent’s truthful reply to the subpoena that the Government received the incriminating documents of which it made “substantial use . . . in the investigation that led to the indictment.” *Brief for United States*.

For these reasons, we cannot accept the Government’s submission that respondent’s immunity did not preclude its derivative use of the produced documents because its “possession of the documents [was] the fruit *only* of a simple physical act—the act of producing the documents.” It was unquestionably necessary for respondent to make extensive use of “the contents of his own mind” in identifying the hundreds of documents responsive to the requests in the subpoena. The assembly of those documents was like telling an inquisitor the combination to a wall safe, not like being forced to surrender the key to a strongbox. The Government’s anemic view of respondent’s act of production as a mere physical act that is principally non-testimonial in character and can be entirely divorced from its “implicit” testimonial aspect so as to constitute a “legitimate, wholly independent source” (as required by *Kastigar*) for the documents produced simply fails to account for these realities.

In sum, we have no doubt that the constitutional privilege against self-incrimination protects the target of a grand jury investigation from being compelled to answer questions designed to elicit information about the existence of sources of potentially incriminating evidence. That constitutional privilege has the same application to the testimonial aspect of a response to a subpoena seeking discovery of those sources. Before the District Court, the Government arguably conceded that respondent’s act of production in this case had a testimonial aspect that entitled him to respond to the

subpoena by asserting his privilege against self-incrimination. On appeal and again before this Court, however, the Government has argued that the communicative aspect of respondent's act of producing ordinary business records is insufficiently "testimonial" to support a claim of privilege because the existence and possession of such records by any businessman is a "foregone conclusion" under our decision in *Fisher v. United States*. This argument both misreads *Fisher* and ignores our subsequent decision in *United States v. Doe*. . . .

Whatever the scope of this "foregone conclusion" rationale, the facts of this case plainly fall outside of it. While in *Fisher* the Government already knew that the documents were in the attorneys' possession and could independently confirm their existence and authenticity through the accountants who created them, here the Government has not shown that it had any prior knowledge of either the existence or the whereabouts of the 13,120 pages of documents ultimately produced by respondent. The Government cannot cure this deficiency through the overbroad argument that a businessman such as respondent will always possess general business and tax records that fall within the broad categories described in this subpoena. The *Doe* subpoenas also sought several broad categories of general business records, yet we upheld the District Court's finding that the act of producing those records would involve testimonial self-incrimination.

Given our conclusion that respondent's act of production had a testimonial aspect, at least with respect to the existence and location of the documents sought by the Government's subpoena, respondent could not be compelled to produce those documents without first receiving a grant of immunity under § 6003. As we construed § 6002 in *Kastigar*, such immunity is co-extensive with the constitutional privilege. *Kastigar* requires that respondent's motion to dismiss the indictment on immunity grounds be granted unless the Government proves that the evidence it used in obtaining the indictment and proposed to use at trial was derived from legitimate sources "wholly independent" of the testimonial aspect of respondent's immunized conduct in assembling and producing the documents described in the subpoena. The Government, however, does not claim that it could make such a showing. Rather, it contends that its prosecution of respondent must be considered proper unless someone—presumably respondent—shows that "there is some substantial relation between the compelled testimonial communications implicit in the act of production (as opposed to the act of production standing alone) and some aspect of the information used in the investigation or the evidence presented at trial." We could not accept this submission without repudiating the basis for our conclusion in *Kastigar* that the statutory guarantee of use and derivative-use immunity is as broad as the constitutional privilege itself. This we are not prepared to do.

The Eleventh Circuit has analyzed how *Fisher* and *Hubbell* apply to a government effort to obtain a computer hard drive and its decryption from an individual by court order. *In re Grand Jury Subpoena Duces Tecum Dated March 25, 2011*, 670 F.3d 1335 (11th Cir. 2012). The court, referring to the individual as "Doe," found the Fifth Amendment to apply under the following analysis:

We hold that the act of Doe's decryption and production of the contents of the hard drives would sufficiently implicate the Fifth Amendment privilege. We reach this holding by concluding that (1) Doe's decryption and production of the contents of the drives would be testimonial, not merely a physical act; and (2) the explicit and implicit factual communications associated with the decryption and production are not foregone conclusions.

First, the decryption and production of the hard drives would require the use of the contents of Doe's mind and could not be fairly characterized as a physical act that would be nontestimonial in nature. We conclude that the decryption and production would be tantamount to testimony by Doe of his knowledge of the existence and location of potentially incriminating files; of his possession, control, and access to the encrypted portions of the drives; and of his capability to decrypt the files.

We are unpersuaded by the Government's derivation of the key/combination analogy in arguing that Doe's production of the unencrypted files would be nothing more than a physical nontestimonial transfer. The Government attempts to avoid the analogy by arguing that it does not seek the combination or the key, but rather the contents. This argument badly misses the mark. In *Fisher*, where the analogy was born, and again in *Hubbell*, the Government never sought the "key" or the "combination" to the safe for its own sake; rather, the Government sought the files being withheld, just as the Government does here. Requiring Doe to use a decryption password is most certainly more akin to requiring the production of a combination because both demand the use of the contents of the mind, and the production is accompanied by the implied factual statements noted above that could prove to be incriminatory. Hence, we conclude that what the Government seeks to compel in this case, the decryption and production of the contents of the hard drives, is testimonial in character.

Moving to the second point, the question becomes whether the purported testimony is a "foregone conclusion." We think not. Nothing in the record before us reveals that the Government knows whether any files exist and are located on the hard drives; what's more, nothing in the record illustrates that the Government knows with reasonable particularity that Doe is even capable of accessing the encrypted portions of the drives.

Finally, on the following pages, Professor Beale gives us some help in stepping back and putting this complicated story together.

THE FIFTH AMENDMENT AND THE GRAND JURY

Sara Sun Beale & James E. Felman, 22 CRIM. JUSTICE 4 (2007)

One of the most complex and difficult areas of current grand jury law is the intersection of the grand jury's subpoena power and the Fifth Amendment rights of those subpoenaed. Grand juries issue subpoenas for only one reason—to obtain evidence of a crime. It follows that those subpoenaed will be called upon at times to produce documents or give testimony that might tend to incriminate them. Because this tension is inherent in the nature of the grand jury process, one might assume that the applicable law would be fairly well settled. As we explain below, however, in a number of important areas there is considerable uncertainty and ongoing evolution. Although we refer below principally to federal cases, the constitutional principles we discuss are equally applicable to state grand jury proceedings.

Our discussion is divided into two parts—(1) subpoenas issued to individuals for their own personal documents or testimony, and (2) subpoenas issued to individuals as custodians of the records of entities. Within each part we have further subdivided our discussion between subpoenas seeking documents and subpoenas seeking testimony.

Subpoenas to individuals. Subpoenas to individuals may seek documents, testimony, or both. We begin with a discussion of testimonial subpoenas, and then turn to the additional and more difficult issues presented by document subpoenas. . . .

Individual subpoenas for documents. The Fifth Amendment was originally interpreted to protect all private papers from compelled production, *Boyd v. United States*, but the Supreme Court has abandoned that interpretation. Under the current understanding of the Fifth Amendment, the courts draw a distinction between the content of subpoenaed documents and the actions required to produce such documents, giving greater protection to the act of production and raising many thorny issues.

It is now settled that an individual may not withhold documents from production pursuant to a grand jury subpoena on the ground that the content of the documents may tend to incriminate the individual. *Fisher v. United States*. There is, however, an exception to this rule when an individual was compelled by the government to incriminate himself or herself by creating the documents in the first place. *Shapiro v. United States*.

Although an individual has no Fifth Amendment right to resist the production of documents because their *content* might be incriminating, the Court has recognized that the mere *act of producing* subpoenaed documents may carry separate incriminating implications. As the Court explained:

The act of producing evidence in response to a subpoena has communicative aspects of its own, wholly aside from the contents of the papers produced. Compliance with the subpoena tacitly concedes the existence of the papers demanded and their possession or control by the

[individual producing the records]. It would also indicate the [individual]’s belief that the papers are those described in the subpoena.

Fisher

Fisher held that the Fifth Amendment protects an individual against any compulsion to incriminate himself or herself by such an act of production, because the conduct of producing the documents is essentially testimonial in nature.

The scope of the Fifth Amendment privilege extends only to instances where the compelled act of production would, in fact, carry incriminating implications. Under some circumstances, the individual’s production of the subpoenaed documents will not be deemed to be incriminating because it conveys nothing the government does not already know. In *Fisher*, where the government subpoenaed documents that it was already aware of, the Court observed that “[t]he existence and location of the [subpoenaed] papers are a foregone conclusion and the [witness] adds little or nothing to the sum total of the Government’s information by conceding that he in fact has the papers.” Under these circumstances the Court held there was no Fifth Amendment right to withhold the documents because compliance was more like “surrender” of them than “testimony” about them. *See also United States v. Norwood* (no Fifth Amendment protection where existence and location of documents a “foregone conclusion”).

A much different factual setting was presented more recently, however, in *United States v. Hubbell*. There, the government sought categories of documents the existence and location of which it had no prior knowledge. The Court held that “the collection and production of the materials demanded was tantamount to answering a series of interrogatories asking a witness to disclose the existence and location of particular documents fitting certain broad descriptions,” in which it was “unquestionably necessary for [the witness] to make extensive use of ‘the contents of his own mind’ in identifying the hundreds of documents responsive to the requests in the subpoena.” Under these circumstances, the Court held that *Hubbell*’s Fifth Amendment rights encompassed the compelled production of the documents pursuant to subpoena.

There is thus a critical distinction between “foregone conclusion” acts of production—which have no Fifth Amendment protection under *Fisher*—and “fishing expedition” acts of production that are protected under *Hubbell*. Locating the dividing line between them turns on the level of the government’s prior knowledge of the existence, location, and authenticity of the documents to be produced. If the case falls on the right side of the line, a witness faced with a potentially incriminating act of production may lawfully refuse to produce the documents altogether.

Litigation in the lower courts has begun to flesh out both the standard under *Hubbell* and the procedure for determining whether that standard has been met. The District of Columbia and the Ninth Circuit have established a “reasonable particularity” standard to determine “whether an act of production is sufficiently testimonial to implicate the Fifth Amendment.” *United States v. Ponds; In re Grand Jury Subpoena*. Under this

standard, a witness who believes the act of producing documents in response to a grand jury subpoena may add to the government's arsenal of incriminating evidence may move for a protective order prior to producing the documents. The burden then falls on the government to establish its knowledge of the existence, possession, and authenticity of the subpoenaed documents with "reasonable particularity" such that the communication inherent in the act of production can be considered a forgone conclusion. *Ponds*. It may be necessary in this process for the witness to submit the documents in question to the court for in camera review. See, e.g., *United States v. Bell* (utilizing *in camera* review); *United States v. Cianciulli* (same).

If the government carries its burden, it is entitled to production of the documents. If the government fails to carry its burden, it may obtain the documents only by extending both use and derivative use immunity to the witness. Where the government elects to confer immunity, the scope of the immunity extends not merely to the evidence of the act of producing the documents, but also to the *contents* of the documents themselves. *Ponds*. Moreover, the contents of the documents obtained through the grant of immunity may not be used in *any* way, including merely refreshing the recollection of another witness.

Given the implications of conferring immunity regarding the contents of subpoenaed documents, the government will likely be reluctant to confer such immunity on a target of its investigation. Moreover, the government may not need to use subpoenas in the cases where it could most easily establish the act of production would be a forgone conclusion. When it has information regarding the existence and location of the documents it seeks, this information may rise to the level of probable cause, which would enable the government to obtain a search warrant. But when the government is truly in the dark about what documents may be in the possession of a witness, the Fifth Amendment provides significant protections to a witness who prefers to keep the lights out.

Subpoenas to records custodians. Many federal crimes investigated with the use of a grand jury involve activities by legal entities as well as individuals. Such entities include not only corporations, but also labor unions and most partnerships. Grand juries typically obtain a legal entity's documents by issuing a subpoena to the custodian of the entity's records, and we first discuss the issues directly related to the production of such documents. We then turn to the additional issues raised by subpoenas seeking testimony related to the production of documents (such as authentication testimony) and subpoenas issued to former employees in possession of entity documents.

Records custodian subpoenas for documents. The Fifth Amendment law regarding entities themselves is well established: artificial legal entities have no privilege against self-incrimination under the Fifth Amendment. *United States v. White*. The Supreme Court has offered various justifications for the collective entities doctrine, but the strongest factor was probably necessity; a recognition of the privilege would have made it nearly impossible to enforce the antitrust laws and many other statutes regulating corporate activity. See generally SARA SUN BEALE ET AL., GRAND JURY LAW

AND PRACTICE, § 6:12 (2nd ed. 1997). Accordingly, corporate records must be produced in response to a grand jury subpoena regardless of their tendency to incriminate the entity. *United States v. Doe*. In the ordinary course of events, this makes grand jury subpoenas for corporate records straightforward. Even if the documents tend to incriminate not only the entity but also certain individuals associated with or employed by the entity, the documents must nevertheless be produced because they are the property of the entity and not the individuals. Where given a choice, entities typically designate as their custodians persons with no potential criminal exposure.

The picture becomes more complex, however, where the documents sought may tend to incriminate not only the entity, but also the records custodian personally. Although the entity has no Fifth Amendment privilege, an individual records custodian does have Fifth Amendment rights, but those rights are quite different than they would be if the subpoena sought personal records. The Supreme Court has long held that an individual cannot rely on a personal privilege against self-incrimination to avoid producing the records of an entity held by the individual in a representative capacity—even if the content of those records might be personally incriminating. *Bellis v. United States*. When an individual becomes a representative of an artificial entity, he or she undertakes certain obligations, including the duty to produce documents subpoenaed from the entity by the government. When acting in a representative capacity, the custodian acts for the entity, not the custodian. Because the entity has no privilege against self-incrimination, its agent likewise has no privilege.

Although the custodian must produce the corporate records regardless of the degree to which their *content* might incriminate the custodian, the Supreme Court has been more solicitous of the custodian's right to avoid incrimination as a result of the communicative aspects of *the act of production*. The Court addressed this tension between the custodian's Fifth Amendment rights regarding the act of production and the grand jury's entitlement to the records of the entity lacking any Fifth Amendment rights in *Braswell v. United States*. The Court solved the dilemma with a compromise: the custodian must produce the records even if the act of producing them would incriminate the custodian, but the government is prohibited from making direct use of the act of production in any subsequent prosecution of the custodian. Because the custodian acts as a representative or agent, the custodian's acts are deemed to be the act of the entity and not that of the custodian personally. If the custodian is later tried on criminal charges and the government uses the documents the custodian produced, the government is permitted to inform the jury that the corporation produced the records. The government may not, however, disclose to the jury that the records were produced on behalf of the corporation by the custodian.

Although the *Braswell* Court did not use this term, it effectively created a limited form of immunity, which is automatic and self-executing. There need be no communication from the government nor order of the court conferring this protection on the custodian. It would be prudent, however, for counsel representing custodians to accompany the document production with a letter confirming that the documents are being produced by

the custodian in a representative rather than individual capacity and that the custodian will be entitled to the protections of *Braswell* in connection with the production.

Note, however, that the informal immunity conferred by *Braswell* is limited to the government's direct use of the custodian's act of production. It does not appear to extend to the government's *derivative* use of the custodian's act of production in its investigation and prosecution of the custodian. See *In re Three Grand Jury Subpoenas Duces Tecum*. Thus evidence discovered as a result of knowledge gleaned from corporate documents produced by the custodian may later be introduced to incriminate the custodian. In contrast, Fifth Amendment rights may only be overcome through a grant of both use and derivative use immunity. Under the rationale of *Braswell*, however, the custodian was not compelled to give up his or her Fifth Amendment claims, so the custodian is not entitled to true use and derivative use immunity. Instead, the limitation on the government's use of the evidence gained from the custodian—though it functions as a form of immunity—simply flows from the recognition that these acts are deemed to be the acts of the corporation, not of the custodian as an individual.

Braswell's automatic use immunity for custodians functions best when the entity at issue has many individuals associated with it, so that a jury would have no reason to assume that the documents in question were produced by the custodian on trial. But what about a custodian who is the only individual associated with the entity, such as a corporation with a single shareholder who is also the sole employee? Under this scenario, the protection of *Braswell* will be largely illusory, because the jury will almost certainly infer that if the documents were produced by the entity, the only person who could have done so is the defendant. The *Braswell* Court recognized this difficulty but declined to address it:

We leave open the question whether the agency rationale supports compelling a custodian to produce corporate records when the custodian [can] establish, by showing for example that he is the sole employee and officer of the corporation, that the jury would inevitably conclude that he produced the records.

This question remains an open one, though the lower courts addressing the issue after *Braswell* have declined to afford any additional protections for custodians of one-person entities. See, e.g., *United States v. Amato*; *In re Grand Jury Subpoena*; *United States v. Stone*. Nevertheless, while the issue remains unresolved by the Supreme Court, counsel representing custodians of one-person legal entities would be prudent to raise it and, if nothing else, preserve the matter for further review.

On the other hand, a sole proprietorship—meaning a business owned by an individual rather than an entity such as a corporation or partnership—is treated for Fifth Amendment purposes as an individual. A sole proprietorship has no established institutional existence separate from its owner, and is regarded as the owner's alter ego. See *Bellis v. United States*; *Herman v. Galvin*; *In re Tower Metal Alloy Co*. Thus

subpoenas to sole proprietorships should be addressed under the framework we discussed above regarding subpoenas to individuals. . . .

Problem 13-1

- (a) Your client Shirley is in your office again for that initial interview. But this time, about halfway through the meeting, she says this: “Huh. I don’t know if this matters. But I just remembered that I put some comments about one of my meetings with Edgar about stock trades in my diary. I like to write about my day before I go to sleep at night. I usually keep my diary next to my bed but I think it’s in an extra handbag that I left at the office today.” Advise Shirley about the diary (and ask her about any additional facts you might need).
- (b) Same as above, but Shirley tells you that she put the comments about the meeting with Edgar on the Notes app on her iPhone. Advise Shirley (and ask her about any additional facts you might need). Might it matter whether Shirley (i) has one phone that she uses for all personal and work matters and that she pays for, (ii) same single phone but Shirley’s company reimburses her for part of the monthly bill, (iii) same single phone but the company pays 100% of the monthly bill, or (iv) Shirley has two phones, one for personal matters that she pays for and the other for work matters that the company pays for, but Shirley has a single iCloud account?

14. ATTORNEY-CLIENT PRIVILEGE

Lawyers are pervasive in the world of corporate regulation, primarily in two capacities: (1) as advisors who participate contemporaneously in activities that may later be subject to legal scrutiny, criminal or otherwise (*i.e.*, deal lawyers); and (2) as representatives of firms and persons subject to ex post enforcement action (*i.e.*, litigators).

The attorney-client privilege and the related work product doctrine have much to say about the activities of both types of lawyers. These areas of law are almost entirely a matter of federal common law. The case law is voluminous and the issues tend to be fact-intensive. Most questions or problems in this area will require careful research. The materials in this chapter provide a sense of some, but not all, of the legal issues relating to the privilege that commonly arise in the corporate enforcement setting.

A. The Privilege: An Overview

As you may have learned in other contexts, the attorney-client privilege has spawned an enormous amount of case law, and it is a doctrine you are likely to encounter in litigation practice of all types. It is also taught in several other law school courses. Because we are interested in the privilege's relevance to corporate crime, it makes sense to use the following treatise excerpt to see an overview of the elements of the privilege and how the doctrinal issues are organized. The chapter then moves to court decisions specific to the area of corporate crime.

PRINCIPLES OF EVIDENCE

Graham C. Lilly, Daniel J. Capra & Stephen A. Saltzburg (West 5th ed.)

§ 10.3 The Attorney-Client Privilege

The privilege protecting communications between attorney and client is recognized in every American jurisdiction. It is firmly rooted and unqualified—that is, once it attaches, it is not subject to a judicial override. Furthermore, it can be claimed, even after the client's death, by her personal representative. The privilege rests both on privacy concerns and, more importantly, on a utilitarian rationale. The privilege encourages frank and full disclosure by the client, thus improving the quality of legal representation. And because the existence of the privilege is widely known, it may encourage persons in need of legal advice to seek it. That said, it is still not easy to craft the proper bounds of the attorney-client privilege.

Here are some of the difficulties. The client may wish to conceal physical evidence, or hide his identity. Note that the protection of information like this is only tenuously connected to the purpose of the privilege—full and frank communications between client and lawyer. Thus the privilege is generally inapplicable in situations like these. Another difficulty arises because, in the course of legal representation, lawyers and clients necessarily interact with a wide range of third parties, such as investigators, paralegals,

accountants, physicians, and consulting attorneys. Thorny problems emerge in determining whether communications with and among these secondary actors fall within the boundaries of the attorney-client privilege. And numbers alone magnify the difficulty of marking the appropriate bounds of this privilege, especially when the holder is a business enterprise, such as a corporation, partnership, or other business association. Wide disclosure of “privileged” communications may suggest that the communications were not intended to be confidential or that even if the privilege initially attached, it has been waived. Special problems also exist when shareholders in a corporation sue management on behalf of the corporation—an increasingly common practice in American business life. Other problems arise when a lawyer represents several clients on a common matter and they subsequently become adversaries, or when separately represented clients cooperate and pool their resources.

In resolving these and other problems, it is important to keep in mind the core objective of the attorney-client privilege: to promote full and candid confidential communications between client and attorney so as to facilitate the rendition of legal services. While the development of the attorney-client privilege generally proceeds by case law, courts have been guided by proposed Federal Rule 503. Even though neither this rule nor the other proposed privilege rules were adopted when Congress enacted the Federal Rules of Evidence in 1975, Congress made it clear that its decision to allow the law of privilege to evolve by judicial decision was not a disapproval of any of the proposed enumerated privileges. Proposed Rule 503 is a carefully crafted, detailed provision, covering many aspects of the attorney-client privilege. It has been an influential “standard” in both federal and state courts and its influence has prompted greater uniformity across jurisdictional lines. You should be aware, however, that some differences in the scope of the attorney-client privilege do exist among the jurisdictions and this is particularly true among the various states. Thus, the following textual materials should be viewed as representing the position of most courts and, in particular, of most federal courts.

Proposed Rule 503 broadly defines the attorney-client privilege. Subsection (b) states:

General rule of privilege. A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client, (1) between himself or his representatives and his lawyer or his lawyer’s representative, or (2) between his lawyer and the lawyer’s representative, or (3) by him or his lawyer to a lawyer representing another in a matter of common interest, or (4) between representatives of the client or between the client and a representative of the client, or (5) between lawyers representing the client.

Proposed Rule 503 contemplates the protection of not only the direct communications between attorney and client, but also of communications between and among various representatives of each. Legal services often involve non-lawyer specialists such as

investigators, physicians, economists, investment bankers, accountants, scientists, and mathematicians. It is important to note, however, that for communications to these non-lawyers to be protected by the attorney-client privilege, these representatives must either be communicating to the lawyer (or his representative) or the client (or his representative) for the purpose of assisting the lawyer in delivering legal services. Proposed Rule 503(a)(3) affirms this observation by defining an attorney's "representative" as one who is engaged "to assist the lawyer in the rendition of professional legal services." . . .

The attorney-client privilege is available not only to individual clients, but also to partnerships, various business entities (such as associations and corporations), and to governmental officers and agencies. Proposed Rule 503(a)(1) defines "client" as a person or entity "who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services from him." The availability of the privilege is not dependent on the payment of legal fees or on a formal contract between client and attorney. The language of Proposed Rule 503(a) ("[consulting] a lawyer with a view to obtaining professional legal services") confirms the well-established principle that the privilege applies to an initial attorney-client consultation even if the client (or the attorney) declines representation. . . .

The privilege requires that the client must be seeking *legal advice* from the lawyer; that requirement emphasizes the obvious fact that not everything said to a lawyer, even in confidence, is privileged. (If that were the case, lawyers would be quite popular at bars and parties). That said, clients often seek lawyers for assistance on complex matters that involve a *mixture* of law, business, policy, and other subjects that are not strictly "legal." But if including any non-legal subject within a broader legal discussion would lose the privilege, then the attorney-client relationship would suffer. Accordingly, the courts have held that if the *dominant intent* of the client is to seek legal advice, the privilege is not lost if advice is also sought on related business, financial, or other not strictly legal matters. . . .

Although the attorney-client privilege was initially formulated to protect only the client's confidential communications, modern courts recognize that the privilege also applies to the attorney's confidential communications to the client. The client's statements and the attorney's statements often interlock. If the privilege did not attach to the attorney's statements, her disclosures could often be used to infer at least the general content of the client's confidential communications to the attorney. This is especially true when the attorney renders legal advice based on what the client has told her. Thus, considerations of both practicality and preserving confidentiality have prompted courts to apply the privilege to the confidential communications of both client and attorney. . . .

[T]he attorney-client privilege *does not apply* to letters, documents . . . or other inscribed items that were not prepared for the purpose of facilitating legal services. If the rule were otherwise, a client could place all "preexisting" documents beyond the reach of discovery by the simple expedient of turning them over to her attorney. The fact that

such documents end up being useful to the lawyer is beside the point—the question is whether the communications were *initially* made to the lawyer for the purpose of securing legal advice. Of course, if the client prepares a confidential letter to the attorney telling him, for example, how to interpret the documents or suggesting trends reflected in the data contained in them, this letter would be protected by the privilege. Furthermore, if an attorney gives confidential legal advice to a client that is based on the attorney's review or analysis of unprotected documents, the *communication from the attorney* to the client is protected by the privilege (while the underlying documents are not). . . .

Students of civil procedure may recall the so-called “work-product” doctrine, traceable to the Supreme Court's decision in *Hickman v. Taylor*. Although that decision concerned the recognition of the doctrine in federal courts, it is generally recognized among the states as well. In recent years, the central features of the doctrine have often been codified in a rule of court or statute. Federal Rule of Civil Procedure 26(b)(3) sets forth the basic rules of work-product; subsection (b)(4) extends the work-product doctrine (or at least its rationale) to experts engaged by a party to assist in trial preparation. Generally speaking, the work-product doctrine extends *conditional immunity* from discovery by an opponent to written materials prepared in “anticipation of litigation.” Typically, the protected materials are prepared by the lawyer, but materials prepared by others—such as an investigator, agent, consultant, or the party himself—are also conditionally immune if prepared for litigation. Familiar examples of a lawyer's work-product would be his notes about a witness's statement or his investigator's recorded measurements of skid marks at the scene of an automobile accident. Like the attorney-client privilege, the work-product doctrine protects the *materials or communications* generated by the lawyer, or by a client who is a party to a suit, or by a representation of either. However, the work-product doctrine *does not protect the client's knowledge*, which includes facts known to his attorney who is his agent. In other words, the client would have to answer an interrogatory: “How far were you from the ‘Hazard’ sign when you first saw it?” Furthermore, the court may order discovery of work-product materials if the party seeking them shows a substantial need or, in the case of a *consulting* expert (who does not testify), exceptional need. The requisite showing of need varies with the particular context and is affected by the discovering party's ability to secure unprotected evidence that is the substantial equivalent of the materials sought. . . .

One qualifies as a lawyer's representative only if engaged “to assist the lawyer in the rendition of professional legal services.” Courts have held that the non-lawyer must be *necessary to the legal representation* for communications to or from the non-lawyer to be privileged. . . . The mere preparation of an income tax return is not legal in nature; indeed most income tax preparers are not attorneys. On the other hand, tax lawyers routinely render legal services, creating many occasions on which communications from their clients (and their communications to their clients) are within the attorney-client privilege. . . .

Incidentally, a question sometimes arises as to whether the name of a client is protected by the attorney-client privilege. For example, a grand jury or the IRS invokes a process such as a summons or subpoena addressed to a lawyer, demanding the identity of the lawyer's client. In most cases, the client has no intention to conceal her identity—disclosure of her identity to the lawyer is preliminary to and independent from any communications made to secure legal advice. Even if a client desired anonymity, sound public policy usually militates against granting it. Occasionally, however, protection of a client's identity is justified, as when a whistleblower seeks legal advice in connection with revealing wrongdoing or when revealing the client's name would disclose the general content of a confidential communication. . . .

Suppose that the client is a corporation (or other business entity) and that the communication in question is made by a corporate agent to the corporation's attorney. Because the corporation can speak only through individuals, the question is whether the corporation—the client and holder of the privilege—is the communicant. Depending on the context and a particular court's view of the proper scope of the attorney-client privilege, the statements of the agent could be either, (1) communications from the corporate client and within the corporation's privilege or, (2) statements of a person who is speaking as an individual witness and whose communications are not within the corporation's privilege.

Note that if the privilege extends far down into the corporate personnel structure—to middle management or even below—the reach of the privilege may unjustifiably hinder the efforts of an opponent to support his claim or defense. It also makes it difficult to discover discrepancies between what a corporate employee says (in a deposition, for example) to the opponent and what he told the corporate attorney.

The application of attorney-client protection in the corporate setting often strains some of the basic doctrines of privilege law, rooted as they are in the context of the individual client. The requirement of confidentiality, for example, meshes poorly with the layered structure of the large corporation, where statements may be passed through many hands before reaching counsel or counsel's advice may be widely shared within the corporation. In addition, the often-indistinct boundary between legal and business advice is likely to be perplexingly blurred in the corporate context, and this is especially true as to communications between a corporate spokesman and in-house counsel. On the other hand, the modern corporation could not realize the full potential of legal advice without some application of the privilege. It, like the individual client, needs to communicate freely and fully with its attorneys, preferably through the corporate agents with the most knowledge. The problem, therefore, is one of drawing a line that sensibly balances the corporation's need for an attorney-client privilege and the opponent's need for fair access to evidence generated within the corporate structure. The extremes are easily recognized and managed. Clearly protected is a confidential communication from the CEO to the attorney, made for the purpose of receiving legal advice for the corporation. Clearly unprotected is a routinely prepared statement by a lower-level employee, made in the normal course of business, but subsequently sent to the corporate attorney. The

difficulties lie in the shadowy area between these polarities. For communications to corporate counsel, two general tests have been devised.

Some states still adhere to the “control-group test” for determining which corporate agents are considered part of the client when communicating to the corporation’s attorney. Under this test, the privilege attaches only if the corporate officer speaking with the attorney is vested with authority both to seek legal advice for the corporation and to participate significantly in the corporation’s response to the attorney’s recommendations. The analogy is to the individual client, who can obtain legal advice and then, if he wishes, tailor his conduct consistently with that advice. The problem with this approach in the corporate context is its heavy reliance on the formal delegation of corporate authority. If the person who speaks with the attorney is an officer within the upper tiers of management, he probably “speaks for the corporation.” Often, however, the high-level corporate spokesperson is not the individual who is fully informed about the matter in question. The attorney will nearly always want to speak with corporate agents who are the most knowledgeable, yet these persons may be outside the circle of upper level personnel empowered to “speak for” the corporation. Although their statements to the attorney may gain qualified protection through the application of the work-product rule (if litigation is anticipated), the unqualified protection of the attorney-client privilege is not available. Thus, from a functional standpoint, the rigidity of the control-group test can have a distorting effect on the choice of corporate spokespersons.

The second approach to the corporate attorney-client privilege is often referred to as the “subject-matter test.” It was adopted for the federal courts in *Upjohn Co. v. United States*, and is the prevailing approach in most states. . . . In brief, the *Upjohn* approach would allow the privilege when the facts showed that: (1) the communication in question was pursuant to a corporate purpose to obtain legal advice, (2) the communication “concerned matters within the scope of the employee’s corporate duties,” (3) the employee knew that he was making a confidential statement and was doing so as part of his employer’s efforts to secure legal advice or services, and (4) the statements were kept confidential or disclosed on a limited basis consistent with maintaining the privilege.

The last requirement—limited disclosure—can apply in two contexts: disclosure *within* or *outside* the corporate firm. Because corporations depend heavily upon information, there is a practical need that corporate records be accessible to those individuals or groups who need access. Yet, there is always a risk that information collected under the umbrella of the attorney-client privilege may be so widely shared that the privilege is lost. Generally, privileged communications should be disclosed only to persons who need access—to those who “need to know” the confidential information in order to do their jobs—and care should be taken to ensure that these persons understand the need to maintain confidentiality. If privileged documents are kept in a general filing system, access should be restricted.

Voluntary disclosures outside the company pose an even greater risk of losing the privilege. Here, it is important to ensure the disclosure is made only to those who are “necessary to the legal representation”—a concept discussed above. Common sense dictates the importance of signaling the confidential nature of the disclosure through the use of labels, cover letters, or other precautionary measures.

Because litigation often deals with events that occurred several or more years before suit was filed, some of the employees or officers who gave privileged communications on the corporation’s behalf may have died or left the company. Their departure from the corporate staff does not affect the availability of the privilege for communications made at the time of their employment. A closer question attends *post-employment* statements by a former employee to corporate counsel. In his concurring opinion in *Upjohn*, Chief Justice Burger suggested that the privilege did embrace these statements because a former employee, like a current employee, may have information that is necessary for the lawyer to give sound legal advice—and lower courts have so held.

Several other issues surrounding the corporate attorney-client privilege warrant brief mention. As we have seen, the holder of the privilege is the corporation. The privilege can be waived only by management; sometimes the board of directors will reserve for itself the right to claim or waive the privilege. The power to waive resides with the current board, regardless of when the privileged communications were made.

Note the anomaly that arises when a corporate agent speaks to the corporate lawyer about a matter that would incriminate him personally. Those communications are privileged, but it is the *corporation* that holds the privilege. If the corporation decides to waive its privilege as to those communications—most commonly to cooperate with the government in order to avoid fines or other penalties—the agent is unprotected, and his own statements can be admitted against him at his trial. This is because there is no personal attorney-client relationship with the corporate lawyer—nor can there be, because a lawyer representing both the corporation and the agent in circumstances of possible corporate/agent wrongdoing would be operating under a conflict of interest, for the very reason that the corporation may find it beneficial to waive its privilege and cooperate with the government, leaving its agent unprotected. . . .

The attorney-client privilege protects *communications*, not factual information that was the subject of a communication between the lawyer and the client—as shown in the following Illustration.

Clyde, whose expensive luxury car is only two years old, has just been told by his mechanic that the car will soon need costly repairs. Doubtful that the mechanic is correct, Clyde (who is mechanically inclined) verifies for himself the imminent repairs. Because the manufacturer’s warranty on the car has expired, Clyde decides to sell it without disclosing its defects.

Subsequently, the buyer sues Clyde and Clyde retains a defense lawyer. He tells his attorney about the mechanic’s report and about his own confirmation of the impending

mechanical failures. During discovery, the plaintiff's lawyer takes Clyde's deposition. He asks Clyde the following series of questions.

Q: "Did you know this car had these [named] serious mechanical defects?"

Q: "Did your mechanic, at Bosch Bros. Luxury Cars, inform you on June 3, 2008, that the car had these [named] defects?"

Q: "Do you have mechanical skills?"

Q: "Isn't it true that on or about June 5, 2008, you personally verified that the car you sold to the plaintiff had precisely the defects and problems identified by the Bosch Bros. mechanic?"

Clyde's attorney objects to these questions on the ground that they call for responses that are protected by the attorney-client privilege. How should the judge rule? None of these questions is improper, and Clyde must provide answers to each. The attorney-client privilege does not apply to facts or events that are the subject of, or described in, a confidential communication. If it did, there would be little or no evidence for the jury to consider. A client could simply relate all the relevant facts to his attorney and thereby insulate the client's knowledge of the underlying events from discovery. Of course, the attorney-client privilege does protect Clyde's *communications* to his lawyer. If it did not, these statements would be admissible as party admissions.

It sometimes happens that several clients with a common problem retain a single lawyer or firm to represent them. For example, one lawyer may represent both *A* and *B* in a matter of joint or common interest, such as their purchase of real estate or their common dispute with an insurance company. The rule in such situations provides that the statements of both clients and those of the lawyer are privileged if made for purposes of seeking legal advice on the common objective. It seems plain enough that, as against outsiders, *each client* is entitled to claim the privilege as to statements *she has made*, as well as to the attorney's responsive statements. But can client *A* invoke the privilege (as against outsiders) so as to prevent disclosure of *B*'s statements to the attorney as well as the attorney's responsive statements to *B*? The issue usually does not arise because *A* and *B* have a common objective and thus each is likely to claim the privilege or agree to waive it. However, should they disagree, most courts hold that all clients remain bound by the common interest arrangement—that is, *A* will not be permitted to disclose any communications made by either party in pursuit of the common interest. (Note that the parties can contract in their common interest arrangement either to bind all parties or to allow parties to waive the protection as to their own communications—but the default rule is that all parties are bound and the privilege is retained.)

In subsequent litigation in which *A* and *B*, having fallen out, become adversaries, the rule is that privilege is lost as to all of their statements. (Here, no "outsider" is involved.) First, when they were joint clients, neither client intended that his communications

would be shielded from the other. Second, even if, say, *A* “secretly” communicated with the attorney, the communication would not be privileged as to *B* because the attorney would have an ethical duty to share it with her other joint client. Proposed Rule 503(d)(5) states that in an action between persons who were formally joint clients, there is no privilege as to communications “made by any [of the joint clients] . . . to a lawyer retained or consulted in common . . .” (Again, though, the parties can contract with each other to protect against disclosure in a subsequent litigation between them).

The rule protecting joint-client discussions has also been extended to protect confidential communications where two or more clients, *each with his own attorney*, agree to pool or share information in order to conserve resources and mount a more effective case—either a defensive or an offensive one. These allied clients have both a mutual and an individual interest: they are sharing information (and perhaps resources) with respect to their common interests, yet each participating client is represented by his own lawyer or firm. These sharing arrangements would seldom materialize if outsiders could successfully argue that confidential disclosures within the group lost the protection of the attorney-client privilege because dissemination went beyond the individual attorney-client units that comprise the pool. Thus, it is not surprising that courts protect the confidential communications of separately represented parties who pursue a common legal objective. Protection under the common-interest doctrine applies, however, only if the parties claiming the attorney-client privilege can show that they have agreed (orally or in writing) to assume an allied position. It is thus advisable for the parties to a pooling arrangement who wish to protect the attorney-client privilege—and most parties do—to enter into a formal, preferably written, agreement. Again, however, if the parties pursuing a common interest later end up suing each other, the communications previously made can be freely used by the parties in that subsequent litigation—this is because there was no expectation of confidentiality vis-a-vis the member of the common interest “unit” at the time the statements were made. (But the parties can, by contract, provide for protection against use of the statements in a subsequent litigation between or among them.) . . .

While a confidential communication between a client and a lawyer on a legal matter is protected by the privilege, that privilege can be waived in a number of circumstances. The basic question of waiver is whether the client has—by some statement or action subsequent to the making of the privileged communication—explicitly or implicitly acted in such a way that justifies a finding that the party no longer wishes to, or should, retain the privilege.

The most obvious form of waiver is a knowing and voluntary disclosure of the privileged information. That waiver-by-disclosure most often occurs when the client determines that the benefits of the disclosure outweigh the risks that the privileged information will be used against the client. A common example is a corporation that is being investigated by a government regulator or prosecutor for possible internal corporate misconduct (e.g., accounting violations). Assume that the corporation had previously hired a law firm to conduct an internal investigation, and the law firm prepared a report. That report is

confidential. But the corporation may decide to voluntarily disclose it to the government investigator. The benefits of disclosure—cooperating with the government and thereby avoiding or ameliorating fines and penalties—often outweigh the risk that the report, now waived, will be used against the corporation in some litigation.

Other situations arise in which waiver is *implied* from the client's conduct. Implied waiver is likely to be found when the client acts in such a way that it would be unfair to the adversary to uphold the privilege. When a client sues her lawyer for malpractice, for example, the lawyer can use relevant confidential statements made during the representation to defend herself—it would be unfair for the client to attack the lawyer's performance and yet leave the lawyer unable to rebut the charges by showing that, for example, he was instructed by the client to do the act for which he is now criticized. Similarly, if a client refuses to pay his attorney, the attorney can support her claim for fees with confidential information. In other words, the privilege is suspended as to any "communication relevant to an issue of breach of duty by the lawyer to . . . [her] client or by the client to his lawyer." This is because it would be unfair for the client to contest the value of the lawyer's services, and yet not allow the lawyer to defend by offering communications by the client that affected those services.

In a related context, a client waives his privilege if he asserts an affirmative defense of "reliance on advice of counsel." It would be unfair for the client to raise the attorney-client discussions as a defense, but then to prevent the adversary from inquiring into just what was said between the client and the attorney on the matter.

Recall that corporations often find it useful to cooperate with government investigations by turning over privileged information. While that is a waiver, should it extend to allowing private parties to use the information? Here is an example: a corporation is being investigated by the SEC for securities fraud. It turns over a confidential report to the SEC. Then private parties sue the corporation, and argue that they are entitled to the report, because the corporation waived the privilege by disclosing it to the SEC. The question in such a case is whether the waiver is *selective* or general. The policy argument for finding the waiver to be selective is that it would encourage corporations to cooperate with the government, because it would limit the costs of that cooperation; and the protection of selective waiver could also limit the costs of government investigations into potential corporate misconduct, because the government would be able to rely on the report instead of having to do its own investigation from square one.

But almost all courts have rejected the notion of selective waiver—meaning that a voluntary disclosure to anyone operates as a waiver to everyone. The courts reason that corporations are *already*—in the absence of selective waiver—cooperating with the government by turning over confidential reports. This is because the benefits of cooperation in avoiding criminal fines and penalties generally outweigh the costs, even including the cost that the privileged material can be used by private parties. Thus, selective waiver is not necessary to encourage cooperation (except, perhaps, for corporations at the margin, but the consequence of establishing selective waiver would

be that *all* corporations would be protected, even those who would cooperate anyway.) Moreover, the courts frown upon strategic activity in the use of the privilege; it seems to be gaming the privilege for a client to say, “I will waive to you, but not to you—it depends on how advantageous the waiver will be to me.”

In litigation, it is often the case that a party will mistakenly disclose privileged information during discovery. This is especially true in electronic discovery cases, where the explosion of information raises substantial challenges for an accurate “privilege review” of documents subject to discovery. In recent years, the costs of electronic discovery have skyrocketed, and most of those costs have been attributed to the resources necessary to make sure that no email, spreadsheet, metadata, etc. contains privileged information. The consequences of mistaken disclosure of privileged information, at least in some common law courts, was to find a waiver no matter how careful the privilege review. And some courts even found a *subject matter* waiver in these circumstances—meaning that all privileged documents related to the subject matter of the mistakenly disclosed documents would also have to be disclosed to the adversary. Federal Rule 502, enacted by Congress in 2008, seeks to reduce the costs of privilege review by providing some measure of protection against a finding of waiver after a mistaken disclosure. Three provisions of the Rule are especially important:

- 1) Rule 502(a) precludes the court from finding a subject matter waiver unless the disclosure of the privileged information was *intentional* and results in unfairness to the adversary. Thus, a mistaken disclosure in discovery will never result in a subject matter waiver.
- 2) Rule 502(b) provides that a mistaken disclosure in a federal proceeding will not be a waiver at all if the party took “reasonable steps” to prevent the disclosure and acted reasonably promptly to retrieve the information once the party learns about the mistaken disclosure. Thus, while a party cannot be careless, it need not undertake herculean efforts to protect against mistaken disclosures in discovery.
- 3) Rule 502(d) provides that if a federal court enters an order that disclosure of privileged information in a proceeding is not a waiver, then that order is binding on all subsequent courts, state and federal. So getting a court order allows parties on each side to limit the costs of preproduction privilege review, because there will not be a waiver if privileged material is disclosed in the litigation.

B. Federal Rules of Evidence

The Federal Rules of Evidence mostly delegate privilege questions to the courts. The relevant Rules are printed below. Note that Rule 502 is a fairly recent rule on waiver, but it only covers some waiver issues, not nearly all of them. Additionally, Proposed Rule 503 was not enacted, though it is frequently cited as persuasive authority.

Rule 501. Privilege in General

The common law—as interpreted by United States courts in the light of reason and experience—governs a claim of privilege unless any of the following provides otherwise:

- the United States Constitution;
- a federal statute; or
- rules prescribed by the Supreme Court.

But in a civil case, state law governs privilege regarding a claim or defense for which state law supplies the rule of decision.

Rule 502. Attorney-Client Privilege and Work Product; Limitations on Waiver

The following provisions apply, in the circumstances set out, to disclosure of a communication or information covered by the attorney-client privilege or work-product protection.

(a) Disclosure Made in a Federal Proceeding or to a Federal Office or Agency;

Scope of a Waiver. When the disclosure is made in a federal proceeding or to a federal office or agency and waives the attorney-client privilege or work-product protection, the waiver extends to an undisclosed communication or information in a federal or state proceeding only if:

- (1) The waiver is intentional;
- (2) The disclosed and undisclosed communications or information concern the same subject matter; and
- (3) They ought in fairness to be considered together.

(b) Inadvertent Disclosure. When made in a federal proceeding or to a federal office or agency, the disclosure does not operate as a waiver in a federal or state proceeding if:

- (1) The disclosure is inadvertent;
- (2) The holder of the privilege or protection took reasonable steps to prevent disclosure; and
- (3) The holder promptly took reasonable steps to rectify the error, including (if applicable) following Federal Rule of Civil Procedure 26 (b)(5)(B).

(c) Disclosure Made in a State Proceeding. When the disclosure is made in a state proceeding and is not the subject of a state-court order concerning waiver, the disclosure does not operate as a waiver in a federal proceeding if the disclosure:

- (1) would not be a waiver under this rule if it had been made in a federal proceeding;
or
 - (2) is not a waiver under the law of the state where the disclosure occurred.
- (d) **Controlling Effect of a Court Order.** A federal court may order that the privilege or protection is not waived by disclosure connected with the litigation pending before the court—in which event the disclosure is also not a waiver in any other federal or state proceeding.
- (e) **Controlling Effect of a Party Agreement.** An agreement on the effect of disclosure in a federal proceeding is binding only on the parties to the agreement, unless it is incorporated into a court order.
- (f) **Controlling Effect of this Rule.** Notwithstanding Rules 101 and 1101, this rule applies to state proceedings and to federal court-annexed and federal court-mandated arbitration proceedings, in the circumstances set out in the rule. And notwithstanding Rule 501, this rule applies even if state law provides the rule of decision.
- (g) **Definitions.** In this rule:
- (1) “attorney-client privilege” means the protection that applicable law provides for confidential attorney-client communications; and
 - (2) “work-product protection” means the protection that applicable law provides for tangible material (or its intangible equivalent) prepared in anticipation of litigation or for trial

Proposed Rule 503. Lawyer-Client Privilege [not enacted, in favor of common law; see Rule 501]

- (a) **Definitions.** As used in this rule:
- (1) A “client” is a person, public officer, or corporation, association, or other organization or entity, either public or private, who is rendered professional legal services by a lawyer, or who consults a lawyer with a view to obtaining professional legal services from him.
 - (2) A “lawyer” is a person authorized, or reasonably believed by the client to be authorized, to practice law in any state or nation.
 - (3) A “representative of the lawyer” is one employed to assist the lawyer in the rendition of professional legal services.
 - (4) A communication is “confidential” if not intended to be disclosed to third persons other than those to whom disclosure is in furtherance of the rendition of

professional legal services to the client or those reasonably necessary for the transmission of the communication.

- (b) **General rule of privilege.** A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client, (1) between himself or his representative and his lawyer or his lawyer's representative, or (2) between his lawyer and the lawyer's representative, or (3) by him or his lawyer to a lawyer representing another in a matter of common interest, or (4) between representatives of the client or between the client and a representative of the client, or (5) between lawyers representing the client.
- (c) **Who may claim the privilege.** The privilege may be claimed by the client, his guardian or conservator, the personal representative of a deceased client, or the successor, trustee, or similar representative of a corporation, association, or other organization, whether or not in existence. The person who was the lawyer at the time of the communication may claim the privilege but only on behalf of the client. His authority to do so is presumed in the absence of evidence to the contrary.
- (d) **Exceptions.** There is no privilege under this rule:
 - (1) Furtherance of crime or fraud. If the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or reasonably should have known to be a crime or fraud; or
 - (2) Claimants through same deceased client. As to a communication relevant to an issue between parties who claim through the same deceased client, regardless of whether the claims are by testate or intestate succession or by inter vivos transaction; or
 - (3) Breach of duty by lawyer or client. As to a communication relevant to an issue of breach of duty by the lawyer to his client or by the client to his lawyer; or
 - (4) Document attested by lawyer. As to a communication relevant to an issue concerning an attested document to which the lawyer is an attesting witness; or
 - (5) Joint clients. As to a communication relevant to a matter of common interest between two or more clients if the communication was made by any of them to a lawyer retained or consulted in common, when offered in an action between any of the clients.

C. The Corporate Privilege

Upjohn is the case on the attorney-client privilege of corporations and the application of the work product doctrine to companies' lawyers. It is very important and helpful to understand the policy considerations that apply to the attorney-client privilege and work product doctrine. Doctrinal problems will be resolved with reference to what result will

further those policy objectives (or not). That said, it's not obvious how the policy arguments play out when the client is a firm. How might the Court's policy analysis in *Upjohn* be subject to criticism?

UPJOHN CO. v. UNITED STATES, 449 U.S. 383 (1981)

Justice REHNQUIST delivered the opinion of the Court.

We granted certiorari in this case to address important questions concerning the scope of the attorney-client privilege in the corporate context and the applicability of the work-product doctrine in proceedings to enforce tax summonses. With respect to the privilege question the parties and various *amici* have described our task as one of choosing between two "tests" which have gained adherents in the courts of appeals. We are acutely aware, however, that we sit to decide concrete cases and not abstract propositions of law. We decline to lay down a broad rule or series of rules to govern all conceivable future questions in this area, even were we able to do so. We can and do, however, conclude that the attorney-client privilege protects the communications involved in this case from compelled disclosure and that the work-product doctrine does apply in tax summons enforcement proceedings.

Petitioner Upjohn Co. manufactures and sells pharmaceuticals here and abroad. In January 1976 independent accountants conducting an audit of one of Upjohn's foreign subsidiaries discovered that the subsidiary made payments to or for the benefit of foreign government officials in order to secure government business. The accountants, so informed petitioner, Mr. Gerard Thomas, Upjohn's Vice President, Secretary, and General Counsel. Thomas is a member of the Michigan and New York Bars, and has been Upjohn's General Counsel for 20 years. He consulted with outside counsel and R. T. Parfet, Jr., Upjohn's Chairman of the Board. It was decided that the company would conduct an internal investigation of what were termed "questionable payments." As part of this investigation the attorneys prepared a letter containing a questionnaire which was sent to "All Foreign General and Area Managers" over the Chairman's signature. The letter began by noting recent disclosures that several American companies made "possibly illegal" payments to foreign government officials and emphasized that the management needed full information concerning any such payments made by Upjohn. The letter indicated that the Chairman had asked Thomas, identified as "the company's General Counsel," "to conduct an investigation for the purpose of determining the nature and magnitude of any payments made by the Upjohn Company or any of its subsidiaries to any employee or official of a foreign government." The questionnaire sought detailed information concerning such payments. Managers were instructed to treat the investigation as "highly confidential" and not to discuss it with anyone other than Upjohn employees who might be helpful in providing the requested information. Responses were to be sent directly to Thomas. Thomas and outside counsel also interviewed the recipients of the questionnaire and some 33 other Upjohn officers or employees as part of the investigation.

On March 26, 1976, the company voluntarily submitted a preliminary report to the Securities and Exchange Commission on Form 8-K disclosing certain questionable payments. A copy of the report was simultaneously submitted to the Internal Revenue Service, which immediately began an investigation to determine the tax consequences of the payments. Special agents conducting the investigation were given lists by Upjohn of all those interviewed and all who had responded to the questionnaire. On November 23, 1976, the Service issued a summons pursuant to 26 U.S.C. § 7602 demanding production of:

“All files relative to the investigation conducted under the supervision of Gerard Thomas to identify payments to employees of foreign governments and any political contributions made by the Upjohn Company or any of its affiliates since January 1, 1971 and to determine whether any funds of the Upjohn Company had been improperly accounted for on the corporate books during the same period.”

“The records should include but not be limited to written questionnaires sent to managers of the Upjohn Company’s foreign affiliates, and memorandums or notes of the interviews conducted in the United States and abroad with officers and employees of the Upjohn Company and its subsidiaries.”

The company declined to produce the documents specified in the second paragraph on the grounds that they were protected from disclosure by the attorney-client privilege and constituted the work product of attorneys prepared in anticipation of litigation. On August 31, 1977, the United States filed a petition seeking enforcement of the summons under 26 U.S.C. §§ 7402(b) and 7604(a) in the United States District Court for the Western District of Michigan. That court adopted the recommendation of a Magistrate who concluded that the summons should be enforced. Petitioners appealed to the Court of Appeals for the Sixth Circuit which rejected the Magistrate’s finding of a waiver of the attorney-client privilege, but agreed that the privilege did not apply “[t]o the extent that the communications were made by officers and agents not responsible for directing Upjohn’s actions in response to legal advice . . . for the simple reason that the communications were not the ‘client’s.’” The court reasoned that accepting petitioners’ claim for a broader application of the privilege would encourage upper-echelon management to ignore unpleasant facts and create too broad a “zone of silence.” Noting that Upjohn’s counsel had interviewed officials such as the Chairman and President, the Court of Appeals remanded to the District Court so that a determination of who was within the “control group” could be made. In a concluding footnote the court stated that the work-product doctrine “is not applicable to administrative summonses issued under 26 U.S.C. § 7602.”

Federal Rule of Evidence 501 provides that “the privilege of a witness . . . shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in light of reason and experience.” The attorney-client privilege is

the oldest of the privileges for confidential communications known to the common law. 8 J. Wigmore, *Evidence* § 2290. Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client. As we stated last Term in *Trammel v. United States*: "The lawyer-client privilege rests on the need for the advocate and counselor to know all that relates to the client's reasons for seeking representation if the professional mission is to be carried out." And in *Fisher v. United States*, we recognized the purpose of the privilege to be "to encourage clients to make full disclosure to their attorneys." This rationale for the privilege has long been recognized by the Court, see *Hunt v. Blackburn* (privilege "is founded upon the necessity, in the interest and administration of justice, of the aid of persons having knowledge of the law and skilled in its practice, which assistance can only be safely and readily availed of when free from the consequences or the apprehension of disclosure"). Admittedly complications in the application of the privilege arise when the client is a corporation, which in theory is an artificial creature of the law, and not an individual; but this Court has assumed that the privilege applies when the client is a corporation and the Government does not contest the general proposition.

The Court of Appeals, however, considered the application of the privilege in the corporate context to present a "different problem," since the client was an inanimate entity and "only the senior management, guiding and integrating the several operations, . . . can be said to possess an identity analogous to the corporation as a whole." The first case to articulate the so-called "control group test" adopted by the court below, *Philadelphia v. Westinghouse Electric Corp., sub nom. General Electric Co. v. Kirkpatrick*, reflected a similar conceptual approach:

"Keeping in mind that the question is, Is it the corporation which is seeking the lawyer's advice when the asserted privileged communication is made?, the most satisfactory solution, I think, is that if the employee making the communication, of whatever rank he may be, is in a position to control or even to take a substantial part in a decision about any action which the corporation may take upon the advice of the attorney, . . . then, in effect, *he is (or personifies) the corporation* when he makes his disclosure to the lawyer and the privilege would apply."

Such a view, we think, overlooks the fact that the privilege exists to protect not only the giving of professional advice to those who can act on it but also the giving of information to the lawyer to enable him to give sound and informed advice. The first step in the resolution of any legal problem is ascertaining the factual background and sifting through the facts with an eye to the legally relevant. See ABA Code of Professional Responsibility, Ethical Consideration 4-1:

“A lawyer should be fully informed of all the facts of the matter he is handling in order for his client to obtain the full advantage of our legal system. It is for the lawyer in the exercise of his independent professional judgment to separate the relevant and important from the irrelevant and unimportant. The observance of the ethical obligation of a lawyer to hold inviolate the confidences and secrets of his client not only facilitates the full development of facts essential to proper representation of the client but also encourages laymen to seek early legal assistance.”

In the case of the individual client the provider of information and the person who acts on the lawyer’s advice are one and the same. In the corporate context, however, it will frequently be employees beyond the control group as defined by the court below—“officers and agents . . . responsible for directing [the company’s] actions in response to legal advice”—who will possess the information needed by the corporation’s lawyers. Middle-level—and indeed lower-level—employees can, by actions within the scope of their employment, embroil the corporation in serious legal difficulties, and it is only natural that these employees would have the relevant information needed by corporate counsel if he is adequately to advise the client with respect to such actual or potential difficulties. This fact was noted in *Diversified Industries, Inc. v. Meredith*:

“In a corporation, it may be necessary to glean information relevant to a legal problem from middle management or non-management personnel as well as from top executives. The attorney dealing with a complex legal problem ‘is thus faced with a “Hobson’s choice.” If he interviews employees not having “the very highest authority,” their communications to him will not be privileged. If, on the other hand, he interviews *only* those employees with the “very highest authority,” he may find it extremely difficult, if not impossible, to determine what happened.’” *Id.* (quoting Weinschel, *Corporate Employee Interviews and the Attorney-Client Privilege*, 12 B.C. IND. & COM. L. REV. (1971)).

The control group test adopted by the court below thus frustrates the very purpose of the privilege by discouraging the communication of relevant information by employees of the client to attorneys seeking to render legal advice to the client corporation. The attorney’s advice will also frequently be more significant to noncontrol group members than to those who officially sanction the advice, and the control group test makes it more difficult to convey full and frank legal advice to the employees who will put into effect the client corporation’s policy. *See, e.g., Duplan Corp. v. Deering Milliken, Inc.* (“After the lawyer forms his or her opinion, it is of no immediate benefit to the Chairman of the Board or the President. It must be given to the corporate personnel who will apply it”).

The narrow scope given the attorney-client privilege by the court below not only makes it difficult for corporate attorneys to formulate sound advice when their client is faced

with a specific legal problem but also threatens to limit the valuable efforts of corporate counsel to ensure their client's compliance with the law. In light of the vast and complicated array of regulatory legislation confronting the modern corporation, corporations, unlike most individuals, "constantly go to lawyers to find out how to obey the law," Burnham, *The Attorney-Client Privilege in the Corporate Arena*, 24 BUS. LAW. (1969), particularly since compliance with the law in this area is hardly an instinctive matter, *see, e.g., United States v. United States Gypsum Co.* ("the behavior proscribed by the [Sherman] Act is often difficult to distinguish from the gray zone of socially acceptable and economically justifiable business conduct"). The test adopted by the court below is difficult to apply in practice, though no abstractly formulated and unvarying "test" will necessarily enable courts to decide questions such as this with mathematical precision. But if the purpose of the attorney-client privilege is to be served, the attorney and client must be able to predict with some degree of certainty whether particular discussions will be protected. An uncertain privilege, or one which purports to be certain but results in widely varying applications by the courts, is little better than no privilege at all. The very terms of the test adopted by the court below suggest the unpredictability of its application. The test restricts the availability of the privilege to those officers who play a "substantial role" in deciding and directing a corporation's legal response. Disparate decisions in cases applying this test illustrate its unpredictability. *Compare, e.g., Hogan v. Zletz, sub nom. Natta v. Hogan* (control group includes managers and assistant managers of patent division and research and development department), *with Congoleum Industries, Inc. v. GAF Corp.* (control group includes only division and corporate vice presidents, and not two directors of research and vice president for production and research).

The communications at issue were made by Upjohn employees to counsel for Upjohn acting as such, at the direction of corporate superiors in order to secure legal advice from counsel. As the Magistrate found, "Mr. Thomas consulted with the Chairman of the Board and outside counsel and thereafter conducted a factual investigation to determine the nature and extent of the questionable payments *and to be in a position to give legal advice to the company with respect to the payments.*" Information, not available from upper-echelon management, was needed to supply a basis for legal advice concerning compliance with securities and tax laws, foreign laws, currency regulations, duties to shareholders, and potential litigation in each of these areas. The communications concerned matters within the scope of the employees' corporate duties, and the employees themselves were sufficiently aware that they were being questioned in order that the corporation could obtain legal advice. The questionnaire identified Thomas as "the company's General Counsel" and referred in its opening sentence to the possible illegality of payments such as the ones on which information was sought. A statement of policy accompanying the questionnaire clearly indicated the legal implications of the investigation. The policy statement was issued "in order that there be no uncertainty in the future as to the policy with respect to the practices which are the subject of this investigation." It began "Upjohn will comply with all laws and regulations," and stated that commissions or payments "will not be used as a subterfuge for bribes or illegal

payments” and that all payments must be “proper and legal.” Any future agreements with foreign distributors or agents were to be approved “by a company attorney” and any questions concerning the policy were to be referred “to the company’s General Counsel.” This statement was issued to Upjohn employees worldwide, so that even those interviewees not receiving a questionnaire were aware of the legal implications of the interviews. Pursuant to explicit instructions from the Chairman of the Board, the communications were considered “highly confidential” when made, and have been kept confidential by the company. Consistent with the underlying purposes of the attorney-client privilege, these communications must be protected against compelled disclosure.

The Court of Appeals declined to extend the attorney-client privilege beyond the limits of the control group test for fear that doing so would entail severe burdens on discovery and create a broad “zone of silence” over corporate affairs. Application of the attorney-client privilege to communications such as those involved here, however, puts the adversary in no worse position than if the communications had never taken place. The privilege only protects disclosure of communications; it does not protect disclosure of the underlying facts by those who communicated with the attorney:

“[T]he protection of the privilege extends only to *communications* and not to facts. A fact is one thing and a communication concerning that fact is an entirely different thing. The client cannot be compelled to answer the question, ‘What did you say or write to the attorney?’ but may not refuse to disclose any relevant fact within his knowledge merely because he incorporated a statement of such fact into his communication to his attorney.” *Philadelphia v. Westinghouse Electric Corp.*

See also Diversified Industries; State ex rel. Dudek v. Circuit Court (“the courts have noted that a party cannot conceal a fact merely by revealing it to his lawyer”). Here the Government was free to question the employees who communicated with Thomas and outside counsel. Upjohn has provided the IRS with a list of such employees, and the IRS has already interviewed some 25 of them. While it would probably be more convenient for the Government to secure the results of petitioner’s internal investigation by simply subpoenaing the questionnaires and notes taken by petitioner’s attorneys, such considerations of convenience do not overcome the policies served by the attorney-client privilege. As Justice Jackson noted in his concurring opinion in *Hickman v. Taylor*: “Discovery was hardly intended to enable a learned profession to perform its functions . . . on wits borrowed from the adversary.”

Needless to say, we decide only the case before us, and do not undertake to draft a set of rules which should govern challenges to investigatory subpoenas. Any such approach would violate the spirit of Federal Rule of Evidence 501. See S. Rep. No. 93-1277 (1974) (“the recognition of a privilege based on a confidential relationship . . . should be determined on a case-by-case basis”). While such a “case-by-case” basis may to some slight extent undermine desirable certainty in the boundaries of the attorney-client

privilege, it obeys the spirit of the Rules. At the same time we conclude that the narrow “control group test” sanctioned by the Court of Appeals, in this case cannot, consistent with “the principles of the common law as . . . interpreted . . . in the light of reason and experience,” Fed. Rule Evid. 501, govern the development of the law in this area.

Our decision that the communications by Upjohn employees to counsel are covered by the attorney-client privilege disposes of the case so far as the responses to the questionnaires and any notes reflecting responses to interview questions are concerned. The summons reaches further, however, and Thomas has testified that his notes and memoranda of interviews go beyond recording responses to his questions. To the extent that the material subject to the summons is not protected by the attorney-client privilege as disclosing communications between an employee and counsel, we must reach the ruling by the Court of Appeals that the work-product doctrine does not apply to summonses issued under 26 U.S.C. § 7602.

The Government concedes, wisely, that the Court of Appeals erred and that the work-product doctrine does apply to IRS summonses. This doctrine was announced by the Court over 30 years ago in *Hickman v. Taylor*. In that case the Court rejected “an attempt, without purported necessity or justification, to secure written statements, private memoranda and personal recollections prepared or formed by an adverse party’s counsel in the course of his legal duties.” The Court noted that “it is essential that a lawyer work with a certain degree of privacy” and reasoned that if discovery of the material sought were permitted

“much of what is now put down in writing would remain unwritten. An attorney’s thoughts, heretofore inviolate, would not be his own. Inefficiency, unfairness and sharp practices would inevitably develop in the giving of legal advice and in the preparation of cases for trial. The effect on the legal profession would be demoralizing. And the interests of the clients and the cause of justice would be poorly served.”

The “strong public policy” underlying the work-product doctrine was reaffirmed recently in *United States v. Nobles*, and has been substantially incorporated in Federal Rule of Civil Procedure 26(b)(3).

As we stated last Term, the obligation imposed by a tax summons remains “subject to the traditional privileges and limitations.” *United States v. Euge*. Nothing in the language of the IRS summons provisions or their legislative history suggests an intent on the part of Congress to preclude application of the work-product doctrine. Rule 26(b)(3) codifies the work-product doctrine, and the Federal Rules of Civil Procedure are made applicable to summons enforcement proceedings by Rule 81(a)(3). See *Donaldson v. United States*. While conceding the applicability of the work-product doctrine, the Government asserts that it has made a sufficient showing of necessity to overcome its protections. The Magistrate apparently so found. The Government relies on the following language in *Hickman*:

“We do not mean to say that all written materials obtained or prepared by an adversary’s counsel with an eye toward litigation are necessarily free from discovery in all cases. Where relevant and nonprivileged facts remain hidden in an attorney’s file and where production of those facts is essential to the preparation of one’s case, discovery may properly be had. . . . And production might be justified where the witnesses are no longer available or can be reached only with difficulty.”

The Government stresses that interviewees are scattered across the globe and that Upjohn has forbidden its employees to answer questions it considers irrelevant. The above-quoted language from *Hickman*, however, did not apply to “oral statements made by witnesses . . . whether presently in the form of [the attorney’s] mental impressions or memoranda.” As to such material the Court did “not believe that any showing of necessity can be made under the circumstances of this case so as to justify production. . . . If there should be a rare situation justifying production of these matters petitioner’s case is not of that type.” Forcing an attorney to disclose notes and memoranda of witnesses’ oral statements is particularly disfavored because it tends to reveal the attorney’s mental processes, 329 U.S., at 513 (“what he saw fit to write down regarding witnesses’ remarks”); *id.*, at 516–17 (“the statement would be his [the attorney’s] language, permeated with his inferences”).

Rule 26 accords special protection to work product revealing the attorney’s mental processes. The Rule permits disclosure of documents and tangible things constituting attorney work product upon a showing of substantial need and inability to obtain the equivalent without undue hardship. This was the standard applied by the Magistrate. Rule 26 goes on, however, to state that “[i]n ordering discovery of such materials when the required showing has been made, the court shall protect against disclosure of the mental impressions, conclusions, opinions or legal theories of an attorney or other representative of a party concerning the litigation.” Although this language does not specifically refer to memoranda based on oral statements of witnesses, the *Hickman* court stressed the danger that compelled disclosure of such memoranda would reveal the attorney’s mental processes. It is clear that this is the sort of material the draftsmen of the Rule had in mind as deserving special protection. *See* Notes of Advisory Committee on 1970 Amendment to Rules, 28 U.S.C. App. p. 442 (“The subdivision . . . goes on to protect against disclosure the mental impressions, conclusions, opinions, or legal theories . . . of an attorney or other representative of a party. The *Hickman* opinion drew special attention to the need for protecting an attorney against discovery of memoranda prepared from recollection of oral interviews. The courts have steadfastly safeguarded against disclosure of lawyers’ mental impressions and legal theories . . .”).

Based on the foregoing, some courts have concluded that *no* showing of necessity can overcome protection of work product which is based on oral statements from witnesses. . . .

We do not decide the issue at this time. It is clear that the Magistrate applied the wrong standard when he concluded that the Government had made a sufficient showing of necessity to overcome the protections of the work-product doctrine. The Magistrate applied the “substantial need” and “without undue hardship” standard articulated in the first part of Rule 26(b)(3). The notes and memoranda sought by the Government here, however, are work product based on oral statements. If they reveal communications, they are, in this case, protected by the attorney-client privilege. To the extent they do not reveal communications, they reveal the attorneys’ mental processes in evaluating the communications. As Rule 26 and *Hickman* make clear, such work product cannot be disclosed simply on a showing of substantial need and inability to obtain the equivalent without undue hardship.

While we are not prepared at this juncture to say that such material is always protected by the work-product rule, we think a far stronger showing of necessity and unavailability by other means than was made by the Government or applied by the Magistrate in this case would be necessary to compel disclosure. Since the Court of Appeals thought that the work-product protection was never applicable in an enforcement proceeding such as this, and since the Magistrate whose recommendations the District Court adopted applied too lenient a standard of protection, we think the best procedure with respect to this aspect of the case would be to reverse the judgment of the Court of Appeals for the Sixth Circuit and remand the case to it for such further proceedings in connection with the work-product claim as are consistent with this opinion.

Accordingly, the judgment of the Court of Appeals is reversed, and the case remanded for further proceedings. . . .

Problem 14-1
(a) What are the major rationales for the attorney-client privilege? Be as specific as possible. (b) Contra <i>Upjohn</i>’s reasoning, critique the application of those rationales to corporations.

The following two decisions, stemming from the same civil litigation, further illustrate *Upjohn*’s application and deal with some issues relating to waiver of the privilege. Notice how the fact pattern here mirrors so many of the corporate cases discussed in previous chapters. And especially pay attention to the dangers of potential privilege waiver highlighted by the second decision.

In re KELLOGG BROWN & ROOT, INC., 756 F.3d 754 (D.C. Cir. 2014) (KBR I)

KAVANAUGH, Circuit Judge:

More than three decades ago, the Supreme Court held that the attorney-client privilege protects confidential employee communications made during a business’s internal investigation led by company lawyers. See *Upjohn Co. v. United States*. In this case, the

District Court denied the protection of the privilege to a company that had conducted just such an internal investigation. The District Court's decision has generated substantial uncertainty about the scope of the attorney-client privilege in the business setting. We conclude that the District Court's decision is irreconcilable with *Upjohn*. We therefore grant KBR's petition for a writ of mandamus and vacate the District Court's March 6 document production order.

Harry Barko worked for KBR, a defense contractor. In 2005, he filed a False Claims Act complaint against KBR and KBR-related corporate entities, whom we will collectively refer to as KBR. In essence, Barko alleged that KBR and certain subcontractors defrauded the U.S. Government by inflating costs and accepting kickbacks while administering military contracts in wartime Iraq. During discovery, Barko sought documents related to KBR's prior internal investigation into the alleged fraud. KBR had conducted that internal investigation pursuant to its Code of Business Conduct, which is overseen by the company's Law Department.

KBR argued that the internal investigation had been conducted for the purpose of obtaining legal advice and that the internal investigation documents therefore were protected by the attorney-client privilege. Barko responded that the internal investigation documents were unprivileged business records that he was entitled to discover. *See generally* Fed. R. Civ. P. 26(b)(1).

After reviewing the disputed documents in camera, the District Court determined that the attorney-client privilege protection did not apply because, among other reasons, KBR had not shown that "the communication would not have been made 'but for' the fact that legal advice was sought." *United States ex rel. Barko v. Halliburton Co.* (quoting *United States v. ISS Marine Services, Inc.*). KBR's internal investigation, the court concluded, was "undertaken pursuant to regulatory law and corporate policy rather than for the purpose of obtaining legal advice." . . .

Federal Rule of Evidence 501 provides that claims of privilege in federal courts are governed by the "common law—as interpreted by United States courts in the light of reason and experience." Fed. R. Evid. 501. The attorney-client privilege is the "oldest of the privileges for confidential communications known to the common law." *Upjohn Co. v. United States*. As relevant here, the privilege applies to a confidential communication between attorney and client if that communication was made for the purpose of obtaining or providing legal advice to the client. . . .

KBR's assertion of the privilege in this case is materially indistinguishable from *Upjohn*'s assertion of the privilege in that case. As in *Upjohn*, KBR initiated an internal investigation to gather facts and ensure compliance with the law after being informed of potential misconduct. And as in *Upjohn*, KBR's investigation was conducted under the auspices of KBR's in-house legal department, acting in its legal capacity. The same considerations that led the Court in *Upjohn* to uphold the corporation's privilege claims apply here.

The District Court in this case initially distinguished *Upjohn* on a variety of grounds. But none of those purported distinctions takes this case out from under *Upjohn*'s umbrella.

First, the District Court stated that in *Upjohn* the internal investigation began after in-house counsel conferred with outside counsel, whereas here the investigation was conducted in-house without consultation with outside lawyers. But *Upjohn* does not hold or imply that the involvement of outside counsel is a necessary predicate for the privilege to apply. On the contrary, the general rule, which this Court has adopted, is that a lawyer's status as in-house counsel "does not dilute the privilege." *In re Sealed Case*. As the Restatement's commentary points out, "Inside legal counsel to a corporation or similar organization . . . is fully empowered to engage in privileged communications." 1 RESTATEMENT § 72, cmt. c.

Second, the District Court noted that in *Upjohn* the interviews were conducted by attorneys, whereas here many of the interviews in KBR's investigation were conducted by non-attorneys. But the investigation here was conducted at the direction of the attorneys in KBR's Law Department. And communications made by and to non-attorneys serving as agents of attorneys in internal investigations are routinely protected by the attorney-client privilege. *See FTC v. TRW, Inc.*; *see also* 1 PAUL R. RICE, ATTORNEY-CLIENT PRIVILEGE IN THE UNITED STATES § 7:18, (2013) ("If internal investigations are conducted by agents of the client at the behest of the attorney, they are protected by the attorney-client privilege to the same extent as they would be had they been conducted by the attorney who was consulted."). So that fact, too, is not a basis on which to distinguish *Upjohn*.

Third, the District Court pointed out that in *Upjohn* the interviewed employees were expressly informed that the purpose of the interview was to assist the company in obtaining legal advice, whereas here they were not. The District Court further stated that the confidentiality agreements signed by KBR employees did not mention that the purpose of KBR's investigation was to obtain legal advice. Yet nothing in *Upjohn* requires a company to use magic words to its employees in order to gain the benefit of the privilege for an internal investigation. And in any event, here as in *Upjohn* employees knew that the company's legal department was conducting an investigation of a sensitive nature and that the information they disclosed would be protected. *Cf. Upjohn* (*Upjohn*'s managers were "instructed to treat the investigation as 'highly confidential'"). KBR employees were also told not to discuss their interviews "without the specific advance authorization of KBR General Counsel." *United States ex rel. Barko v. Halliburton Co.*

In short, none of those three distinctions of *Upjohn* holds water as a basis for denying KBR's privilege claim.

More broadly and more importantly, the District Court also distinguished *Upjohn* on the ground that KBR's internal investigation was undertaken to comply with Department of Defense regulations that require defense contractors such as KBR to maintain compliance programs and conduct internal investigations into allegations of potential

wrongdoing. The District Court therefore concluded that the purpose of KBR's internal investigation was to comply with those regulatory requirements rather than to obtain or provide legal advice. In our view, the District Court's analysis rested on a false dichotomy. So long as obtaining or providing legal advice was one of the significant purposes of the internal investigation, the attorney-client privilege applies, even if there were also other purposes for the investigation and even if the investigation was mandated by regulation rather than simply an exercise of company discretion.

The District Court began its analysis by reciting the "primary purpose" test, which many courts (including this one) have used to resolve privilege disputes when attorney-client communications may have had both legal and business purposes. *See also In re Sealed Case*. But in a key move, the District Court then said that the primary purpose of a communication is to obtain or provide legal advice only if the communication would not have been made "but for" the fact that legal advice was sought. In other words, if there was any other purpose behind the communication, the attorney-client privilege apparently does not apply. The District Court went on to conclude that KBR's internal investigation was "undertaken pursuant to regulatory law and corporate policy rather than for the purpose of obtaining legal advice." *Id.* (citing federal contracting regulations). Therefore, in the District Court's view, "the primary purpose of" the internal investigation "was to comply with federal defense contractor regulations, not to secure legal advice." *United States ex rel. Barko v. Halliburton Co.*; *see id.* ("Nothing suggests the reports were prepared to obtain legal advice. Instead, the reports were prepared to try to comply with KBR's obligation to report improper conduct to the Department of Defense.").

The District Court erred because it employed the wrong legal test. The but-for test articulated by the District Court is not appropriate for attorney-client privilege analysis. Under the District Court's approach, the attorney-client privilege apparently would not apply unless the sole purpose of the communication was to obtain or provide legal advice. That is not the law. We are aware of no Supreme Court or court of appeals decision that has adopted a test of this kind in this context. The District Court's novel approach to the attorney-client privilege would eliminate the attorney-client privilege for numerous communications that are made for both legal and business purposes and that heretofore have been covered by the attorney-client privilege. And the District Court's novel approach would eradicate the attorney-client privilege for internal investigations conducted by businesses that are required by law to maintain compliance programs, which is now the case in a significant swath of American industry. In turn, businesses would be less likely to disclose facts to their attorneys and to seek legal advice, which would "limit the valuable efforts of corporate counsel to ensure their client's compliance with the law." *Upjohn*. We reject the District Court's but-for test as inconsistent with the principle of *Upjohn* and longstanding attorney-client privilege law.

Given the evident confusion in some cases, we also think it important to underscore that the primary purpose test, sensibly and properly applied, cannot and does not draw a rigid distinction between a legal purpose on the one hand and a business purpose on the other.

After all, trying to find the one primary purpose for a communication motivated by two sometimes overlapping purposes (one legal and one business, for example) can be an inherently impossible task. It is often not useful or even feasible to try to determine whether the purpose was A or B when the purpose was A and B. It is thus not correct for a court to presume that a communication can have only one primary purpose. It is likewise not correct for a court to try to find the one primary purpose in cases where a given communication plainly has multiple purposes. Rather, it is clearer, more precise, and more predictable to articulate the test as follows: Was obtaining or providing legal advice a primary purpose of the communication, meaning one of the significant purposes of the communication? As the Reporter's Note to the Restatement says, "In general, American decisions agree that the privilege applies if one of the significant purposes of a client in communicating with a lawyer is that of obtaining legal assistance." 1 RESTATEMENT § 72, Reporter's Note. We agree with and adopt that formulation—"one of the significant purposes"—as an accurate and appropriate description of the primary purpose test. Sensibly and properly applied, the test boils down to whether obtaining or providing legal advice was one of the significant purposes of the attorney-client communication.

In the context of an organization's internal investigation, if one of the significant purposes of the internal investigation was to obtain or provide legal advice, the privilege will apply. That is true regardless of whether an internal investigation was conducted pursuant to a company compliance program required by statute or regulation, or was otherwise conducted pursuant to company policy. . . .

In this case, there can be no serious dispute that one of the significant purposes of the KBR internal investigation was to obtain or provide legal advice. In denying KBR's privilege claim on the ground that the internal investigation was conducted in order to comply with regulatory requirements and corporate policy and not just to obtain or provide legal advice, the District Court applied the wrong legal test and clearly erred. . . .

In re KELLOGG BROWN & ROOT, INC., 796 F.3d 137 (D.C. Cir. 2015) (KBR II)

WILKINS, Circuit Judge:

In a prior petition for writ of mandamus on this case, we noted that "[m]ore than three decades ago, the Supreme Court held that the attorney-client privilege protects confidential employee communications made during a business's internal investigation led by company lawyers." *In re Kellogg Brown & Root, Inc.* ("*In re KBR*") (citing *Upjohn Co. v. United States*). Accordingly, we granted the writ and vacated the District Court's order to produce key documents from such an investigation. We allowed, however, that the District Court might consider "timely asserted other arguments for why these documents are not covered by either the attorney-client privilege or the work-product protection."

In a series of orders on which Petitioner Kellogg Brown & Root (“KBR”) now seeks a second writ of mandamus, the District Court found that the same contested documents should be turned over in discovery. We agree that these challenged decisions suffer from the same fundamental flaw: They run contrary to precedent by injecting uncertainty into application of attorney-client privilege and work product protection to internal investigations. *See Swidler & Berlin v. United States; Upjohn; In re KBR*. Because we find the District Court’s orders irreconcilable with binding precedent, we grant the writ and vacate the orders. KBR now seeks our intervention on the District Court’s determinations that the attorney-client privilege and work product protection were impliedly waived for these same documents. . . .

KBR’s purported implied waiver runs to a February 2014 deposition of Christopher Heinrich, KBR Vice President (Legal), on behalf of KBR. *See* Fed. R. Civ. P. 30(b)(6) (requiring a corporation to “designate one or more officers” or other persons to testify “about information known or reasonably available to the organization.”). Among the subjects that Barko directed KBR to produce a representative to testify on was “Topic Q,” defined as:

Any investigation or inquiry, internal or external, formal or informal, of [the KBR employee and subcontractor at the center of the alleged fraud] or any of the matters identified in [above-listed topics]. The scope shall include knowledge of everyone who participated in the investigation.

KBR’s litigation counsel offered a “preliminary statement” at the outset of the deposition that KBR was producing Heinrich as the company’s representative on four noticed topics, including Topic Q, but was doing so “subject to the company’s claims of attorney-client privilege” and work product protection. In answer to a question from Barko’s attorney, Heinrich testified he had in preparation for the deposition reviewed the now-disputed documents related to KBR’s internal investigation (the Code of Business Conduct documents or “COBC documents”). Throughout the examination, KBR’s attorney instructed Heinrich not to answer questions about the contents of the internal investigation on the basis of attorney-client privilege and work product protection.

After Barko’s lawyer completed his examination of Heinrich, KBR’s litigation counsel conducted a cross-examination. He explained that Heinrich had been asked “several questions designed to try to determine whether or not the Code of Business Conduct investigation is privileged, and I am going to ask questions establishing that they are.” Responding to the questions that followed, Heinrich testified that KBR had a contractual reporting duty pursuant to the Anti-Kickback Act to notify the Department of Defense if it had reason to believe that a violation of the Act had occurred. Heinrich testified that KBR adhered to that obligation and had made disclosures pursuant to the same duty in other instances. And Heinrich explained that even when KBR has made a notification to the Department as required by a contract, it has never provided an internal investigation

itself to the Department because it has always treated the investigation as subject to attorney-client privilege. . . .

First, the District Court concluded that the COBC documents must be produced under Federal Rule of Evidence 612 on the theory that KBR waived attorney-client privilege and work product protection when Heinrich reviewed the documents in preparation for his deposition.

Second, the District Court concluded that KBR waived attorney-client privilege and work product protection for the COBC documents under the doctrine of “at issue” waiver.

Both rulings were in error for the reasons that follow. . . .

At Heinrich’s deposition, he stated that he had reviewed the COBC documents in preparation for his testimony. Barko thereafter sought disclosure of the COBC documents under Federal Rule of Evidence 612, which provides that where a witness has used a writing to refresh memory before testifying, the adverse party is entitled to have it produced and to introduce into evidence any portion that relates to the witness’s testimony, “if the court decides that justice requires the party to have those options.” Fed. R. Evid. 612(a)(2).

To make its decision, the District Court engaged in a balancing test. It identified several factors supporting disclosure and several factors running against disclosure. And it concluded that “fairness considerations support disclosure” based on this “context-specific determination about the fairness of the proceedings and whether withholding the documents is consistent with the purposes of attorney-client privilege.”

The balancing test was inappropriate in the first instance. Rule 612 applies only where a witness “uses a writing to refresh memory.” Fed. R. Evid. 612(a). Thus, “even if the witness consults a writing while testifying, the adverse party is not entitled to see it unless the writing influenced the witness’s testimony.” 4 JACK B. WEINSTEIN & MARGARET A. BERGER, WEINSTEIN’S FEDERAL EVIDENCE § 612.04(2)(b)(i) (2d ed. 1997); *see, e.g., Sporck v. Peil* (granting mandamus to vacate a Rule 612(a)(2) production order where there had been no witness admission that his answers to “specific areas of questioning were informed by documents he had reviewed”). It cannot be the case that just stating the documents were privileged constitutes a testimonial reliance on their contents; else, attorney-client privilege and work product protection would mean nothing at all in that their mere invocation would entitle an adversary to production of the privileged or protected materials.

Further, even if the balancing test had been appropriate, the District Court’s conclusions were precluded by *Upjohn*. Courts have divided on how to reconcile Rule 612 balancing with attorney-client privilege and work product protection. *See generally Barrer v. Women’s Nat’l Bank* (describing conflicting authority on interaction of Rule 612 and claims of attorney-client privilege or work product protection); *cf.* H.R. Rep. No. 93-650

(1973) (“The Committee intends that nothing in [Rule 612] be construed as barring the assertion of a privilege with respect to writings used by a witness to refresh his memory.”). But the District Court’s balancing would allow the attorney-client privilege and work product protection covering internal investigations to be defeated routinely by a counter-party noticing a deposition on the topic of the privileged nature of the internal investigation. *Upjohn* teaches that “[a]n uncertain privilege, or one which purports to be certain but results in widely varying application by the courts, is little better than no privilege at all.” The District Court’s ruling, therefore, runs counter to *Upjohn*.

In this case, Barko noticed the deposition to cover the topic of the COBC investigation itself, as distinguished from the events that were the subject of the investigation. Both parties told us that their understanding at the time of the deposition was that Barko intended to examine whether and to what extent the COBC investigation was privileged. To prepare adequately for the deposition, Heinrich had no choice but to review documents related to the COBC investigation.

At oral argument on this Petition, Barko took the absurd position that KBR’s mistake was having Heinrich personally review the COBC documents rather than having someone give him a summary. Barko asserted that in order to avoid privilege waiver KBR should have produced a Rule 30(b)(6) representative with only second- or third-hand knowledge of the investigation rather than first-hand knowledge. This makes no sense. Such a rule would encourage entities to provide less knowledgeable corporate representatives for deposition, thus defeating the purpose of civil discovery to establish “the fullest possible knowledge of the issues and facts before trial.” *Societe Internationale Pour Participations Industrielles et Commerciales S.A. v. Brownell*.

Barko cannot “overcome the privilege by putting [the COBC investigation] in issue” at the deposition, *Koch v. Cox*, and then demanding under Rule 612 to see the investigatory documents the witness used to prepare. Allowing privilege and protection to be so easily defeated would defy “reason and experience,” Fed. R. Evid. 501, and “potentially upend certain settled understandings and practices” about the protections for such investigations, *In re KBR*.

In sum, the District Court’s Rule 612 ground for its production order was clear error because there was no basis for the fairness balancing test it conducted and, even had there been, the test failed to give due weight to the privilege and protection attached to the internal investigation materials.

The District Court also found that KBR had waived attorney-client privilege and work product protection by placing the COBC documents “at issue.” Such waivers are certainly possible: “Under the common-law doctrine of implied waiver, the attorney-client privilege is waived when the client places otherwise privileged matters in controversy.” *Ideal Elec. Sec. Co. v. Int’l Fid. Ins. Co.* (citing 6 JAMES W. MOORE ET AL., MOORE’S FEDERAL PRACTICE § 26.49(5) (3d ed.1997)). . . .

We have explained—and the District Court noted our precedent—that a party may not use privilege “as a tool for manipulation of the truth-seeking process.” *In re Sealed Case* (“*Sealed Case* (general counsel’s files)”). As such, a party asserting attorney-client privilege “cannot be allowed, after disclosing as much as he pleases, to withhold the remainder.” *Id.* (quoting 8 JOHN H. WIGMORE & JOHN T. MCNAUGHTON, EVIDENCE IN TRIALS AT COMMON LAW § 2327 (1961); *see also Clark v. United States* (“The privilege takes flight if the relation is abused.”); *United States v. Bilzerian* (“[T]he attorney-client privilege cannot at once be used as a shield and a sword.”)). At the same time, we have held that a “general assertion lacking substantive content that one’s attorney has examined a certain matter is not sufficient to waive the attorney-client privilege.” *United States v. White*.

The District Court found that “KBR injected the COBC contents into the litigation by itself soliciting Heinrich’s Rule 30(b)(6) testimony.” It noted that excerpts from this testimony disclosing the fact of the COBC investigations and KBR’s reporting duties under Defense Department contracts were attached to KBR’s motion for summary judgment and that KBR referenced deposition language in its Statement of Material Facts as to Which There Is No Genuine Dispute, required by Local Civil Rule of Procedure 7(h)(1). And, KBR discussed the COBC “investigative mechanism” in its memorandum in support of summary judgment (in a footnote quoted in full in Part I of the body of this Opinion). All this, in the view of the District Court, added up to a “message” that the COBC reports “contain no reasonable grounds to believe a kickback occurred.” Thus, it concluded that KBR created an implied waiver by “actively” seeking “a positive inference in its favor based on what KBR claims the documents show.” The District Court also denied KBR leave to amend its pleadings to strike the sections that the District Court interpreted as waiving the privilege and protection.

To the extent the District Court relied on Heinrich’s deposition testimony or the statement of undisputed material facts, we think that—as a matter of logic—neither could possibly give rise to an inference that places the contents of the deposition at issue. The deposition transcript is simply a record of what was said, not itself an argument. The Rule 7(h)(1) statement is a required companion filing to a summary judgment motion submitting “material facts as to which the moving party contends there is no genuine issue.” Local Civ. R. 7(h)(1). The opposing party has the opportunity to respond to each asserted fact with a contention that there is a “genuine issue necessary to be litigated,” but there are no inferences to be made and none to be contested in these statements alone. This is not to say that deposition testimony or a Rule 7(h)(1) statement can never create a waiver of attorney-client privilege or work product protection. By making partial disclosures of privileged information, they surely can. But the deposition transcript and Rule 7(h)(1) statements cannot themselves give rise to inferences that place privileged materials “at issue.” *See In re Sims* (holding that privilege waiver analysis based on deposition testimony in civil action must recognize that the testimony “might never come to the attention of any decisionmaker”).

The reference to the COBC investigation in the memorandum in support of summary judgment presents what is at first glance a more difficult question. By stating that KBR performed a COBC investigation and that, afterward, KBR did not report any wrongdoing to the Department of Defense, a factfinder could infer that the investigation found no wrongdoing. The District Court concluded that KBR had asked it to draw an “unavoidable” inference by placing the footnote at the end of a sentence calling Barko’s claims “baseless.” We disagree that such an inference was unavoidable, because an alternative inference—presumably, the one Barko would ask a fact-finder to draw—is that the investigation showed wrongdoing but KBR nonetheless made no report to the government.

Pursuant to the acquisition regulations under which it contracted, KBR was required to “have in place and follow reasonable procedures designed to prevent and detect possible violations [of the Anti-Kickback statute],” to make a written report when it “ha[d] reasonable grounds to believe that a violation . . . may have occurred,” and to “cooperate fully with any Federal agency investigating a possible violation.” 48 CFR § 52.2037(c)(1)–(3). KBR has represented without dispute that it was expressly permitted to retain privilege as to the contents of its investigations, which is not unusual in federal government compliance programs. Department of Justice policy, for instance, provides that “waiving the attorney-client and work product protections has never been a prerequisite under the Department’s prosecution guidelines for a corporation to be viewed as cooperative,” U.S. Attorney’s Manual § 9–28.710, and that, with respect to internal investigations, “[a] corporation need not disclose, and prosecutors may not request, the disclosure of such attorney work product as a condition for the corporation’s eligibility to receive cooperation credit,” § 9–28.720(b). Under such compliance programs, companies know that their disclosures may receive greater credence if they choose to buttress them with otherwise-privileged information. But companies and the government can, and often do, structure legitimate compliance and reporting programs that do not involve waiving privilege. Where companies choose not to waive privilege, “[t]hey will, of course, bear the risk that their reports will not be accepted as full disclosures.” *Sealed Case* (general counsel’s files).

Read in this context, footnote 5 in KBR’s summary judgment motion is essentially a recitation of the terms of its deal with the government, including the express reservation of attorney-client privilege and work product protection. There was certainly no actual disclosure of opinion work product (the conclusions of the COBC investigation) in the footnote. Instead, the District Court found that KBR impliedly disclosed opinion work product, that is, “the substantive conclusion of its COBC investigations.” In *Sealed Case* (general counsel’s files), we found implied waiver primarily because waiver was consistent with holding the company to the terms of its bargain. Here, holding KBR to the terms of its bargain would mean deciding that “[KBR’s] reports will not be accepted as full disclosures,” rather than inferring that KBR was intending to say that its non-report to the government should be given weight and credibility as a finding of no wrongdoing.

There's the rub: Where KBR neither directly stated that the COBC investigation had revealed no wrongdoing nor sought any specific relief because of the results of the investigation, KBR has not "based a claim or defense upon the attorney's advice." *Koch*; see also *White*. As we explained in *Sealed Case* (general counsel's files):

Corporations may protect their privileges without manipulation simply by being forthright with their regulators and identifying material as to which they claim privilege at the time they submit their voluntary disclosure reports. They will, of course, bear the risk that their reports will not be accepted as full disclosures. But if they choose to make a pretense of unconditional disclosure, they bear another risk—that we will imply a waiver of privilege with respect to any material necessary for a fair evaluation of their disclosures.

Here, there was no pretense of unconditional disclosure.

Notwithstanding all this, KBR's summary judgment motion footnote said not only that it conducted a COBC investigation relating to Barko's claims and did not report any wrongdoing to the government, but also that when it discovers wrongdoing during investigations, "KBR makes such disclosures." KBR Defendants' Motion for Summary Judgment ECF No. 136. The District Court's order turned on this point and it is undoubtedly the highest hurdle to our conclusion that KBR did not waive the privilege.

But we think the context of the whole passage is essential to our clear error conclusion. First, the footnote constitutes a recitation of facts that appears only in the motion's introduction, not in an argument or claim concerning the privileged documents' contents. We previously have rejected the idea that we must treat recitations of facts as making arguments, and KBR benefits from the application of that principle here. See *Am. Wildlands v. Kempthorne* (explaining that appellant forfeited argument by explaining only its underlying facts in "the statement of the facts section of its opening brief."). Second, and in any event, "[i]t is not our practice . . . to indulge cursory arguments made only in a footnote," *C.I.R. v. Simmons*; see also *Hutchins v. District of Columbia*. Furthermore, even though KBR did not affirmatively argue that the court should find no wrongdoing because KBR's investigation had found no wrongdoing, the District Court reasoned that such an "argument" could be inferred from the footnote. But KBR was the movant for summary judgment, and it is beyond peradventure that all inferences were to be drawn against KBR at this stage of the litigation, *Anderson v. Liberty Lobby, Inc.*, and "it was error for the district court not to view [KBR]'s statements in the light most favorable to [Barko]," *Carr v. District of Columbia*. In sum, the District Court may not, in resolving the motion for summary judgment, make any inference in KBR's favor based on the contents of the privileged documents. . . . [The court's discussions of work product doctrine and standards of review are omitted.]

Who controls the privilege in the dual representation context: As will be further discussed in Chapter 15, it can be permissible in some circumstances for an attorney to simultaneously represent a corporation and the corporation's employee. The question can arise in that context who controls waiver with respect to particular communications in the course of the representation: the corporation or the individual. There is substantial case law on how to conduct waiver analysis in this context. For present purposes, one only need to see the contours of the issue, as illustrated in this recent decision in the pretrial litigation connected to the prosecution of Theranos founder Elizabeth Holmes.

UNITED STATES v. HOLMES, 2021 WL 2309980 (N.D. Cal. June 3, 2021)

NATHANAEL M. COUSINS, United States Magistrate Judge:

The government seeks to have certain Theranos corporate documents deemed admissible for trial against Defendant Elizabeth A. Holmes. . . .

In 2011, Boies Schiller Flexner LLP ("BSF") began representing Holmes and Theranos in an intellectual property dispute. After the representation began, BSF continued to offer Holmes and Theranos a variety of legal services in relation to Theranos' patent portfolio, press interactions, and inquiries from government agencies and departments. Despite the breadth and duration of BSF's involvement, Holmes and BSF did not sign an engagement letter or establish any formal guidelines describing the scope of BSF's legal representation. Holmes believed that BSF and BSF partner, David Boies, were her attorneys up to the point when she retained separate counsel to represent her in the Securities and Exchange Commission and Department of Justice investigations into Theranos in 2016.

In June 2020, the government served Holmes with its Exhibit List for trial, which included thirteen documents that Holmes claims implicate her attorney client privilege. The government worked with the Theranos Assignee, "the controller of any remaining Theranos corporate privilege," to handle the documents. Holmes' claim for attorney client privilege is predicated on her understanding that Boies and BSF jointly represented Theranos and Holmes as an individual, not as a representative of the company. The government contests this assertion, insisting that there was no joint representation, so the documents are subject only to corporate privilege. . . .

Attorney-client privilege is the oldest common law privilege for confidential communications. *Upjohn Co. v. U.S.* "Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." Information is covered by attorney-client privilege: (1) Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such, (3) the communications relating to that purpose, (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) unless the protection be waived.

Holmes opposes the government's motion on the grounds that Boies and BSF jointly represented her and Theranos. The parties disagree on whether the Court should apply a subjective belief test or the *Graf* test. Following Ninth Circuit case law, the Court applies the *Graf* test. At the December 16, 2020 hearing, Holmes argued that the Court should not use the *Graf* test because it does not apply to this case. The Court disagrees for three reasons.

First, contrary to Holmes' assertion, the Ninth Circuit's discussion of two joint representation tests in the *Graf* opinion does not limit the *Graf* test's application to specific cases. The *Graf* opinion describes the two possible tests for joint representation—the *Bevill* test and the subjective belief test—but after extensive discussion of policy and the case law in other circuits, the Ninth Circuit unambiguously chose to adopt the *Bevill/Graf* test. *U.S. v. Graf*.

Second, the facts of *Graf* are analogous to this case. Like Holmes, Graf was indicted for his involvement in the fraudulent operation of a company. *Graf*. Like Holmes, Graf was the founder of the company, and he sought to exclude the testimony of attorneys who represented the company by asserting his individual attorney-client privilege. Although Graf was not listed as an employee of the company, the Ninth Circuit determined that this classification was an effort to circumvent several cease-and-desist orders against him so it treated Graf as a "functional employee, not an independent outside consultant." These factual parallels reinforce that even if the *Graf* test did not apply to all joint representation disputes, this case would fall within its purview.

Finally, Holmes argues that *Graf* does not apply here because *Graf* addresses the question of formation while *In re Teleglobe Communications Corp.* addresses the question of scope. The Court disagrees with this characterization of the cases. To demonstrate: envision a Venn diagram with one circle for "company legal matters," another circle for "individual legal matters," and a small area of overlap for "common interests." The *Graf* test establishes that communications with corporate counsel about "individual legal matters" are controlled by the individual's privilege. *Teleglobe* states that communications in the overlapping "common interests" area are controlled by the individual's privilege and the company's privilege. Because the two tests govern different parts of the diagram, they are not conflicting tests that apply at different times; rather they work together to define who holds the privilege for what at any moment. Aside from the fact that the *Teleglobe* decision is not binding on this Court, it does not apply to this case because Holmes asserts that the documents at issue regard her individual legal matters, not "common interests." Therefore, the Court must apply the Ninth Circuit's *Graf* test.

Graf requires the person seeking to assert individual privilege to satisfy all of the following factors to establish a joint representation:

First, they must show they approached counsel for the purpose of seeking legal advice. Second, they must demonstrate that when they approached counsel they made it clear that they were seeking legal

advice in their individual rather than in their representative capacities. Third, they must demonstrate that the counsel saw fit to communicate with them in their individual capacities, knowing that a possible conflict could arise. Fourth, they must prove that their conversations with counsel were confidential. And fifth, they must show that the substance of their conversations with counsel did not concern matters within the company or the general affairs of the company.

Before analyzing admissibility of the exhibits, the Court must first apply *Graf* to determine if Holmes has an individual privilege to assert.

The Court finds that Holmes fails to establish a joint representation because she cannot satisfy the second, fourth, and fifth elements of the *Graf* test. To satisfy the *Graf* test, Holmes must show that when she approached Boies and BSF for legal advice, she made it clear that she was seeking legal advice in her personal capacity. Holmes fails to make this showing. In her opposition, Holmes insists that “Boies Schiller’s representation of Ms. Holmes (in addition to Theranos) is a matter of public record and thus there is no relationship to be implied,” but she is unable to point to any documents supporting this allegedly obvious joint representation. Holmes admits that “there was no engagement letter relating to Mr. Boies’ or his firm’s representation of Ms. Holmes and/or Theranos.” And Holmes does not point to any financial records showing that she paid Boies or BSF from her own accounts, not Theranos’. Holmes heavily relies on her belief that Boies and BSF jointly represented her and Theranos, however, Holmes’ subjective belief is not the standard. The standard is a “clear” communication that the individual sought legal advice as an individual, not as a representative of the company; and on that Holmes falls short.

Holmes also cannot show that her conversations with Boies and BSF were confidential. None of the contested documents include conversations exclusively between Holmes and Boies or BSF. Holmes argues that “with one exception, the communications are between Ms. Holmes or other senior Theranos employees, Theranos in-house attorneys, and Boies Schiller attorneys.” However, if Holmes is arguing that she sought individual legal advice, the presence of Theranos employees and attorneys destroys the privilege.

Lastly, Holmes fails to show that the substance of her conversations with Boies and BSF did not concern matters within the general affairs of the company. None of the contest exhibits discuss Holmes’ individual legal interests. All thirteen documents related to her “official duties” or the “general affairs” of the company like conversations with investors, billing, and media strategy.

In sum, the Court finds that Boies and BSF did not jointly represent Holmes and Theranos because Holmes does not satisfy the second, fourth, and fifth factors of the *Graf* test. Therefore, the holder of attorney-client privilege over the contested documents Theranos’ Assignee, and admissibility of the documents hinges on their waiver of corporate privilege. See *Commodity Futures Trading Com v. Weintraub* (finding that

“when control of a corporation passes to new management, the authority to assert and waive the corporation’s attorney-client privilege passes as well.”).

For the foregoing reasons, the Court GRANTS the government’s motion and finds that the thirteen disputed documents, labeled as Exhibits 1-13 in ECF 559-12, are not subject to Holmes’ individual privilege. The documents are only subject to the Theranos Assignee’s corporate privilege, which the Assignee has waived. . . .

D. Joint Defense Agreements

Joint defense agreements (JDAs) are routine in the investigation and defense of corporate crime cases. Parties to such agreements typically include the corporation and the various employees whose conduct may be within the scope of the matter under investigation who are represented by their own counsel. The ability to share costs and information among those under government investigation can make a JDA essential to conducting an effective defense.

In the following case, the court explains the important relationship between JDAs and the attorney-client privilege. The essential and logically necessary principle about this relationship is this: A joint defense agreement cannot create or expand an attorney-client privilege; it can only limit the circumstances that will result in a *waiver* of the privilege. In other words, the so-called “common interest doctrine” is an exception to the general principles governing waiver of the attorney-client privilege. The difficulty in the joint defense situation is the avoidance of thorny conflicts of interest among the various counsel as a result of information-sharing. (Conflict of interest principles are further explored in Chapter 15.) When representing either a corporation or its individual employees, it is important to thoroughly explain the potential benefits and drawbacks of entering into a JDA, as well as the obligations a JDA does and does not impose on the parties.

UNITED STATES v. STEPNEY, 246 F. Supp. 2d 1069 (N.D. Cal. 2003)

PATEL, Chief Judge:

Defendants are charged with participation in the criminal enterprises of a street gang in the Hunter’s Point area of San Francisco. In a series of three indictments, the government has charged a total of nearly thirty defendants with over seventy substantive counts relating to the operation of the gang over a period of several years. The number of defendants and the separate crimes charged render this case extraordinarily factually complex. Defense counsel report that they have already received discovery of over 20,000 pages of police reports, FBI memos, and other law enforcement materials.

In an effort to prepare coherent defenses efficiently, various defense counsel have sought to enter into joint defense agreements that would allow defendants to share factual investigations and legal work product. Out of concern for the Sixth Amendment rights of the defendants and the integrity of the proceedings, at the parties’ initial appearance

on October 15, 2001, the court ordered that any joint defense agreements be committed to writing and provided to the court for in camera review. No joint defense agreements were ever filed with the court pursuant to this order.

More than a year after the court's initial order, the attorney for one defendant moved to withdraw his representation on the grounds that he had entered into a joint defense agreement with another defendant who he had since come to believe was cooperating with the prosecution. Although the attorney seeking to withdraw did not believe that he had obtained confidential information from the cooperating defendant, he did believe that the joint defense agreement had created an implied attorney-client relationship that included a duty of loyalty. The attorney maintained that this duty of loyalty would prevent him from cross-examining the cooperating defendant, should he testify at trial.

The court denied the motion to withdraw after conducting a colloquy in which the cooperating defendant waived any attorney-client privilege with respect to information received by the moving attorney. The court also ruled that joint defense agreements do not create in one attorney a duty of loyalty toward the defendant with whom he collaborates. In an order dated November 22, 2002, the court set forth requirements that future joint defense agreements: (1) be in writing; (2) contain a full description of the extent of the privilege shared; (3) contain workable withdrawal provisions; and (4) be signed not only by the attorneys but also by the clients who hold the privileges at issue.

The joint defense privilege is commonly described as an extension of the attorney-client privilege. Scholarly commentators have uniformly argued that the joint defense privilege differs sufficiently from the attorney-client privilege in both purpose and scope that the two should be viewed as entirely separate doctrines. To inform the analysis of the proposed joint defense agreements, the court must first examine in detail the nature of the joint defense privilege.

"The attorney-client privilege is an evidentiary rule designed to prevent the forced disclosure in a judicial proceeding of certain confidential communications between a client and a lawyer." The purpose of the privilege is to encourage "full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice."

The attorney-client privilege limits only the power of a court to compel disclosure of attorney-client communications or otherwise admit the communications themselves into evidence. Outside the courtroom, the privilege does not provide grounds for sanctioning an attorney's voluntary disclosure of confidential communications to third parties. This is not to say that attorneys may freely reveal their clients' confidences should they so desire.

The ethical duty of confidentiality may be enforced by more than just sanctions against an offending attorney. In a criminal case, where an attorney violates this ethical duty by revealing a client's confidences to the government, a court may suppress the resulting

evidence. Prosecutors may also be subject to sanctions where they have induced an attorney to violate her duty of confidentiality.

In criminal cases, the Constitution also protects confidential attorney-client communications from the eyes and ears of the government. An intrusion by the government into an attorney-client relationship in order to obtain confidential information may be deemed a violation of a defendant's Sixth Amendment right to effective assistance of counsel or Fifth Amendment due process rights. In such a situation, a court may suppress evidence gathered as a result of the communication or, in egregious cases where the prejudice cannot otherwise be cured, dismiss the indictment. . . .

The joint defense privilege initially arose as an extension of the attorney-client privilege against court-ordered disclosure against confidential communications. Ordinarily, the attorney-client privilege will be deemed waived where a client discloses the contents of an otherwise privileged communication to a third party or where the communication occurs in the presence of third parties. The joint defense privilege was adopted as an exception to this waiver rule, under which communications between a client and his own lawyer remain protected by the attorney-client privilege when disclosed to co-defendants or their counsel for purposes of a common defense.

Although established as an evidentiary rule which bound courts from compelling disclosure of certain evidence, the joint defense privilege was soon applied as an ethical doctrine which imposed on counsel a limited duty of confidentiality toward their client's co-defendants regarding information obtained in furtherance of a common defense. In particular, courts have ruled that an attorney may be disqualified if her client's interests require that she cross-examine (or oppose in a subsequent action) another member of a joint defense agreement about whom she has learned confidential information. . . .

"Under their supervisory power, courts have substantial authority to oversee their own affairs to ensure that justice is done." A court may exercise its supervisory powers to implement a remedy for the violation of a recognized statutory or constitutional right, or may take preemptive steps to avoid such violations by imposing procedural rules not specifically required by the Constitution or Congress.

These supervisory powers unquestionably allow courts to require disclosure of the precise nature of a criminal defendant's representation to ensure that no conflict of interest exists that would deprive a defendant of his Sixth Amendment right to effective assistance of counsel. Courts have routinely intervened—prior to any controversy arising—where the circumstances of a criminal defendant's representation raises the potential for conflict of interest during the course of the proceedings, even before intervention is required by statutory or constitutional rule. . . .

[J]oint defense agreements impose an ethical duty of confidentiality on participating attorneys, presenting the potential for conflicts of interest that might lead to the withdrawal or disqualification of a defense attorney late in the proceedings or the

reversal of conviction on appeal. When a party to a joint defense agreement decides to cooperate with the government, the potential for disclosure of confidential information also threatens other defendants' Sixth Amendment rights. "Federal courts have an independent interest in ensuring that criminal trials are conducted within the ethical standards of the profession and that legal proceedings appear fair to all who observe them." . . . Given the high potential for mischief, courts are well justified in inquiring into joint defense agreements before problems arise. . . .

The threat that these agreements might pose to defendants' Sixth Amendment rights—and to the integrity of the proceedings—warrants the minimal disclosures that the court has thus far required and the restrictions imposed by this court. The court appreciates defendants' concern that disclosing who among them have signed a joint defense agreement might give the government insight into the trial strategies of various defendants. Defendants have not, however, asserted any legal grounds to prevent disclosure of joint defense agreements to the court. To the extent that joint defense agreements simply set forth the existence of attorney-client relationships—implied or otherwise—between various attorneys and defendants, the contents of such agreements do not fall within the attorney-client privilege. . . .

The proposed agreement submitted by defendants is problematic in at least two material respects. First, the proposed agreement purports to create a duty of loyalty on the part of signing attorneys that extends to all signing defendants. The proposed defense agreement also does not contain workable withdrawal provisions that adequately avoid the possibility of disqualification on the eve of trial, or even during trial.

The proposed joint defense agreement explicitly imposes on signing attorneys not only a duty of confidentiality, but a separate general duty of loyalty to all signing defendants. Such a duty has no foundation in law and, if recognized, would offer little chance of a trial unmarred by conflict of interest and disqualification.

Joint defense agreements are not contracts which create whatever rights the signatories chose, but are written notice of defendants' invocation of privileges set forth in common law. Joint defense agreements therefore cannot extend greater protections than the legal privileges on which they rest. A joint defense agreement which purports to do so does not accurately set forth the protections which would be given to defendants who sign. . . .

Courts have consistently viewed the obligations created by joint defense agreements as distinct from those created by actual attorney-client relationships. . . . [C]ourts have also consistently ruled that where an attorney represents a client whose interests diverge from a party with whom the attorney has previously participated in a joint defense agreement, no conflict of interest arises unless the attorney actually obtained relevant confidential information. This position is inconsistent with a general duty of loyalty owed to former clients, which would automatically preclude an attorney from subsequently representing a client with an adverse interest. . . .

Admittedly, there is a significant difference between the disclosure of confidential information and the use of confidential information without disclosure. Both the common law doctrine of attorney-client privilege and the ethical duty of confidentiality address only the disclosure of confidential information and not the use of confidential information, without disclosure, in a manner adverse to the client's interests. Any obligation on the part of an attorney not to use confidential information against a client arises from separate duties. An attorney might use information gained in confidence to structure an investigation for facts with which she could discredit the cooperating witness without ever disclosing the information and running afoul of either the attorney-client privilege or the duty of confidentiality. . . .

The court finds no cases recognizing joint defense agreements as creating either a true attorney-client relationship or a general duty of loyalty. . . .

There is good reason for the law to refrain from imposing on attorneys a duty of loyalty to their clients' co-defendants. A duty of loyalty between parties to a joint defense agreement would create a minefield of potential conflicts. Should any defendant that signed the agreement decide to cooperate with the government and testify in the prosecution's case-in-chief, an attorney for a non-cooperating defendant would be put in the position of cross-examining a witness to whom she owed a duty of loyalty on behalf of her own client, to whom she also would owe a duty of loyalty. This would create a conflict of interest which would require withdrawal. Thus, the existence of a duty of loyalty would require that the attorneys for all non-cooperating defendants withdraw from the case in the event that any one participating defendant decided to testify for the government.

A duty of loyalty would even require withdrawal where a defendant sought to put on a defense that in any way conflicted with the defenses of the other defendants participating in a joint defense agreement. An attorney with a duty of loyalty to defendants other than her client could not shift blame to other defendants or introduce any evidence which undercut their defenses. Nor could an attorney cross-examine a defendant who testified on his own behalf.

As these scenarios illustrate, a joint defense agreement that imposes a duty of loyalty to all members of the joint defense agreement eliminates the utility of employing separate counsel for each defendant and (for purposes of conflict analysis) effectively creates a situation in which all signing defendants are represented jointly by a team of all signing attorneys. . . .

Disqualification of attorneys late in the proceedings benefits no one—it deprives defendants of counsel whom they know and trust and perhaps even chose; it forces delays while new counsel become acquainted with the case, which harm defendants, the prosecution, and the court. . . .

Because neither precedent nor sound policy supports imposing on attorneys who sign a joint defense agreement a general duty of loyalty to all participating defendants, the court

finds the provisions of the proposed Joint Defense Agreement that purport to create a duty of loyalty unacceptable. . . .

The proposed joint defense agreement provides that any member may withdraw from the agreement by giving notice to all other members. At the hearing on the proposed agreements, defense counsel suggested that signing defendants were willing accept the risk of conflict created by a withdrawing defendant by accepting the risk that counsel might be disqualified. Ordinarily, defendants seeking to enter into representation which holds potential conflicts of interest accept risks by waiving their rights to assert the conflict, rather than by steeling themselves to assert it as defense counsel suggests. The situation created by the joint defense agreement is no exception.

A first question arising as to the nature of an appropriate waiver is at what point in the proceedings defendants should waive their rights in order to avoid conflicts. Given the highly divergent interests of defendants in the present case, the court is entitled to require that waiver provisions be included in the joint defense agreement, so that defendants who participate are fully apprised of the potential for conflict and understand the consequences both of entering into the joint defense agreement and of withdrawing from it. The alternative—deferring action on waiver until one defendant decides to testify—fails to avoid the danger of disqualification entirely.

A second and more complicated question is what sort of waiver provisions would avoid the threat of conflict while adequately protecting defendants' right to cooperate on a joint defense. . . . One court has allowed defendants to waive potential conflict by agreeing in advance that no attorney will use any information obtained by reason of the confidentiality in cross-examining defendants. This method of waiving conflict, however, stands in tension with the general principle that where an attorney has actually obtained confidential information relevant to her representation of a client, the law presumes that she cannot avoid relying on the information—however indirectly or unintentionally—in forming legal advice and trial strategy. Because the cross-examining attorney still holds relevant confidences of the witness, it is not clear that she can truly operate free from conflict. The solution also compromises one defendant's right to a fully zealous attorney for another defendant's decision to testify. The waiver is less informed, as each defendant must waive the right to use the others' confidences before knowing what those confidences are.

The better form of waiver is suggested by the American Law Institute–American Bar Association in their model joint defense agreement, which provides:

Nothing contained herein shall be deemed to create an attorney-client relationship between any attorney and anyone other than the client of that attorney and the fact that any attorney has entered this Agreement shall not be used as a basis for seeking to disqualify any counsel from representing any other party in this or any other proceeding; and no attorney who has entered into this Agreement shall be disqualified from examining or cross-examining any client who testifies at any

proceeding, whether under a grant of immunity or otherwise, because of such attorney's participation in this Agreement; and the signatories and their clients further agree that a signatory attorney examining or cross-examining any client who testifies at any proceeding, whether under a grant of immunity or otherwise, may use any Defense Material or other information contributed by such client during the joint defense; and it is herein represented that each undersigned counsel to this Agreement has specifically advised his or her respective client of this clause and that such client has agreed to its provisions.

Joint Defense Agreement, Am. Law Institute–Am. Bar Ass'n, Trial Evidence in the Federal Courts: Problems and Solutions (1999). Under this regime, all defendants have waived any duty of confidentiality for purposes of cross-examining testifying defendants, and generally an attorney can cross-examine using any and all materials, free from any conflicts of interest. This form of waiver also places the loss of the benefits of the joint defense agreement only on the defendant who makes the choice to testify. Defendants who testify for the government under a grant of immunity lose nothing by this waiver. Those that testify on their own behalf have already made the decision to waive their Fifth Amendment right against self-incrimination and to admit evidence through their cross-examination that would otherwise be inadmissible.

The conditional waiver of confidentiality also provides notice to defendants that their confidences may be used in cross-examination, so that each defendant can choose with suitable caution what to reveal to the joint defense group. Although a limitation on confidentiality between a defendant and his own attorney would pose a severe threat to the true attorney-client relationship, making each defendant somewhat more guarded about the disclosures he makes to the joint defense effort does not significantly intrude on the function of joint defense agreements. . . . Joint defense agreements, . . . serve a different purpose. Each defendant entering a joint defense agreement already has a representative, fully and confidentially informed of the client's situation. The joint defense privilege allows defendants to share information so as to avoid unnecessarily inconsistent defenses that undermine the credibility of the defense as a whole. In criminal cases where discovery is limited, such collaboration is necessary to assure a fair trial in the face of the prosecution's informational advantage gained through the power to gather evidence by searches and seizures. Co-defendants may eliminate inconsistent defenses without the same degree of disclosure that would be required for an attorney to adequately represent her client. The legitimate value of joint defense agreements will not be significantly diminished by including a limited waiver of confidentiality by testifying defendants for purposes of cross-examination only.

For the foregoing reasons, the Court rules as follows:

- (1) Any joint defense agreement entered into by defendants must be committed to writing, signed by defendants and their attorneys, and submitted in camera to the court for review prior to going into effect.

(2) Each joint defense agreement submitted must explicitly state that it does not create an attorney-client relationship between an attorney and any defendant other than the client of that attorney. No joint defense agreement may purport to create a duty of loyalty.

(3) Each joint defense agreement must contain provisions conditionally waiving confidentiality by providing that a signatory attorney cross-examining any defendant who testifies at any proceeding, whether under a grant of immunity or otherwise, may use any material or other information contributed by such client during the joint defense.

(4) Each joint defense agreement must explicitly allow withdrawal upon notice to the other defendants.

The following is a sample joint defense agreement (envisioning a civil matter; however, the terms of such an agreement in a criminal matter would be highly similar). JDAs are contracts and should be read accordingly. What would be the pluses and minuses of this form of agreement if one were representing an individual in a corporate crime investigation?

JOINT DEFENSE AGREEMENT

This Joint Defense (the “Agreement”) is made and entered into as of {DATE} by and among the undersigned counsel, for themselves and on behalf of their respective clients {LIST PARTIES} (each individually a “Party,” and collectively, “Parties”).

RECITALS

WHEREAS, the Parties {have been named as defendants/may be potential subjects of investigation} in {DESCRIPTION OF MATTER}.

WHEREAS, for purposes of this Agreement, the term “Counsel” means and includes any attorney representing any Party, including in-house attorneys, any and all paralegals, law clerks, and any outside vendors of the Parties’ respective outside counsel acting at the direction of outside counsel, and any other persons expressly agreed to in writing by the Parties. The term “Outside Counsel” means and includes any attorney representing any Party at an outside law firm, as well as paralegals and law clerks working for such attorneys. The term “Joint Defense Group” means and includes the Parties and Counsel.

WHEREAS, the Parties possess common legal interests in the analysis and defense of certain assertions and claims relating to {MATTER}, including any and all potential affirmative defenses and counterclaims. The Parties wish to ensure that their attorneys are free to share and exchange information that may be useful in the representation of each Party, without waiving the confidentiality of communications and documents protected by the attorney-client privilege, the attorney-work product doctrine, or any other applicable privilege. The undersigned attorneys consider disclosure of matters of common concern to the Parties to be conducive to the

effective representation of the Parties. Accordingly, the Parties are in agreement that all disclosures between and among the Parties and their counsel for purposes of a common defense shall be and are confidential, covered by the attorney-client privilege, the work-product doctrine, and any other applicable privileges, and that the Parties intend to preserve and extend the applicability of any applicable privilege or immunity to all information shared or exchanged pursuant to this Joint Defense Agreement in preparation for, during the defense of, and after the resolution of {MATTER}. Notwithstanding the foregoing, nothing in this Joint Defense Agreement obligates the Parties to pursue joint defenses during the course of {MATTER}.

NOW, THEREFORE, the Parties and the Parties' Counsel agree as follows:

1. Sharing Joint Defense Materials.

a. Members of the Joint Defense Group are entitled to communicate and share information with each other as they see fit, both orally and in writing, in connection with {MATTER}. To that end, the Joint Defense Group (i) may share with each other information protected by the attorney-client privilege and the attorney work-product doctrine in order to assert common or joint defenses to the claims that are or may be asserted in {MATTER}, and (ii) may exchange with each other privileged and work-product information, whether oral, written, or electronic in form, including without limitation factual and/or legal analyses, mental impressions, legal memoranda, legal research, reports of witness interviews, expert reports, draft briefs and pleadings, and other information (once exchanged, the "Joint Defense Materials"). The Joint Defense Materials include, but are not limited to, the following: (a) any information or documents relating or referring to {MATTER} provided by or on behalf of any Party, (b) all copies, memoranda, summaries, analyses, and notes prepared by any Party or their respective counsel, experts or consultants relating to {MATTER}; (c) any portion, communication, or transmission of any information or documents described in this paragraph (d) information regarding the identification and description of documents relating to {MATTER}; (e) information regarding the transactions and events that are the subject of {MATTER}; (f) information and documents obtained from interviews with, and investigations of, clients, whether joint or individual; (g) information and documents obtained from interviews with, and investigations of, witnesses and potential witnesses; (h) information and documents obtained from interviews with experts or consultants; (i) drafts of pleadings and other papers; and (j) research, analyses, strategies, theories, mental impressions and other attorney work product.

b. To the extent the Parties and/or Counsel already have communicated and shared with each other confidential attorney-client communications and/or attorney work product or other information concerning {MATTER} that come within the definition of Joint Defense Materials under this Agreement, all such communications and information previously shared are subject to the terms of this Agreement.

2. **Preservation of All Privileges.**

a. Except as set forth below, unless expressly stated in writing to the contrary, any communications among the Joint Defense Group concerning Joint Defense Materials are confidential and remain protected from disclosure to any third party by the attorney-client privilege, work product protection and the joint defense doctrine, and any other applicable privileges, to the maximum extent permitted by law. Any inadvertent or purposeful disclosure of information exchanged pursuant to this Agreement, including by one member of the Joint Defense Group to another, shall not constitute a waiver of any privilege or protection.

b. No member of the Joint Defense Group may waive, intentionally or otherwise, any privilege possessed by any other member of the Joint Defense Group. In the event any Party or Counsel purports to waive any privilege of another member of the Joint Defense Group, intentionally or otherwise, that waiver shall not be considered a waiver of the privilege by the Party or Counsel possessing the privilege and cannot be construed against the Party or Counsel possessing the privilege.

3. **No Disclosure to Third Parties.** Each member of the Joint Defense Group shall take reasonable steps to preserve the confidentiality of the Joint Defense Materials. Except as set forth in this Agreement, the Joint Defense Group members shall not disclose Joint Defense Materials to third parties without the consent of the member of the Joint Defense Group who provided the Joint Defense Materials pursuant to this Agreement. The Joint Defense Group members are not third parties, and disclosure to any other member of the Joint Defense Group conforms to this Agreement and is not a waiver of the attorney-client privilege, work product protection or the joint defense privilege. All persons permitted access to any Joint Defense Information shall be informed in writing that such information is confidential and privileged and subject to the terms of this Agreement, and shall agree to comply with the terms of this Agreement with respect to the confidentiality of such information by signing Exhibit A.

4. **No Agency or Fiduciary Relationship.** The existence of this Agreement or of a joint defense effort in connection with the Lawsuit shall not be deemed to create any new attorney-client relationship between any attorney and any Party, nor any new fiduciary or agency relationships between any attorney and any Party. Any attorney-client or fiduciary relationships shall be determined without reference to this Agreement. This Agreement shall not be used offensively or defensively in any dispute between the signatories to this Agreement involving any issues relating to or deriving from {MATTER}. Nothing in this Agreement is intended to affect, waive or otherwise modify any agreement to defend or indemnify, or any reservation of rights in connection with same, between any Parties to this Agreement.

5. **No Conflict of Interest.** No Party to this Agreement will claim that counsel for any other Party is now or will be in the future disqualified from representing any Party in any proceeding by reason of this Agreement or the joint defense effort. Nothing in this Agreement shall create a conflict of interest requiring disqualification of counsel,

and the Parties to this Agreement hereby knowingly and willingly waive any such conflict of interest. Each attorney represents that he or she has informed his or her client of the general nature of the conflicts that might arise, and that his or her client has knowingly and intelligently waived any conflict of interest that may arise on account of the Agreement, including, specifically from an attorney member of this Agreement (other than his or her own attorney) examining him or her at trial or any other proceeding relating to the Lawsuit. Therefore, the attorneys, for themselves and on behalf of their clients, hereby waive any right to seek the disqualification of counsel for the other Party based on a communication of joint defense privileged information made in accordance with this Agreement.

6. **Withdrawal.** Any Party may withdraw from this Agreement upon prior written notice to all other members of the Joint Defense Group, in which case this Agreement shall no longer apply to the withdrawing Party prospectively, but shall continue to protect all Joint Defense Materials communicated or exchanged prior to such withdrawal. Notwithstanding the termination of or withdrawal from this Agreement, the confidentiality obligations set forth herein shall survive as binding obligations of the Joint Defense Group and shall remain in full force and effect without regard to whether {MATTER} is terminated by final judgment, settlement or otherwise. In the event any Party withdraws from the Agreement, the remaining members of the Joint Defense Group are free to use the Joint Defense Materials and make derivative use of any privileged information, including information that they obtained from the withdrawing member, in {MATTER} pursuant to the terms of this Agreement.

7. **Compliance With Discovery Obligations.** Nothing in this Agreement shall be interpreted as requiring or suggesting that any Party has agreed to withhold any materials properly discoverable under applicable law. This Agreement is not intended to and should not be construed to evidence any agreement to prevent disclosure of all properly discoverable information, documents and materials.

8. **Notice of Discovery Demands or Disclosure.** The Joint Defense Group, and each of them, shall claim, assert and defend the joint defense privilege and any other applicable privilege for the Joint Defense Materials. Should any member of the Joint Defense Group become aware of a request for, or actual, disclosure to a third party of any materials or information protected by this Agreement, whether pursuant to subpoena or otherwise, the member will immediately notify the Joint Defense Group of such request or disclosure, and take all reasonable steps necessary or appropriate to permit the assertion of applicable rights with respect to such Joint Defense Information. In the event of any efforts by a third party to compel disclosure of information obtained solely as a result of this Agreement, the target of the subpoena or other form of compulsory process shall promptly notify the Joint Defense Group so as to afford the Joint Defense Group the opportunity to seek protection from the disclosure of such information.

9. **No Waiver of Defenses.** By entering into this Agreement, none of the members is waiving any claim or defense in connection with {MATTER} or otherwise.

10. **Return of Joint Defense Information.** At the resolution of {MATTER}, the Parties and Counsel shall within thirty (30) business days, return to the producing Party, or destroy, all Joint Defense Materials provided to that Party by the other Parties and shall provide written confirmation of the same.

11. **Modifications.** No amendment or modification of this Agreement shall be effective unless it is in writing and signed by the other members of the Joint Defense Group.

12. **Governing Law.** This Agreement is governed by the laws of {JURISDICTION} and may be enforced by any of the parties to this Agreement in any court of appropriate jurisdiction. The Joint Defense Group members agree that the rights, privileges and interests protected by this Agreement are unique and that any violation of this Agreement will result in irreparable harm and injury to the other members. Therefore, the Joint Defense Group agrees that the terms of this Agreement may be enforced by appropriate injunctive or other equitable relief. The Joint Defense Group further agrees that this paragraph is not intended to limit the rights or remedies of the parties to this Agreement in any manner.

13. **Actions Between Members of the Joint Defense Group.** For avoidance of doubt, the Joint Defense Group's community of interest shall not include any claims, actions, proceedings or suits by any member of the Joint Defense Group against any other member of the Joint Defense Group.

14. **Counterparts.** This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, and all counterparts taken together shall constitute one agreement. A telefax or PDF signature on a copy of this Agreement shall be deemed as effective and binding as if it were an original signature.

15. **Entire Agreement.** This Agreement constitutes the complete agreement of the Parties with respect to the subject matter hereto, and memorializes and supersedes any prior or written agreements, and applies to all prior and future communications and exchanges of Joint Defense Materials.

16. **Confidentiality of Agreement.** This Agreement and its terms are confidential and may not be produced or disclosed in discovery or offered in evidence in any proceedings, for any purpose, except to prove its existence and the agreement of the Parties hereto.

IN WITNESS THEREOF, the parties hereto have executed this Agreement as of the date and year first written above.

Problem 14-2
Explain joint defense agreements to your client Shirley and advise her on whether she should consent to enter into a JDA in her matter.

E. Waiver and Prosecutorial Discretion

There was a major controversy over prosecutors' handling of the corporate attorney-client privilege between roughly 2002 and 2008—specifically, a DOJ practice of requesting or expecting waiver as part of credit for cooperation. The controversy has since quieted but has not disappeared. The following two cases provide examples of the possible issues that attorneys may face when balancing the need to protect privileged information with the benefits of cooperation with enforcement authorities. The first case, which involved an individual prosecution following an FCPA investigation, also includes a helpful restatement of privilege law. Bear in mind that these are both decisions of judges in district court. The specific waiver issues they raise have not yet been addressed in detail by a federal appellate court and the D.C. Circuit's decision in the *KBR* decisions above indicate at least that court's support for a strong corporate privilege.

UNITED STATES v. COBURN, 2022 WL 357217 (D. N.J.)

McNULTY, United States District Court Judge:

A [] limit on what may be obtained by [a pretrial subpoena under Rule 17] is a legitimate claim of privilege that is not waived. Here, the relevant privileges are the attorney-client privilege and the work product doctrine.

The Third Circuit has stated that the attorney-client privilege applies only if

(1) the asserted holder of the privilege is or sought to become a client; (2) the person to whom the communication was made (a) is a member of the bar of a court, or his subordinate and (b) in connection with this communication is acting as a lawyer; (3) the communication relates to a fact of which the attorney was informed (a) by his client (b) without the presence of strangers (c) for the purpose of securing primarily either (i) an opinion on law or (ii) legal services or (iii) assistance in some legal proceeding, and not (d) for the purpose of committing a crime or tort; and (4) the privilege has been (a) claimed and (b) not waived by the client.

In re Grand Jury Investigation.

The party asserting the attorney-client privilege bears the burden to show that it applies. *See In re Grand Jury Empaneled Feb. 14, 1978*. “Because the attorney-client privilege obstructs the truth-finding process, it is construed narrowly” and “protects only those disclosures—necessary to obtain informed legal advice—which might not have been made absent the privilege.” *Westinghouse Elec. Corp. v. Republic of Philippines*; *see also Fisher v. United States* (“[S]ince the privilege has the effect of withholding relevant information from the fact-finder, . . . it protects only those disclosures necessary to obtain informed legal advice which might not have been made absent the privilege”). Moreover, the privilege guards only against the disclosure of the protected

communication, not against disclosure of facts underlying those communications. *See Upjohn Co. v. United States*.

The attorney-client privilege unquestionably applies to both corporations and individuals. *See Upjohn*; *Matter of Bevill, Bresler & Schulman Asset Mgmt. Corp.* However, because “a corporation must act through its agents,” adjudicating claims of privilege “in the case of corporations . . . presents special problems.” *Id.* (quoting *Commodity Futures Trading Comm’n v. Weintraub*). The privilege will extend to the communications of a corporation’s management and employees when doing so would give effect to the purposes of the privilege, *see Upjohn*, and is “equally available to a corporation’s in-house counsel.” *Leonen v. Johns-Manville* (citing *Hasso v. Retail Credit Company* and *International Telephone and Telegraph Corporation v. United Telephone Company of Florida*). However, the privilege’s protections vanish where the communication is not in furtherance of the securing of *legal* advice. Advice that is predominantly concerned with corporate business, technical issues, or public relations is not protected. *See e.g., Dejewski v. Nat’l Beverage Corp.; Louisiana Mun. Police Emps. Ret. Sys. v. Sealed Air Corp.*

The work product doctrine safeguards documents from discovery where such documents are “materials prepared or collected by an attorney ‘in the course of preparation for possible litigation.’” *In re Grand Jury Investigation* (quoting *Hickman v. Taylor*); *see also* Fed. R. Civ. P. 26(b)(3) (“Ordinarily, a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative”). The party asserting work product protection bears the burden of showing that the doctrine applies. *See Conoco, Inc. v. U.S. Dep’t of Justice*. Courts in this Circuit have generally applied a two-pronged inquiry for determining whether a document should be protected under the work-product doctrine—first, looking to whether “litigation could reasonably have been anticipated” at the time the document was made, and second, looking to whether the document was “prepared or obtained because of the prospect of litigation.” *In re Gabapentin Patent Litig.* Documents created in the ordinary course of business are not protected by the work-product doctrine. Since, like other privileges, work product protections may “obstruct the search for truth,” both it and the attorney-client privilege “should be recognized only when necessary to achieve their respective purposes.” *In re Chevron Corp.*

Although disclosure of ostensibly privileged communications to a third party “has long been considered inconsistent with an assertion of the privilege,” a waiver of attorney-client privilege does not necessarily constitute a waiver of work product protection, or vice versa. *See Westinghouse*. Generally, the attorney-client privilege aims to promote frank, honest communication between client and lawyer, and it is thus waived when a client discloses otherwise privileged communications to a third party. Such third-party disclosures usually imply that the clients “would also have divulged [the information] to their attorneys, even without the protection of the privilege,” and thus that “the basic justification for the privilege no longer applies.” On the other hand, however, where

such “disclosure to a third party is necessary for the client to obtain informed legal advice,” such disclosure will not trigger a waiver of the privilege.

For work product protections to be waived, disclosure to a third party must be such as would “enable an adversary to gain access to the information.” Such disclosure inherently negates the secrecy rationale of these protections, i.e., to guard “the confidentiality of papers prepared by or on behalf of attorneys in anticipation of litigation” and “enabl[e] attorneys to prepare cases without fear that their work product will be used against their clients.” *Id.* (citing *Hickman*). . . .

If there is a waiver, the court must determine its scope. “When a disclosure waives privilege or work-product protection, that waiver will extend to undisclosed documents or communications if: 1) the waiver is intentional; 2) the disclosed and undisclosed communications or information concern the same subject matter; and 3) they ought in fairness be considered together.” *Shire LLC v. Amneal Pharms.* (citing Fed. R. Evid. 502(a) (providing for subject matter waiver “[w]hen the disclosure is made . . . to a federal office or agency”). This “subject matter waiver” is most often found by courts in this District “when the privilege-holder has attempted to use the privilege as both ‘a sword’ and ‘a shield’ or when the party attacking the privilege will be prejudiced at trial.” *Id.* (quoting *Koch Materials Company v. Shore Slurry Seal, Inc.*); see also *Westinghouse* (noting that where a partial waiver disadvantages the disclosing party’s adversary “by, for example, allowing the disclosing party to present a one-sided story to the court, the privilege will be waived as to all communications on the same subject”). . . .

Defendants argue that Cognizant [the corporation] has improperly withheld or redacted documents, including those concerning conversations in which Schwartz allegedly authorized the payment of bribes, claiming attorney-client privilege. Such documents, according to Defendants, “may contain facts or material unrelated to the provision of legal advice,” and in any event, any privilege was waived by Cognizant’s disclosure of these documents to the Government. Indeed, they claim that Cognizant has waived any privilege regarding the entire subject of Cognizant’s internal investigation and must also disclose documents revealing all statements made by Cognizant employees describing conversations with Schwartz related to this investigation. Cognizant maintains that it properly asserted attorney-client privilege over documents containing legal advice or otherwise within the permissible ambit of the privilege. Moreover, it urges that it did not effectuate a subject matter waiver of attorney client privilege over the entire internal investigation simply by cooperating with DOJ or disclosing portions of investigative documents.

The first category in dispute consists of Cognizant’s draft press releases and public disclosures. I agree with Defendants that these materials were not created for the predominant purpose of obtaining legal advice, or in order to prepare for litigation. See *In re Grand Jury Investigation*. Instead, they fall squarely within the type of non-legal, business or public relations advice that are not privileged. See *Fisher*; *Westinghouse*.

Similarly, Cognizant's communications with public relations firms Finsbury and CLS Strategies concerning "public disclosure, communications, potential litigation and related legal strategy" relevant to Cognizant's internal investigation are not protected by either privilege because they bear too tenuous a connection to the provision of legal advice or confidential preparations for litigation. *See e.g., Dejewski; Louisiana Mun. Police Emps. Ret. Sys.*

A second disputed category of documents consists of Cognizant's records pertaining to document retention and collection policies. Documents relating to legal advice concerning the formulation of such policies are facially privileged and will not be produced. More generally, Cognizant represents that certain records were made when Cognizant was facing criminal and civil liability in connection with the allegations against Defendants. According to Cognizant, they include (1) communications among Cognizant's executives, in-house counsel, and outside counsel; and (2) litigation hold memoranda and other documents that relate to the areas to be investigated and the custodians and document sources to be searched. Such records clearly pertain to litigation strategy and the provision of legal advice in advance of litigation, and were created at a time when litigation was reasonably anticipated. Thus, Cognizant's assertion of attorney client and work product privilege over them is proper. *See Upjohn; Leonen; In re Gabapentin Patent Litig.*

A caveat: I will require that the document retention policies themselves, and the dates of their promulgation, be produced, as they do not bear the earmarks of privilege and are relevant to understanding the document production itself.

A third disputed category consists of Cognizant's communications with the accounting firm E&Y concerning Cognizant's internal investigation and related updates given to the Board of Directors, DOJ, and SEC are closely related to the provision of legal advice. Indeed, the nature of the allegations against Defendants and the scope of Cognizant's internal investigation would understandably make accounting expertise vital to any law firm representing Cognizant. *See United States v. Kovel* (holding that a client's communications to an accountant employed by the client's attorney were reasonably related to the legal representation and remained privileged). As to those communications, the privilege is appropriately asserted.

A fourth, more general category consists of Cognizant's internal investigation. As to the existence of the privilege as such, this category is less controversial; by its nature it consists of attorneys' fact gathering for the purpose of rendering legal advice. Here, the real issue is the scope of any waiver of the privilege.

I next turn to Defendants' argument that Cognizant effected a subject matter waiver over broad categories of documents—namely, any communications regarding conduct alleged in the indictment and any materials related to Cognizant's internal investigation—by disclosing a summary of its investigation's findings to DOJ. While Defendants characterize this waiver too expansively, I agree that there was a significant waiver here.

To begin with, Cognizant may not now claim privilege over materials that it furnished to the Government. These disclosures, referred to as the “DLA Downloads” in the parties’ briefing, consist of “detailed accounts of 42 interviews of 19 Cognizant employees, including Defendants.” By disclosing this information to the Government while under threat of prosecution, Cognizant handed these materials to a potential adversary and destroyed any confidentiality they may have had, undermining the purpose of both attorney-client and work-product privileges. *See Chevron* (holding that “purposeful disclosure of [] purportedly privileged material to a third-party” may waive attorney-client and work product privileges “if that disclosure undermines the purpose behind each privilege”).

The next question concerns the breadth of the waiver. Cognizant’s voluntary turnover of materials or revelation of the fruits of its investigation to the DOJ also entailed a waiver of the privilege as to communications that “concern the same subject matter” and “ought in fairness be considered together” with the actual disclosures to DOJ. *Shire LLC v. Amneal Pharms.* (citing Fed. R. Evid. 502(a)).

First, to the extent that summaries of interviews were conveyed to the government, whether orally or in writing, the privilege is waived as to all memoranda, notes, summaries, or other records of the interviews themselves. Second, to the extent the summaries directly conveyed the contents of documents or communications, those underlying documents or communications themselves are within the scope of the waiver. Third, the waiver extends to documents and communications that were reviewed and formed any part of the basis of any presentation, oral or written, to the DOJ in connection with this investigation. . . .

SEC v. HERRERA, 2017 WL 6041750 (S.D. Fla. Dec. 5, 2017)

GOODMAN, United States Magistrate Judge:

This Order concerns the legal consequences, if any, which arise when a major law firm conducting an internal corporate investigation into its client’s financial and business activities produces what the parties here call “oral downloads” of witness interview notes and memoranda to the regulatory agency investigating its client. To be more specific, the primary issue addressed here (but there are other issues, as well) is whether that law firm waived work product protection when it voluntarily gave the Securities and Exchange Commission oral summaries of the work product notes and memoranda its attorneys prepared about interviews of its client’s executives and employees. The memoranda and notes summarize the relevant portions of the witness interviews (or at least what the attorney participating in the interview deemed to be relevant enough to include in these materials).

Because there is little or no substantive distinction for waiver purposes between the actual physical delivery of the work product notes and memoranda and reading or orally summarizing the same written material’s meaningful substance to one’s legal adversary, the Undersigned concludes that the Morgan Lewis & Bockius LLP law firm (“ML”)

waived work product protection and must provide to Defendants the interview notes and memoranda that were orally downloaded. To that extent, the Undersigned grants Defendants' motion to compel against ML. The waiver, however, is *limited* to only the witnesses whose interview notes and memoranda were orally provided, which is far less than all the witnesses ML interviewed.

In addition, the Undersigned rejects Defendants' additional argument that ML should produce to them *all* the witness-interview notes and memoranda on the ground that ML also provided all witness-interview notes and memoranda to its client's auditor, Deloitte & Touche ("Deloitte"). The Undersigned finds persuasive those cases holding that disclosure of work product information to an auditor does not generate a waiver.

Unlike the SEC, Deloitte is not the adversary of ML's client, General Cable Corp. ("GCC"), the publicly-traded company being investigated. As such, the Undersigned is not persuaded by Defendants' argument that the accounting firm is actually an adversary (based on the theory that Deloitte was worried that the SEC was also investigating its auditing services, and therefore had motive to suggest that GCC did not timely and fully provide accurate information for the financial statements that needed to be restated and which led to a hefty fine against GCC by the SEC). So the Undersigned denies that portion of the motion to compel.

Finally, the Undersigned also rejects the defense argument that additional work product material should be provided because Defendants have a substantial need for it. Under the present circumstances, that is an inadequate ground to compel production of additional work-product information, especially attorney work-product memoranda. The Undersigned therefore denies that portion of the motion to compel as well.

The SEC filed its lawsuit against Mathias Francisco Sandoval Herrera, Maria D. Cidre, and another defendant who entered into a consent judgment with the SEC shortly after the lawsuit was filed. Herrera was the CEO and Cidre was the CFO of GCC's Latin American operation. The Complaint is based on allegations that Herrera and Cidre concealed the manipulation of accounting systems at the Brazilian operations of GCC, a global manufacturer of wire and cable products. The lawsuit alleges that Defendants hid from GCC's executive management material inventory accounting errors at GCC's Brazilian subsidiary, including the overstatement of inventory. . . .

The origins of the specific discovery dispute date back to late 2012, when GCC retained ML to provide legal advice concerning accounting errors at the Brazilian subsidiary. ML conducted an internal investigation, which included interviewing dozens of GCC personnel. ML attorneys then prepared notes and memoranda about those interviews. According to Defendants, "many" of the witnesses were interviewed "live" in Brazil.

After ML disclosed in November 2012 to the SEC that it was conducting an investigation of GCC's accounting errors, the SEC began its own investigation of the company. In doing so, it issued several requests to GCC. In response, GCC produced documents,

including e-mail communications to and from Defendants and the persons who ML interviewed.

The SEC also asked for the investigative findings, and ML provided the SEC with information about its findings, including a presentation prepared for the SEC and information about specific witness interviews, which were provided orally. An April 15, 2013 PowerPoint presentation that ML made to the SEC contained, among other things, an events timeline, the names of witnesses whom ML had already interviewed, a breakdown of the transactions deemed to be at the heart of the accounting discrepancy, and the results of its investigation. This 28-page PowerPoint presentation is now in the public record of this lawsuit, as Defendants filed it as an exhibit to their motion. The cover page of the ML-produced PowerPoint says “FOIA Confidential Treatment Request,” however.

On October 29, 2013, ML attorneys met with SEC staff and provided oral downloads of 12 witness interviews.

In addition, during the investigation, Deloitte asked for information from ML about its investigative steps and findings, including information obtained through ML-conducted witness interviews. ML provided Deloitte with the information and says that it did so because it believed “Deloitte would keep it confidential, consistent with Deloitte’s professional obligations to its client [GCC].” Although ML provided the SEC with oral downloads of only 12 witness interviews, it provided Deloitte with information about all the interviews notes and memoranda. It appears as though this was accomplished through the reading (by an ML attorney) of memoranda and interview notes to Deloitte and generalized “access” to review interview notes selected by Deloitte’s investigative team. . . .

The party claiming work product immunity (which is ML in this dispute) has the burden to establish the claimed protection. *Hinchee*. There is no dispute here that the notes and memoranda prepared by ML attorneys are in fact work product material. Rather, the dispute is over the *waiver* of the work-product doctrine protection.

Although the party seeking work-product protection bears the initial burden for establishing that the documents are entitled to such protection, after that initial burden is met, the burden shifts to the party asserting waiver to show that the party claiming the privilege has waived its right to do so. *Mitsui Sumitomo Ins. Co. v. Carbel, LLC*. In the context of work product, the question is not, as in the case of the attorney-client privilege, *whether* confidential communications are disclosed, but *to whom* the disclosure is made—because the protection is designed to protect an attorney’s mental processes from discovery by *adverse* parties. *See generally Jordan v. U.S. Dep’t of Justice*. . . .

The SEC was the adversary of ML’s client, GCC. The SEC was investigating GCC for alleged misstatements in its financial reports submitted as a public company and eventually imposed a \$6.5 million civil penalty against it. And it does not appear as though ML takes the position that the SEC was not an adversary, as it explains in its

response that “Morgan Lewis does not contend that [GCC] and the SEC shared a common interest[.]”

So the Undersigned easily concludes that the disclosure to the SEC was one made to an adversary. . . .

ML contends that no waiver occurred, however, because it never actually produced the notes and memoranda of the witness interviews to the SEC. ML argues that there is a meaningful distinction between the actual production of a witness interview note or memo and providing the same or similar information *orally*. The Undersigned is not convinced. *See S.E.C. v. Vitesse Semiconductor Corp.* (“While it is undisputed that NuHo did not actually produce the notes themselves to the SEC, after reviewing the SEC’s notes the Court found that NuHo effectively produced these notes to the SEC through its oral summaries.”); *S.E.C. v. Berry* (finding waiver of privilege in interview memoranda for five witnesses where attorneys orally disclosed to the SEC facts contained in the interviews); *S.E.C. v. Roberts* (“to the extent that Howrey orally disclosed to the government factual information contained in any of the written material identified by Roberts, Howrey has waived the attorney-client and work product privileges with respect to that information.”).

ML does not contend that it provided only vague references of the witness notes and memoranda to the SEC, nor does it argue that only detail-free conclusions or general impressions were orally provided. To the contrary, it factually concedes that its attorneys provided oral downloads of the substance of the 12 witness interview notes. . . .

ML also argues that Defendants’ claim—that they seek to “level the playing field”—is an argument which “rings hollow” because “the SEC does not have what the Defendants are seeking.” But that is an incomplete argument. Yes, it is true that the SEC does not have the *actual* witness notes and memoranda—but it has the functional equivalent of them by receiving the oral summaries of the interview materials. The cases discussed above reject this crabbed theory. *See, e.g., Vitesse Semiconductor.* . . .

After describing Defendants’ motion concerning the purported waiver by production to Deloitte as based on “scant facts,” ML then explains that it does not contest that it read interviews notes and memoranda to Deloitte for purposes of this motion. According to its response memorandum, 38 witnesses were interviewed. ML’s argument here is different from the argument it made for the materials provided to the SEC; it contends that even the actual physical production of work product to a company’s auditors does not waive work-product protection because an independent or outside auditor typically shares a common interest with the corporation for purpose of the work product and waiver doctrines.

The Undersigned agrees with ML that documents shared with Deloitte are protected from disclosure. *See United States v. Deloitte LLP* (holding that documents disclosed to Deloitte by client did not waive work product protection); *In re Weatherford Int’l Sec. Litig.* (“Ernst & Young functioned as Weatherford’s outside auditor. In this circuit,

disclosure to an outside auditor does not generally waive work product protection.”); *see also Regions Fin. Corp. v. United States* (finding same, because “E & Y was an independent auditor [and] not a potential adversary of Regions.”); *Gutter v. E.I. Dupont de Nemours & Co.* (“Transmittal of documents to a company’s outside auditors does not waive the work product privilege because such a disclosure cannot be said to have posed a substantial danger at the time that the document would be disclosed to plaintiffs.”).

In their motion, Defendants say that there is a “split” on the legal consequences arising from disclosures to a corporation’s accountants or auditors but then concede that “the majority” of courts hold that auditing and accounting firms typically do share a common interest. Nevertheless, they have crafted a theory to distinguish the precedent adopting the common-interest approach: they say that Deloitte “itself was on the SEC’s radar and entered into a tolling agreement with the SEC regarding its own conduct.” Therefore, Defendants argue, Deloitte was a “*potential* adversary” to GCC “because Deloitte was motivated to claim that GCC personnel had misled Deloitte regarding the accounting practices at GCC.”

The Undersigned is not persuaded by this effort to treat Deloitte differently from those cases that hold that an outside auditor has a common interest with the corporation for work-product waiver issues. First, the SEC never brought an enforcement action against Deloitte concerning this investigation.

Second, the SEC’s request for a tolling agreement with Deloitte occurred ten months after ML shared the results of its interviews with Deloitte.

Third, Defendants have not adequately established that ML or GCC knew at the time the witness interview materials were shared with Deloitte that the SEC was interested in a tolling agreement with Deloitte.

Fourth, Defendants have not cited any legal authority, binding or otherwise, to support the notion that a common interest disappears under factually analogous scenarios.

And fifth, even if Deloitte was a potential adversary on *that* issue, it still had a common interest for *other* purposes. *See generally Visual Scene, Inc. v. Pilkington Bros., plc.* (noting that “common interests exception applies where the parties, although nominally aligned on the same side of the case, are antagonistic as to some issues, but united as to others” and holding that both attorney-client privileged and work product-protected information exchanged between parties retained status under common interest doctrine even though the parties “in another respect” were “adversaries in the litigation and aligned as plaintiff and defendant respectively”). . . .

Although this Order compels ML to produce to Defendants the witness interview notes and memoranda for the 12 witnesses flagged in Defendants’ motion, Defendants also argue that they are entitled to *all* of the material because they have a substantial need for it.

According to Defendants' motion, ML has pledged to continue to assist *only* the SEC—but not Defendants—by making witnesses, including current and former GCC employees whom ML represents, available for further interviews and testimony in the United States, without regard for territorial limits. And Defendants similarly contend that, armed with ML's prior disclosures and ongoing cooperation, the SEC can cherry-pick which witnesses to call and which to avoid and ML's counsel can prepare those witnesses to testify with the benefit of a panoramic view of what all witnesses previously stated.

In the same vein, Defendants also say that the SEC is similarly advantaged with regard to the Deloitte witnesses by having access to the ML interviews, and therefore, having knowledge of what all witnesses previously stated. They note that many of the witnesses are in Brazil, which means that they have no workable alternative to interview them other than letters rogatory, which they say is time-consuming and likely to be unhelpful (because, for example, they must submit the questions in advance and be only observers in a judge-conducted questioning procedure). And they express concern over the fact that the witnesses' memories have faded—and that the interview notes and memoranda from a few years ago would be more accurate and helpful.

The Undersigned is not persuaded.

First, ML points out that Defendants have all of the 400,000-plus documents which GCC produced to the SEC, including contemporaneous e-mail communications among the witnesses at issue, which can be used to refresh recollections. Second, if the letters-rogatory process does in fact take longer than a traditional deposition, then Defendants can seek appropriate extensions of time. Third, and perhaps most importantly, Defendants are seeking the additional disclosure of attorney work product, which is entitled to heightened protection.

An attorney's notes and memoranda of interviews performed in the course of an internal investigation are "classic attorney work product." *See, e.g., Hickman v. Taylor* ("the privacy of an attorney's course of preparation is . . . essential to an orderly working of our system of legal procedure[.]"). Therefore, as the Supreme Court has explained, "Forcing an attorney to disclose notes and memoranda of witnesses' oral statements is particularly disfavored because it tends to reveal the attorney's mental processes[.]" *Upjohn Co. v. United States*.

"Substantial need cannot be overcome simply with an argument that documents are relevant and will assist in bolstering a party's affirmative defenses." *Beaubrun v. GEICO Gen. Ins. Co.* And courts must not allow parties to claim substantial need as a means to "short-cut" preparation of cases. *See Stern*.

ML waived work-product protection for the witnesses whose interview notes and memoranda its attorneys disclosed to the SEC in the so-called "oral downloads." Defendants advise that "at least twelve" interview memos were orally relayed, so the Undersigned is using that number, as well. If it turns out that ML provided information

to the SEC about other witness interviews besides the 12 already identified, then it shall disclose to Defendants the additional notes and memoranda. ML shall provide the notes and memoranda within 7 days of this Order. . . .

Bottom line for now, alas: it is not entirely clear how much a company can disclose in the name of cooperation before the privilege is waived. DOJ used to routinely request waivers of the privilege in corporate criminal investigations. Now it doesn't ask anymore, at least not explicitly. Defense counsel sometimes complain that waiver is still expected and rewarded. What are the legitimate interests here of both firms and the government? How should they be balanced? Consider what DOJ's policy on waiver, which is set out in the Justice Manual excerpt below, means in light of the law of attorney-client privilege and waiver as detailed in this Chapter.

U.S. DEPARTMENT OF JUSTICE, JUSTICE MANUAL, SECTION 9-28.000. PRINCIPLES OF FEDERAL PROSECUTION OF BUSINESS ORGANIZATIONS (Excerpts)

9-28.700. The Value of Cooperation

Cooperation is a mitigating factor, by which a corporation—just like any other subject of a criminal investigation—can gain credit in a case that otherwise is appropriate for indictment and prosecution. Of course, the decision not to cooperate by a corporation (or individual) is not itself evidence of misconduct, at least where the lack of cooperation does not involve criminal misconduct or demonstrate consciousness of guilt (*e.g.*, suborning perjury or false statements, or refusing to comply with lawful discovery requests). Thus, failure to cooperate, in and of itself, does not support or require the filing of charges with respect to a corporation any more than with respect to an individual.

A. General Principle: In order for a company to receive any consideration for cooperation under this section, the company must identify all individuals involved in or responsible for the misconduct at issue, regardless of their position, status or seniority, and provide to the Department all facts relating to that misconduct. If a company seeking cooperation credit declines to learn of such facts or to provide the Department with complete factual information about the individuals involved, its cooperation will not be considered a mitigating factor under this section. Nor, if a company is prosecuted, will the Department support a cooperation-related reduction at sentencing. *See* U.S.S.G. § 8C2.5(g), cmt. (n.13) (“A prime test of whether the organization has disclosed all pertinent information” necessary to receive a cooperation-related reduction in its offense level calculation “is whether the information is sufficient . . . to identify . . . the individual(s) responsible for the criminal conduct.”). If a company meets the threshold requirement of providing all relevant facts with respect to individuals, it will be eligible for consideration for cooperation credit. To be clear, a company is not required to waive its attorney-client privilege and attorney work product protection in order satisfy this threshold. *See* USAM 9-28.720. The extent of the cooperation credit earned will depend on all the various factors that have traditionally applied in making this assessment (*e.g.*,

the timeliness of the cooperation, the diligence, thoroughness and speed of the internal investigation, and the proactive nature of the cooperation).

B. Comment: In investigating wrongdoing by or within a corporation, a prosecutor may encounter several obstacles resulting from the nature of the corporation itself. It may be difficult to determine which individual took which action on behalf of the corporation. Lines of authority and responsibility may be shared among operating divisions or departments, and records and personnel may be spread throughout the United States or even among several countries. Where the criminal conduct continued over an extended period of time, the culpable or knowledgeable personnel may have been promoted, transferred, or fired, or they may have quit or retired. Accordingly, a corporation's cooperation may be critical in identifying potentially relevant actors and locating relevant evidence, among other things, and in doing so expeditiously.

This dynamic—*i.e.*, the difficulty of determining what happened, where the evidence is, and which individuals took or promoted putatively illegal corporate actions—can have negative consequences for both the government and the corporation that is the subject or target of a government investigation. More specifically, because of corporate attribution principles concerning actions of corporate officers and employees, *see* USAM 9.28-210, uncertainty about who authorized or directed apparent corporate misconduct can inure to the detriment of a corporation. For example, it may not matter under the law which of several possible executives or leaders in a chain of command approved of or authorized criminal conduct; however, that information if known might bear on the propriety of a particular disposition short of indictment of the corporation. It may not be in the interest of a corporation or the government for a charging decision to be made in the absence of such information, which might occur if, for example, a statute of limitations were relevant and authorization by any one of the officials were enough to justify a charge under the law. Moreover, a protracted government investigation of such an issue could disrupt the corporation's business operations or even depress its stock price.

For these reasons and more, cooperation can be a favorable course for both the government and the corporation. Cooperation benefits the government by allowing prosecutors and federal agents, for example, to avoid protracted delays, which compromise their ability to quickly uncover and address the full extent of widespread corporate crimes. With cooperation by the corporation, the government may be able to reduce tangible losses, limit damage to reputation, and preserve assets for restitution. At the same time, cooperation may benefit the corporation—and ultimately shareholders, employees, and other often blameless victims—by enabling the government to focus its investigative resources in a manner that will not unduly disrupt the corporation's legitimate business operations. In addition, cooperation may benefit the corporation by presenting it with the opportunity to earn credit for its efforts.

The requirement that companies cooperate completely as to individuals does not mean that Department attorneys should wait for the company to deliver the information about

individual wrongdoers and then merely accept what companies provide. To the contrary, Department attorneys should be proactively investigating individuals at every step of the process—before, during, and after any corporate cooperation. Department attorneys should vigorously review any information provided by companies and compare it to the results of their own investigation, in order to best ensure that the information provided is indeed complete and does not seek to minimize the behavior or role of any individual or group of individuals.

Department attorneys should strive to obtain from the company as much information as possible about responsible individuals before resolving the corporate case. In addition, the company's continued cooperation with respect to individuals may be necessary post-resolution. If so, the corporate resolution agreement should include a provision that requires the company to provide information about all individuals involved and that is explicit enough so that a failure to provide the information results in specific consequences, such as stipulated penalties and/or a material breach. . . .

9-28.710. Attorney-Client and Work Product Protections

The attorney-client privilege and the attorney work product protection serve an extremely important function in the American legal system. The attorney-client privilege is one of the oldest and most sacrosanct privileges under the law. *See Upjohn v. United States*. As the Supreme Court has stated, “[i]ts purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice.” The value of promoting a corporation's ability to seek frank and comprehensive legal advice is particularly important in the contemporary global business environment, where corporations often face complex and dynamic legal and regulatory obligations imposed by the federal government and also by states and foreign governments. The work product doctrine serves similarly important goals.

For these reasons, waiving the attorney-client and work product protections has never been a prerequisite under the Department's prosecution guidelines for a corporation to be viewed as cooperative. Nonetheless, a wide range of commentators and members of the American legal community and criminal justice system have asserted that the Department's policies have been used, either wittingly or unwittingly, to coerce business entities into waiving attorney-client privilege and work-product protection. Everyone agrees that a corporation may freely waive its own privileges if it chooses to do so; indeed, such waivers occur routinely when corporations are victimized by their employees or others, conduct an internal investigation, and then disclose the details of the investigation to law enforcement officials in an effort to seek prosecution of the offenders. However, the contention, from a broad array of voices, is that the Department's position on attorney-client privilege and work product protection waivers has promoted an environment in which those protections are being unfairly eroded to the detriment of all.

The Department understands that the attorney-client privilege and attorney work product protection are essential and long-recognized components of the American legal system. What the government seeks and needs to advance its legitimate (indeed, essential) law enforcement mission is not waiver of those protections, but rather the facts known to the corporation about the putative criminal misconduct under review. In addition, while a corporation remains free to convey non-factual or “core” attorney-client communications or work product—if and only if the corporation voluntarily chooses to do so—prosecutors should not ask for such waivers and are directed not to do so. The critical factor is whether the corporation has provided the facts about the events, as explained further herein.

9-28.720. Cooperation: Disclosing the Relevant Facts

Eligibility for cooperation credit is not predicated upon the waiver of attorney-client privilege or work product protection. Instead, the sort of cooperation that is most valuable to resolving allegations of misconduct by a corporation and its officers, directors, employees, or agents is disclosure of the relevant *facts* concerning such misconduct. In this regard, the analysis parallels that for a non-corporate defendant, where cooperation typically requires disclosure of relevant factual knowledge and not of discussions between an individual and his attorneys.

Thus, when the government investigates potential corporate wrongdoing, it seeks the relevant facts. For example, how and when did the alleged misconduct occur? Who promoted or approved it? Who was responsible for committing it? In this respect, the investigation of a corporation differs little from the investigation of an individual. In both cases, the government needs to know the facts to achieve a just and fair outcome. The party under investigation may choose to cooperate by disclosing the facts, and the government may give credit for the party’s disclosures. If a corporation wishes to receive credit for such cooperation, which then can be considered with all other cooperative efforts and circumstances in evaluating how fairly to proceed, then the corporation, like any person, must disclose the relevant facts of which it has knowledge.

(a) Disclosing the Relevant Facts—Facts Gathered Through Internal Investigation

Individuals and corporations often obtain knowledge of facts in different ways. An individual knows the facts of his or others’ misconduct through his own experience and perceptions. A corporation is an artificial construct that cannot, by definition, have personal knowledge of the facts. Some of those facts may be reflected in documentary or electronic media like emails, transaction or accounting documents, and other records. Often, the corporation gathers facts through an internal investigation. Exactly how and by whom the facts are gathered is for the corporation to decide. Many corporations choose to collect information about potential misconduct through lawyers, a process that may confer attorney-client privilege or attorney work product protection on at least some of the information collected. Other corporations may choose a method of fact-gathering that does not have that effect—for example, having employee or other witness statements collected after interviews by non-attorney personnel. Whichever process the

corporation selects, the government's key measure of cooperation must remain the same as it does for an individual: has the party timely disclosed the relevant facts about the putative misconduct? That is the operative question in assigning cooperation credit for the disclosure of information—*not* whether the corporation discloses attorney-client or work product materials. Accordingly, a corporation should receive the same credit for disclosing facts contained in materials that are not protected by the attorney-client privilege or attorney work product as it would for disclosing identical facts contained in materials that are so protected. On this point the Report of the House Judiciary Committee, submitted in connection with the attorney-client privilege bill passed by the House of Representatives (H.R. 3013), comports with the approach required here:

[A]n . . . attorney of the United States may base cooperation credit on the facts that are disclosed, but is prohibited from basing cooperation credit upon whether or not the materials are protected by attorney-client privilege or attorney work product. As a result, an entity that voluntarily discloses should receive the same amount of cooperation credit for disclosing facts that happen to be contained in materials not protected by attorney-client privilege or attorney work product as it would receive for disclosing identical facts that are contained in materials protected by attorney-client privilege or attorney work product. There should be no differentials in an assessment of cooperation (*i.e.*, neither a credit nor a penalty) based upon whether or not the materials disclosed are protected by attorney-client privilege or attorney work product.

H.R. Rep. No. 110-445 (2007).

In short, the company may be eligible for cooperation credit regardless of whether it chooses to waive privilege or work product protection in the process, if it provides all relevant facts about the individuals who were involved in the misconduct. But if the corporation does not disclose such facts, it will not be entitled to receive any credit for cooperation.

Two final and related points bear noting about the disclosure of facts, although they should be obvious. First, the government cannot compel, and the corporation has no obligation to make, such disclosures (although the government can obviously compel the disclosure of certain records and witness testimony through subpoenas). Second, a corporation's failure to provide relevant information about individual misconduct alone does not mean the corporation will be indicted. It simply means that the corporation will not be entitled to mitigating credit for that cooperation. Whether the corporation faces charges will turn, as it does in any case, on the sufficiency of the evidence, the likelihood of success at trial, and all of the other factors identified in USAM 9-28.300. If there is insufficient evidence to warrant indictment, after appropriate investigation has been completed, or if the other factors weigh against indictment, then the corporation should not be indicted, irrespective of whether it has earned cooperation credit. The converse is also true: The government may charge even the most cooperative corporation pursuant

to these Principles if, in weighing and balancing the factors described herein, the prosecutor determines that a charge is required in the interests of justice. Put differently, even the most sincere and thorough effort to cooperate cannot necessarily absolve a corporation that has, for example, engaged in an egregious, orchestrated, and widespread fraud. Cooperation is a potential mitigating factor, but it alone is not dispositive.

(b) Legal Advice and Attorney Work Product

Separate from (and usually preceding) the fact-gathering process in an internal investigation, a corporation, through its officers, employees, directors, or others, may have consulted with corporate counsel regarding or in a manner that concerns the legal implications of the putative misconduct at issue. Communications of this sort, which are both independent of the fact-gathering component of an internal investigation and made for the purpose of seeking or dispensing legal advice, lie at the core of the attorney-client privilege. Such communications can naturally have a salutary effect on corporate behavior—facilitating, for example, a corporation’s effort to comply with complex and evolving legal and regulatory regimes. Except as noted in subparagraphs (b)(i) and (b)(ii) below, a corporation need not disclose and prosecutors may not request the disclosure of such communications as a condition for the corporation’s eligibility to receive cooperation credit.

Likewise, non-factual or core attorney work product—for example, an attorney’s mental impressions or legal theories—lies at the core of the attorney work product doctrine. A corporation need not disclose, and prosecutors may not request, the disclosure of such attorney work product as a condition for the corporation’s eligibility to receive cooperation credit.

(i) Advice of Counsel Defense in the Instant Context

Occasionally a corporation or one of its employees may assert an advice-of-counsel defense, based upon communications with in-house or outside counsel that took place prior to or contemporaneously with the underlying conduct at issue. In such situations, the defendant must tender a legitimate factual basis to support the assertion of the advice-of-counsel defense. *See, e.g., Pitt v. Dist. of Columbia; United States v. Wenger; United States v. Cheek.* The Department cannot fairly be asked to discharge its responsibility to the public to investigate alleged corporate crime, or to temper what would otherwise be the appropriate course of prosecutive action, by simply accepting on faith an otherwise unproven assertion that an attorney—perhaps even an unnamed attorney—approved potentially unlawful practices. Accordingly, where an advice-of-counsel defense has been asserted, prosecutors may ask for the disclosure of the communications allegedly supporting it.

(ii) Communications in Furtherance of a Crime or Fraud

Communications between a corporation (through its officers, employees, directors, or agents) and corporate counsel that are made in furtherance of a crime or fraud are, under settled precedent, outside the scope and protection of the attorney-client privilege. *See United States v. Zolin; United States v. BDO Seidman, LLP*. As a result, the Department may properly request such communications if they in fact exist. . . .

For a thorough summary of the controversy over waiver of attorney-client privilege in corporate investigations, see Julie R. O’Sullivan, *Does DOJ’s Privilege Waiver Policy Threaten the Rationales Underlying the Attorney-Client Privilege and Work Product Doctrine? A Preliminary “No,”* 45 AM. CRIM. L. REV. 1237 (2008). O’Sullivan argues that corporations have pushed hard against the DOJ’s treatment of the privilege because Fourth and Fifth Amendment law leaves corporations, unlike individuals, legally unprotected in criminal investigations. Thus, the attorney-client privilege is the only doctrine remaining to afford some measure of informational protection or advantage in this high-stakes adversarial setting. It is also undeniable that the privilege is particularly important, including economically, to the corporate bar.

Problem 14-3

- (a) You work as an associate at the firm of BigLaw2. BigLaw2 has been retained by BigPharma to represent all of its employees in their initial contacts with the Department of Justice and the SEC, which have commenced an investigation of BigPharma for potential Foreign Corrupt Practices Act violations in connection with its operations in Vietnam. The BigLaw2 partner who landed the assignment for the firm has chosen you to handle the representation of Wally, a plant manager at BigPharma's main facility in Vietnam. The firm BigLaw1 represents BigPharma as a corporation and recommended that BigLaw2 be retained to represent the employees.

An initial interview of Wally with the SEC and DOJ is scheduled to take place in Washington at the DOJ offices. You accompany a jet-lagged Wally to the interview room that morning, in which—unusually, to say the least—you find three government lawyers, two FBI agents, and two lawyers from BigLaw1.

Wally turns to you and asks to speak to you in the hallway. You go outside and he says, "What is going on here? I'm totally confused about who is here and why, what my rights are, whom I should talk to, and what I should say. Please straighten me out!" Advise Wally and determine how to proceed. (You may have to ask everyone else at the meeting to go get a cup of coffee or two.)

- (b) Under English law, there are two privileges relevant to corporate investigations. One is the "legal advice privilege," which protects communications between corporate personnel and attorneys for the corporation for purposes of providing legal advice; it applies only to communications between counsel and those corporate personnel who can control the work of counsel (*i.e.*, it follows something akin to the "control test" rejected in *Upjohn*). The second is the "litigation privilege," which covers all communications between lawyers and corporate personnel for the purposes of preparing for litigation and similar proceedings; it applies only when it is "reasonably likely" that an action will be brought against the corporation. How might the scope of these privileges affect the investigation of corporate crime in the United Kingdom?
- (c) If you were representing a corporation before the DOJ in a major criminal investigation, how would you strategically advise the corporation to, on balance, (i) conduct a full and effective internal investigation, (ii) protect its attorney-client privilege to the maximum extent possible, and (iii) position itself to obtain the greatest possible credit for cooperation from the DOJ.

15. SIXTH AMENDMENT AND INDIVIDUALS

The Sixth Amendment to the U.S. Constitution guarantees the right to the assistance of counsel, which has been interpreted to mean “effective” counsel.

The right to effective counsel has been said to include: the right to an attorney of one’s choosing; the right to spend one’s own money (indeed, all of it), but not necessarily someone else’s money, on a defense; the right to have a defense paid for by the state if one is indigent; the right to conflict-free counsel—a right in which the public also has an interest; and the right to counsel who performs adequately under the Supreme Court’s decision in *Strickland v. Washington*, 466 U.S. 668 (1984), and its progeny. The last right is very important in street crime but rarely leads to litigation in white collar crime.

Representation rights are important to understand in the field of corporate crime principally because the corporation may have a role in individual representation in two ways: by paying for private counsel for employees; and by interacting directly with employees through lawyers who represent the corporation. Thus, the main issues in the corporate crime context relate to the funding of counsel and conflicts of interest. Access to corporate funding of counsel for employees may be afforded by statute and/or by employment contract—according, generally speaking, to whether one occupies a senior position in a large corporation—or may not be legally guaranteed but commonly provided as a matter of a corporation’s ordinary business practices.

A. Relevant Legal Provisions

These issues implicate several bodies of law, including the Sixth Amendment of the U.S. Constitution, state corporate codes (this chapter focuses on Delaware, as that is the leading jurisdiction for incorporation), and the ABA’s Model Rules of Professional Conduct, all provided below.

U.S. Constitution Amendment VI

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the state and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, **and to have the assistance of counsel for his defense.**

Delaware Code § 145

(a) A corporation shall have power to indemnify any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of the corporation) by reason of the fact that the person is or was a director, officer, employee or agent of the corporation, or is or was serving at the request

of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, against expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by the person in connection with such action, suit or proceeding if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had no reasonable cause to believe the person's conduct was unlawful. The termination of any action, suit or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, shall not, of itself, create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to any criminal action or proceeding, had reasonable cause to believe that the person's conduct was unlawful. . . .

(c) To the extent that a present or former director or officer of a corporation has been successful on the merits or otherwise in defense of any action, suit or proceeding referred to in subsections (a) and (b) of this section, or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees) actually and reasonably incurred by such person in connection therewith. . . .

(e) Expenses (including attorneys' fees) incurred by an officer or director of the corporation in defending any civil, criminal, administrative or investigative action, suit or proceeding may be paid by the corporation in advance of the final disposition of such action, suit or proceeding upon receipt of an undertaking by or on behalf of such director or officer to repay such amount if it shall ultimately be determined that such person is not entitled to be indemnified by the corporation as authorized in this section. Such expenses (including attorneys' fees) incurred by former directors and officers or other employees and agents of the corporation or by persons serving at the request of the corporation as directors, officers, employees or agents of another corporation, partnership, joint venture, trust or other enterprise may be so paid upon such terms and conditions, if any, as the corporation deems appropriate. . . .

(g) A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against such person and incurred by such person in any such capacity, or arising out of such person's status as such, whether or not the corporation would have the power to indemnify such person against such liability under this section. . . .

ABA Model Rules of Professional Conduct

Rule 1.7 Conflict of Interest: Current Clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

- (1) the representation of one client will be directly adverse to another client; or
- (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

- (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
- (2) the representation is not prohibited by law;
- (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
- (4) each affected client gives informed consent, confirmed in writing.

Rule 1.8 Conflict of Interest: Current Clients: Specific Rules

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules. . . .

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

- (1) the client gives informed consent;
- (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
- (3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include

the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement. . . .

Rule 1.9 Duties to Former Clients

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing. . . .

Rule 1.13 Organization as Client

(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law that reasonably might be imputed to the organization, and that is likely to result in substantial injury to the organization, then the lawyer shall proceed as is reasonably necessary in the best interest of the organization. Unless the lawyer reasonably believes that it is not necessary in the best interest of the organization to do so, the lawyer shall refer the matter to higher authority in the organization, including, if warranted by the circumstances, to the highest authority that can act on behalf of the organization as determined by applicable law.

(c) Except as provided in paragraph (d), if

(1) despite the lawyer's efforts in accordance with paragraph (b) the highest authority that can act on behalf of the organization insists upon or fails to address in a timely and appropriate manner an action, or a refusal to act, that is clearly a violation of law, and

(2) the lawyer reasonably believes that the violation is reasonably certain to result in substantial injury to the organization,

then the lawyer may reveal information relating to the representation whether or not Rule 1.6 permits such disclosure, but only if and to the extent the lawyer reasonably believes necessary to prevent substantial injury to the organization.

(d) Paragraph (c) shall not apply with respect to information relating to a lawyer's representation of an organization to investigate an alleged violation of law, or to defend the organization or an officer, employee or other constituent associated with the organization against a claim arising out of an alleged violation of law.

(e) A lawyer who reasonably believes that he or she has been discharged because of the lawyer's actions taken pursuant to paragraphs (b) or (c), or who withdraws under circumstances that require or permit the lawyer to take action under either of those

paragraphs, shall proceed as the lawyer reasonably believes necessary to assure that the organization's highest authority is informed of the lawyer's discharge or withdrawal.

(f) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when the lawyer knows or reasonably should know that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(g) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

Rule 4.2 Communication with Person Represented by Counsel

In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.

B. Conflicts of Interest

In the following case, the Sixth Amendment right to an attorney of one's own choosing collides with the right to conflict-free counsel, which turns out to have a public interest dimension according to the Supreme Court. This problem often comes up in sophisticated federal criminal practice: A defendant wishes to have a particular lawyer who also happens to have a conflict, the prosecutor thinks that should not be allowed, and the court has to decide what to do. *Wheat* is the foundational case.

WHEAT v. UNITED STATES, 486 U.S. 153 (1988)

Chief Justice REHNQUIST delivered the opinion of the Court.

The issue in this case is whether the District Court erred in declining petitioner's waiver of his right to conflict-free counsel and by refusing to permit petitioner's proposed substitution of attorneys.

Petitioner Mark Wheat, along with numerous codefendants, was charged with participating in a far-flung drug distribution conspiracy. . . . Also charged in the conspiracy were Juvenal Gomez-Barajas and Javier Bravo, who were represented in their criminal proceedings by attorney Eugene Iredale. Gomez-Barajas was tried first and was acquitted on drug charges overlapping with those against petitioner. To avoid a second trial on other charges, however, Gomez-Barajas offered to plead guilty to tax evasion and illegal importation of merchandise. . . .

At the conclusion of Bravo's guilty plea proceedings on August 22, 1985, Iredale notified the District Court that he had been contacted by petitioner and had been asked to try petitioner's case as well.

. . . [T]he Government objected to petitioner's proposed substitution on the ground that Iredale's representation of Gomez-Barajas and Bravo created a serious conflict of interest. The Government's position was premised on two possible conflicts. First, the District Court had not yet accepted the plea and sentencing arrangement negotiated between Gomez-Barajas and the Government; in the event that arrangement were rejected by the court, Gomez-Barajas would be free to withdraw the plea and stand trial. He would then be faced with the prospect of representation by Iredale, who in the meantime would have acted as petitioner's attorney. Petitioner, through his participation in the drug distribution scheme...was thus likely to be called as a witness for the Government at any subsequent trial of Gomez-Barajas. This scenario would pose a conflict of interest for Iredale, who would be prevented from cross-examining petitioner and thereby from effectively representing Gomez-Barajas.

Second, and of more immediate concern, Iredale's representation of Bravo would directly affect his ability to act as counsel for petitioner. . . . [T]he Government contacted Iredale and asked that Bravo be made available as a witness to testify against petitioner, and agreed in exchange to modify its position at the time of Bravo's sentencing. In the likely event that Bravo were called to testify, Iredale's position in representing both men would become untenable, for ethical proscriptions would forbid him to cross-examine Bravo in any meaningful way. By failing to do so, he would also fail to provide petitioner with effective assistance of counsel. Thus, because of Iredale's prior representation of Gomez-Barajas and Bravo and the potential for serious conflict of interest, the Government urged the District Court to reject the substitution of attorneys.

In response, petitioner emphasized his right to have counsel of his own choosing and the willingness of Gomez-Barajas, Bravo, and petitioner to waive the right to conflict-free counsel. Petitioner argued that the circumstances posited by the Government that would create a conflict for Iredale were highly speculative and bore no connection to the true relationship between the co-conspirators. If called to testify, Bravo would simply say that he did not know petitioner and had no dealings with him; no attempt by Iredale to impeach Bravo would be necessary. Further, in the unlikely event that Gomez-Barajas went to trial on the charges of tax evasion and illegal importation, petitioner's lack of involvement in those alleged crimes made his appearance as a witness highly improbable. Finally, and most importantly, all three defendants agreed to allow Iredale to represent petitioner and to waive any future claims of conflict of interest. In petitioner's view, the Government was manufacturing implausible conflicts in an attempt to disqualify Iredale, who had already proved extremely effective in representing Gomez-Barajas and Bravo.

. . . The court then ruled:

[B]ased upon the representation of the Government in [its] memorandum that the Court really has no choice at this point other than to find that an irreconcilable conflict of interest exists. I don't think it can be waived, and accordingly, Mr. Wheat's request to substitute Mr. Iredale in as attorney of record is denied.

Petitioner proceeded to trial with his original counsel and was convicted. . . .

The Sixth Amendment to the Constitution guarantees that "[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence." . . . [T]his right was designed to assure fairness in the adversary criminal process. Realizing that an unaided layman may have little skill in arguing the law or in coping with an intricate procedural system, we have held that the Sixth Amendment secures the right to the assistance of counsel, by appointment if necessary, in a trial for any serious crime. We have further recognized that the purpose of providing assistance of counsel "is simply to ensure that criminal defendants receive a fair trial," and that in evaluating Sixth Amendment claims, "the appropriate inquiry focuses on the adversarial process, not on the accused's relationship with his lawyer as such." Thus, while the right to select and be represented by one's preferred attorney is comprehended by the Sixth Amendment, the essential aim of the Amendment is to guarantee an effective advocate for each criminal defendant rather than to ensure that a defendant will inexorably be represented by the lawyer whom he prefers.

The Sixth Amendment right to choose one's own counsel is circumscribed in several important respects. Regardless of his persuasive powers, an advocate who is not a member of the bar may not represent clients (other than himself) in court. Similarly, a defendant may not insist on representation by an attorney he cannot afford or who for other reasons declines to represent the defendant. Nor may a defendant insist on the counsel of an attorney who has a previous or ongoing relationship with an opposing party, even when the opposing party is the Government. The question raised in this case is the extent to which a criminal defendant's right under the Sixth Amendment to his chosen attorney is qualified by the fact that the attorney has represented other defendants charged in the same criminal conspiracy.

In previous cases, we have recognized that multiple representation of criminal defendants engenders special dangers of which a court must be aware. While "permitting a single attorney to represent codefendants . . . is not per se violative of constitutional guarantees of effective assistance of counsel," a court confronted with and alerted to possible conflicts of interest must take adequate steps to ascertain whether the conflicts warrant separate counsel. As we said in *Holloway*:

Joint representation of conflicting interests is suspect because of what it tends to prevent the attorney from doing. . . . [A] conflict may . . . prevent an attorney from challenging the admission of evidence

prejudicial to one client but perhaps favorable to another, or from arguing at the sentencing hearing the relative involvement and culpability of his clients in order to minimize the culpability of one by emphasizing that of another.

Petitioner insists that the provision of waivers by all affected defendants cures any problems created by the multiple representation. But no such flat rule can be deduced from the Sixth Amendment presumption in favor of counsel of choice. Federal courts have an independent interest in ensuring that criminal trials are conducted within the ethical standards of the profession and that legal proceedings appear fair to all who observe them. Both the American Bar Association's Model Code of Professional Responsibility and its Model Rules of Professional Conduct, as well as the rules of the California Bar Association (which governed the attorneys in this case), impose limitations on multiple representation of clients. . . . Not only the interest of a criminal defendant but the institutional interest in the rendition of just verdicts in criminal cases may be jeopardized by unregulated multiple representation.

For this reason, the Federal Rules of Criminal Procedure direct trial judges to investigate specially cases involving joint representation. In pertinent part, Rule 44(c) provides:

[T]he court shall promptly inquire with respect to such joint representation and shall personally advise each defendant of his right to the effective assistance of counsel, including separate representation. Unless it appears that there is good cause to believe no conflict of interest is likely to arise, the court shall take such measures as may be appropriate to protect each defendant's right to counsel.

Although Rule 44(c) does not specify what particular measures may be taken by a district court, one option suggested by the Notes of the Advisory Committee is an order by the court that the defendants be separately represented in subsequent proceedings in the case. This suggestion comports with our instructions . . . that the trial courts, when alerted by objection from one of the parties, have an independent duty to ensure that criminal defendants receive a trial that is fair and does not contravene the Sixth Amendment.

To be sure, this need to investigate potential conflicts arises in part from the legitimate wish of district courts that their judgments remain intact on appeal. As the Court of Appeals accurately pointed out, trial courts confronted with multiple representations face the prospect of being "whip-sawed" by assertions of error no matter which way they rule. If a district court agrees to the multiple representation, and the advocacy of counsel is thereafter impaired as a result, the defendant may well claim that he did not receive effective assistance. On the other hand, a district court's refusal to accede to the multiple representation may result in a challenge such as petitioner's in this case. Nor does a waiver by the defendant necessarily solve the problem, for we note, without passing judgment on, the apparent willingness of Courts of Appeals to entertain ineffective-assistance claims from defendants who have specifically waived the right to conflict-free counsel.

Thus, where a court justifiably finds an actual conflict of interest, there can be no doubt that it may decline a proffer of waiver, and insist that defendants be separately represented. . . .

Unfortunately for all concerned, a district court must pass on the issue whether or not to allow a waiver of a conflict of interest by a criminal defendant not with the wisdom of hindsight after the trial has taken place, but in the murkier pre-trial context when relationships between parties are seen through a glass, darkly. The likelihood and dimensions of nascent conflicts of interest are notoriously hard to predict, even for those thoroughly familiar with criminal trials. It is a rare attorney who will be fortunate enough to learn the entire truth from his own client, much less be fully apprised before trial of what each of the Government's witnesses will say on the stand. A few bits of unforeseen testimony or a single previously unknown or unnoticed document may significantly shift the relationship between multiple defendants. These imponderables are difficult enough for a lawyer to assess, and even more difficult to convey by way of explanation to a criminal defendant untutored in the niceties of legal ethics. Nor is it amiss to observe that the willingness of an attorney to obtain such waivers from his clients may bear an inverse relation to the care with which he conveys all the necessary information to them.

For these reasons we think the district court must be allowed substantial latitude in refusing waivers of conflicts of interest not only in those rare cases where an actual conflict may be demonstrated before trial, but in the more common cases where a potential for conflict exists which may or may not burgeon into an actual conflict as the trial progresses. In the circumstances of this case, with the motion for substitution of counsel made so close to the time of trial, the District Court relied on instinct and judgment based on experience in making its decision. We do not think it can be said that the court exceeded the broad latitude which must be accorded it in making this decision. Petitioner of course rightly points out that the Government may seek to "manufacture" a conflict in order to prevent a defendant from having a particularly able defense counsel at his side; but trial courts are undoubtedly aware of this possibility, and must take it into consideration along with all of the other factors which inform this sort of a decision. . . .

Viewing the situation as it did before trial, we hold that the District Court's refusal to permit the substitution of counsel in this case was within its discretion and did not violate petitioner's Sixth Amendment rights. Other district courts might have reached differing or opposite conclusions with equal justification, but that does not mean that one conclusion was "right" and the other "wrong". The District Court must recognize a presumption in favor of petitioner's counsel of choice, but that presumption may be overcome not only by a demonstration of actual conflict but by a showing of a serious potential for conflict. The evaluation of the facts and circumstances of each case under this standard must be left primarily to the informed judgment of the trial court. . . .

The following case involves a famous prosecution in which the Second Circuit approved a trial judge's decision to prevent attorneys, including for the notorious mafia boss John

Gotti, from representing at trial defendants on grounds that the lawyers' "house counsel" status and other factors created non-waivable conflicts under *Wheat*.

UNITED STATES v. LOCASCIO, 6 F.3d 924 (2d Cir. 1993)

ALTIMARI, Circuit Judge:

On July 18, 1991, a grand jury in the Eastern District of New York returned a thirteen count superseding indictment against [John] Gotti and [Frank] Locascio. The indictment also named two other defendants, Salvatore Gravano and Thomas Gambino, who are not parties to this appeal. All four defendants were charged with violating the Racketeer Influenced and Corrupt Organizations Act ("RICO"), for unlawfully conducting and participating in the affairs of a criminal enterprise through a pattern of racketeering activity. The charged enterprise was the Gambino Organized Crime Family of La Cosa Nostra ("the Gambinos," "The Gambino Family," or "the Gambino Crime Family"). Gotti was charged as the head of the organization, and Locascio was accused of being the "underboss," or second-in-command.

Gravano was charged as the "consigliere," or advisor, to Gotti. Following the indictment, Gravano pleaded guilty to a superseding racketeering charge and testified at length at trial against Gotti and Locascio. The charges against Gambino, a "captain" in the organization, were severed. . . .

The government's proof to support the allegations that Gotti and Locascio had been in command of an extensive criminal enterprise was comprised mostly of lawfully intercepted tape-recorded conversations of the defendants-appellants and other alleged members of the Gambino Family. The government introduced tape recordings from four different locations over an eight-year period. . . .

The tape recordings, combined with Gravano's testimony, presented to the jury a picture of a large-scale enterprise involved in various criminal activities. The jury heard evidence on the structure and inner workings of the Gambino Family, and learned of the miscellaneous crimes with which Gotti and Locascio were charged: murders, obstruction of legal proceedings, conspiracies, gambling operations, and loansharking activities. . . .

Prior to trial, the district court disqualified [the] attorney for . . . Gotti. . . . Gotti . . . now contend[s] that this [disqualification was] unwarranted and violated [his] Sixth Amendment rights.

The Sixth Amendment to the Constitution provides that "[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence." U.S. Const. Amend. VI. The accused, however, does not have the absolute right to counsel of her own choosing. As the Court stated in *Wheat*,

while the right to select and be represented by one's preferred attorney is comprehended by the Sixth Amendment, the essential aim of the Amendment is to guarantee an effective advocate for each criminal

defendant rather than to ensure that a defendant will inexorably be represented by the lawyer whom he prefers.

Similarly, although a criminal defendant can waive her Sixth Amendment rights in some circumstances, that right to waiver is not absolute, since “[f]ederal courts have an independent interest in ensuring that criminal trials are conducted within the ethical standards of the profession and that legal proceedings appear fair to all who observe them.” The question of disqualification therefore implicates not only the Sixth Amendment right of the accused, but also the interests of the courts in preserving the integrity of the process and the government’s interests in ensuring a just verdict and a fair trial.

In deciding a motion for disqualification, the district court recognizes a presumption in favor of the accused’s chosen counsel, although this presumption can be overcome by a showing of an actual conflict or potentially serious conflict.

There are many situations in which a district court can determine that disqualification of counsel is necessary. The most typical is where the district court finds a potential or actual conflict in the chosen attorney’s representation of the accused, either in a multiple representation situation, or because of the counsel’s prior representation of a witness or co-defendant. Courts have also considered disqualification where the chosen counsel is implicated in the allegations against the accused and could become an unsworn witness for the accused, or where the chosen counsel is somehow unable to serve without unreasonable delay or inconvenience in completing the trial. . . .

Bruce Cutler served as Gotti’s attorney in previous criminal trials in federal court. Prior to trial, the government moved to disqualify Cutler from acting as Gotti’s attorney. Although the motion also dealt with the disqualification of other Gotti attorneys, only the disqualification of Cutler has been challenged on appeal.

The district court granted the motion to disqualify on several grounds. Judge Glasser, in a thoughtful and well-reasoned opinion, found that Cutler had acted as “house counsel” to the Gambino Crime Family by receiving “benefactor payments” from Gotti to represent others in the criminal enterprise. The district court based this conclusion on excerpts from the government’s taped transcripts, which left “little doubt that Gotti paid significant sums of money for legal services rendered to others.”

The district court further determined that Cutler’s participation in government-taped conversations at which illegal activity was discussed would impair his representation of Gotti. Specifically, the court noted that Cutler’s mere presence at trial could make him an “unsworn witness” before the jury in explaining his own conduct and interpreting Gotti’s conversations on the tapes. Even if Gotti waived the conflict, and even if the government did not intend to call Cutler as a witness, the district court found that Cutler’s representation would still compromise the integrity of the proceeding.

Third, the district court found that Cutler's prior representation of Michael Coiro, a potential government witness, gave rise to a conflict of interest. The court reasoned that this conflict mandated disqualification both because Cutler was privy to events surrounding an obstruction charge, and because Cutler's cross examination of Coiro at trial would be circumscribed by the prior representation.

Finally, the district court also found disqualification warranted because of the implication by Gotti in taped conversations that he had paid Cutler money "under the table." This made Cutler a potential accomplice as well as a potential witness to Gotti's tax fraud.

In conclusion, the district court noted that it was mindful that disqualification is a drastic remedy for conflict problems, but that no less severe alternatives were viable. The court therefore held that "the grave peril the continued representation by [Cutler] poses to the integrity of the trial process" mandated disqualification.

Gotti now appeals the district court's ruling, arguing that the disqualification was an abuse of discretion. We disagree, and affirm the disqualification on two grounds: (1) Cutler's role as house counsel to the Gambino Crime Family; and (2) Cutler's anticipated role as an "unsworn witness" for Gotti had he been allowed to serve. . . .

Gotti argues that the facts before the district court did not merit the conclusion that Cutler had acted as "house counsel" to the Gambino Crime Family. Rather, Gotti argues that Cutler was merely his personal attorney.

Ethical considerations warn against an attorney accepting fees from someone other than her client. As we stated in a different context, the acceptance of such "benefactor payments" "may subject an attorney to undesirable outside influence" and raises an ethical question "as to whether the attorney's loyalties are with the client or the payor." In this context, proof of house counsel can be used by the government to help establish the existence of the criminal enterprise under RICO, by showing the connections among the participants.

Contrary to Gotti's assertions, there was sufficient evidence for the district court to determine that Cutler had acted as house counsel to the Gambino Crime Family. For example, the court cited one conversation in which Gotti, in the time-honored tradition of legal clients, complained about his legal fees:

I gave youse [sic] 300,000 in one year. Youse [sic] didn't defend me. I wasn't even mentioned in none of these [expletive deleted] things. I had nothing to do with none of these [expletive deleted] people. What the [expletive deleted] is your "beef?" Before youse [sic] made a court appearance, youse [sic] got 40,000, 30,000 and 25,000. That's without counting [attorney] John Pollok. . . . You standing there in the hallway with me last night, and you're plucking me. . . . "Tony Lee's" lawyer, but you're plucking me. I'm paying for it. . . . Where does it end?

Gambino Crime Family? This is the Shargel, Cutler and who do you call it Crime Family.

Gotti thus demonstrated that he was incurring the legal fees for representation of others. As support for disqualification, the government indicated that it would introduce the testimony of Michael Coiro, who would testify that he had paid nothing to Cutler and another attorney for their services to him, presumably because Gotti paid for his defense.

Cutler's role as house counsel to the Gambinos raised a credible issue of the ethical propriety of his representation of Gotti in this case. An attorney cannot properly serve two masters, and the evidence before the district court indicated that Cutler had represented the Gambino Family as a whole. Moreover, Cutler's status as house counsel was potentially part of the proof of the Gambino criminal enterprise. We cannot say that the district court abused its discretion in disqualifying Cutler on this basis, considering the volume of proof of Cutler's proximity to the affairs of the Gambino Crime Family offered by the government in this case.

An even stronger basis for disqualification, however, was the possibility that Cutler would function in his representational capacity as an unsworn witness for Gotti. An attorney acts as an unsworn witness when his relationship to his client results in his having first-hand knowledge of the events presented at trial. If the attorney is in a position to be a witness, ethical codes may require him to withdraw his representation.

Even if the attorney is not called, however, he can still be disqualified, since his performance as an advocate can be impaired by his relationship to the events in question. For example, the attorney may be constrained from making certain arguments on behalf of his client because of his own involvement, or may be tempted to minimize his own conduct at the expense of his client. Moreover, his role as advocate may give his client an unfair advantage, because the attorney can subtly impart to the jury his first-hand knowledge of the events without having to swear an oath or be subject to cross examination.

The district court disqualified Cutler partially on the ground that his representation of Gotti would place him in the role of such an unsworn witness. The clearest support for this finding was Cutler's presence during the Ravenite Apartment discussions taped by the government. The government was legitimately concerned that, when Cutler argued before the jury for a particular interpretation of the tapes, his interpretation would be given added credibility due to his presence in the room when the statements were made. This would have given Gotti an unfair advantage, since Cutler would not have had to take an oath in presenting his interpretation, but could merely frame it in the form of legal argument.

Gotti argues, however, that the district court erred in disqualifying Cutler where the government had no intention of calling Cutler. He also maintains that Cutler's presence and participation on the government's tapes could have been redacted to eliminate references to and statements by Cutler, thereby eliminating the unsworn witness

problem. The first contention is meritless, since the district court explicitly and correctly noted that “whether the government will or will not call . . . Cutler . . . has no significance for this motion.” The second contention is equally unavailing, since the district court explicitly found that redaction of the tapes would have eviscerated the government’s case. We are not in a position to second-guess the district court’s clearly supported factual findings on review. Moreover, we agree with the district court that the government’s case should not be unfairly impaired so that an accused can continue with conflicted counsel.

The unsworn witness problem arises not only in relation to the Ravenite tapes, but to other grounds cited by the district court in support of disqualification. For example, the court found that Gotti’s references to Cutler’s acceptance of fees “under the table” were relevant to the government’s case on the tax fraud count. Had Cutler argued Gotti’s defense to that count, he would not only have had a conflict of interest but he would have been arguing as to events in which he was allegedly involved.

We are aware that disqualification is a drastic remedy to the unsworn witness problem. We are also, however, cognizant that this is an unusual case, in that Cutler had allegedly entangled himself to an extraordinary degree in the activities of the Gambino Crime Family: he is recorded on government tapes when discussions of allegedly illegal activity took place; he is allegedly involved in the tax fraud count against Gotti; his role as house counsel could be used to prove the criminal enterprise; and his representation of government witnesses caused a conflict with his representation of Gotti. Although we are cognizant of the right of the accused to secure representation, we are also conscious of the institutional interest in protecting the integrity of the judicial process. If an attorney will not perform his ethical duty, it is up to the courts to perform it for him. Bruce Cutler had no place representing John Gotti in this case, and the district court properly determined that he should be disqualified. . . .

Although disqualification is a drastic measure, the district court is in the best position to evaluate what is needed to ensure a fair trial. Here, the district court made careful findings of fact on each disqualification, and supported its decisions with well-reasoned opinions. We conclude that the district court properly exercised its discretion

Conflicts of interest may also arise when corporate counsel offers to represent an employee simultaneously with the corporation. As you read the following ethics opinion out of New York, consider how these issues may be further complicated by anti-solicitation rules.

NEW YORK COUNTY LAWYERS ASSOCIATION

PROFESSIONAL ETHICS COMMITTEE

FORMAL OPINION 747

June 9, 2014

TOPIC: Whether corporate counsel's offer to represent corporate employee or former employee constitutes improper solicitation within the meaning of Rule of Professional Conduct (RPC) 7.3.

DIGEST: A lawyer representing a corporation in a lawsuit has arranged to interview unrepresented corporate employees and former employees, who are potential parties or witnesses, for purposes of learning relevant information. The corporation has requested the lawyer to offer to represent the individuals in connection with the lawsuit if the lawyer would not have a conflict of interest and the individuals would benefit from representation. If the lawyer reasonably concludes based on an interview that the multiple representation is permissible under the conflict of interest rules, the lawyer may personally offer to represent the employee or former employee without violating the rule against solicitation (RPC 7.3).

RULES OF PROFESSIONAL CONDUCT: 1.6, 1.7, 1.13, 7.3

OPINION: Corporations and other entities frequently provide legal representation to current or former officers or employees who are potential testifying witnesses or parties in legal proceedings. In some situations, the corporation is contractually or statutorily obligated to provide legal representation, or has an internal policy so providing. In other situations, the decision to provide counsel to corporate constituents is made on an ad hoc basis in connection with the particular lawsuit. The corporation may compensate separate counsel for representing the corporate constituent or, where consistent with conflict of interest rules, for jointly representing multiple constituents. However, for financial and/or strategic reasons, the corporation may prefer that its own lawyer concurrently represent one or more corporate constituents, insofar as it is permissible under the conflict of interest rules. The corporation may therefore authorize its lawyer to offer representation to an otherwise unrepresented employee or former employee who may benefit from representation in a lawsuit. One question this raises is whether, consistently with the rule against solicitation, the lawyer may personally offer to represent the employee or former employee. This opinion addresses the question in the context where the lawyer begins by interviewing the current or former employee as a non-client to learn potentially relevant information and, based on the information acquired, concludes that a joint representation of the corporation and employee is permissible.

By way of background, the ordinary practice is for the corporation's lawyer initially to meet with the employee or former employee in his or her capacity as a non-client who is a potential witness, not as a prospective client. The corporation may arrange the

meeting or the lawyer may do so independently. The purpose will be to learn relevant information from the individual in order to advance the representation of the corporate client in the lawsuit. The lawyer will provide any necessary warnings under Rules 1.13(a) and 4.3 to ensure that the individual understands the lawyer's role as counsel only for the corporation.⁶ One reason to make clear at this stage that the lawyer represents only the corporation is to avoid assuming a confidentiality obligation to the current or former employee under Rule 1.18. In communications with the witness, the lawyer should avoid assuming a confidentiality obligation to the employee that might later conflict with the lawyer's duties to the corporation.

After interviewing the employee, the lawyer should be in a position to determine whether the employee would benefit from legal representation. If not, establishing a lawyer-client representation solely to benefit the corporate client may be impermissible from the perspective of the individual, who may be misled regarding the need for a lawyer or who may be burdened by a representation that exclusively benefits the employer. If the representation is established in bad faith, it may also be impermissible from the perspective of the opposing party, who may be disabled by Rule 4.2 from communicating directly with the represented employee. Whether a lawyer may permissibly represent an employee or former employee exclusively for the corporation's benefit, where the individual has no need of legal services as a party or potential testifying witness in the lawsuit, is a question beyond the scope of this opinion. For purposes of this opinion, we assume the representation does serve the interests of the current or former employee as well as the corporate employer.

After the initial interview, the lawyer should also be in a position to determine whether a joint representation of the corporation and employee is permissible under Rules 1.7 and 1.13(d) with the respective clients' informed consent. *See* N.Y. City Bar Assoc. Comm. on Prof'l and Jud. Ethics, Formal Op. 2004-2 (2004) (discussing representation of a corporation and its constituents in a government investigation). Rule 1.7, the conflict of interest rule, is implicated when the lawyer's representation of two or more clients "will involve the lawyer in representing differing interests," which is often the case when the lawyer represents both a corporation and its individual employee in connection with a lawsuit. In that event, the representation is permissible only if "the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to

⁶ When an organization's interests may differ from those of the organization's individual constituent (e.g., officer or employee), Rule 1.13(a) requires the organization's lawyer to advise the individual that the lawyer represents the organization, not the individual. Rule 4.3 requires a client's lawyer communicating with an unrepresented person to avoid stating or implying that the lawyer is disinterested; to avoid giving legal advice other than to retain counsel; and, if the person misunderstands the lawyer's role in the matter, to "make reasonable efforts to correct the misunderstanding." In some circumstances, lawyers elaborate on the required warnings or provide additional legal information, such as an explanation that the organization will control the attorney-client privilege with regard to the constituent's statements to counsel. *See generally United States v. Int'l Bhd. of Teamsters*, 119 F.3d 210, 217 (2d Cir. 1997); Gary H. Collins & David Z. Seide, WARNING THE WITNESS: A GUIDE TO INTERNAL INVESTIGATIONS AND THE ATTORNEY-CLIENT PRIVILEGE (ABA 2010).

each affected client” and “each affected client gives informed consent, confirmed in writing.” Among other things, “informed consent” requires an understanding of the risks of, and alternatives to, the joint representation; whether and to what extent confidences will be shared between the joint clients; and what will occur if a client withdraws from the joint representation or a later conflict arises that precludes continuing the joint representation.

If the lawyer reasonably concludes that the current or former employee would benefit from legal assistance and that the conflict of interest rules allow joint representation, the lawyer may seek to convey the corporation’s willingness to compensate the lawyer to represent the employee. This raises a question concerning the application of Rule 7.3(a), which forbids “solicitation . . . [b]y in-person or telephone contact” with an individual who is not “a close friend, relative, former client or existing client.” Rule 7.3(b) defines “solicitation” for purposes of this Rule to mean

any advertisement initiated by or on behalf of a lawyer or law firm that is directed to, or targeted at, a specific recipient or group of recipients, or their family members or legal representatives, the primary purpose of which is the retention of the lawyer or law firm, and a significant motive for which is pecuniary gain. It does not include a proposal or other writing prepared and delivered in response to a specific request of a prospective client.

Rule 1.0(a), in turn, defines “advertisement” to mean “any public or private communication made by or on behalf of a lawyer or law firm about that lawyer or law firm’s services, the primary purpose of which is for the retention of the lawyer or law firm. It does not include communications to existing clients or other lawyers.”

Under Rule 7.3(b), the question of whether the lawyer properly may offer in-person (rather than in writing) to represent the corporation’s employee following the conclusion of the interview depends on whether the “primary purpose” of the lawyer’s “private communication” with the employee “is the retention of the lawyer or law firm, and a significant motive for [the communication] is pecuniary gain.” We conclude that conveying the corporation’s offer, and following up if the employee expresses interest, would not constitute a “solicitation” for several reasons.

First, the primary purpose of the in-person meeting at its inception is not to offer the lawyer’s services to the employee, but to interview the employee as a potential witness. Indeed, in many cases, that may turn out to be the exclusive purpose of the meeting, if the lawyer concludes that the employee does not require legal representation or that the lawyer cannot provide it. Second, when the lawyer initially offers to represent the employee, the lawyer is acting on behalf of the corporation, as its lawyer and agent, primarily for purposes of conveying the corporation’s offer to secure legal representation for an employee in need of legal assistance. The corporation could, of course, have one of its non-lawyer officers or its in-house counsel extend the offer on behalf of the corporation. But, as the corporation’s lawyer and agent, the lawyer may be in a better

position to do so, because the lawyer may be better qualified to answer questions and provide information about the implications of the representation. Moreover, in conveying the corporation's offer and, if the employee is interested, following up by offering representation, the lawyer's "primary purpose" is not to secure legal fees from a new client but to render competent representation to a current corporate client by enabling it to fulfill its objective (and, in some cases, its statutory or contractual obligation or internal policy) of making legal assistance available to an employee who may need counsel. *See, e.g., Wells Fargo Bank, N.A. v. LaSalle Bank Nat. Ass'n* (finding that offering to represent corporate client's former employees at corporation's expense was not improper solicitation: "[D]efense counsel was attempting to represent its client, the corporation, and also to protect the interests of the former employees whose conduct forms the basis for Plaintiff's claims in this case. In addition, Defense counsel would have spent a great deal of time with these individuals, regardless of whether they were clients, in order to fully and competently represent Defendant."). . . .

CONCLUSION: When a corporation's lawyer conveys in person or by telephone an offer to represent a corporate employee in connection with a lawsuit, the application of the solicitation rule, Rule 7.3(a), depends on the factual context and the lawyer's motivation. Under *Rivera*, the communication would be improper if the lawyer's motivation was exclusively "to gain a tactical advantage in th[e] litigation by insulating [witnesses] from any informal contact with plaintiff's counsel." However, we conclude that an offer of representation at the corporation's request would be proper where the lawyer initially interviews the employee as a non-client witness in order to learn relevant information and subsequently determines that the individual is in need of legal services as a party or potential testifying witness and that the concurrent representation would be permissible.

Note that Model Rule 4.2, the ethics rule against lawyers contacting represented persons directly without going through counsel, presents potential complications for prosecutors in the investigation of corporate crime. When corporations (as they commonly do) arrange counsel for their employees early in an investigation, prosecutors will be prohibited (including by acting through their agents) from engaging in the surreptitious and surprise contacts that are common and often effective in the investigation of street crime. *See United States v. Hammad*, 858 F.2d 834 (2d Cir. 1988); *see also Massiah v. United States*, 377 U.S. 201 (1964) (finding a Sixth Amendment dimension to government contacts with charged defendants represented by counsel).

Even if individual corporate employees do not yet have their own counsel, Rule 4.2 may restrict prosecutors and their agents. Some courts have held that if a corporation is represented by counsel (as nearly all are), contact with employees, at least at the management level, may constitute contact with a "represented person," on the theory that a corporation is a "person" that can be communicated with only through its human agents. *See, e.g., Polycast Technology Corp. v. Uniroyal, Inc.*, 129 F.R.D. 621 (S.D.N.Y. 1990); *Meachum v. Outdoor World Corp.*, 654 N.Y.S.2d 240 (Sup. Ct. 1996);

see also U.S. DEP'T OF JUSTICE, JUSTICE MANUAL, Crim. Resource Manual § 296 (summarizing the uneven state of the law on contacts with represented corporations and advising federal prosecutors to study local law before acting).

C. Funding of Counsel

On the matter of who bears the costs of lawyers in corporate crime investigations and prosecutions, policy considerations intersect with constitutional law.⁷ As always, follow the money. One cannot think about the Sixth Amendment issues here without thinking about the economics. Recall that the Delaware General Corporation Law includes several provisions regarding mandatory and permissive indemnification, as well as permissive fee advancement. The Constitution does not impose any such regulations on corporations, of course, but it is an open question the extent to which the Constitution may limit government action that affects access to corporate funding of counsel.

CAPLIN & DRYSDALE, CTD. v. UNITED STATES, 491 U.S. 617 (1989)

Justice WHITE delivered the opinion of the Court.

We are called on to determine whether the federal drug forfeiture statute includes an exemption for assets that a defendant wishes to use to pay an attorney who conducted his defense in the criminal case where forfeiture was sought. Because we determine that no such exemption exists, we must decide whether that statute, so interpreted, is consistent with the Fifth and Sixth Amendments. We hold that it is.

In January 1985, Christopher Reckmeyer was charged in a multicount indictment with running a massive drug importation and distribution scheme. The scheme was alleged to be a continuing criminal enterprise (CCE), in violation of 84 Stat. 1265, as amended, 21 U.S.C. § 848 (1982 ed., Supp. V). Relying on a portion of the CCE statute that authorizes forfeiture to the Government of “property constituting, or derived from . . . proceeds . . . obtained” from drug-law violations, § 853(a), the indictment sought forfeiture of specified assets in Reckmeyer’s possession. At this time, the District Court, acting pursuant to § 853(e)(1)(A), entered a restraining order forbidding Reckmeyer to transfer any of the listed assets that were potentially forfeitable.

Sometime earlier, Reckmeyer had retained petitioner, a law firm, to represent him in the ongoing grand jury investigation which resulted in the January 1985 indictments. Notwithstanding the restraining order, Reckmeyer paid the firm \$25,000 for preindictment legal services a few days after the indictment was handed down; this sum was placed by petitioner in an escrow account. Petitioner continued to represent Reckmeyer following the indictment.

⁷ For a discussion of legal funding arrangements in a number of high-profile white collar cases as well as complications that may arise as a result of these arrangements, see Andrew Ross Sorkin, *Wall St. Debates Who Pays Legal Bills*, N.Y. TIMES (Aug. 12, 2013, 8:50 PM), <https://dealbook.nytimes.com/2013/08/12/wall-st-debates-who-should-pay-legal-bills>.

On March 7, 1985, Reckmeyer moved to modify the District Court's earlier restraining order to permit him to use some of the restrained assets to pay petitioner's fees; Reckmeyer also sought to exempt from any postconviction forfeiture order the assets that he intended to use to pay petitioner. However, one week later, before the District Court could conduct a hearing on this motion, Reckmeyer entered a plea agreement with the Government. Under the agreement, Reckmeyer pleaded guilty to the drug-related CCE charge, and agreed to forfeit all of the specified assets listed in the indictment. The day after the Reckmeyer's plea was entered, the District Court denied his earlier motion to modify the restraining order, concluding that the plea and forfeiture agreement rendered irrelevant any further consideration of the propriety of the court's pretrial restraints. Subsequently, an order forfeiting virtually all of the assets in Reckmeyer's possession was entered by the District Court in conjunction with his sentencing.

After this order was entered, petitioner filed a petition under § 853(n), which permits third parties with an interest in forfeited property to ask the sentencing court for an adjudication of their rights to that property; specifically, § 853(n)(6)(B) gives a third party who entered into a bona fide transaction with a defendant a right to make claims against forfeited property, if that third party was "at the time of [the transaction] reasonably without cause to believe that the [defendant's assets were] subject to forfeiture." *See also* § 853(c). Petitioner claimed an interest in \$170,000 of Reckmeyer's assets, for services it had provided Reckmeyer in conducting his defense; petitioner also sought the \$25,000 being held in the escrow account, as payment for preindictment legal services. Petitioner argued alternatively that assets used to pay an attorney were exempt from forfeiture under § 853, and if not, the failure of the statute to provide such an exemption rendered it unconstitutional. The District Court granted petitioner's claim for a share of the forfeited assets. . . .

Petitioner contends that the statute infringes on criminal defendants' Sixth Amendment right to counsel of choice, and upsets the "balance of power" between the Government and the accused in a manner contrary to the Due Process Clause of the Fifth Amendment. We consider these contentions in turn.

Petitioner's first claim is that the forfeiture law makes impossible, or at least impermissibly burdens, a defendant's right "to select and be represented by one's preferred attorney." *Wheat v. United States*. Petitioner does not, nor could it defensibly do so, assert that impecunious defendants have a Sixth Amendment right to choose their counsel. The Amendment guarantees defendants in criminal cases the right to adequate representation, but those who do not have the means to hire their own lawyers have no cognizable complaint so long as they are adequately represented by attorneys appointed by the courts. "[A] defendant may not insist on representation by an attorney he cannot afford." *Wheat*. Petitioner does not dispute these propositions. Nor does the Government deny that the Sixth Amendment guarantees a defendant the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire, or who is willing to represent the defendant even though he is without funds. Applying these principles to the statute in question here, we observe that nothing in § 853 prevents a defendant from

hiring the attorney of his choice, or disqualifies any attorney from serving as a defendant's counsel. Thus, unlike *Wheat*, this case does not involve a situation where the Government has asked a court to prevent a defendant's chosen counsel from representing the accused. Instead, petitioner urges that a violation of the Sixth Amendment arises here because of the forfeiture, at the instance of the Government, of assets that defendants intend to use to pay their attorneys.

Even in this sense, of course, the burden the forfeiture law imposes on a criminal defendant is limited. The forfeiture statute does not prevent a defendant who has nonforfeitable assets from retaining any attorney of his choosing. Nor is it necessarily the case that a defendant who possesses nothing but assets the Government seeks to have forfeited will be prevented from retaining counsel of choice. Defendants like Reckmeyer may be able to find lawyers willing to represent them, hoping that their fees will be paid in the event of acquittal, or via some other means that a defendant might come by in the future. The burden placed on defendants by the forfeiture law is therefore a limited one.

Nonetheless, there will be cases where a defendant will be unable to retain the attorney of his choice, when that defendant would have been able to hire that lawyer if he had access to forfeitable assets, and if there was no risk that fees paid by the defendant to his counsel would later be recouped under § 853(c). It is in these cases, petitioner argues, that the Sixth Amendment puts limits on the forfeiture statute.

This submission is untenable. Whatever the full extent of the Sixth Amendment's protection of one's right to retain counsel of his choosing, that protection does not go beyond "the individual's right to spend his own money to obtain the advice and assistance of . . . counsel." *Walters v. National Assn. of Radiation Survivors*. A defendant has no Sixth Amendment right to spend another person's money for services rendered by an attorney, even if those funds are the only way that that defendant will be able to retain the attorney of his choice. A robbery suspect, for example, has no Sixth Amendment right to use funds he has stolen from a bank to retain an attorney to defend him if he is apprehended. The money, though in his possession, is not rightfully his; the Government does not violate the Sixth Amendment if it seizes the robbery proceeds and refuses to permit the defendant to use them to pay for his defense. "[N]o lawyer, in any case, . . . has the right to . . . accept stolen property, or . . . ransom money, in payment of a fee. . . . The privilege to practice law is not a license to steal." *Laska v. United States*. Petitioner appears to concede as much, as respondent in *Monsanto* clearly does.

Petitioner seeks to distinguish such cases for Sixth Amendment purposes by arguing that the bank's claim to robbery proceeds rests on "pre-existing property rights," while the Government's claim to forfeitable assets rests on a "penal statute" which embodies the "fictive property-law concept of . . . relation-back" and is merely "a mechanism for preventing fraudulent conveyances of the defendant's assets, not . . . a device for determining true title to property." In light of this, petitioner contends, the burden placed on defendant's Sixth Amendment rights by the forfeiture statute outweighs the Government's interest in forfeiture.

The premises of petitioner's constitutional analysis are unsound in several respects. First, the property rights given the Government by virtue of the forfeiture statute are more substantial than petitioner acknowledges. In § 853(c), the so-called "relation-back" provision, Congress dictated that "[a]ll right, title and interest in property" obtained by criminals via the illicit means described in the statute "vests in the United States upon the commission of the act giving rise to forfeiture." As Congress observed when the provision was adopted, this approach, known as the "taint theory," is one that "has long been recognized in forfeiture cases," including the decision in *United States v. Stowell*. See S. Rep. No. 98-225 (1983). In *Stowell*, the Court explained the operation of a similar forfeiture provision (for violations of the Internal Revenue Code) as follows:

"As soon as [the possessor of the forfeitable asset committed the violation] of the internal revenue laws, the forfeiture under those laws took effect, and (though needing judicial condemnation to perfect it) operated from that time as a statutory conveyance to the United States of all the right, title and interest then remaining in the [possessor]; and was as valid and effectual, against all the world, as a recorded deed. The right so vested in the United States could not be defeated or impaired by any subsequent dealings of the . . . [possessor]." *Stowell*.

In sum, § 853(c) reflects the application of the long-recognized and lawful practice of vesting title to any forfeitable assets, in the United States, at the time of the criminal act giving rise to forfeiture. Concluding that Reckmeyer cannot give good title to such property to petitioner because he did not hold good title is neither extraordinary or novel. Nor does petitioner claim, as a general proposition that the relation-back provision is unconstitutional, or that Congress cannot, as a general matter, vest title to assets derived from the crime in the Government, as of the date of the criminal act in question. Petitioner's claim is that whatever part of the assets that is necessary to pay attorney's fees cannot be subjected to forfeiture. But given the Government's title to Reckmeyer's assets upon conviction, to hold that the Sixth Amendment creates some right in Reckmeyer to alienate such assets, or creates a right on petitioner's part to receive these assets, would be peculiar.

There is no constitutional principle that gives one person the right to give another's property to a third party, even where the person seeking to complete the exchange wishes to do so in order to exercise a constitutionally protected right. While petitioner and its supporting *amici* attempt to distinguish between the expenditure of forfeitable assets to exercise one's Sixth Amendment rights, and expenditures in the pursuit of other constitutionally protected freedoms, there is no such distinction between, or hierarchy among, constitutional rights. If defendants have a right to spend forfeitable assets on attorney's fees, why not on exercises of the right to speak, practice one's religion, or travel? The full exercise of these rights, too, depends in part on one's financial wherewithal; and forfeiture, or even the threat of forfeiture, may similarly prevent a defendant from enjoying these rights as fully as he might otherwise. Nonetheless, we are

not about to recognize an ant forfeiture exception for the exercise of each such right; nor does one exist for the exercise of Sixth Amendment rights.

Petitioner's "balancing analysis" to the contrary rests substantially on the view that the Government has only a modest interest in forfeitable assets that may be used to retain an attorney. Petitioner takes the position that, in large part, once assets have been paid over from client to attorney, the principal ends of forfeiture have been achieved: dispossessing a drug dealer or racketeer of the proceeds of his wrongdoing. We think that this view misses the mark for three reasons.

First, the Government has a pecuniary interest in forfeiture that goes beyond merely separating a criminal from his ill-gotten gains; that legitimate interest extends to recovering *all* forfeitable assets, for such assets are deposited in a Fund that supports law-enforcement efforts in a variety of important and useful ways. *See* 28 U.S.C. § 524(c), which establishes the Department of Justice Assets Forfeiture Fund. The sums of money that can be raised for law-enforcement activities this way are substantial, and the Government's interest in using the profits of crime to fund these activities should not be discounted.

Second, the statute permits "rightful owners" of forfeited assets to make claims for forfeited assets before they are retained by the Government. *See* 21 U.S.C. § 853(n)(6)(A). The Government's interest in winning undiminished forfeiture thus includes the objective of returning property, in full, to those wrongfully deprived or defrauded of it. Where the Government pursues this restitutionary end, the Government's interest in forfeiture is virtually indistinguishable from its interest in returning to a bank the proceeds of a bank robbery; and a forfeiture-defendant's claim of right to use such assets to hire an attorney, instead of having them returned to their rightful owners, is no more persuasive than a bank robber's similar claim.

Finally, as we have recognized previously, a major purpose motivating congressional adoption and continued refinement of the racketeer influenced and corrupt organizations (RICO) and CCE forfeiture provisions has been the desire to lessen the economic power of organized crime and drug enterprises. *See Russell v. United States*. This includes the use of such economic power to retain private counsel. As the Court of Appeals put it: "Congress has already underscored the compelling public interest in stripping criminals such as Reckmeyer of their undeserved economic power, and part of that undeserved power may be the ability to command high-priced legal talent." The notion that the Government has a legitimate interest in depriving criminals of economic power, even insofar as that power is used to retain counsel of choice, may be somewhat unsettling. But when a defendant claims that he has suffered some substantial impairment of his Sixth Amendment rights by virtue of the seizure or forfeiture of assets in his possession, such a complaint is no more than the reflection of "the harsh reality that the quality of a criminal defendant's representation frequently may turn on his ability to retain the best counsel money can buy." *Morris v. Slappy*. Again, the Court of Appeals put it aptly: "The modern day Jean Valjean must be satisfied with appointed counsel. Yet the drug

merchant claims that his possession of huge sums of money . . . entitles him to something more. We reject this contention, and any notion of a constitutional right to use the proceeds of crime to finance an expensive defense.” . . .

The Court in *Caplin & Drysdale* held that the Sixth Amendment right to counsel does not include the right to spend someone else’s money on a criminal defense. The next case states that this is true even when the procedural structure of forfeiture law seems to prevent access to what might ultimately be determined to be one’s own money.

KALEY v. UNITED STATES, 571 U.S. 320 (2014)

Justice KAGAN delivered the opinion of the Court.

A federal statute, 21 U.S.C. § 853(e), authorizes a court to freeze an indicted defendant’s assets prior to trial if they would be subject to forfeiture upon conviction. In *United States v. Monsanto*, we approved the constitutionality of such an order so long as it is “based on a finding of probable cause to believe that the property will ultimately be proved forfeitable.” And we held that standard to apply even when a defendant seeks to use the disputed property to pay for a lawyer.

In this case, two indicted defendants wishing to hire an attorney challenged a pre-trial restraint on their property. The trial court convened a hearing to consider the seizure’s legality under *Monsanto*. The question presented is whether criminal defendants are constitutionally entitled at such a hearing to contest a grand jury’s prior determination of probable cause to believe they committed the crimes charged. We hold that they have no right to relitigate that finding.

Criminal forfeitures are imposed upon conviction to confiscate assets used in or gained from certain serious crimes. *See* 21 U.S.C. § 853(a). Forfeitures help to ensure that crime does not pay: They at once punish wrongdoing, deter future illegality, and “lessen the economic power” of criminal enterprises. *Caplin & Drysdale, Chartered v. United States*; *see id.* (“Forfeiture provisions are powerful weapons in the war on crime”). The Government also uses forfeited property to recompense victims of crime, improve conditions in crime-damaged communities, and support law enforcement activities like police training. Accordingly, “there is a strong governmental interest in obtaining full recovery of all forfeitable assets.”

In line with that interest, § 853(e)(1) empowers courts to enter pre-trial restraining orders or injunctions to “preserve the availability of [forfeitable] property” while criminal proceedings are pending. Such an order, issued “[u]pon application of the United States,” prevents a defendant from spending or transferring specified property, including to pay an attorney for legal services. In *Monsanto*, our principal case involving this procedure, we held a pre-trial asset restraint constitutionally permissible whenever there is probable cause to believe that the property is forfeitable. That determination has two parts, reflecting the requirements for forfeiture under federal law: There must be probable

cause to think (1) that the defendant has committed an offense permitting forfeiture, and (2) that the property at issue has the requisite connection to that crime. *See* § 853(a). The Monsanto Court, however, declined to consider “whether the Due Process Clause requires a hearing” to establish either or both of those aspects of forfeitability. . . .

The grand jury’s indictment in this case charges a scheme to steal prescription medical devices and resell them for profit. The indictment accused petitioner Kerri Kaley, a sales representative for a subsidiary of Johnson & Johnson, and petitioner Brian Kaley, her husband, with transporting stolen medical devices across state lines and laundering the proceeds of that activity. The Kaleys have contested those allegations throughout this litigation, arguing that the medical devices at issue were unwanted, excess hospital inventory, which they could lawfully take and market to others.

Immediately after obtaining the indictment, the Government sought a restraining order under § 853(e)(1) to prevent the Kaleys from transferring any assets traceable to or involved in the alleged offenses. Included among those assets is a \$500,000 certificate of deposit that the Kaleys intended to use for legal fees. The District Court entered the requested order. Later, in response to the Kaleys’ motion to vacate the asset restraint, the court denied a request for an evidentiary hearing and confirmed the order, except as to \$63,000 that it found (based on the parties’ written submissions) was not connected to the alleged offenses. . . .

This Court has twice considered claims, similar to the Kaleys’, that the Fifth Amendment’s right to due process and the Sixth Amendment’s right to counsel constrain the way the federal forfeiture statute applies to assets needed to retain an attorney. *See Caplin & Drysdale; Monsanto*. We begin with those rulings not as mere background, but as something much more. On the single day the Court decided both those cases, it cast the die on this one too.

In *Caplin & Drysdale*, we considered whether the Fifth and Sixth Amendments exempt from forfeiture money that a convicted defendant has agreed to pay his attorney. We conceded a factual premise of the constitutional claim made in the case: Sometimes “a defendant will be unable to retain the attorney of his choice,” if he cannot use forfeitable assets. Still, we held, the defendant’s claim was “untenable.” “A defendant has no Sixth Amendment right to spend another person’s money” for legal fees—even if that is the only way to hire a preferred lawyer. Consider, we submitted, the example of a “robbery suspect” who wishes to “use funds he has stolen from a bank to retain an attorney to defend him if he is apprehended.” That money is “not rightfully his.” *Ibid*. Accordingly, we concluded, the Government does not violate the Constitution if, pursuant to the forfeiture statute, “it seizes the robbery proceeds and refuses to permit the defendant to use them” to pay for his lawyer.

And then, we confirmed in *Monsanto* what our “robbery suspect” hypothetical indicated: Even prior to conviction (or trial)—when the presumption of innocence still applies—the Government could constitutionally use § 853(e) to freeze assets of an indicted defendant “based on a finding of probable cause to believe that the property will

ultimately be proved forfeitable.” In *Monsanto*, too, the defendant wanted to use the property at issue to pay a lawyer, and maintained that the Fifth and Sixth Amendments entitled him to do so. We disagreed. We first noted that the Government may sometimes “restrain persons where there is a finding of probable cause to believe that the accused has committed a serious offense.” Given that power, we could find “no constitutional infirmity in § 853(e)’s authorization of a similar restraint on [the defendant’s] property” in order to protect “the community’s interest” in recovering “ill-gotten gains.” Nor did the defendant’s interest in retaining a lawyer with the disputed assets change the equation. Relying on *Caplin & Drysdale*, we reasoned: “[I]f the Government may, post-trial, forbid the use of forfeited assets to pay an attorney, then surely no constitutional violation occurs when, after probable cause is adequately established, the Government obtains an order barring a defendant from frustrating that end by dissipating his assets prior to trial.” So again: With probable cause, a freeze is valid.

The Kaleys little dispute that proposition; their argument is instead about who should have the last word as to probable cause. A grand jury has already found probable cause to think that the Kaleys committed the offenses charged; that is why an indictment issued. No one doubts that those crimes are serious enough to trigger forfeiture. Similarly, no one contests that the assets in question derive from, or were used in committing, the offenses. The only question is whether the Kaleys are constitutionally entitled to a judicial re-determination of the conclusion the grand jury already reached: that probable cause supports this criminal prosecution (or alternatively put, that the prosecution is not “baseless,” as the Kaleys believe). And that question, we think, has a ready answer, because a fundamental and historic commitment of our criminal justice system is to entrust those probable cause findings to grand juries.

This Court has often recognized the grand jury’s singular role in finding the probable cause necessary to initiate a prosecution for a serious crime. . . . The grand jury gets to say—without any review, oversight, or second-guessing—whether probable cause exists to think that a person committed a crime.

And that inviolable grand jury finding, we have decided, may do more than commence a criminal proceeding (with all the economic, reputational, and personal harm that entails); the determination may also serve the purpose of immediately depriving the accused of her freedom. If the person charged is not yet in custody, an indictment triggers “issuance of an arrest warrant without further inquiry” into the case’s strength. *Gerstein*; see *Kalina v. Fletcher*. Alternatively, if the person was arrested without a warrant, an indictment eliminates her Fourth Amendment right to a prompt judicial assessment of probable cause to support any detention. See *Gerstein*. In either situation, this Court—relying on the grand jury’s “historical role of protecting individuals from unjust persecution”—has “let [that body’s] judgment substitute for that of a neutral and detached magistrate.” The grand jury, all on its own, may effect a pre-trial restraint on a person’s liberty by finding probable cause to support a criminal charge.

The same result follows when, as here, an infringement on the defendant's property depends on a showing of probable cause that she committed a crime. If judicial review of the grand jury's probable cause determination is not warranted (as we have so often held) to put a defendant on trial or place her in custody, then neither is it needed to freeze her property. The grand jury that is good enough—reliable enough, protective enough—to inflict those other grave consequences through its probable cause findings must needs be adequate to impose this one too. Indeed, Monsanto already noted the absence of any reason to hold property seizures to different rules: As described earlier, the Court partly based its adoption of the probable cause standard on the incongruity of subjecting an asset freeze to any stricter requirements than apply to an arrest or ensuing detention. *See supra* (“[I]t would be odd to conclude that the Government may not restrain property” on the showing often sufficient to “restrain persons “). By similar token, the probable cause standard, once selected, should work no differently for the single purpose of freezing assets than for all others. So the longstanding, unvarying rule of criminal procedure we have just described applies here as well: The grand jury's determination is conclusive.

And indeed, the alternative rule the Kaleys seek would have strange and destructive consequences. The Kaleys here demand a do-over, except with a different referee. They wish a judge to decide anew the exact question the grand jury has already answered—whether there is probable cause to think the Kaleys committed the crimes charged. But suppose the judge performed that task and came to the opposite conclusion. Two inconsistent findings would then govern different aspects of one criminal proceeding: Probable cause would exist to bring the Kaleys to trial (and, if otherwise appropriate, hold them in prison), but not to restrain their property. And assuming the prosecutor continued to press the charges, the same judge who found probable cause lacking would preside over a trial premised on its presence. That legal dissonance, if sustainable at all, could not but undermine the criminal justice system's integrity—and especially the grand jury's integral, constitutionally prescribed role. For in this new world, every prosecution involving a pre-trial asset freeze would potentially pit the judge against the grand jury as to the case's foundational issue. . . .

Note that, in *Luis v. United States*, 136 S. Ct. 1083 (2016), the Court held that the Sixth Amendment *does* bar the government from using an asset freeze to prevent a defendant from accessing funds for the purpose of paying counsel if those funds are frozen only as “substitute assets” under forfeiture law—that is, monies that are not tainted by criminal proceeds but which the government seeks to forfeit as a substitute for “dirty” money that, for whatever reason, the government can no longer find or obtain.

Problem 15-1

What is the difference, for purposes of law and legal theory, between “house counsel” for the mob and counsel for the corporation when each deals with witnesses in an investigation? Why is the former treated as a situation rife with conflict, while the latter viewed as routine and necessary?

The next case involves KPMG again, this time on review before the Second Circuit after the trial judge harshly criticized the government (see the district court decision in *KPMG* in Chapter 12). It seems here that perhaps there *is* a Sixth Amendment right to spend someone else’s money on your defense in certain circumstances. Does the court’s constitutional analysis hold up? What are the limits of this case?

UNITED STATES v. STEIN, 541 F.3d 130 (2d Cir. 2008)

DENNIS JACOBS, Chief Judge:

The United States appeals from an order of the United States District Court for the Southern District of New York (Kaplan, J.), dismissing an indictment against thirteen former partners and employees of the accounting firm KPMG, LLP. Judge Kaplan found that, absent pressure from the government, KPMG would have paid defendants’ legal fees and expenses without regard to cost. Based on this and other findings of fact, Judge Kaplan ruled that the government deprived defendants of their right to counsel under the Sixth Amendment by causing KPMG to impose conditions on the advancement of legal fees to defendants, to cap the fees, and ultimately to end payment. Judge Kaplan also ruled that the government deprived defendants of their right to substantive due process under the Fifth Amendment.

We hold that KPMG’s adoption and enforcement of a policy under which it conditioned, capped and ultimately ceased advancing legal fees to defendants followed as a direct consequence of the government’s overwhelming influence, and that KPMG’s conduct therefore amounted to state action. We further hold that the government thus unjustifiably interfered with defendants’ relationship with counsel and their ability to mount a defense, in violation of the Sixth Amendment, and that the government did not cure the violation. Because no other remedy will return defendants to the status quo ante, we affirm the dismissal of the indictment as to all thirteen defendants. In light of this disposition, we do not reach the district court’s Fifth Amendment ruling.

In January 2003, then-United States Deputy Attorney General Larry D. Thompson promulgated a policy statement, Principles of Federal Prosecution of Business Organizations (the “Thompson Memorandum”), which articulated “principles” to govern the Department’s discretion in bringing prosecutions against business organizations. The Thompson Memorandum was closely based on a predecessor document issued in 1999 by then-U.S. Deputy Attorney General Eric Holder, Federal Prosecution of Corporations. Along with the familiar factors governing charging decisions, the Thompson Memorandum identifies nine additional considerations, including the company’s “timely and voluntary disclosure of wrongdoing and its

willingness to cooperate in the investigation of its agents.” Mem. from Larry D. Thompson, Deputy Att’y Gen., U.S. Dep’t of Justice, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003). The Memorandum explains that prosecutors should inquire

whether the corporation appears to be protecting its culpable employees and agents [and that] a corporation’s promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining the employees without sanction for their misconduct, or through providing information to the employees about the government’s investigation pursuant to a joint defense agreement, may be considered by the prosecutor in weighing the extent and value of a corporation’s cooperation.

. . . In December 2006—after the events in this prosecution had transpired—the Department of Justice replaced the Thompson Memorandum with the McNulty Memorandum, under which prosecutors may consider a company’s fee advancement policy only where the circumstances indicate that it is “intended to impede a criminal investigation,” and even then only with the approval of the Deputy Attorney General. Mem. from Paul J. McNulty, Deputy Att’y Gen., U.S. Dep’t of Justice, Principles of Federal Prosecution of Business Organizations (Dec. 12, 2006).

After Senate subcommittee hearings in 2002 concerning KPMG’s possible involvement in creating and marketing fraudulent tax shelters, KPMG retained Robert S. Bennett of the law firm Skadden, Arps, Slate, Meagher & Flom LLP (“Skadden”) to formulate a “cooperative approach” for KPMG to use in dealing with federal authorities. Bennett’s strategy included “a decision to ‘clean house’—a determination to ask Jeffrey Stein, Richard Smith, and Jeffrey Eischeid, all senior KPMG partners who had testified before the Senate and all now [Defendants-Appellees] here—to leave their positions. . . . Stein resigned with arrangements for a three-year \$100,000-per-month consultancy, and an agreement that KPMG would pay for Stein’s representation in any actions brought against Stein arising from his activities at the firm. KPMG negotiated a contract with Smith that included a similar clause; but that agreement was never executed.

In February 2004, KPMG officials learned that the firm and 20 to 30 of its top partners and employees were subjects of a grand jury investigation of fraudulent tax shelters. On February 18, 2004, KPMG’s CEO announced to all partners that the firm was aware of the United States Attorney’s Office’s (“USAO”) investigation and that “[a]ny present or former members of the firm asked to appear will be represented by competent coun[sel] at the firm’s expense.”

In preparation for a meeting with Skadden on February 25, 2004, the prosecutors—including Assistant United States Attorneys (“AUSAs”) Shirah Neiman and Justin Weddle—decided to ask whether KPMG would advance legal fees to employees under investigation. Bennett started the meeting by announcing that KPMG had resolved to “clean house,” that KPMG “would cooperate fully with the government’s investigation,”

and that its goal was not to protect individual employees but rather to save the firm from being indicted. AUSA Weddle inquired about the firm's plans for advancing fees and about any legal obligation to do so. Later on, AUSA Neiman added that the government would "take into account" the firm's legal obligations to advance fees, but that "the Thompson Memorandum [w]as a point that had to be considered." Bennett then advised that although KPMG was still investigating its legal obligations to advance fees, its "common practice" was to do so. However, Bennett explained, KPMG would not pay legal fees for any partner who refused to cooperate or "took the Fifth," so long as KPMG had the legal authority to do so.

Later in the meeting, AUSA Weddle asked Bennett to ascertain KPMG's legal obligations to advance attorneys' fees. AUSA Neiman added that "misconduct" should not or cannot "be rewarded" under "federal guidelines." One Skadden attorney's notes attributed to AUSA Weddle the prediction that, if KPMG had discretion regarding fees, the government would "look at that under a microscope."

Skadden then reported back to KPMG. In notes of the meeting, a KPMG executive wrote the words "[p]aying legal fees" and "[s]everance" next to "not a sign of cooperation."

On March 2, 2004, Bennett told AUSA Weddle that although KPMG believed it had no legal obligation to advance fees, "it would be a big problem" for the firm not to do so given its partnership structure. But Bennett disclosed KPMG's tentative decision to limit the amount of fees and condition them on employees' cooperation with prosecutors.

Two days later, a Skadden lawyer advised counsel for Defendant-Appellee Carol G. Warley (a former KPMG tax partner) that KPMG would advance legal fees if Warley cooperated with the government and declined to invoke her Fifth Amendment privilege against self-incrimination.

On a March 11 conference call with Skadden, AUSA Weddle recommended that KPMG tell employees that they should be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing," explaining that this would give him good material for cross-examination. That same day, Skadden wrote to counsel for the KPMG employees who had been identified as subjects of the investigation. The letter set forth KPMG's new fees policy ("Fees Policy"), pursuant to which advancement of fees and expenses would be

[i] capped at \$400,000 per employee;

[ii] conditioned on the employee's cooperation with the government; and

[iii] terminated when an employee was indicted.

The government was copied on this correspondence.

On March 12, KPMG sent a memorandum to certain other employees who had not been identified as subjects, urging them to cooperate with the government, advising them that

it might be advantageous for them to exercise their right to counsel, and advising that KPMG would cover employees' "reasonable fees."

The prosecutors expressed by letter their "disappoint[ment] with [the] tone" of this memorandum and its "one-sided presentation of potential issues," and "demanded that KPMG send out a supplemental memorandum in a form they proposed." The government's alternative language, premised on the "assum[ption] that KPMG truly is committed to fully cooperating with the Government's investigation," [and] advised employees that they could "meet with investigators without the assistance of counsel." KPMG complied, and circulated a memo advising that employees "may deal directly with government representatives without counsel."

At a meeting in late March, Skadden asked the prosecutors to notify Skadden in the event any KPMG employee refused to cooperate. Over the following year, the prosecutors regularly informed Skadden whenever a KPMG employee refused to cooperate fully, such as by refusing to proffer or by proffering incompletely (in the government's view). Skadden, in turn, informed the employees' lawyers that fee advancement would cease unless the employees cooperated. The employees either knuckled under and submitted to interviews, or they were fired and KPMG ceased advancing their fees. For example, Watson and Smith attended proffer sessions after receiving KPMG's March 11 letter announcing the Fees Policy, and after Skadden reiterated to them that fees would be terminated absent cooperation. They did so because (they said, and the district court found) they feared that KPMG would stop advancing attorneys fees—although Watson concedes he attended a first session voluntarily. As Bennett later assured AUSA Weddle: "Whenever your Office has notified us that individuals have not . . . cooperat[ed], KPMG has promptly and without question encouraged them to cooperate and threatened to cease payment of their attorney fees and . . . to take personnel action, including termination."

In an early-March 2005 meeting, then-U.S. Attorney David Kelley told Skadden and top KPMG executives that a non-prosecution agreement was unlikely and that he had reservations about KPMG's level of cooperation: "I've seen a lot better from big companies." Bennett reminded Kelley how KPMG had capped and conditioned its advancement of legal fees. Kelley remained unconvinced.

KPMG moved up the Justice Department's chain of command. At a June 13, 2005 meeting with U.S. Deputy Attorney General James Comey, Bennett stressed KPMG's pressure on employees to cooperate by conditioning legal fees on cooperation; it was, he said, "precedent[]setting." KPMG's entreaties were ultimately successful: on August 29, 2005, the firm entered into a deferred prosecution agreement (the "DPA") under which KPMG admitted extensive wrongdoing, paid a \$456 million fine, and committed itself to cooperation in any future government investigation or prosecution.

On August 29, 2005—the same day KPMG executed the DPA—the government indicted six of the Defendants. . . . A superseding indictment filed on October 17, 2005 named ten additional employees. . . . Pursuant to the Fees Policy, KPMG promptly stopped advancing legal fees to the indicted employees who were still receiving them.

On January 12, 2006, the thirteen defendants (among others) moved to dismiss the indictment based on the government's interference with KPMG's advancement of fees. In a submission to the district court, KPMG represented that

the Thompson memorandum in conjunction with the government's statements relating to payment of legal fees affected KPMG's determination(s) with respect to the advancement of legal fees and other defense costs to present or former partners and employees. . . . In fact, KPMG is prepared to state that the Thompson memorandum substantially influenced KPMG's decisions with respect to legal fees. . .

At a hearing on March 30, 2006, Judge Kaplan asked the government whether it was "prepared at this point to commit that [it] has no objection whatsoever to KPMG exercising its free and independent business judgment as to whether to advance defense costs to these defendants and that if it were to elect to do so the government would not in any way consider that in determining whether it had complied with the DPA?" The AUSA responded: "That's always been the case, your Honor. That's fine. We have no objection to that. . . . They can always exercise their business judgment. As you described it, your Honor, that's always been the case. It's the case today, your Honor." . .

We review first the government's challenges to the district court's factual findings, including its finding that but for the Thompson Memorandum and the prosecutors' conduct KPMG would have paid employees' legal fees—pre-indictment and post-indictment—without regard to cost. Next, . . . we decide whether the promulgation and enforcement of KPMG's Fees Policy amounted to state action under the Constitution and whether the government deprived defendants of their Sixth Amendment right to counsel. . . .

The government points out that the Thompson Memorandum lists "fees advancement" as just one of many considerations in a complex charging decision, and thus argues that Judge Kaplan overread the Thompson Memorandum as a threat that KPMG would be indicted unless it ceased advancing legal fees to its employees.

. . . KPMG was faced with the fatal prospect of indictment; it could be expected to do all it could, assisted by sophisticated counsel, to placate and appease the government. As Judge Kaplan noted, KPMG's chief legal officer, Sven Erik Holmes, testified that he considered it crucial "to be able to say at the right time with the right audience, we're in full compliance with the Thompson Memorandum." Moreover, KPMG's management and counsel had reason to consider the impact of the firm's indictment on the interests of the firm's partners, employees, clients, creditors and retirees.

The government reads the Thompson Memorandum to say that fees advancement is to be considered as a negative factor only when it is part of a campaign to "circle the wagons," i.e., to protect culpable employees and obstruct investigators. . . . But even if

the government's reading is plausible, the wording nevertheless empowers prosecutors to determine which employees will be deprived of company-sponsored counsel: prosecutors may reasonably foresee that employees they identify as "culpable" will be cut off from fees. . . .

Nor can we disturb Judge Kaplan's finding that "the government conducted itself in a manner that evidenced a desire to minimize the involvement of defense attorneys." During the March 11 phone call between the prosecutors and Skadden, AUSA Weddle demanded that KPMG tell its employees to be "totally open" with the USAO, "even if that [meant admitting] criminal wrongdoing," so that he could gather material for cross-examination. On March 12, the prosecutors prevailed upon KPMG to supplement its first advisory letter with another, which clarified that employees could meet with the government without counsel. In addition, prosecutors repeatedly used Skadden to threaten to withhold legal fees from employees who refused to proffer—even if defense counsel had recommended that an employee invoke the Fifth Amendment privilege.

Finally, we cannot say that the district court's ultimate finding of fact—that absent the Thompson Memorandum and the prosecutors' conduct KPMG would have advanced fees without condition or cap—was clearly erroneous. The government itself stipulated in Stein I that KPMG had a "longstanding voluntary practice" of advancing and paying employees' legal fees "without regard to economic costs or considerations" and "without a preset cap or condition of cooperation with the government . . . in any civil, criminal or regulatory proceeding" arising from activities within the scope of employment. Although it "is far from certain" that KPMG is legally obligated to advance defendants' legal fees, a firm may have potent incentives to advance fees, such as the ability to recruit and retain skilled professionals in a profession fraught with legal risk. Also, there is evidence that, before the prosecutors' intervention, KPMG executed an agreement under which it would advance Stein's legal fees without cap or condition (and negotiated toward an identical agreement with Smith). . . . Indeed, KPMG itself represented to the court that the Thompson Memorandum and the prosecutors' conduct "substantially influenced [its] determination(s) with respect to the advancement of legal fees." . . .

Judge Kaplan found that "KPMG's decision to cut off all payments of legal fees and expenses to anyone who was indicted and to limit and to condition such payments prior to indictment upon cooperation with the government was the direct consequence of the pressure applied by the Thompson Memorandum and the USAO." The government protests that KPMG's adoption and enforcement of its Fees Policy was private action, outside the ambit of the Sixth Amendment. . . .

Actions of a private entity are attributable to the State if "there is a sufficiently close nexus between the State and the challenged action of the . . . entity so that the action of the latter may be fairly treated as that of the State itself." The "close nexus" test is not satisfied when the state "[m]ere[ly] approv[es] of or acquiesce[s] in the initiatives" of the private entity, or when an entity is merely subject to governmental regulation. "The purpose of the [close-nexus requirement] is to assure that constitutional standards are

invoked only when it can be said that the State is responsible for the specific conduct of which the plaintiff complains.” Such responsibility is normally found when the State “has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State.”

Although Supreme Court cases on this issue “have not been a model of consistency,” some principles emerge. “A nexus of state action exists between a private entity and the state when the state exercises coercive power, is entwined in the management or control of the private actor, or provides the private actor with significant encouragement, either overt or covert, or when the private actor operates as a willful participant in joint activity with the State or its agents, is controlled by an agency of the State, has been delegated a public function by the state, or is entwined with governmental policies.”

The government argues: KPMG simply took actions in the shadow of an internal DOJ advisory document (the Thompson Memorandum) containing multiple factors and caveats; the government’s approval of KPMG’s Fees Policy did not render the government responsible for KPMG’s actions enforcing it; even if the government had specifically required KPMG to adopt a policy that penalized non-cooperation, state action would still have been lacking because KPMG would have retained the power to apply the policy; and although the prosecutors repeatedly informed KPMG when employees were not cooperating, they did so at KPMG’s behest, without knowing how KPMG would react. We disagree.

KPMG’s adoption and enforcement of the Fees Policy amounted to “state action” because KPMG “operate[d] as a willful participant in joint activity” with the government, and because the USAO “significant[ly] encourage[d]” KPMG to withhold legal fees from defendants upon indictment. The government brought home to KPMG that its survival depended on its role in a joint project with the government to advance government prosecutions. The government is therefore legally “responsible for the specific conduct of which the [criminal defendants] complain[].”

. . . State action is established here as a matter of law because the government forced KPMG to adopt its constricted Fees Policy. The Thompson Memorandum itself—which prosecutors stated would be considered in deciding whether to indict KPMG—emphasizes that cooperation will be assessed in part based upon whether, in advancing counsel fees, “the corporation appears to be protecting its culpable employees and agents.” Since defense counsel’s objective in a criminal investigation will virtually always be to protect the client, KPMG’s risk was that fees for defense counsel would be advanced to someone the government considered culpable. So the only safe course was to allow the government to become (in effect) paymaster.

The prosecutors reinforced this message by inquiring into KPMG’s fees obligations, referring to the Thompson Memorandum as “a point that had to be considered,” and warning that “misconduct” should not or cannot “be rewarded” under “federal guidelines.” The government had KPMG’s full attention. It is hardly surprising, then, that KPMG decided to condition payment of fees on employees’ cooperation with the

government and to terminate fees upon indictment: only that policy would allow KPMG to continue advancing fees while minimizing the risk that prosecutors would view such advancement as obstructive.

To ensure that KPMG's new Fees Policy was enforced, prosecutors became "entwined in the . . . control" of KPMG. They intervened in KPMG's decisionmaking, expressing their "disappoint[ment] with [the] tone" of KPMG's first advisory memorandum, and declaring that "[t]hese problems must be remedied" by a proposed supplemental memorandum specifying that employees could meet with the government without being burdened by counsel. Prosecutors also "made plain" their "strong preference" as to what the firm should do, and their "desire to share the fruits of such intrusions." They did so by regularly "reporting to KPMG the identities of employees who refused to make statements in circumstances in which the USAO knew full well that KPMG would pressure them to talk to prosecutors." . . . The prosecutors thus steered KPMG toward their preferred fee advancement policy and then supervised its application in individual cases. Such "overt" and "significant encouragement" supports the conclusion that KPMG's conduct is properly attributed to the State. . . .

An adversarial relationship does not normally bespeak partnership. But KPMG faced ruin by indictment and reasonably believed it must do everything in its power to avoid it. The government's threat of indictment was easily sufficient to convert its adversary into its agent. KPMG was not in a position to consider coolly the risk of indictment, weigh the potential significance of the other enumerated factors in the Thompson Memorandum, and decide for itself how to proceed.

We therefore conclude that KPMG's adoption and enforcement of the Fees Policy (both before and upon defendants' indictment) amounted to state action. The government may properly be held "responsible for the specific conduct of which the [criminal defendants] complain[]," i.e., the deprivation of their Sixth Amendment right to counsel, if the violation is established.

The district court's ruling on the Sixth Amendment was based on the following analysis (set out here in *précis*). The Sixth Amendment protects "an individual's right to choose the lawyer or lawyers he or she desires," and "to use one's own funds to mount the defense that one wishes to present." The goal is to secure "a defendant's right to spend his own money on a defense." Because defendants reasonably expected to receive legal fees from KPMG, the fees "were, in every material sense, their property." The government's interest in retaining discretion to treat as obstruction a company's advancement of legal fees "is insufficient to justify the government's interference with the right of individual criminal defendants to obtain resources lawfully available to them in order to defend themselves." Defendants need not make a "particularized showing" of how their defense was impaired, because "[v]irtually everything the defendants do in this case may be influenced by the extent of the resources available to them," such as selection of counsel and "what the KPMG Defendants can pay their lawyers to do."

Therefore, the Sixth Amendment violation “is complete irrespective of the quality of the representation they receive.”

Most of the state action relevant here—the promulgation of the Thompson Memorandum, the prosecutors’ communications with KPMG regarding the advancement of fees, KPMG’s adoption of a Fees Policy with caps and conditions, and KPMG’s repeated threats to employees identified by prosecutors as being uncooperative—pre-dated the indictments of August and October 2005. (Of course, after the indictments were filed KPMG ceased advancing fees to all thirteen of the present defendants who were still receiving fees up to that point. As explained, this was also state action.) So we must determine how this pre-indictment conduct may bear on defendants’ Sixth Amendment claim.

“The Sixth Amendment right of the ‘accused’ to assistance of counsel in ‘all criminal prosecutions’ is limited by its terms: it does not attach until a prosecution is commenced.” “Attachment” refers to “when the [Sixth Amendment] right may be asserted”; it does not concern the separate question of “what the right guarantees,” i.e., “what the substantive guarantee of the Sixth Amendment” is at that stage of the prosecution. The Supreme Court has “pegged commencement [of a prosecution] to ‘the initiation of adversary judicial criminal proceedings—whether by way of formal charge, preliminary hearing, indictment, information, or arraignment.’” “The rule is not ‘mere formalism,’ but a recognition of the point at which ‘the government has committed itself to prosecute,’ ‘the adverse positions of government and defendant have solidified,’ and the accused ‘finds himself faced with the prosecutorial forces of organized society, and immersed in the intricacies of substantive and procedural criminal law.’” . . .

Although defendants’ Sixth Amendment rights attached only upon indictment, the district court properly considered pre-indictment state action that affected defendants post-indictment. When the government acts prior to indictment so as to impair the suspect’s relationship with counsel post-indictment, the pre-indictment actions ripen into cognizable Sixth Amendment deprivations upon indictment. As Judge Ellis explained in *United States v. Rosen*, “it is entirely plausible that pernicious effects of the pre-indictment interference continued into the post-indictment period, effectively hobbling defendants’ Sixth Amendment rights to retain counsel of choice with funds to which they had a right. . . . [I]f, as alleged, the government coerced [the employer] into halting fee advances on defendants’ behalf and the government did so for the purpose of undermining defendants’ relationship with counsel once the indictment issued, the government violated defendants’ right to expend their own resources towards counsel once the right attached.”

Since the government forced KPMG to adopt the constricted Fees Policy—including the provision for terminating fee advancement upon indictment—and then compelled KPMG to enforce it, it was virtually certain that KPMG would terminate defendants’ fees upon indictment. We therefore reject the government’s argument that its actions (virtually all pre-indictment) are immune from scrutiny under the Sixth Amendment.

We now consider “what the [Sixth Amendment] right guarantees.” The Sixth Amendment ensures that “[i]n all criminal prosecutions, the accused shall enjoy the right . . . to have the Assistance of Counsel for his defence.” Thus “the Sixth Amendment guarantees the defendant the right to be represented by an otherwise qualified attorney whom that defendant can afford to hire, or who is willing to represent the defendant even though he is without funds.” “[A]n element of this right is the right of a defendant who does not require appointed counsel to choose who will represent him.”

The government must “honor” a defendant’s Sixth Amendment right to counsel:

This means more than simply that the State cannot prevent the accused from obtaining the assistance of counsel. The Sixth Amendment also imposes on the State an affirmative obligation to respect and preserve the accused’s choice to seek this assistance. . . . [A]t the very least, the prosecutor and police have an affirmative obligation not to act in a manner that circumvents and thereby dilutes the protection afforded by the right to counsel.

This is intuitive: the right to counsel in an adversarial legal system would mean little if defense counsel could be controlled by the government or vetoed without good reason.

Consistent with this principle of non-interference, courts have identified violations of the Sixth Amendment right to counsel where the government obtains incriminating statements from a defendant outside the presence of counsel and then introduces those statements at trial. Likewise, the government violates the Sixth Amendment when it intrudes on the attorney-client relationship, preventing defense counsel from “participat[ing] fully and fairly in the adversary factfinding process.”

Defendants-Appellees do not say that they were deprived of constitutionally effective counsel. Their claim is that the government unjustifiably interfered with their relationship with counsel and their ability to mount the best defense they could muster. . . .

The holding of *Caplin & Drysdale* is narrow: the Sixth Amendment does not prevent the government from reclaiming its property from a defendant even though the defendant had planned to fund his legal defense with it. It is easy to distinguish the case of an employee who reasonably expects to receive attorneys’ fees as a benefit or perquisite of employment, whether or not the expectation arises from a legal entitlement. As has been found here as a matter of fact, these defendants would have received fees from KPMG but for the government’s interference. Although “there is no Sixth Amendment right for a defendant to obtain counsel using tainted funds, [a defendant] still possesses a qualified Sixth Amendment right to use wholly legitimate funds to hire the attorney of his choice.”

It is axiomatic that if defendants had already received fee advances from KPMG, the government could not (absent justification) deliberately interfere with the use of that money to fuel their defenses. And the government concedes that it could not prevent a

lawyer from furnishing a defense gratis. . . . And if the Sixth Amendment prohibits the government from interfering with such arrangements, then surely it also prohibits the government from interfering with financial donations by others, such as family members and neighbors—and employers. In a nutshell, the Sixth Amendment protects against unjustified governmental interference with the right to defend oneself using whatever assets one has or might reasonably and lawfully obtain.

The government points out that KPMG’s past fee practice was voluntary and subject to change, and that defendants therefore could have had no reasonable expectation of the ongoing advancement of fees. But this argument simply quarrels with Judge Kaplan’s finding that absent any state action, KPMG would have paid defendants’ legal fees and expenses without regard to cost. Therefore, unless the government’s interference was justified, it violated the Sixth Amendment.

The government is sometimes allowed to interfere with defendants’ choice or relationship with counsel, such as to prevent certain conflicts of interest. However, the government has failed to establish a legitimate justification for interfering with KPMG’s advancement of legal fees. . . .

Judge Kaplan found that defendants Gremminger, Hasting, Ritchie and Watson were unable to retain the counsel of their choosing as a result of the termination of fee advancements upon indictment. The government does not contest this factual finding, and we will not disturb it. A defendant who is deprived of counsel of choice (without justification) need not show how his or her defense was impacted; such errors are structural and are not subject to harmless-error review. . . .

The remaining defendants . . . do not claim they were deprived of their chosen counsel. Rather, they assert that the government unjustifiably interfered with their relationship with counsel and their ability to defend themselves. . . . We agree: these defendants can easily demonstrate interference in their relationships with counsel and impairment of their ability to mount a defense based on Judge Kaplan’s non-erroneous findings that the post-indictment termination of fees “caused them to restrict the activities of their counsel,” and thus to limit the scope of their pre-trial investigation and preparation. Defendants were indicted based on a fairly novel theory of criminal liability; they faced substantial penalties; the relevant facts are scattered throughout over 22 million documents regarding the doings of scores of people, the subject matter is “extremely complex,” technical expertise is needed to figure out and explain what happened; and trial was expected to last between six and eight months. As Judge Kaplan found, these defendants “have been forced to limit their defenses . . . for economic reasons and . . . they would not have been so constrained if KPMG paid their expenses.” We therefore hold that these defendants were also deprived of their right to counsel under the Sixth Amendment. . . .

The following recent trial court decision deals with conflicts and state action in the context of privilege waiver rather than funding of counsel. It is most important for its

fact pattern, which can serve as a kind of roadmap to the dangers that individual corporate employees may face from dealing with corporate counsel in the earlier phases of an investigation. Never a bad idea to have personal counsel review any agreement that corporate counsel asks one to sign!

UNITED STATES v. TOURNANT, 2023 WL 5276776 (S.D.N.Y. Aug. 15, 2023)

LAURA TAYLOR SWAIN, Chief United States District Judge

In May 2022, Mr. Tournant was indicted on a number of charges alleging that he engaged in a scheme to defraud investors while he was employed at Allianz Global Investors U.S. LLC (“AGI”), a company which was a subsidiary of Allianz SE (“Allianz”), one of the world’s largest financial services firms. Mr. Tournant worked as a portfolio manager at AGI, overseeing a number of high-profile investment funds worth billions of dollars.

Most notably, Mr. Tournant oversaw the management of a group of funds known as the Structured Alpha Funds (the “Funds”), a series of private investment funds that employed bespoke investment strategies which were “marketed . . . as providing broad market exposure while maintaining specific risk protections to safeguard against losses in the event of a market crash.” The Indictment alleges that Mr. Tournant, as manager of this funds group, engaged in a scheme to deceive and defraud investors by essentially “understating the risk to which investors’ assets were exposed, and therefore how the returns they touted were actually generated.” This scheme was allegedly carried out by Mr. Tournant (and his employees) in three ways: (1) by “overstat[ing] the level of independent oversight that AGI US and its parent company Allianz were exercising over the Funds’ strategy,” (2) by “misrepresent[ing] the hedging and other risk-mitigation strategies they were undertaking to protect investor funds,” and (3) “fraudulently alter[ing] documents” that AGI provided to investors and failing to “disclose relevant risk information” to investors. In March 2020, following the onset of the pandemic, the Funds lost more than \$7 billion in market value, and were eventually shut down. The indictment alleges that Mr. Tournant personally benefited from this fraudulent scheme, earning over \$60 million during the relevant time period.

The Securities and Exchange Commission (“SEC”) began investigating the Funds’ closure, notified Allianz of its civil inquiry in August 2020, and filed its civil complaint against Allianz in September 2020. Allianz also initiated its own internal investigation into the circumstances surrounding the Funds’ collapse. The United States Attorney’s Office for the Southern District of New York (the “Government”) began a separate criminal investigation into the Funds around the same time. The Government’s investigation, however, remained covert for some time, and was not formally announced to Allianz until June 10, 2021.

In the fall of 2020, Mr. Tournant and other Allianz employees retained counsel in connection with the SEC’s investigation. First, Mr. Tournant retained Milbank LLP (“Milbank”) as his personal counsel to represent him in connection with the internal

investigation and the SEC investigation. Second, two different law firms, Sullivan & Cromwell (“S&C”) and Ropes & Gray (collectively, the “Firms”), began a joint representation of Allianz and Mr. Tournant, in connection with the internal investigation and the SEC civil matter. The Firms also assisted Allianz in conducting its internal investigation. Mr. Tournant signed an engagement letter with S&C on November 17, 2020, which set out the terms and scope of the joint representation. In the Agreement, Mr. Tournant acknowledged that he understood both the “benefits and the risks involved” with proceeding with a joint representation and stated that, should S&C conclude that a conflict of interest had arisen between Mr. Tournant and Allianz, S&C would “discuss the situation” with Mr. Tournant “with a view to arriving at a mutually agreeable solution.” The Agreement also provided that, if Allianz deemed it appropriate, Allianz could release Mr. Tournant’s confidential information to the Government and could waive any applicable claim of privilege, which would “mean that the protections of the attorney-client privilege that [Mr. Tournant] may have for such [confidential materials] would no longer apply.”

The investigations continued throughout the winter and spring of 2021. On May 5, 2021, Allianz (together with S&C) presented the preliminary findings of Allianz’s internal investigation to the SEC. Allianz denied any wrongdoing and maintained that “the collapse [of the Fund] had been caused by the unforeseeable market downturns” of the early pandemic. On May 20 and 21, 2021, Stephen Bond-Nelson, another Allianz portfolio manager who worked on the Funds alongside Mr. Tournant, testified before the SEC. During his testimony, Mr. Bond-Nelson was represented by his individual counsel, as well as by the Firms (who appeared on behalf of both Mr. Bond-Nelson and Allianz). Mr. Bond-Nelson was questioned extensively about the Funds and certain alterations that had been made to documents sent out to investors, and he initially maintained that “any alterations had not been fraudulent but had instead been attempts to make investor documents more accurate.” During the second day of questioning, however, Mr. Bond-Nelson abruptly adjourned his testimony and refused to answer further questions. His individual counsel then communicated to the SEC that Mr. Bond-Nelson wished to cooperate with the SEC’s investigation and with any parallel criminal investigation, and Mr. Bond-Nelson disengaged the Firms as his counsel. Mr. Bond-Nelson thereafter began cooperating¹ with both the SEC and the Government, implicating Mr. Tournant as the “mastermind” who had “directed the fraud” behind the Funds collapse.

Mr. Tournant maintains that this event was a key “inflection point in the Firms’ strategy in representing Allianz”—namely, that Mr. Bond-Nelson’s testimony and cooperation caused the Firms to shift from their initial strategy of denying any wrongdoing by Allianz and Mr. Tournant, to a new strategy of “shift[ing] the blame” to Mr. Tournant in order to “serve him up as a scapegoat to avoid the worst sanctions for Allianz.” As an example of this shift in strategy, the defense points to presentation materials prepared by S&C which expressly state that, “[i]mmediately after Bond-Nelson’s SEC testimony,” Allianz “assumed control and pledged full cooperation in connection with the investigations” and “[c]ommissioned a forensic review” of the suspected fraud issues involving the

Funds. The defense asserts that, at this point in May 2021, the Firms should have realized that the interests of Allianz and Mr. Tournant had diverged to such an extent that joint representation was no longer ethical, and that they should have apprised Mr. Tournant of this potential conflict before continuing the representation.

After Mr. Bond-Nelson's testimony, S&C arranged to meet with Mr. Tournant on June 3, 2021, for the dual purposes of continuing Allianz's internal investigation and helping Mr. Tournant to prepare for his anticipated SEC testimony. At the time the meeting took place, the Government's criminal investigation was still covert and had not been announced to Allianz. Two days before the meeting, S&C re-sent Mr. Tournant (through his individual counsel) a copy of his engagement letter with S&C, and reminded him that, "under the terms of Mr. Tournant's engagement letter with [S&C], AllianzGI could decide to disclose Mr. Tournant's statements to the Firm" to third parties if it so chose. During the meeting, S&C attorneys engaged in a mock cross-examination of Mr. Tournant and asked him about various topics relating to his role in overseeing the Funds, including detailed questions about the altered documents that were sent to investors, and about Mr. Tournant's communications with Mr. Bond-Nelson.

Toward the end of the meeting, the S&C attorneys "ambushed" Mr. Tournant by questioning him about whether he had used a second cell phone, what the phone was used for, and why he had failed to disclose his use of a second phone during prior interviews. They confronted Mr. Tournant with previously undisclosed documents relating to the second cell phone. The meeting concluded shortly after this questioning. The defense asserts that the true purpose of this June 3 meeting was to elicit incriminating information from Mr. Tournant that could be used against him in the Government's criminal proceeding, in an effort to secure cooperation credit for Allianz. After this meeting, Mr. Tournant cut off direct contact with the Firms and, on June 5, 2021, the Firms informed Mr. Tournant that they would be terminating their representation of him, explaining in their termination letters that Mr. Tournant's interests had "potentially diverged from those of the Allianz Entities." The Firms continued to represent Allianz.

On June 10, 2021, the Government contacted Allianz and several employees directly to inform them of the criminal investigation into the collapse of the Funds, and began making document requests to Allianz. Over the next several months, the Government engaged in an intensive investigation into Allianz, an effort which involved "reviewing thousands of documents, engaging subject-matter experts, and interviewing more than 20 individuals, including 10 AGI employees," and in the meantime Allianz continued its own internal investigation into the misconduct. At various points during the Government's investigation, Allianz made presentations to the Government to report on the findings of its internal investigation.

During the course of the criminal investigation, the Government began to suspect that Mr. Tournant had engaged in obstructive conduct with regard to the SEC investigation—specifically, that Mr. Tournant had directed Mr. Bond-Nelson to lie when responding to

SEC inquiries about alterations to investor documents. The Government informed Allianz in October 2021 that it was “looking into efforts by Allianz employees to obstruct the SEC investigation,” and asked Allianz to “provide the Government with any facts Allianz had learned during its internal interviews regarding the purported rationale for altering risk reports.” In November 2021, in response to this inquiry, Allianz provided the Government with “partial summaries” of several interviews conducted during the internal investigation, including the June 3 interview of Mr. Tournant. Further, in January 2022, Allianz provided the Government with a full oral summary of the June 3 interview.

On January 20, 2022, S&C made a presentation to the Government which expressly advocated for the prosecution of Mr. Tournant and others in lieu of charging Allianz. For example, S&C stated that “Tournant, Taylor, and Bond-Nelson engaged in serious misconduct intended to understate [the] risk of the SA Funds,” that there was no “knowledge or involvement in the misconduct” by Allianz management, and that a guilty plea by Allianz/AGI was “unnecessary because DOJ action against individuals will satisfy the goals of federal prosecution.”

The parties dispute when, precisely, the Government became aware of S&C’s prior joint representation of Mr. Tournant and Allianz. The defense asserts that the Government should have “understood that Mr. Tournant was personally represented by the Firms” sometime in 2021 based on several events that occurred during the investigation. The defense states that the SEC was clearly aware of the Firms’ joint representation, because the SEC sent legal documents directly to Ropes & Gray as Mr. Tournant’s counsel in April 2021, and the Firms appeared as counsel for Mr. Bond-Nelson and Allianz during Bond-Nelson’s SEC testimony in May 2021. The defense also notes that, based on the notes summary of the June 3 interview that was provided to the Government in November 2021, it was “clear that the Firms were acting as Mr. Tournant’s counsel” during that meeting.

The Government asserts that it did not become aware of the joint representation until January 2022. The Government notes that, during the multiple meetings it had with Mr. Tournant during the fall of 2021 and winter of 2022, Mr. Tournant was either represented by his individual counsel (Milbank) or his present counsel. The Government also notes that, when Allianz shared the June 3 interview materials with the Government, “counsel for Allianz did not disclose that the company had shared counsel with Tournant, a fact that remained unknown to the Government.” Shortly after Mr. Tournant’s new counsel entered the case (on January 28, 2022), Mr. Tournant’s new counsel informed the Government that, during the June 3 interview, Mr. Tournant had been represented by the Firms—which the Government asserts was “the first time the Government learned of the joint representation.” It was also during this time that Mr. Tournant’s new counsel first raised the defense claims of privilege violations, informing the Government that Allianz’s disclosure of Mr. Tournant’s confidential information to the Government may have tainted the Government’s investigation.

Upon receiving this information, the Government “promptly and carefully evaluated the issue,” and concluded that, based on the engagement letters that Mr. Tournant had signed with the Firms, S&C acted “within its rights to provide information to the Government” and that “Tournant’s privilege had not been breached by [S&C’s] recounting of the [June 3] interview to the Government.” Nevertheless, “in an abundance of caution” the Government elected to treat the disputed materials as “potentially privileged.” The specific categories of materials (the “disputed materials”) that the Government set aside encompassed: “notes of Tournant’s statements to [S&C] during the [June 3] interview; references to those statements in Allianz’s presentations to the Government; and documents that were (i) produced by Allianz pursuant to the non-waiver agreement, (ii) created during the period that Tournant was jointly represented, and (iii) included Tournant.” The disputed materials were segregated by a filter team and made unavailable to the main prosecution team. On Feb 25, 2022, the Government informed Mr. Tournant’s counsel that, in bringing any criminal case against Mr. Tournant, it would not rely on any of the disputed materials. . . .

Here, there is no dispute that, barring waiver, Mr. Tournant’s communications with his attorneys—including, most notably, his communications with S&C during the June 3, 2021 interview—would be protected by the attorney-client privilege. These communications occurred between Mr. Tournant and his counsel, were intended to be confidential, and were designed, at least from Mr. Tournant’s perspective, to provide legal advice.

The attorney client privilege can be waived, either expressly or impliedly. *See In re Grand Jury Proc.* “It is well settled that ‘the burden of establishing the existence of an attorney-client privilege, in all of its elements, rests with the party asserting [the privilege].’” “The party claiming privilege also carries the burden of showing that it has not been waived.” *Hollis v. O’Driscoll*. Because “enforcement of a claim of privilege acts in derogation of the overriding goals of liberal discovery and adjudication of cases on their merits . . . ; privileges are disfavored and generally to be construed narrowly.” *Bowne of New York City, Inc. v. AmBase Corp.* The attorney-client privilege can be expressly waived by the client, including through a contract. *See Lugosch v. Congel* (noting that a client may waive privilege when “the client’s communication(s) or the legal advice given [are] shared, in some form or fashion, with a third party,” and that a “waiver such as this may be done explicitly or implicitly, or conversely, intentionally or inadvertently”).

Here, Mr. Tournant signed an engagement letter with S&C on November 17, 2020, that set out “the terms of S&C’s joint representation of you [Tournant] and the Allianz Entities.” (Mtn., Exhibit A (“the Agreement”)). The Agreement stated, in relevant part, as follows:

By execution of this Letter Agreement, you acknowledge that you understand the implications of this joint representation, including the benefits and the risks involved. Such benefits include, but are not limited to, the efficiencies from avoiding duplicative

efforts by different lawyers and the advice of counsel who has been engaged in the matter and is familiar with its facts, circumstances, and issues. The risks or potential disadvantages of such joint representation may include, but are not limited to, the possibility that if a conflict of interest arises, you may need to proceed solely with Milbank LLP (or another counsel of your choosing) . . .

The mutual interests of the Allianz Entities and you may be best served by sharing oral or written confidential information (“Materials”). Some or all of the Materials may be protected from disclosure to anyone else as a result of the attorney-client privilege, the work-product doctrine, or other applicable privileges. You agree that S&C may share such Materials (when and if S&C deems it appropriate) with the Allianz Entities, representatives of the Allianz Entities, third parties retained by S&C, and other persons. You agree that if management of the Allianz Entities deems it appropriate, the Allianz Entities may decide to release Materials to the government and to other persons outside of the Allianz Entities who agree to keep such Materials confidential, to release Materials in response to legal process, and to waive any applicable privileges to the disclosure of such Materials. You understand that such disclosure may mean that the protections of the attorney-client privilege that you may have for such Material would no longer apply.

The Government argues that this Agreement effectuated a clear and valid waiver of any claim of privilege Mr. Tournant might hold over the disputed materials, and that Mr. Tournant has not met his burden of showing a lack of waiver. The defense, however, argues that the Advance Waiver provision was invalidated by the conflict of interest that arose between Allianz and Mr. Tournant during the course of the joint representation. According to the defense, once this conflict of interest arose, S&C had an obligation to either disclose the conflict to Mr. Tournant and obtain a new written waiver; or to terminate the joint representation. The defense points to two bases for this alleged duty to disclose: (1) the provisions of the Agreement that set out S&C’s obligations to Tournant; and (2) the basic ethical duties that apply to all attorneys. The Court addresses these arguments in turn. . . .

In particular, the defense argues that S&C failed to abide by the following provision of the Agreement:

In the event we [S&C] conclude, as the facts concerning the Structured Alpha Matter and the positions of you and the Allianz Entities develop, that the interests of the Allianz Entities and/or other individuals whom we may represent in the Structured Alpha Matters are in conflict with your interests (including, for example, because the Allianz Entities of are the view that the joint representation imposes constraints on its ability to cooperate with any government investigation) such that it may become inadvisable or improper for us to continue to represent you, we will discuss the situation with you with a view to arriving at a mutually agreeable solution. You agree that, if there is

such a conflict that we cannot otherwise resolve to our mutual satisfaction, [S&C] may terminate its relationship with you. . . .

The defense asserts that this conflict of interest arose “no later than” May 22, 2021—the time at which Allianz “changed their entire approach and started cooperating” with the Government. In support of this position, the defense notes that, according to S&C’s own documents, “immediately after Bond-Nelson’s [May 21, 2021] SEC testimony,” Allianz “[a]ssumed control and pledged full cooperation in connection with the [Government and SEC] investigations.” On May 22, 2021, Allianz initiated a large-scale internal forensic review, a “primary goal of which,” according to the defense, was to “build the Government’s case against Mr. Tournant and serve him up as a scapegoat.” Moreover, in the weeks leading up to the June 3 interview, S&C investigated and developed evidence regarding Mr. Tournant’s second cell phone, without his knowledge and with the intent to “ambush” him with this evidence at the interview.

The defense argues that, after these events, it was objectively clear that a conflict had developed between the interests of Allianz and the interests of Mr. Tournant, which triggered S&C’s contractual obligation to “discuss the situation with [Mr. Tournant] with a view to arriving at a mutually agreeable solution.” According to the defense, S&C’s subsequent failure to discuss the conflict with Mr. Tournant resulted in a material breach of the Agreement. Relatedly, the defense, pointing to a portion of the Agreement in which “S&C and the Allianz Entities” confirmed that they were “not presently aware of any such conflict” of interest at the time the letter was signed, argues that the Agreement “premised S&C’s joint representation on the absence of a conflict between Allianz and Mr. Tournant,” such that the Advance Waiver provision ceased to be effective at the time that a conflict developed. In other words, the defense appears to argue that the Advance Waiver provision was conditioned on S&C’s promise to provide Mr. Tournant with warning of conflicts of interest that could later arise, and that S&C’s failure to provide such warnings when needed invalidated the Advance Waiver provision. . . .

The Court concludes, based on the plain language of the Agreement, that, whether or not the provision requiring discussion of a conflict was breached, S&C’s failure to apprise Mr. Tournant of the potential conflict did not vitiate the Agreement’s Advance Waiver provision. First, the Court notes that it is unclear whether the Agreement’s Conflict Disclosure provision was even triggered in this case—the Agreement provides that S&C will “discuss the situation” with Tournant “in the event [S&C] conclude[s] . . . that the interests of the Allianz Entities . . . are in conflict with [Tournant’s] interests.” The defense argues that the events of late May 2021 should have indicated to S&C that a conflict had arisen between Allianz and Mr. Tournant. However, the Agreement does not impose an obligation on S&C to act when it should have perceived a conflict. Rather, the Conflict Disclosure provision sets a subjective standard, requiring action when S&C itself actually concludes that a conflict exists. Although the defense has presented facts that, in hindsight, may suggest that S&C could or should have concluded earlier that there was a potential conflict, there is no indication that S&C was truly aware of an

actual conflict between Allianz and Mr. Tournant, or had reached a conclusion that such a conflict existed, at any time prior to the day that S&C terminated the representation.

Second, and more to the point, nothing in the Agreement indicates that the two provisions the defense cites—the Advance Waiver provision and the Conflict Disclosure provision—were interdependent. The two provisions are located in different paragraphs on different pages of the Agreement, deal with different topics, and discuss the rights and the conduct of different actors. The Advance Waiver provision grants Allianz unilateral control over the disclosure of privileged materials should Allianz determine that such disclosure is appropriate, while the Conflict Disclosure provision deals with the status of the attorney-client relationship between Mr. Tournant and S&C. The latter provision obligated S&C to engage in discussion with Mr. Tournant in aid of seeking a mutually acceptable resolution if it concluded that there was a conflict and provides that, if no such mutually acceptable resolution were reached, S&C had no further obligations to Mr. Tournant and could “terminate its relationship” with him. Nothing in the Conflict Disclosure provision purports to limit Mr. Tournant's grant of disclosure authority to Allianz.

Finally, the record indicates that Mr. Tournant entered into this Agreement knowingly, intelligently, and with the benefit of the advice of his independent counsel. At the time that Mr. Tournant signed the Agreement, he was represented by his own independent counsel from Milbank, who would have been available to advise him fully of the risks, benefits, and implications of signing the joint representation Agreement. . . .

The defense further argues that S&C's conduct invalidated Mr. Tournant's waiver of the attorney client privilege because S&C violated professional ethical rules. Specifically, Mr. Tournant argues that (1) the events of late May 2021 (prior to the June 3 interview) created an un-waivable conflict of interest between Allianz and Mr. Tournant; and (2) in the alternative, even if the conflict was waivable, in order to ethically continue the representation after the events of late May 2021, S&C was required to make full disclosures to Mr. Tournant and obtain his updated consent in writing. As a consequence of this conflict of interest, the defense contends, the Advance Waiver provision “does not apply” and “was not enforceable” following S&C's failure to obtain updated informed consent from Mr. Tournant.

As an initial matter, this defense argument appears to be based on a conflation of two different types of advance waivers—advance confidentiality waivers, and advance conflict waivers. In an advance conflict waiver, a client agrees to waive “the firm's potential future conflicting engagements” as to other clients, so that he may hire the attorney of his choosing despite those potential future conflicts.

In contrast, in an advance confidentiality waiver, a client agrees to waive future claims of attorney-client privilege, thus allowing his attorney to share his otherwise-confidential information with third parties.

The Agreement at issue here features an advance confidentiality waiver, under which Mr. Tournant agreed that Allianz would control the privilege, and that in the future Allianz might decide to release Mr. Tournant's confidential materials to third parties, including government authorities, in which case Mr. Tournant would “waive any applicable privileges to the disclosure of such Materials.” The Agreement does not, however, contain an advance conflict waiver regarding the joint representation—Mr. Tournant never agreed to waive any future conflicts of interest by S&C that might later develop during the representation. Instead, the Agreement simply provides that, if an unresolvable conflict of interest should later arise, S&C “may terminate its relationship” with Mr. Tournant. . . .

Moreover, the rule that the defense asks the Court to adopt—under which the Government could be held to account for, and its ability to prosecute alleged criminal activity impeded by, an attorney's failure to apprise joint clients of every potential conflict during the course of the representation prior to the commencement of prosecution of a former client—would be unworkable and highly impractical. As the Government commented at oral argument, such a rule “would require the Government to impermissibly wade into attorney-client relationships on a massive scale” by requiring it to “engage with corporate counsel” in detail about “the status of their joint representation” every time the Government asked “for a voluntary production of documents.”

Based on all of these considerations, the Court concludes that the defense has not met its burden of demonstrating that the Advance Waiver provision was invalid and has failed to establish grounds for dismissal of the indictment or further inquiry into the Government's use of the material provided to it by Allianz's counsel on the basis of invasion of Mr. Tournant's attorney-client privilege. . . .

The Court next addresses the defense argument that the Government obtained improper access to privileged materials under circumstances that would render the continued prosecution of this case violative of Mr. Tournant's constitutional rights. This argument fails because (1), as explained above, Mr. Tournant had granted Allianz control over waiver of his claim of privilege with respect to his confidential communications from the outset of the joint representation; (2) the defense has not shown that the Government's interaction with S&C in this case was of a manifestly corrupt character; and (3) the defense has not shown that the Government's general encouragement of cooperation by corporate defendants is of so coercive a character as to be manifestly corrupt and require dismissal of the indictment. . . .

The Court concludes that Mr. Tournant has not demonstrated any manifest corruption or violation of his constitutional rights by the Government. First, as explained above, there has been no disclosure of materials as to which Mr. Tournant retained the ability to assert his claim of privilege. It is elementary that a defendant cannot sustain a claim for unconstitutional intrusion into his attorney-client privilege when he has made no showing that his communications were privileged when the government received them.

Second, even if the communications had been privileged, nothing in the proffered evidence indicates that the Government improperly intruded into the attorney-client relationship, or that the Government otherwise took any corrupt or outrageous actions with regard to its relations with S&C and Allianz. . . .

Specifically, the defense argues that S&C's conduct was legally attributable to the Government because the Government's cooperation guidelines incentivize corporations to provide information regarding the misconduct of individual employees. These arguments are insufficient to raise a material issue regarding improper government conduct. . . .

Here . . . there is no indication that a government policy forced Allianz or its counsel to take any particular action, or directly intervened in its decision-making. The decision to include the Advance Waiver provision in the retainer agreement for joint representation was consistent with Allianz's interest in facilitating both its employees' ability to obtain legal services and its own ability to develop its knowledge of the relevant circumstances. Allianz' [sic] decision to invoke the Advance Waiver provision when it perceived that its interests had diverged from Mr. Tournant's (and that it would be in a better position under the Principles if it provided information to the Government) was consistent with Allianz' [sic] self-interest and with the express language of the Advance Waiver provision to which Mr. Tournant had agreed.

The Court accordingly concludes that Mr. Tournant has failed to provide a plausible basis for any inference that the Government's actions in this case were manifestly corrupt and his motion to dismiss the indictment on constitutional grounds must be denied.

Problem 15-2

As anyone familiar with the work of innocence projects—much less anyone paying attention to the criminal justice system—knows, deficient performance by underfunded and less than competent appointed counsel is endemic to the U.S. legal system, even in capital cases. At the same time, numerous defendants in high-profile corporate crime cases have spent tens of millions of dollars on their defenses, some spending well over \$50 million on a single defense. What, if anything, is wrong with this situation? How might one go about changing it?

16. INDIVIDUAL PLEAS AND SETTLEMENTS

Well over 90 percent of all criminal cases in the federal system, including white collar cases, are disposed of by guilty pleas prior to trial. That means—somewhat amazingly—that for lawyers representing individuals in federal court, understanding the plea negotiation process might be more important than knowing how to try a case.

This chapter looks at the major building blocks of the plea-bargaining machine, as they relate to white collar cases. Bear in mind that we already have one such building block from the early chapters: the substantive criminal statutes that (broadly) define offenses and set (relatively high) maximum punishments, supplying prosecutors with much of their leverage in plea bargaining.

A. Applicable Rules

This puts the cart before the horse a bit, but once the defendant has a plea agreement (or no plea agreement—the rules permit a defendant to “plead straight up” to the indictment), the following rule governs the plea proceeding. The most important things here are (1) understanding the difference between “(B) pleas” and “(C) pleas” under Rule 11(c)(1), and (2) seeing the policy concerns that motivate many of the provisions in Rule 11.

Federal Rule of Criminal Procedure 11. Pleas

(a) Entering a Plea.

- (1) *In General.* A defendant may plead not guilty, guilty, or (with the court’s consent) nolo contendere.
- (2) *Conditional Plea.* With the consent of the court and the government, a defendant may enter a conditional plea of guilty or nolo contendere, reserving in writing the right to have an appellate court review an adverse determination of a specified pretrial motion. A defendant who prevails on appeal may then withdraw the plea.
- (3) *Nolo Contendere Plea.* Before accepting a plea of nolo contendere, the court must consider the parties’ views and the public interest in the effective administration of justice.
- (4) *Failure to Enter a Plea.* If a defendant refuses to enter a plea or if a defendant organization fails to appear, the court must enter a plea of not guilty.

(b) Considering and Accepting a Guilty or Nolo Contendere Plea.

- (1) *Advising and Questioning the Defendant.* Before the court accepts a plea of guilty or nolo contendere, the defendant may be placed under oath, and the court must address the defendant personally in open court. During this address, the

court must inform the defendant of, and determine that the defendant understands, the following:

- (A) the government's right, in a prosecution for perjury or false statement, to use against the defendant any statement that the defendant gives under oath;
 - (B) the right to plead not guilty, or having already so pleaded, to persist in that plea;
 - (C) the right to a jury trial;
 - (D) the right to be represented by counsel—and if necessary have the court appoint counsel—at trial and at every other stage of the proceeding;
 - (E) the right at trial to confront and cross-examine adverse witnesses, to be protected from compelled self-incrimination, to testify and present evidence, and to compel the attendance of witnesses;
 - (F) the defendant's waiver of these trial rights if the court accepts a plea of guilty or nolo contendere;
 - (G) the nature of each charge to which the defendant is pleading;
 - (H) any maximum possible penalty, including imprisonment, fine, and term of supervised release;
 - (I) any mandatory minimum penalty;
 - (J) any applicable forfeiture;
 - (K) the court's authority to order restitution;
 - (L) the court's obligation to impose a special assessment;
 - (M) in determining a sentence, the court's obligation to calculate the applicable sentencing-guideline range and to consider that range, possible departures under the Sentencing Guidelines, and other sentencing factors under 18 U.S.C. §3553(a); and
 - (N) the terms of any plea-agreement provision waiving the right to appeal or to collaterally attack the sentence.
- (2) *Ensuring That a Plea Is Voluntary.* Before accepting a plea of guilty or nolo contendere, the court must address the defendant personally in open court and determine that the plea is voluntary and did not result from force, threats, or promises (other than promises in a plea agreement).

- (3) *Determining the Factual Basis for a Plea.* Before entering judgment on a guilty plea, the court must determine that there is a factual basis for the plea.

(c) *Plea Agreement Procedure.*

- (1) *In General.* An attorney for the government and the defendant's attorney, or the defendant when proceeding pro se, may discuss and reach a plea agreement. The court must not participate in these discussions. If the defendant pleads guilty or nolo contendere to either a charged offense or a lesser or related offense, the plea agreement may specify that an attorney for the government will:

- (A) not bring, or will move to dismiss, other charges;
- (B) recommend, or agree not to oppose the defendant's request, that a particular sentence or sentencing range is appropriate or that a particular provision of the Sentencing Guidelines, or policy statement, or sentencing factor does or does not apply (such a recommendation or request does not bind the court); or
- (C) agree that a specific sentence or sentencing range is the appropriate disposition of the case, or that a particular provision of the Sentencing Guidelines, or policy statement, or sentencing factor does or does not apply (such a recommendation or request binds the court once the court accepts the plea agreement).

- (2) *Disclosing a Plea Agreement.* The parties must disclose the plea agreement in open court when the plea is offered, unless the court for good cause allows the parties to disclose the plea agreement in camera.

(3) *Judicial Consideration of a Plea Agreement.*

- (A) To the extent the plea agreement is of the type specified in Rule 11(c)(1)(A) or (C), the court may accept the agreement, reject it, or defer a decision until the court has reviewed the presentence report.
- (B) To the extent the plea agreement is of the type specified in Rule 11(c)(1)(B), the court must advise the defendant that the defendant has no right to withdraw the plea if the court does not follow the recommendation or request.

- (4) *Accepting a Plea Agreement.* If the court accepts the plea agreement, it must inform the defendant that to the extent the plea agreement is of the type specified in Rule 11(c)(1)(A) or (C), the agreed disposition will be included in the judgment.

- (5) *Rejecting a Plea Agreement.* If the court rejects a plea agreement containing provisions of the type specified in Rule 11(c)(1)(A) or (C), the court must do the following on the record and in open court (or, for good cause, in camera):
- (A) *inform* the parties that the court rejects the plea agreement;
 - (B) advise the defendant personally that the court is not required to follow the plea agreement and give the defendant an opportunity to withdraw the plea; and
 - (C) advise the defendant personally that if the plea is not withdrawn, the court may dispose of the case less favorably toward the defendant than the plea agreement contemplated.
- (d) *Withdrawing a Guilty or Nolo Contendere Plea.* A defendant may withdraw a plea of guilty or nolo contendere:
- (1) before the court accepts the plea, for any reason or no reason; or
 - (2) after the court accepts the plea, but before it imposes sentence if:
 - (A) the court rejects a plea agreement under 11(c)(5); or
 - (B) the defendant can show a fair and just reason for requesting the withdrawal.
- (e) *Finality of a Guilty or Nolo Contendere Plea.* After the court imposes sentence, the defendant may not withdraw a plea of guilty or nolo contendere, and the plea may be set aside only on direct appeal or collateral attack.
- (f) *Admissibility or Inadmissibility of a Plea, Plea Discussions, and Related Statements.* The admissibility or inadmissibility of a plea, a plea discussion, and any related statement is governed by Federal Rule of Evidence 410.
- (g) *Recording the Proceedings.* The proceedings during which the defendant enters a plea must be recorded by a court reporter or by a suitable recording device. If there is a guilty plea or a nolo contendere plea, the record must include the inquiries and advice to the defendant required under Rule 11(b) and (c).
- (h) *Harmless Error.* A variance from the requirements of this rule is harmless error if it does not affect substantial rights.
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In addition to Rule 11(f), the admissibility of pleas, plea discussions, and related statements is also governed by Federal Rule of Evidence 410. Why do these rules exist? Are they necessary?

FEDERAL RULE OF EVIDENCE 410. PLEAS, PLEA DISCUSSIONS, AND RELATED STATEMENTS

- (a) Prohibited Uses. In a civil or criminal case, evidence of the following is not admissible against the defendant who made the plea or participated in the plea discussions:
 - (1) a guilty plea that was later withdrawn;
 - (2) a nolo contendere plea;
 - (3) a statement made during a proceeding on either of those pleas under Federal Rule of Criminal Procedure 11 or a comparable state procedure; or
 - (4) a statement made during plea discussions with an attorney for the prosecuting authority if the discussions did not result in a guilty plea or they resulted in a later-withdrawn guilty plea.
- (b) Exceptions. The court may admit a statement described in Rule 410(a)(3) or (4):
 - (1) in any proceeding in which another statement made during the same plea or plea discussions has been introduced, if in fairness the statements ought to be considered together; or
 - (2) in a criminal proceeding for perjury or false statement, if the defendant made the statement under oath, on the record, and with counsel present.

B. The Proffer Process

Many plea negotiations begin with the government taking a “proffer” from the defendant. This is an essential step in enlisting any cooperating witness, as it provides prosecutors with the opportunity to assess an individual’s credibility and the value of that person’s information before committing to granting any benefits in a plea agreement. Such discussions typically take place under a written proffer agreement that affords the individual a limited form of “use immunity” so that the person is not required to, in effect, provide a full confession before knowing whether a plea bargain will be reached.

You will see a lot of proffer agreements in corporate crime practice. The careful lawyer will often insist on such protection before allowing a client to talk to the government, even if the lawyer thinks the client may not be charged and thus may not need to engage in plea bargaining with prosecutors. A proffer agreement is a temporary or limited contract executed on the way to a plea agreement, or as protection for the purpose of talking to the government for a day when the ultimate results of an ongoing investigation remain unclear. (You may hear these agreements referred to by some practitioners, in an unfortunate and hackneyed phrase, as “queen for a day” agreements.)

Consider the terms of the following sample proffer agreement. What does it give the client? What does it give the government? What does it *not* give both parties? (Hint: recall the materials on immunity from Chapter 12.)

[SAMPLE PROFFER AGREEMENT]

With respect to the meeting of _____ (“Client”) and his attorney _____, Esq., with Assistant United States Attorney _____ to be held at the Office of the United States Attorney for the Southern District of New York on [Meeting Date] (“the meeting”), the following understandings exist:

(1) THIS IS NOT A COOPERATION AGREEMENT, The Client has agreed to provide the Government with information, and to respond to questions, so that the Government may evaluate Client’s information and responses in making prosecutive decisions. By receiving Client’s proffer, the Government does not agree to make a motion on the Client’s behalf or to enter into a cooperation agreement, plea agreement, immunity or non-prosecution agreement. The Government makes no representation about the likelihood that any such agreement will be reached in connection with this proffer.

(2) In any prosecution brought against Client by this Office, except as provided below the Government will not offer in evidence on its case-in-chief, or in connection with any sentencing proceeding for the purpose of determining an appropriate sentence, any statements made by Client at the meeting, except in a prosecution for false statements, obstruction of justice or perjury with respect to any acts committed or statements made during or after the meeting or testimony given after the meeting.

Notwithstanding item (2) above: (a) the Government may use information derived directly or indirectly from the meeting for the purpose of obtaining leads to other evidence, which evidence may be used in any prosecution of Client by the Government; (b) in any prosecution brought against Client, the Government may use statements made by Client at the meeting and all evidence obtained directly or indirectly therefrom for the purpose of cross-examination should Client testify; and (c) the Government may also use statements made by Client at the meeting to rebut any evidence or arguments offered by or on behalf of Client (including arguments made or issues raised sua sponte by the District Court) at any stage of the criminal prosecution (including bail, all phases of trial, and sentencing) in any prosecution brought against Client.

(3) The Client understands and agrees that in the event the Client seeks to qualify for a reduction in sentence under Title 18, United States Code, Section 3553(f) or United States Sentencing Guidelines, Sections 2D 1.1(b) (6) or 5C1.2, the Office may offer in evidence, in connection with the sentencing, statements made by the Client at the meeting and all evidence obtained directly or indirectly therefrom.

(4) To the extent that the Government is entitled under this Agreement to offer in evidence any statements made by Client or leads obtained therefrom, Client shall

assert no claim under the United States Constitution, any statute, Rule 11(e)(6) of the Federal Rules of Criminal Procedure, Rule 410 of the Federal Rules of Evidence, or any other federal rule that such statements or any leads therefrom should be suppressed. It is the intent of this Agreement to waive all rights in the foregoing respects.

(5) If this Office receives a request from another prosecutor's office for access to information obtained pursuant to this Proffer Agreement, this Office may furnish such information but will do so only on the condition that the requesting office honor the provisions of this Agreement.

(6) It is further understood that this Agreement is limited to the statements made by Client at the meeting and does not apply to any oral, written or recorded statements made by Client at any other time. No understandings, promises, agreements and/or conditions have been entered into with respect to the meeting other than those set forth in this Agreement and none will be entered into unless in writing and signed by all parties.

(7) The understandings set forth in paragraphs 1 through 7 above extend to the continuation of this meeting on the dates that appear below.

(8) Client and Attorney acknowledge that they have fully discussed and understand every paragraph and clause in this Agreement and the consequences thereof.

The following case is about the kinds of disputes that can arise during the enforcement of a proffer agreement and helps explain what protections a typical proffer agreement provides and does not provide to a defendant. The obvious lesson here is that it may be nearly impossible for an individual to testify in her own defense at a trial after she has made a full proffer to the government.

UNITED STATES v. VELEZ, 354 F.3d 190 (2d Cir. 2004)

JOSÉ A. CABRANES, Circuit Judge:

On November 21, 2001, defendant was indicted for being a convicted felon in possession of a firearm shipped and transported in interstate commerce, in violation of 18 U.S.C. § 922(g)(1). The charge was based on the observations of three New York Police Department officers—namely, that on August 18, 2001 the officers saw defendant pull a gun from his waistband, heard the sound of metal hitting pavement, and then recovered a gun from the ground where defendant had been standing.

Shortly after being charged, defendant participated in two proffer sessions. In a first session on January 14, 2002, defendant, accompanied by counsel, asserted his innocence, claiming that he did not possess the gun found on the ground where he had been standing. The Government did not credit defendant's statements.

On May 9, 2002, defendant, again accompanied by counsel, participated in a second proffer session, which he had requested. (At this session, defendant was represented by his second attorney, because the District Court had granted defendant's request that he be relieved of his prior counsel.) Before participating in the meeting, defendant signed an agreement in which he waived, in certain circumstances, the protection otherwise applicable to his proffer statements that prohibits use of those statements as evidence against him. Relevant to this appeal, the waiver provision to which defendant agreed provides:

[T]he Government may . . . use statements made by [defendant] at the meeting to rebut any evidence or arguments offered by or on behalf of [defendant] (including arguments made or issues raised *sua sponte* by the District Court) at any stage of the criminal prosecution (including bail, all phases of trial, and sentencing) in any prosecution brought against [defendant].

Accordingly, by signing the proffer agreement that included this waiver provision, defendant authorized the Government to introduce defendant's proffer statements at trial if defendant introduced evidence or arguments that were inconsistent with his proffer statements.

In the second proffer session, defendant recanted his claims of innocence at the initial session and admitted facts pertaining to one element of the charged offense—namely, that he owned and possessed the firearm that the officers found on the ground near him.

Defendant thereafter requested a third proffer session, which the Government scheduled, but defendant canceled the meeting and elected to proceed to trial.

Before the start of trial, however, defendant presented two issues to the District Court. First, he requested that the Court again appoint new defense counsel, on the ground that he would not receive a fair trial because his current (second) counsel had stated that he was "limited to attack[ing] certain areas," which, as defendant contended, was due to counsel's presence at the proffer session. The District Court denied defendant's request.

Second, through his attorney at a pretrial conference and in an *in limine* motion, defendant sought a preliminary ruling from the District Court on the scope of the defense's arguments and defense witness testimony that would open the door to the Government's use of defendant's proffer statements. In response to defendant's argument at the pretrial conference, the Government informed the Court that it did not seek to introduce defendant's proffer statements in its case-in-chief, but that it reserved the right "to introduce such statements if they are deemed necessary to rebut testimony or arguments made by or on behalf of the defendant that are inconsistent with statements made by the defendant during the proffer session."

The District Court initially did not rule on defendant's motion, but it noted that certain anticipated defense witness testimony would "come 'close' to opening the door to [the

Government's] introduction of [defendant's] proffer statements." When defense counsel informed the Court that it would not elicit that testimony, the District Court provided additional time for the defense to reconsider its decision. However, later in the day, the District Court stated that if the anticipated defense witness testimony were introduced, the Court would indeed permit the Government to introduce defendant's proffer admissions, thereby implicitly finding that the proffer agreement was enforceable. Defendant did not introduce the anticipated testimony.

After a three-day trial, the jury convicted defendant of the sole count of the indictment, which yielded a sentencing range of 100 to 125 months' imprisonment under applicable guidelines. At sentencing, in the context of offering mitigation to warrant a sentence at the low end of the range, defendant stated that he had been "trap[ped]" into making his admissions at the second proffer session. The District Court declined to credit defendant's statement as relevant to mitigation, and on December 16, 2002, sentenced defendant principally to 120 months' imprisonment.

On appeal, defendant argues that the waiver provision in the proffer agreement—which permits the Government to offer a proffer admission by the defendant in rebuttal to contradictory evidence or argument—violates defendant's constitutional rights to mount a defense, to the effective assistance of counsel, and to a fair trial. We disagree. . . .

Ordinarily, statements made by a defendant during plea negotiations, including proffer sessions, are inadmissible at trial. Fed. R. Evid. 410. However, a defendant can waive the protection afforded by Rule 410 as long as there is no "affirmative indication that the agreement [to waive] was entered into unknowingly or involuntarily." *Mezzanatto*. In *Mezzanatto*, as defendant correctly points out, the Supreme Court considered and enforced a narrow waiver provision in which the defendant permitted the Government to use his plea-negotiation statements only when responding to contrary testimony by the defendant himself. *Id.* at 198. Here we face a more expansive waiver of Rule 410 because, in the proffer agreement at issue, defendant waived his exclusionary privilege in all circumstances in which the defense presents contradictory testimony, evidence, or arguments—whether or not defendant himself testifies. We agree with the District Court's implicit decision that the agreement is enforceable.

In contending that the agreement is unenforceable, defendant relies principally on *United States v. Duffy*, in which the district court refused to enforce a waiver provision in a proffer agreement similar to the one we consider here. The *Duffy* ruling determined that the waiver provision "prevent[ed defense counsel] from making any sort of *meaningful* defense," and that it "exploit[ed]" a disparity of bargaining power between the Government and the defendant. The court stated: "After signing the standard proffer agreement, the terms of which are dictated by the government, the only thing that a defendant is guaranteed is the chance to convince the prosecutor to enter a deal. At the same time, the defendant bears all of the risk." Concluding that the waiver provision effectively forfeited the defendant's fundamental rights to present a defense and to the

effective assistance of counsel and, in doing so, implicated important public interests, the district court held the waiver provision unenforceable.

For the reasons that follow, we respectfully decline to adopt the position advanced in *Duffy*. . . .

As the *Gomez* ruling points out, “fairness dictates that the agreement be enforced.” “If the proffer agreement is not enforced, a defendant will have less incentive to be truthful, for he will know that his proffer statements cannot be used against him at trial as long as he does not testify, even if he presents inconsistent evidence or arguments.”

In addition, invalidating a waiver provision like the one before us would clearly interfere with plea bargaining and cooperation efforts—in direct contravention of the criminal justice system’s legitimate goal of encouraging plea bargaining in appropriate circumstances. The Supreme Court has noted that, “[i]f prosecutors were precluded from securing [waiver] agreements, they might well decline to enter into cooperation discussions in the first place and might never take this potential first step toward a plea bargain.”

We do not lightly dismiss the observation in *Duffy* that the Government holds significant bargaining power in arranging proffer sessions and securing a waiver provision as a prerequisite for a defendant’s participation. However, “[t]he mere potential for abuse of prosecutorial bargaining power is an insufficient basis for foreclosing negotiation altogether.” *Mezzanatto*. Indeed, to the extent there is a disparity between the parties’ bargaining positions, it is likely attributable to the Government’s evidence of the defendant’s guilt. We thus reject the argument that defendant, relying on *Duffy*, makes in this case—that the asserted disparity of power between the Government and a defendant in proffers renders waiver provisions in proffer agreements unenforceable.

Finally, a defendant remains free to present evidence inconsistent with his proffer statements, with the fair consequence that, if he does, “the Government [is] then . . . permitted to present the defendant’s own words in rebuttal.” *Gomez*. With this avenue open to him, a defendant who has consented to a waiver provision like the one at issue here has not forfeited his constitutional right to present a defense, to the effective assistance of his counsel, or to a fair trial.

Accordingly, we reject defendant’s claim that the waiver provision is unconstitutional, and we hold that, where a proffer agreement is entered into knowingly and voluntarily, a provision in which defendant waives his exclusionary privilege under Federal Rule of Evidence 410 by permitting the Government to introduce defendant’s proffer statements to rebut contrary evidence or arguments presented by the defense, whether or not defendant testifies, is enforceable. . . .

C. Plea Bargaining and the Constitution

A key element in understanding the power of prosecutors in plea negotiations, and the prevalence of guilty pleas, is the limited constitutional constraints on the practice of plea bargaining. The following two cases are the foundational Supreme Court decisions on the subject. Why do these rulings give so much power to the prosecutor? What is the rationale for doing so? What is potentially wrong with that power? If one wanted the prosecutor to have less power, could the Court have decided these cases differently? Exactly how?

BRADY v. UNITED STATES, 397 U.S. 742 (1970)

Mr. Justice WHITE delivered the opinion of the Court.

In 1959, petitioner was charged with kidnaping in violation of 18 U.S.C. § 1201(a). Since the indictment charged that the victim of the kidnaping was not liberated unharmed, petitioner faced a maximum penalty of death if the verdict of the jury should so recommend. Petitioner, represented by competent counsel throughout, first elected to plead not guilty. Apparently because the trial judge was unwilling to try the case without a jury, petitioner made no serious attempt to reduce the possibility of a death penalty by waiving a jury trial. Upon learning that his codefendant, who had confessed to the authorities, would plead guilty and be available to testify against him, petitioner changed his plea to guilty. His plea was accepted after the trial judge twice questioned him as to the voluntariness of his plea. Petitioner was sentenced to 50 years' imprisonment, later reduced to 30.

In 1967, petitioner sought relief under 28 U.S.C. § 2255, claiming that his plea of guilty was not voluntarily given because § 1201(a) operated to coerce his plea, because his counsel exerted impermissible pressure upon him, and because his plea was induced by representations with respect to reduction of sentence and clemency. It was also alleged that the trial judge had not fully complied with Rule 11 of the Federal Rules of Criminal Procedure. . . .

The trial judge in 1959 found the plea voluntary before accepting it; the District Court in 1968, after an evidentiary hearing, found that the plea was voluntarily made; the Court of Appeals specifically approved the finding of voluntariness. We see no reason on this record to disturb the judgment of those courts. Petitioner, advised by competent counsel, tendered his plea after his codefendant, who had already given a confession, determined to plead guilty and became available to testify against petitioner. It was this development that the District Court found to have triggered Brady's guilty plea.

The voluntariness of Brady's plea can be determined only by considering all of the relevant circumstances surrounding it. One of these circumstances was the possibility of a heavier sentence following a guilty verdict after a trial. It may be that Brady, faced with a strong case against him and recognizing that his chances for acquittal were slight, preferred to plead guilty and thus limit the penalty to life imprisonment rather than to

elect a jury trial which could result in a death penalty. But even if we assume that Brady would not have pleaded guilty except for the death penalty provision of § 1201(a), this assumption merely identifies the penalty provision as a ‘but for’ cause of his plea. That the statute caused the plea in this sense does not necessarily prove that the plea was coerced and invalid as an involuntary act.

The State to some degree encourages pleas of guilty at every important step in the criminal process. For some people, their breach of a State’s law is alone sufficient reason for surrendering themselves and accepting punishment. For others, apprehension and charge, both threatening acts by the Government, jar them into admitting their guilt. In still other cases, the post-indictment accumulation of evidence may convince the defendant and his counsel that a trial is not worth the agony and expense to the defendant and his family. All these pleas of guilty are valid in spite of the State’s responsibility for some of the factors motivating the pleas; the pleas are no more improperly compelled than is the decision by a defendant at the close of the State’s evidence at trial that he must take the stand or face certain conviction.

Of course, the agents of the State may not produce a plea by actual or threatened physical harm or by mental coercion overbearing the will of the defendant. But nothing of the sort is claimed in this case; nor is there evidence that Brady was so gripped by fear of the death penalty or hope of leniency that he did not or could not, with the help of counsel, rationally weigh the advantages of going to trial against the advantages of pleading guilty. Brady’s claim is of a different sort: that it violates the Fifth Amendment to influence or encourage a guilty plea by opportunity or promise of leniency and that a guilty plea is coerced and invalid if influenced by the fear of a possibly higher penalty for the crime charged if a conviction is obtained after the State is put to its proof.

Insofar as the voluntariness of his plea is concerned, there is little to differentiate Brady from (1) the defendant, in a jurisdiction where the judge and jury have the same range of sentencing power, who pleads guilty because his lawyer advises him that the judge will very probably be more lenient than the jury; (2) the defendant, in a jurisdiction where the judge alone has sentencing power, who is advised by counsel that the judge is normally more lenient with defendants who plead guilty than with those who go to trial; (3) the defendant who is permitted by prosecutor and judge to plead guilty to a lesser offense included in the offense charged; and (4) the defendant who pleads guilty to certain counts with the understanding that other charges will be dropped. In each of these situations, as in Brady’s case, the defendant might never plead guilty absent the possibility or certainty that the plea will result in a lesser penalty than the sentence that could be imposed after a trial and a verdict of guilty. We decline to hold, however, that a guilty plea is compelled and invalid under the Fifth Amendment whenever motivated by the defendant’s desire to accept the certainty or probability of a lesser penalty rather than face a wider range of possibilities extending from acquittal to conviction and a higher penalty authorized by law for the crime charged.

The issue we deal with is inherent in the criminal law and its administration because guilty pleas are not constitutionally forbidden, because the criminal law characteristically extends to judge or jury a range of choice in setting the sentence in individual cases, and because both the State and the defendant often find it advantageous to preclude the possibility of the maximum penalty authorized by law. For a defendant who sees slight possibility of acquittal, the advantages of pleading guilty and limiting the probable penalty are obvious—his exposure is reduced, the correctional processes can begin immediately, and the practical burdens of a trial are eliminated. For the State there are also advantages—the more promptly imposed punishment after an admission of guilt may more effectively attain the objectives of punishment; and with the avoidance of trial, scarce judicial and prosecutorial resources are conserved for those cases in which there is a substantial issue of the defendant's guilt or in which there is substantial doubt that the State can sustain its burden of proof. It is this mutuality of advantage that perhaps explains the fact that at present well over three-fourths of the criminal convictions in this country rest on pleas of guilty, a great many of them no doubt motivated at least in part by the hope or assurance of a lesser penalty than might be imposed if there were a guilty verdict after a trial to judge or jury.

Of course, that the prevalence of guilty pleas is explainable does not necessarily validate those pleas or the system which produces them. But we cannot hold that it is unconstitutional for the State to extend a benefit to a defendant who in turn extends a substantial benefit to the State and who demonstrates by his plea that he is ready and willing to admit his crime and to enter the correctional system in a frame of mind that affords hope for success in rehabilitation over a shorter period of time than might otherwise be necessary.

A contrary holding would require the States and Federal Government to forbid guilty pleas altogether, to provide a single invariable penalty for each crime defined by the statutes, or to place the sentencing function in a separate authority having no knowledge of the manner in which the conviction in each case was obtained. In any event, it would be necessary to forbid prosecutors and judges to accept guilty pleas to selected counts, to lesser included offenses, or to reduced charges. The Fifth Amendment does not reach so far. . . .

The standard as to the voluntariness of guilty pleas must be essentially that defined by Judge Tuttle of the Court of Appeals for the Fifth Circuit:

(A) plea of guilty entered by one fully aware of the direct consequences, including the actual value of any commitments made to him by the court, prosecutor, or his own counsel, must stand unless induced by threats (or promises to discontinue improper harassment), misrepresentation (including unfulfilled or unfulfillable promises), or perhaps by promises that are by their nature improper as having no proper relationship to the prosecutor's business (e.g. bribes).

Under this standard, a plea of guilty is not invalid merely because entered to avoid the possibility of a death penalty.

BORDENKIRCHER v. HAYES, 434 U.S. 367 (1978)

Mr. Justice STEWART delivered the opinion of the Court.

The question in this case is whether the Due Process Clause of the Fourteenth Amendment is violated when a state prosecutor carries out a threat made during plea negotiations to reindict the accused on more serious charges if he does not plead guilty to the offense with which he was originally charged.

The respondent, Paul Lewis Hayes, was indicted by a Fayette County, Ky., grand jury on a charge of uttering a forged instrument in the amount of \$88.30, an offense then punishable by a term of 2 to 10 years in prison. Ky. Rev. Stat. § 434.130 (1973) (repealed 1975). After arraignment, Hayes, his retained counsel, and the Commonwealth's Attorney met in the presence of the Clerk of the Court to discuss a possible plea agreement. During these conferences the prosecutor offered to recommend a sentence of five years in prison if Hayes would plead guilty to the indictment. He also said that if Hayes did not plead guilty and "save[d] the court the inconvenience and necessity of a trial," he would return to the grand jury to seek an indictment under the Kentucky Habitual Criminal Act, then Ky. Rev. Stat. § 431.190 (1973) (repealed 1975), which would subject Hayes to a mandatory sentence of life imprisonment by reason of his two prior felony convictions. Hayes chose not to plead guilty, and the prosecutor did obtain an indictment charging him under the Habitual Criminal Act. It is not disputed that the recidivist charge was fully justified by the evidence, that the prosecutor was in possession of this evidence at the time of the original indictment, and that Hayes' refusal to plead guilty to the original charge was what led to his indictment under the habitual criminal statute.

A jury found Hayes guilty on the principal charge of uttering a forged instrument and, in a separate proceeding, further found that he had twice before been convicted of felonies. As required by the habitual offender statute, he was sentenced to a life term in the penitentiary. The Kentucky Court of Appeals rejected Hayes' constitutional objections to the enhanced sentence, holding in an unpublished opinion that imprisonment for life with the possibility of parole was constitutionally permissible in light of the previous felonies of which Hayes had been convicted, and that the prosecutor's decision to indict him as a habitual offender was a legitimate use of available leverage in the plea-bargaining process.

On Hayes' petition for a federal writ of habeas corpus, the United States District Court for the Eastern District of Kentucky agreed that there had been no constitutional violation in the sentence or the indictment procedure, and denied the writ. The Court of Appeals for the Sixth Circuit reversed the District Court's judgment. While recognizing "that plea bargaining now plays an important role in our criminal justice system," the appellate court thought that the prosecutor's conduct during the bargaining negotiations

had violated the principles of *Blackledge v. Perry*, which “protect[ed] defendants from the vindictive exercise of a prosecutor’s discretion.” Accordingly, the court ordered that Hayes be discharged “except for his confinement under a lawful sentence imposed solely for the crime of uttering a forged instrument.” We granted certiorari to consider a constitutional question of importance in the administration of criminal justice.

It may be helpful to clarify at the outset the nature of the issue in this case. While the prosecutor did not actually obtain the recidivist indictment until after the plea conferences had ended, his intention to do so was clearly expressed at the outset of the plea negotiations. Hayes was thus fully informed of the true terms of the offer when he made his decision to plead not guilty. This is not a situation, therefore, where the prosecutor without notice brought an additional and more serious charge after plea negotiations relating only to the original indictment had ended with the defendant’s insistence on pleading not guilty. As a practical matter, in short, this case would be no different if the grand jury had indicted Hayes as a recidivist from the outset, and the prosecutor had offered to drop that charge as part of the plea bargain.

The Court of Appeals nonetheless drew a distinction between “concessions relating to prosecution under an existing indictment,” and threats to bring more severe charges not contained in the original indictment—a line it thought necessary in order to establish a prophylactic rule to guard against the evil of prosecutorial vindictiveness. Quite apart from this chronological distinction, however, the Court of Appeals found that the prosecutor had acted vindictively in the present case since he had conceded that the indictment was influenced by his desire to induce a guilty plea. The ultimate conclusion of the Court of Appeals thus seems to have been that a prosecutor acts vindictively and in violation of due process of law whenever his charging decision is influenced by what he hopes to gain in the course of plea bargaining negotiations.

We have recently had occasion to observe: “[W]hatever might be the situation in an ideal world, the fact is that the guilty plea and the often concomitant plea bargain are important components of this country’s criminal justice system. Properly administered, they can benefit all concerned.” *Blackledge v. Allison*. The open acknowledgment of this previously clandestine practice has led this Court to recognize the importance of counsel during plea negotiations, *Brady v. United States*, the need for a public record indicating that a plea was knowingly and voluntarily made, *Boykin v. Alabama*, and the requirement that a prosecutor’s plea-bargaining promise must be kept, *Santobello v. New York*. The decision of the Court of Appeals in the present case, however, did not deal with considerations such as these, but held that the substance of the plea offer itself violated the limitations imposed by the Due Process Clause of the Fourteenth Amendment. For the reasons that follow, we have concluded that the Court of Appeals was mistaken in so ruling.

This Court held . . . that the Due Process Clause of the Fourteenth Amendment “requires that vindictiveness against a defendant for having successfully attacked his first conviction must play no part in the sentence he receives after a new trial.” The same

principle was later applied to prohibit a prosecutor from reindicting a convicted misdemeanant on a felony charge after the defendant had invoked an appellate remedy, since in this situation there was also a “realistic likelihood of ‘vindictiveness.’” *Blackledge v. Perry*.

In those cases the Court was dealing with the State’s unilateral imposition of a penalty upon a defendant who had chosen to exercise a legal right to attack his original conviction—a situation “very different from the give-and-take negotiation common in plea bargaining between the prosecution and defense, which arguably possess relatively equal bargaining power.” *Parker v. North Carolina*. The Court has emphasized that the due process violation in cases such as *Pearce* and *Perry* lay not in the possibility that a defendant might be deterred from the exercise of a legal right, but rather in the danger that the State might be retaliating against the accused for lawfully attacking his conviction.

To punish a person because he has done what the law plainly allows him to do is a due process violation of the most basic sort, and for an agent of the State to pursue a course of action whose objective is to penalize a person’s reliance on his legal rights is “patently unconstitutional.” *Chaffin v. Stynchcombe*. But in the “give-and-take” of plea bargaining, there is no such element of punishment or retaliation so long as the accused is free to accept or reject the prosecution’s offer.

Plea bargaining flows from “the mutuality of advantage” to defendants and prosecutors, each with his own reasons for wanting to avoid trial. Defendants advised by competent counsel and protected by other procedural safeguards are presumptively capable of intelligent choice in response to prosecutorial persuasion, and unlikely to be driven to false self-condemnation. Indeed, acceptance of the basic legitimacy of plea bargaining necessarily implies rejection of any notion that a guilty plea is involuntary in a constitutional sense simply because it is the end result of the bargaining process. By hypothesis, the plea may have been induced by promises of a recommendation of a lenient sentence or a reduction of charges, and thus by fear of the possibility of a greater penalty upon conviction after a trial.

While confronting a defendant with the risk of more severe punishment clearly may have a “discouraging effect on the defendant’s assertion of his trial rights, the imposition of these difficult choices [is] an inevitable”—and permissible—“attribute of any legitimate system which tolerates and encourages the negotiation of pleas.” *Chaffin v. Stynchcombe*. It follows that, by tolerating and encouraging the negotiation of pleas, this Court has necessarily accepted as constitutionally legitimate the simple reality that the prosecutor’s interest at the bargaining table is to persuade the defendant to forgo his right to plead not guilty.

It is not disputed here that Hayes was properly chargeable under the recidivist statute, since he had in fact been convicted of two previous felonies. In our system, so long as the prosecutor has probable cause to believe that the accused committed an offense defined by statute, the decision whether or not to prosecute, and what charge to file or

bring before a grand jury, generally rests entirely in his discretion. Within the limits set by the legislature's constitutionally valid definition of chargeable offenses, "the conscious exercise of some selectivity in enforcement is not in itself a federal constitutional violation" so long as "the selection was [not] deliberately based upon an unjustifiable standard such as race, religion, or other arbitrary classification." *Oyler v. Boles*. To hold that the prosecutor's desire to induce a guilty plea is an "unjustifiable standard," which, like race or religion, may play no part in his charging decision, would contradict the very premises that underlie the concept of plea bargaining itself. Moreover, a rigid constitutional rule that would prohibit a prosecutor from acting forthrightly in his dealings with the defense could only invite unhealthy subterfuge that would drive the practice of plea bargaining back into the shadows from which it has so recently emerged.

There is no doubt that the breadth of discretion that our country's legal system vests in prosecuting attorneys carries with it the potential for both individual and institutional abuse. And broad though that discretion may be, there are undoubtedly constitutional limits upon its exercise. We hold only that the course of conduct engaged in by the prosecutor in this case, which no more than openly presented the defendant with the unpleasant alternatives of forgoing trial or facing charges on which he was plainly subject to prosecution, did not violate the Due Process Clause of the Fourteenth Amendment. . . .

Problem 16-1

Why has the Supreme Court largely rejected the idea of constitutional regulation of the coerciveness of plea bargaining, even as public and academic concerns about the dominance of plea-bargaining mills in the criminal justice system has grown? Can you think of a different approach a future Court might be able to take to constitutional regulation of plea bargains?

D. Plea Agreements Without Cooperation

The following is an example of a "straight" plea agreement, without cooperation provisions, in an insider trading prosecution related to the investigation of Raj Rajaratnam and the Galleon hedge fund, discussed in Chapter 4. What does the defendant get under this type of agreement? What does the defendant give up? Ask the same questions with respect to the prosecutor, and tally the results. Why might a client wish to enter into this kind of "straight" plea agreement?

U.S. Department of Justice
United States Attorney
Southern District of New York

January 18, 2011

Alan Kaufman, Esq.
Kelley Drye & Warren
101 Park Avenue
New York, NY 10178

Re: United States v. Danielle Chiesi, SI 09 Cr. 1184 (RJH)

Dear Mr. Kaufman:

On the understandings specified below, the Office of the United States Attorney for the Southern District of New York (“this Office”) will accept a guilty plea from Danielle Chiesi (“the defendant”) to Counts Five, Six and Seven of the above-referenced Indictment.

Counts Five, Six and Seven charge the defendant with conspiracy to commit securities fraud, in violation of Title 18, United States Code, Section 371, and each count carries a maximum sentence of five years’ imprisonment; a maximum fine, pursuant to Title 18, United States Code, Section 3571 of the greatest of \$250,000, twice the gross pecuniary gain derived from the offense, or twice the gross pecuniary loss to persons other than the defendant resulting from the offense; a mandatory \$100 special assessment; and a maximum period of supervised release of three years. The total maximum term of imprisonment for all three counts is fifteen years, in addition to the foregoing, the Court must order restitution in accordance with Sections 3663, 3663A and 3664 of Title 18, United States Code.

In consideration of the defendant’s plea to the above offenses, the defendant will not be further prosecuted criminally by this Office (except for criminal tax violations as to which this Office cannot, and does not, make any agreement) for her participation in schemes to engage in insider trading from in or about July 2008 through in or about April 2009 in the securities of Sun Microsystems Inc., Advanced Micro Devices, Inc., International Business Machines Corp., Akamai Technologies, Inc., Sybase, Inc., Lenovo Group Ltd., and Marvell Technology Group Ltd., as charged in Counts Five, Six and Seven of the Indictment and disclosed in the Bill of Particulars filed in this matter. In addition, at the time of sentencing, the Government will move to dismiss any open Count(s) against the defendant. The defendant agrees that with respect to any and all dismissed charges she is not a “prevailing party” within the meaning of the “Hyde Amendment,” Section 617, P.L. (Nov. 26, 1997), and will not file any claim under that law.

The defendant hereby admits the forfeiture allegations with respect to Counts Five, Six and Seven of the Indictment and agrees to forfeit to the United States, pursuant

to Title 18, United States Code, Section 981(a)(1)(C) and Title 28, United States Code, Section 2461, the proceeds she obtained as a result of the offenses charged in Counts Five, Six and Seven of the Indictment. The defendant agrees that she will not file a claim or a petition for remission or mitigation in any forfeiture proceeding and will not cause or assist anyone else in doing so. It is further understood that any forfeiture of the defendant's assets shall not be treated as satisfaction of any fine, restitution, cost of imprisonment, or any other penalty the Court may impose upon her in addition to forfeiture.

In consideration of the foregoing and pursuant to United States Sentencing Guidelines ("U.S.S.G." or "Guidelines") Section 6B1.4, the parties hereby stipulate to the following:

A. Offense Level

1. The Guidelines provisions in effect as of November 1, 2010 apply in this case.
2. The Guidelines provision applicable to the offenses charged in Counts Five, Six and Seven of the Indictment is U.S.S.G. § 2B1.4. Pursuant to U.S.S.G. § 2B1.4(a), the base offense level is 8.
3. The base offense level is increased by 16 levels because the gain is greater than \$1,000,000 but not more than \$2,500,000. U.S.S.G. §§ 2B 1.4(b)(1), 2B1.1(b)(1)(I).
4. Assuming the defendant clearly demonstrates acceptance of responsibility, to the satisfaction of the Government, through her allocution and subsequent conduct prior to the imposition of sentence, a two-level reduction will be warranted, pursuant to U.S.S.G. § 3E1.1(a). Furthermore, assuming the defendant has accepted responsibility as described in the previous sentence, an additional one-level reduction is warranted, pursuant to U.S.S.G. § 3E1.1 (b), because the defendant gave timely notice of her intention to enter a plea of guilty, thereby permitting the Government to avoid preparing for trial and permitting the Court to allocate its resources efficiently.

In accordance with the above, the applicable Guidelines offense level is 21.

B. Criminal History Category

Based upon the information now available to this Office (including representations by the defense), the defendant has no criminal history points. Accordingly, the defendant's Criminal History Category is I.

C. Sentencing Range

Based upon the calculations set forth above, the defendant's stipulated sentencing Guidelines range is 37 to 46 months' imprisonment (the "Stipulated Guidelines Range"). In addition, after determining the defendant's ability to pay, the Court may impose a fine pursuant to §5E1.2. At Guidelines level 21, the applicable fine range is \$7,500 to \$75,000.

The parties agree that neither a downward nor an upward departure from the Stipulated Guidelines Range set forth above is warranted. Accordingly, neither party will seek any departure or adjustment pursuant to the Guidelines that is not set forth herein. Nor will either party suggest that the Probation Office consider such a departure or adjustment under the Guidelines, or suggest that the Court *sua sponte* consider any such departure or adjustment.

The parties agree that either party may seek a sentence outside of the Stipulated Guidelines Range, suggest that the Probation Office consider a sentence outside of the Stipulated Guidelines Range, and suggest that the Court *sua sponte* consider a sentence outside of the Stipulated Guidelines Range, based upon the factors to be considered in imposing a sentence pursuant to Title 18, United States Code, Section 3553(a).

Except as provided in any written Proffer Agreement(s) that may have been entered into between this Office and the defendant, nothing in this Agreement limits the right of the parties (i) to present to the Probation Office or the Court any facts relevant to sentencing; (ii) to make any arguments regarding where within the Stipulated Guidelines Range (or such other range as the Court may determine) the defendant should be sentenced and regarding the factors to be considered in imposing a sentence pursuant to Title 18, United States Code, Section 3553(a); (iii) to seek an appropriately adjusted Guidelines range if it is determined based upon new information that the defendant's criminal history category is different from that set forth above; and (iv) to seek an appropriately adjusted Guidelines range or mandatory minimum term of imprisonment if it is subsequently determined that the defendant qualifies as a career offender under U.S.S.G. § 4B1.1. Nothing in this Agreement limits the right of the Government to seek denial of the adjustment for acceptance of responsibility, *see* U.S.S.G. § 3E1.1, regardless of any stipulation set forth above, if the defendant fails clearly to demonstrate acceptance of responsibility, to the satisfaction of the Government, through her allocution and subsequent conduct prior to the imposition of sentence. Similarly, nothing in this Agreement limits the right of the Government to seek an enhancement for obstruction of justice, *see* U.S.S.G. § 3C1.1, regardless of any stipulation set forth above, should it be determined that the defendant has either (i) engaged in conduct, unknown to the Government at the time of the signing of this Agreement, that constitutes obstruction of justice or (ii) committed another crime after signing this Agreement.

It is understood that pursuant to U.S.S.G. § 6B 1.4(d), neither the Probation Office nor the Court is bound by the above Guidelines stipulation, either as to questions of fact or as to the determination of the proper Guidelines to apply to the facts. In the

event that the Probation Office or the Court contemplates any Guidelines adjustments, departures, or calculations different from those stipulated to above, or contemplates any sentence outside of the Stipulated Guidelines Range, the parties reserve the right to answer any inquiries and to make all appropriate arguments concerning the same.

It is understood that the sentence to be imposed upon the defendant is determined solely by the Court. It is further understood that the Guidelines are not binding on the Court. The defendant acknowledges that her entry of a guilty plea to Counts Five, Six and Seven of the Indictment authorizes the sentencing court to impose any sentence, up to and including the statutory maximum sentence. This Office cannot, and does not, make any promise or representation as to what sentence the defendant will receive. Moreover, it is understood that the defendant will have no right to withdraw her plea of guilty should the sentence imposed by the Court be outside the Stipulated Guidelines Range set forth above.

It is agreed (i) that the defendant will not file a direct appeal; nor bring a collateral challenge, including but not limited to an application under Title 28, United States Code, Section 2255 and/or Section 2241; nor seek a sentence modification pursuant to Title 18, United States Code, Section 3582(c), of any sentence within or below the Stipulated Guidelines Range of 37 to 46 months imprisonment and (ii) that the Government will not appeal any sentence within or above the Stipulated Guidelines Range. This provision is binding on the parties even if the Court employs a Guidelines analysis different from that stipulated to herein. Furthermore, it is agreed that any appeal as to the defendant's sentence that is not foreclosed by this provision will be limited to that portion of the sentencing calculation that is inconsistent with (or not addressed by) the above stipulation. The parties agree that this waiver applies regardless of whether the term of imprisonment is imposed to run consecutively to or concurrently with the undischarged portion of any other sentence of imprisonment that has been imposed on the defendant at the time of sentencing in this case. The defendant further agrees not to appeal any term of supervised release that is less than or equal to the statutory maximum.

The defendant hereby acknowledges that she has accepted this Agreement and decided to plead guilty because she is in fact guilty. By entering this plea of guilty, the defendant waives any and all right to withdraw her plea or to attack her conviction, either on direct appeal or collaterally, on the ground that the Government has failed to produce any discovery material, *Jencks* Act material, exculpatory material pursuant to *Brady v. Maryland*, other than information establishing the factual innocence of the defendant, and impeachment material pursuant to *Giglio v. United States*, that has not already been produced as of the date of the signing of this Agreement.

It is further agreed that should the conviction(s) following the defendant's plea(s) of guilty pursuant to this Agreement be vacated for any reason, then any prosecution that is not time-barred by the applicable statute of limitations on the date of the signing of this agreement (including any counts that the Government has agreed to dismiss at sentencing pursuant to this Agreement) may be commenced or reinstated against the

defendant, notwithstanding the expiration of the statute of limitations between the signing of this Agreement and the commencement or reinstatement of such prosecution. It is the intent of this Agreement to waive all defenses based on the statute of limitations with respect to any prosecution that is not time-barred on the date that this Agreement is signed.

It is further understood that this Agreement does not bind any federal, state, or local prosecuting authority other than this Office.

Apart from any written Proffer Agreement(s) that may have been entered into between this Office and defendant, this Agreement supersedes any prior understandings, promises, or conditions between this Office and the defendant. No additional understandings, promises, or conditions have been entered into other than those set forth in this Agreement, and none will be entered into unless in writing and signed by all parties.

Very truly yours,

PREET BHARARA
United States Attorney

E. Plea Agreements with Cooperation

To understand the benefits to defendants of entering into plea agreements that involve cooperation with prosecutors, including testimony, one must begin with the Sentencing Guidelines. Since the 1980s, the following provision has been the engine producing large numbers of cooperation agreements in federal criminal cases. Why is (or was) it so powerful? (The answer to this question will become clearer when the Sentencing Guidelines are taken up in full in Chapter 18.)

United States Sentencing Guidelines § 5K1.1 Substantial Assistance to Authorities (Policy Statement)

Upon motion of the government stating that the defendant has provided substantial assistance in the investigation or prosecution of another person who has committed an offense, the court may depart from the guidelines.

- (a) The appropriate reduction shall be determined by the court for reasons stated that may include, but are not limited to, consideration of the following:
 - (1) the court's evaluation of the significance and usefulness of the defendant's assistance, taking into consideration the government's evaluation of the assistance rendered;
 - (2) the truthfulness, completeness, and reliability of any information or testimony provided by the defendant;
 - (3) the nature and extent of the defendant's assistance;

- (4) any injury suffered, or any danger or risk of injury to the defendant or his family resulting from his assistance;
- (5) the timeliness of the defendant's assistance.

The following is an example of a plea agreement with cooperation provisions. (This defendant was the star witness who broke open the FIFA corruption case for the government, although he died before he or anyone else could see the full results of his cooperation.) What does the defendant get in this type of agreement? What does the defendant give up? Same questions as to the prosecutor. How does the resulting tally differ from that in a plea agreement without cooperation provisions like the Chiesi agreement above?

United States v. Charles Blazer

No. 1:13-cr-00602-RJD (E.D.N.Y. June 15, 2015)

Cooperation Agreement

Pursuant to Rule 11 of the Federal Rules of Criminal Procedure, the United States Attorney's Office for the Eastern District of New York (the "Office") and CHARLES BLAZER (the "defendant") agree to the following:

1. The defendant will waive indictment and, where applicable, venue and plead guilty to a 10-count information to be filed in this District charging violations of 18 U.S.C. § 1962(d) (Count One), 18 U.S.C. § 1349 (Count Two), 18 U.S.C. § 1956(h) (Count Three), 26 U.S.C. § 7201 (counts Four through Nine) and 31 U.S.C. § 5314 (Count Ten). The foregoing counts carry the following statutory penalties:

Count One (Racketeering Conspiracy)

- a. Maximum term of imprisonment: 20 years (18 U.S.C. § 1963(a)).
- b. Minimum term of imprisonment: 0 years (18 U.S.C. § 1963(a)).
- c. Maximum supervised release term: 3 years, to follow any term of imprisonment; if a condition of release is violated, the defendant may be sentenced to up to 2 years' imprisonment without credit for pre-release imprisonment or time previously served on post-release supervision (18 U.S.C. §§ 3583 (b), (e)).
- d. Maximum fine: the greater of \$250,000 or twice the gross profits of the enterprise (18 U.S.C. §§ 3571 and 1963(a)).
- e. Restitution: mandatory, in an amount to be determined by the court (18 U.S.C. §§ 3663 and 3663A).

- f. \$100 special assessment (18 U.S.C. § 3013).
- g. Criminal forfeiture: the defendant consents to criminal forfeiture, as set forth below in paragraphs 7 through 14 (18 U.S.C. §§ 1963(a) and 1963(m)).

Count Two (Wire Fraud Conspiracy)

- a. Maximum term of imprisonment: 20 years (18 U.S.C. §§ 1343, 1349).
- b. Minimum term of imprisonment: 0 years (18 U.S.C. §§ 1343, 1349).
- c. Maximum supervised release term: 3 years, to follow any term of imprisonment; if a condition of release is violated, the defendant may be sentenced to up to 2 years' imprisonment without credit for pre-release imprisonment or time previously served on post-release supervision (18 U.S.C. §§ 3583(b), (e)).
- d. Maximum fine: the greater of \$250,000 or twice the gross gain or gross loss (18 U.S.C. §§ 3571(b)(3), (d)).
- e. Restitution: mandatory, in an amount to be determined by the Court (18 U.S.C. §§ 3663 and 3663A).
- f. \$100 special assessment (18 U.S.C. § 3013).
- g. Criminal forfeiture: the defendant consents to criminal forfeiture, as set forth below in paragraphs 7 through 14 (18 U.S.C. § 981(a)(1)(C), 28 U.S.C. § 2461(c) and 21 U.S.C. § 853(p)).

Count Three (Money Laundering Conspiracy)

- a. Maximum term of imprisonment: 20 years (18 U.S.C. §§ 1956 (a), (h)).
- b. Minimum term of imprisonment: 0 years (18 U.S.C. §§ 1956 (a), (h)).
- c. Maximum supervised release term: 3 years, to follow any term of imprisonment; if a condition of release is violated, the defendant may be sentenced to up to 2 years' imprisonment without credit for pre-release imprisonment or time previously served on post-release supervision (18 U.S.C. §§ 3583 (b), (e)).
- d. Maximum fine: the greater of \$500,000 or twice the value of the monetary instrument or funds involved (18 U.S.C. § 1956(a)).
- e. Restitution: mandatory, in an amount to be determined by the Court (18 U.S.C. §§ 3663 and 3663A).
- f. \$100 special assessment (18 U.S.C. § 3013).

g. Criminal forfeiture: the defendant consents to criminal forfeiture, as set forth below in paragraphs 7 through 14 (18 U.S.C. §§ 982(a)(1) and 982(b), 28 U.S.C. § 2461(c) and 21 U.S.C. § 853(p)).

Counts Four through Nine (Tax Evasion)

- a. Maximum term of imprisonment: 5 years (26 U.S.C. § 7201).
- b. Minimum term of imprisonment: 0 years (26 U.S.C. § 7201).
- c. Maximum supervised release term: 3 years, to follow any term of imprisonment; if a condition of release is violated, the defendant may be sentenced to up to 2 years' imprisonment without credit for pre-release imprisonment or time previously served on post-release supervision (18 U.S.C. § 3583(b), (e)).
- d. Maximum fine: \$100,000 and the costs of prosecution (26 U.S.C. § 7201).
- e. Restitution: As further described below in paragraph 3(g), the defendant agrees to pay restitution to the Internal Revenue Service, and further agrees that the tax due and owing for the years 2005 through 2010 will be based on unreported total income in excess of \$11 million (18 U.S.C. § 3663).
- f. \$100 special assessment (18 U.S.C. § 3013).

Count Ten (Failure to File FBAR)

- a. Maximum term of imprisonment: 10 years (31 U.S.C. § 5322(b)).
- b. Minimum term of imprisonment: 0 years (31 U.S.C. § 5322 (b)).
- c. Maximum supervised release term: 3 years, to follow any term of imprisonment; if a condition of release is violated, the defendant may be sentenced to up to 2 years' imprisonment without credit for pre-release imprisonment or time previously served on post-release supervision (18 U.S.C. § 3583(b), (e)).
- d. Maximum fine: \$500,000 (31 U.S.C. § 5322(b)).
- e. Restitution: in an amount to be determined by the court (18 U.S.C. § 3663).
- f. \$100 special assessment. (18 U.S.C. § 3013).
- g. Other penalties: A civil money penalty of \$487,875.74, as described further below in paragraph 3(g) (31 U.S.C. § 5321(a)(5)(C), (D)).

The sentence imposed on each count may run consecutively.

2. The defendant understands that although imposition of a sentence in accordance with the United States Sentencing Guidelines (the "Guidelines" and "U.S.S.G.") is not

mandatory, the Guidelines are advisory and the Court is required to consider any applicable Guidelines provisions as well as other factors enumerated in 18 U.S.C. § 3553(a) to arrive at an appropriate sentence in this case. The Office will advise the Court and the Probation Department of information relevant to sentencing, including all criminal activity engaged in by the defendant, and such information may be used by the Court in determining the defendant's sentence. If the defendant clearly demonstrates acceptance of responsibility, through allocution and subsequent conduct prior to the imposition of sentence, a two-level reduction will be warranted, pursuant to U.S.S.G. § 3B1.1(a). Furthermore, if the defendant has accepted responsibility as described above, and if the defendant pleads guilty on or before November 25, 2013, an additional one-level reduction will be warranted, pursuant to U.S.S.G. § 3E1.1(b).

3. The defendant will provide truthful, complete and accurate information and will cooperate fully with the Office. This cooperation will include, but is not limited to, the following:

a. The defendant agrees to be fully debriefed and to attend all meetings at which his presence is requested, concerning his participation in and knowledge of all criminal activities.

b. The defendant agrees to furnish to the Office all documents and other material that may be relevant to the investigation and that are in the defendant's possession or control and to participate in undercover activities pursuant to the specific instructions of law enforcement agents or this Office.

c. The defendant agrees not to reveal his cooperation, or any information derived therefrom, to any third party without prior consent of the Office.

d. The defendant agrees to testify at any proceeding in the Eastern District of New York or elsewhere; including in foreign jurisdictions, as requested by the Office.

e. The defendant consents to adjournments of his sentence as requested by the Office.

f. The defendant agrees to cooperate fully with the Internal Revenue Service in the ascertainment, computation and payment of his correct federal income tax liability for the years 2005 through 2013, as well as any later tax years that become due and owing prior to the imposition of sentence. To that end, the defendant will file tax returns for the years 2005 through 2013, along with all tax due and owing, exclusive of penalties and interest, within one (1) year of the date of this agreement and consents to the disclosure to the Internal Revenue Service of information relating to his financial affairs that is in the possession of third parties. With respect to the years 2005 through 2010, which are the subject of Counts Four through Nine of the information and the agreement regarding restitution noted above, the defendant stipulates and agrees that the tax due and owing will be based on unreported total income in excess of \$11 million.

The defendant further agrees to allow the contents of his Internal Revenue Service criminal file to be given to civil attorneys and support staff of the Internal Revenue Service to enable them to investigate any and all civil penalties that may be due and owing by the defendant. With respect to disclosure of the criminal file to the Internal Revenue Service, the defendant waives any rights under Title 26, United States Code, Section 7213 and Fed R. Crim. P. 6(e), and any other right to privacy with respect to the defendant's tax returns and tax information. The defendant agrees that for the purposes of 31 U.S.C. §§ 5321(a)(5)(C) and (D), the value of his unreported account at First Caribbean International Bank (Bahamas) in 2010 was \$975,751.48, and he is subject to a civil monetary penalty of 50% of that amount, or \$487,875.74.

g. The defendant agrees to comply with the forfeiture provisions set forth in paragraphs 7 through 14, below.

h. The defendant will consent to, and not oppose, any ban that may hereafter be imposed on him by the Federation Internationale de Football Association ("FIFA") or any other soccer governing body.

4. The Office agrees that:

a. Except as provided in paragraphs 1, 16 and 17, no criminal charges will be brought against the defendant for his heretofore disclosed participation in (i) criminal activity involving mail, wire and bank fraud, money laundering, interstate and foreign travel in aid of racketeering, interstate and foreign transportation of money taken by fraud and New York State commercial bribery, all in connection with the following: (A) aiding and abetting the receipt of a bribe and/or kickback payment offered in connection with the voting to host the 1998 FIFA World Cup, which conduct took place in or about 1992; (B) the sale of tickets for FIFA World Cups in or about and between 1994 and 2002; (C) the receipt of bribe and/or kickback payments made in connection with the sale of media and marketing rights associated with the Confederation of North, Central American and Caribbean Association Football ("CONCACAF") Gold Cups played between 1996 and 2003, which conduct took place in or about and between 1993 and 2003; and (D) the receipt of bribe and/or kickback payments made in connection with the voting to host the 2010 FIFA World Cup, which conduct took place in or about and between 2004 and 2011; (ii) violations of Title 26, United States Code, in connection with the willful failure to file personal income tax returns for tax years 1994 through 2010; and (iii) violations of Title 31, United States Code, in connection with the willful failure to file Reports of Foreign Bank and Financial Accounts for tax years 1994 through 2010.

b. No statements made by the defendant during the course of this cooperation will be used against him except as provided in paragraphs 2, 16 and 17.

5. The defendant agrees that the Office may meet with and debrief him without the presence of counsel, unless the defendant specifically requests counsel's presence at

such debriefings and meetings. Upon request of the defendant, the Office will endeavor to provide advance notice to counsel of the place and time of meetings and debriefings, it being understood that the Office's ability to provide such notice will vary according to time constraints and other circumstances. The Office may accommodate requests to alter the time and place of such debriefings. It is understood, however, that any cancellations or reschedulings of debriefings or meetings requested by the defendant that hinder the Office's ability to prepare adequately for trials, hearings or other proceedings may adversely affect the defendant's ability to provide substantial assistance. Matters occurring at any meeting or debriefing may be considered by the Office in determining whether the defendant has provided substantial assistance or otherwise complied with this agreement and may be considered by the Court in imposing sentence regardless of whether counsel was present at the meeting or debriefing.

6. If the Office determines that the defendant has cooperated fully, provided substantial assistance to law enforcement authorities and otherwise complied with the terms of this agreement, the Office will file a motion pursuant to U.S.S.G. § 5K1.1 with the sentencing court setting forth the nature and extent of his cooperation. Such a motion will allow the Court, in applying the advisory Guidelines, to consider a range below the Guidelines range that would otherwise apply. In this connection, it is understood that a good faith determination by the Office as to whether the defendant has cooperated fully and provided substantial assistance and has otherwise complied with the terms of this agreement, including the demonstration of acceptance of responsibility described in paragraph 2, and the Office's good faith assessment of the value, truthfulness, completeness and accuracy of the cooperation, shall be binding upon him. The defendant agrees that, in making this determination, the Office may consider facts known to it at this time. The Office will not recommend to the Court a specific sentence to be imposed. Further, the Office cannot and does not make a promise or representation as to what sentence will be imposed by the Court.

7. The defendant acknowledges that money and property is subject to forfeiture as a result of his violations of 18 U.S.C. §§ 1962(d), 1349 and 1956(h), as alleged in the information. Pursuant to 18 U.S.C. §§ 1963(a), 981(a)(1)(C) and 982(a)(1), and 28 U.S.C. § 2461(c), the defendant consents to the forfeiture of one million nine hundred fifty-eight thousand ninety-two dollars and seventy two cents (\$1,958,092.72), which represents a portion of the monies that defendant received from bribes, kickbacks and unauthorized World Cup ticket sales . . . and to the forfeiture of a second unspecified amount of United States currency to be determined by the Court. . . . [ed: *extensive procedural provisions for facilitating the forfeiture process have been omitted*].

16. The defendant must at all times give complete, truthful and accurate information and testimony, and must not commit, or attempt to commit, any further crimes. Should it be judged by the Office that the defendant has failed to cooperate fully, has intentionally given false, misleading or incomplete information or testimony, has committed or attempted to commit any further crimes, or has otherwise violated any provision of this agreement, the defendant will not be released from his plea of guilty

but this Office will be released from its obligations under this agreement, including (a) not to oppose a downward adjustment of two levels for acceptance of responsibility described in paragraph 2 above and to make the motion for an additional one-level reduction described in paragraph 2 above, and (b) to file the motion described in paragraph 6 above. Moreover, this Office may withdraw the motion described in paragraph 6 above, if such motion has been filed prior to sentencing. The defendant will also be subject to prosecution for any federal criminal violation of which the Office has knowledge, including, but not limited to, the criminal activity described in paragraph 4 above, perjury and obstruction of justice.

17. Any prosecution resulting from the defendant's failure to comply with the terms of this agreement may be premised upon, among other things: (a) any statements made by the defendant to the Office or to other law enforcement agents on or after December 29, 2011; (b) any testimony given by him before any grand jury or other tribunal, whether before or after the date this agreement is signed by the defendant; and (c) any leads derived from such statements or testimony. Prosecutions that are not time-barred by the applicable statutes of limitation on the date this agreement is signed may be commenced against the defendant in accordance with this paragraph, notwithstanding the expiration of the statutes of limitation between the signing of this agreement and the commencement of any such prosecutions. Furthermore, the defendant waives all claims under the United States constitution, Rule 11(f) of the Federal Rules of Criminal Procedure, Rule 410 of the Federal Rules of Evidence, or any other federal statute or rule, that statements made by him on or after December 29, 2011, or any leads derived therefrom, should be suppressed.

18. This agreement does not bind any federal, state or local prosecuting authority other than the Office, and does not prohibit the Office from initiating or prosecuting any civil or administrative proceedings directly or indirectly involving the defendant. Apart from the written proffer agreements dated December 29, 2011, January 17, 2012, January 18, 2012, January 31, 2012, February 1, 2012, March 13, 2012, March 15, 2012, March 21, 2012, April 25, 2012, April 27, 2012, May 14, 2012, June 26, 2012, July 19, 2012, October 3, 2012, October 5, 2012, January 14, 2013, January 16, 2013, June 10, 2013 and November 13, 2013. no promises, agreements or conditions have been entered into other than those set forth in this agreement, and none will be entered into unless memorialized in writing and signed by all parties. This agreement supersedes any prior promises, agreements or conditions between the parties. To become effective, this agreement must be signed by all signatories listed below and must be approved by the Tax Division of the United States Department of Justice.

Problem 16-2

Shirley, the trader from Edgar's hedge fund, is back in your office. Now she has been charged in a federal indictment with four counts of securities fraud, based on insider trading, each of which carries a statutory maximum term of imprisonment of 10 years. It is decision time. Explain to Shirley what her options are and what the pluses, minuses, and consequences are of each of her options.

17. FIRM PLEAS AND SETTLEMENTS

Much of the discussion in this chapter will be occasion for review of concepts discussed at the outset of the materials, and returned to throughout, involving corporate liability and the purposes of imposing various kinds of sanctions on firms. (Now might be an opportune time to review the materials in Chapter 1, particularly the Justice Department's corporate prosecution guidelines.) In addition to showing the forms of corporate settlements and their common features, this chapter provides a close look at the facts involved in examples of major settlements—as a way of prompting assessment of how federal prosecutors use their powers to extract penalties and terms from corporations in criminal matters.

A. Forms of Corporate Dispositions

A corporate criminal prosecution (or investigative matter) will be disposed of under current practice in one of the following ways:

1. The government may choose to **decline prosecution** after completing an investigation.
2. The government and the company may enter into a **non-prosecution agreement (NPA)**, a contractual settlement that involves no filed criminal charges.
3. The government and the company may enter into a **deferred prosecution agreement (DPA)**, a contractual settlement that includes the filing of criminal charges, the prosecution of which is deferred for some period and then prosecutors move to dismiss them if the company complies with the agreement.
4. The government and the company may enter into a **plea agreement**, a contractual settlement in which charges are filed, the company enters a guilty plea, and a court imposes a **sentence** on the company. (Sentencing of corporations is addressed in Chapter 18.)
5. The government may file charges against a company and the company may choose to contest the charges at **trial**. A jury's acquittal will end the matter, while a conviction will be followed by a court imposing a **sentence** on the company.

To generalize, all these events—with the exception of a (1) declination or (5) an acquittal at trial—will result in some combination of sanctions imposed on a corporation by the terms of a contractual agreement or by a judge's sentence. As the Justice Department prosecution guidelines and the examples that will follow in this chapter make clear, there is a great deal of variation from case to case in how sanctions are structured. The corporate sanction menu available to prosecutors and courts includes, at least most commonly, these items:

1. Monetary fines and penalties.
2. Restitution to victims, directly or indirectly (as through funding of projects).
3. Remediation of harm (this is particularly common in environmental and consumer products cases).
4. Suspension or debarment from an industry or line of business.
5. Internal corporate reforms, particularly in the areas of management structure and compliance systems.
6. Imposition of an outside monitor to oversee the corporation's compliance with a settlement and to report to the prosecutor or court on the corporation's progress with mandated reforms.
7. Obligations to cooperate by assisting the government in investigation of individuals and further wrongdoing.
8. Admission of wrongdoing, in the form of a guilty plea or agreement to a statement of facts.
9. Waiver of legal rights, including rights to challenge admission of wrongdoing in the event that the corporation is deemed in violation of a settlement and then prosecuted for the original violations.
10. Agreement that the prosecutor retains sole power to determine whether the corporation has violated the terms of a settlement.

B. Settlement Examples

No corporate counsel can now competently advise a company regarding resolution of a criminal matter, and negotiate with federal prosecutors, without having extensive familiarity with what might be called the “common law” of Justice Department settlements, reflected in how these agreements and their terms have developed over time and across a wide variety of corporate cases. Abundant examples of corporate criminal settlements in many different forms can be found at the Corporate Prosecution Registry and the Foreign Corrupt Practices Clearinghouse.⁸

This chapter provides two examples as a basis for discussion. As you read these detailed settlement agreements, pay closest attention to three things: (1) the nature and seriousness of the underlying conduct, (2) the penalties imposed on the corporation and the prosecutors' explanation of the suitability of those penalties in the case, and (3) the terms that restrict the corporation's legal rights and freedom of action in various ways.

⁸ CORPORATE PROSECUTION REGISTRY, <http://lib.law.virginia.edu/Garrett/corporate-prosecution-registry/index.html>; FOREIGN CORRUPT PRACTICES CLEARINGHOUSE, <http://fcpa.stanford.edu/>.

Meanwhile, consider why the corporate managers and their lawyers in these cases decided to accept the terms of these agreements.

United States v. Volkswagen AG, No. 16-CR-20394 (E.D. Mich. 2017)

Rule 11 Plea Agreement

The United States of America, by and through the Department of Justice, Criminal Division, Fraud Section, the United States Attorney's Office for the Eastern District of Michigan, and the Department of Justice, Environment and Natural Resources Division, Environmental Crimes Section and with the approval of the Deputy Attorney General (collectively hereafter, "the Offices"), and the Defendant, Volkswagen AG (the "Defendant"), by and through its undersigned attorneys, and through its authorized representative, pursuant to authority granted by the Defendant's Management Board, with the consent of the Supervisory Board, hereby submit and enter into this plea agreement (the "Agreement"), pursuant to Rule 11(c)(1)(C) of the Federal Rules of Criminal Procedure. The terms and conditions of this Agreement are as follows:

1. Guilty Plea

A. Waiver of Indictment and Venue

Pursuant to Fed. R. Crim. P. 7, the Defendant agrees to knowingly waive its right to grand jury indictment and its right to challenge venue in the United States District Court for the Eastern District of Michigan, and to plead guilty to Counts One through Three of the Third Superseding Information.

B. Counts of Conviction

The Third Superseding Information charges three counts: (1) Count One—conspiracy in violation of 18 U.S.C. § 371, (2) Count Two—obstruction of justice in violation of 18 U.S.C. § 1512(c), and (3) Count Three—introducing imported merchandise into the United States by means of false statements in violation of 18 U.S.C. § 542. The Defendant further agrees to persist in that plea through sentencing and, as set forth below, to cooperate fully with the Offices in their investigation into the conduct described in this Agreement and other conduct related to the introduction into the United States of diesel vehicles with defeat devices as defined under U.S. law.

C. Elements of Offense

The elements of Count One (conspiracy) are as follows:

- (1) The elements for conspiracy to defraud the United States by obstructing the lawful function of the federal government are as follows:
 - (a) That two or more persons conspired, or agreed, to defraud the United States or one of its agencies or departments, in this case, the Environmental Protection Agency (EPA), by dishonest means;

- (b) That the defendant knowingly and voluntarily joined the conspiracy; and
 - (c) That a member of the conspiracy did one of the overt acts described in the indictment for the purpose of advancing or helping the conspiracy.
- (2) The elements for conspiracy to violate the wire fraud statute and Clean Air Act are as follows:
- (a) That two or more persons conspired, or agreed, to commit a crime, in this case, a violation of the wire fraud statute (18 U.S.C. § 1343) and the Clean Air Act (42 U.S.C. § 7413(c)(2)(A)) as described below;
 - (b) That the defendant knowingly and voluntarily joined the conspiracy; and
 - (c) That a member of the conspiracy did one of the overt acts described in the indictment for the purpose of advancing or helping the conspiracy.

Object of the Conspiracy – Wire Fraud – 18 U.S.C. § 1343

- (a) The defendant knowingly participated in, devised, or intended to devise a scheme to defraud in order to obtain money or property;
- (b) The scheme included a material misrepresentation or concealment of a material fact;
- (c) The defendant had the intent to defraud; and
- (d) The defendant used (or caused another to use) wire, radio or television communications in interstate or foreign commerce in furtherance of the scheme.

Object of the Conspiracy – Clean Air Act – 42 U.S.C. § 7413(c)(2)(A)

- (a) The defendant knowingly made (or caused to be made) a false material statement, representation, certification, or omission of material information;
- (b) The statement, representation or certification that was made (or omitted), or caused to be made or omitted was in a notice, application, record report, plan or other document required to be filed or maintained under the Clean Air Act; and
- (c) The statement representation, certification, or omission of information, was material.

The elements of Count Two (obstruction of justice) are as follows:

- (1) That the defendant altered, destroyed, mutilated, or concealed a record, document or other object;
- (2) That the defendant acted knowingly;

- (3) That the defendant acted corruptly; and
- (4) That the defendant acted with the intent to impair the record, document or object's integrity or availability for use in an official proceeding.

The elements of Count Three (entry of goods by false statement) are as follows:

- (1) That merchandise was imported;
- (2) That the defendant entered or introduced merchandise into the commerce of the United States;
- (3) That the defendant did so by means of a false statement, which it knew was false; and
- (4) That the false statement was material to the entry of the merchandise.

D. Statutory Maximum Penalties

The statutory maximum sentence that the Court can impose for a violation of Title 18, United States Code, Section 371 is a fine of \$500,000 or twice the gross pecuniary gain or gross pecuniary loss resulting from the offense, whichever is greatest, Title 18, United States Code, Section 3571(c), (d); five years' probation, Title 18, United States Code, Section 3561(c)(1); and a mandatory special assessment of \$400, Title 18, United States Code, Section 3013(a)(2)(B). The statutory maximum sentence that the Court can impose for a violation of Title 18, United States Code, Section 1512(c) (Count Two) is a fine of \$500,000; five years' probation, Title 18, United States Code, Section 3561(c)(1); and a mandatory special assessment of \$400, Title 18, United States Code, Section 3013(a)(2)(B). The statutory maximum sentence that the Court can impose for a violation of Title 18, United States Code, Section 542 (Count Three) is a fine of \$500,000 or twice the gross pecuniary gain or gross pecuniary loss resulting from the offense, whichever is greatest, Title 18, United States Code, Section 3571(c), (d); five years' probation, Title 18, United States Code, Section 3561(c)(1); and a mandatory special assessment of \$400, Title 18, United States Code, Section 3013(a)(2)(B).

E. Factual Basis for Guilty Plea

The Defendant is pleading guilty because it is guilty of the charges contained in the Third Superseding Information. The Defendant admits, agrees, and stipulates that the factual allegations set forth in Exhibit 2 (the Statement of Facts) are true and correct, that it is responsible under the laws of the United States for the acts of its employees described in Exhibit 2, and that the facts set forth in Exhibit 2 accurately reflect the Defendant's criminal conduct and provide a factual basis for the guilty plea. The Defendant agrees that it will neither contest the admissibility of, nor contradict, the Statement of Facts contained in Exhibit 2 in any proceeding.

2. Sentencing Guidelines

A. Standard of Proof

The Court will find sentencing factors by a preponderance of the evidence.

B. Guideline Range

There are no disputes with respect to the sentencing guidelines that require resolution by the court. While the Defendant does not adopt, agree or accept the United States Sentencing Guidelines (U.S.S.G.) analysis contained herein, for purposes of avoiding the need for a contested sentencing proceeding and achieving a just and fair result, and because the Defendant agrees that the overall fine proposed herein achieves such a result, the Defendant does not contest the factual or legal basis of the Office's U.S.S.G. analysis contained in this Paragraph for the purposes of this proceeding and stipulates that the proposed fine constitutes a reasonable sentence under the factors listed in Title 18, United States Code, Section 3553(a). Pursuant to *United States v. Booker*, the Court must determine an advisory sentencing guideline range pursuant to the United States Sentencing Guidelines (U.S.S.G.). The Court will then determine a reasonable sentence within the statutory range after considering the advisory sentencing guideline range and the factors listed in Title 18, United States Code, Section 3553(a). The Defendant also understands that if the Court accepts this Agreement, the Court is bound by the sentencing provisions in Paragraph 3. The Offices submit that a faithful application of the U.S.S.G. to determine the applicable fine range yields the following analysis:

- a. The 2016 U.S.S.G. are applicable to this matter.
- b. Offense Level. Based upon U.S.S.G. § 2B1.1, the total offense level is 41, calculated as follows:

(a)(1)	Base Offense Level	7
(b)(1)(P)	Amount of Loss > \$550 million	+30
(b)(2)(A)(i)	More than 10 Victims	+2
(b)(10)(B)	Substantial Part of Scheme Committed from Outside the United States	+2
TOTAL		41

- c. Base Fine. Based upon U.S.S.G. § 8C2.4(a), the base fine is \$8,543,169,187 (the pecuniary loss from the offense caused by the Defendant).
- d. Culpability Score. Based upon U.S.S.G. § 8C2.5, the culpability score is 11, calculated as follows:

(a)	Base Culpability Score	5

(b)(1)	The unit of the organization within which the offense was committed had 5,000 or more employees and an individual within high-level personnel of the unit participated in, condoned, or was willfully ignorant of the offense	+5
(e)	Obstruction of justice	+3
(g)(3)	The organization fully cooperated in the investigation and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct	-2
TOTAL		11

Calculation of Fine Range

Base Fine	\$8,543,169,187 ⁹
Multipliers	2 (min) / 4 (max)
Fine Range	\$17,086,338,374(min)/\$34,172,676,746(max)

3. Sentence

Pursuant to Fed. R. Crim. P. 11(c)(1)(C), the United States and the Defendant agree that the appropriate disposition of this case is as set forth in this Section and agree to recommend jointly that the Court at a hearing to be scheduled at an agreed upon time impose it.

A. Relevant Considerations

The Offices enter into this Agreement based on the individual facts and circumstances presented by this case and the Defendant. Among the factors considered were the following:

1. the Defendant did not voluntarily disclose to the Offices the conduct described in Exhibit 2 (the Statement of Facts);
2. the Defendant cooperated with the Offices' investigation by, among other things, (i) gathering substantial amounts of evidence and performing forensic data collections in multiple jurisdictions; (ii) producing documents, including

⁹ The base fine consists of the loss amount as calculated under USSG § 2B1.1 and accompanying Application Notes, discounted to reflect a 50% reduction for the litigation risk that both parties would bear were there a contested sentencing proceeding. *See, e.g., United States v. Giovenco*, 773 F.3d 866 (7th Cir. 2014); *United States v. Prosperi*, 686 F.3d 32 (1st Cir. 2012).

translations, to the Offices in ways that did not implicate foreign data privacy laws; (iii) collecting, analyzing, organizing, and producing voluminous evidence and information; (iv) interviewing hundreds of witnesses in the United States and overseas; (v) providing non-privileged facts relating to individuals and companies involved in the criminal conduct; and (vi) facilitating and encouraging cooperation and voluntary disclosure of information and documents by current and former company personnel;

3. the Defendant has already agreed to compensate members of the class in *In re Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation*, which consists of victims of the underlying criminal conduct that is the subject of this Agreement, and to pay into a NOx remediation trust, in an aggregate amount of approximately \$11 billion (based on net present value);
4. despite obstruction of justice committed by certain of the Defendant's employees, principally in the form of document destruction, the Defendant, including through its outside counsel, self-disclosed this conduct to the Offices, remediated the conduct by recovering large portions of the deleted documents through a variety of forensic means, and conducted a thorough investigation of the conduct, the findings of which it reported to the Offices;
5. the Defendant engaged in remedial measures, including creation of a management board position to supervise the Defendant's legal and compliance functions, reorganization of the whistleblower system, improvements to its risk assessment systems, specific reforms to its engine-related practices, including a program to audit these reforms, termination [sic] the employment of six individuals who participated in, or failed to supervise employees who participated in, the misconduct described in the Statement of Facts, suspending an additional eight individuals who participated in the misconduct described in the Statement of Facts for varying periods, and disciplining an additional three employees who participated in the misconduct described in the Statement of Facts; however, the Defendant's remediation remains incomplete;
6. the Defendant has committed to continue to enhance its compliance program and internal controls;
7. the Defendant has agreed, as part of its continuing cooperation obligations, and to ensure that the Defendant and its wholly-owned subsidiary Volkswagen Group of America ("VW GOA") implements an effective compliance program, to the appointment of an independent monitor (the "Monitor") for a period of up to three years, who will have authority with respect to the Defendant and VW GOA;
8. the nature and seriousness of the offenses;
9. the Defendant has no prior criminal history;

10. the Defendant has agreed to continue to cooperate with the Offices in any ongoing investigation of the conduct of the Defendant and its officers, directors, employees, agents, business partners, and consultants relating to the violations to which the Defendant is pleading guilty; and
11. the Defendant has agreed to pay an additional \$1,500,000,000 to the United States to resolve claims for civil penalties arising from the underlying conduct that is the subject of this Agreement;
12. accordingly, after considering (1) through (11) above, (a) the Defendant received an aggregate discount of approximately 20% off of the bottom of the otherwise applicable U.S. Sentencing Guidelines fine range, reflecting its cooperation in the investigation, and (b) after application of the foregoing discount, the Defendant in addition received a credit of \$11 billion, representing the net present value of the Defendant's settlements with consumers and payments to the NOx remediation trust in settlement of civil litigation.

B. Fine

The Defendant shall pay to the United States a criminal fine of \$2,800,000,000, payable in full within ten days of the entry of judgment following the sentencing hearing in this matter. The Defendant shall not seek or accept directly or indirectly reimbursement or indemnification from any source with regard to the penalty amount that the Defendant pays pursuant to this Agreement. The Defendant further agrees that it shall not claim assert, or apply for, either directly or indirectly, any tax deduction, tax credit, or any other offset with regard to any U.S. federal, state, or local tax or taxable income for any fine or forfeiture paid pursuant to this Agreement.

C. Probation

The parties agree that a term of organizational probation for a period of three years should be imposed on the Defendant pursuant to 18 U.S.C. §§ 3551(c)(1) and 3561(c)(1). The parties further agree, pursuant to U.S.S.G. 8D1.4, that the term of probation shall include as conditions the obligations set forth in Paragraphs 5 and 6 below as well as the payment of the fine set forth in this Paragraph, but shall not include the obligations set forth in Paragraph 7 below.

D. Special Assessment

The Defendant shall pay to the Clerk of the Court for the United States District Court for the Eastern District of Michigan within ten days of the time of sentencing the mandatory special assessment of \$1,200 (\$400 per count).

E. Restitution

No order of restitution is appropriate in this case pursuant to 18 U.S.C. § 3663A(c)(3) as the number of identifiable victims is so large as to make restitution impracticable and/or determining complex issues of fact related to the cause or amount of victims' losses would complicate or prolong the sentencing process to a degree that the need to provide restitution to any victim is outweighed by the burden on the sentencing process. Moreover, as noted in Paragraph 2(A) above the Defendant has already agreed to compensate members of the class in *In re Volkswagen "Clean Diesel" Marketing, Sales Practice, and Products Liability Litigation*, which consists of individuals who purchased affected vehicles described in Exhibit 2.

4. Other Charges

In exchange for the guilty plea of the Defendant and the complete fulfillment of all of its obligations under this Agreement, the Offices agree that they will not file additional criminal charges against the Defendant or any of its direct or indirect affiliates or subsidiaries related to: (1) any conduct described in the Third Superseding Information or Exhibit 2; (2) any conduct related to the emissions, or compliance with U.S. emissions standards, of the Subject Vehicles or the Porsche Vehicles as described and defined in the Third Superseding Information and Exhibit 2; and (3) any conduct disclosed by, or on behalf of, the Defendant or otherwise known to the Offices or the BPA as of the date of this Agreement. The Offices, however, may use any information related to the conduct described in the Statement of Facts against the Defendant: (a) in a prosecution for perjury or obstruction of justice apart from the charge in the Third Superseding Information and identified in the Statement of Facts; (b) in a prosecution for making a false statement; (c) in a prosecution or other proceeding relating to any crime of violence; or (d) in a prosecution or other proceeding relating to a violation of any provision of Title 26 of the United States Code. This Paragraph does not provide any protection against prosecution for any other conduct, including but not limited to crimes committed in the future by the Defendant or by any of its affiliates subsidiaries, officers, directors, employees, agents or consultants, whether or not disclosed by the Defendant pursuant to the terms of this Agreement. In addition, this Agreement does not provide any protection against prosecution of any joint ventures of which the Defendant is a part, or any individuals, regardless of their affiliation with the Defendant. The Defendant agrees that nothing in this Agreement is intended to release the Defendant from any and all of the Defendant's excise and income tax liabilities and reporting obligations for any and all income not properly reported and/or legally or illegally obtained or derived.

5. The Defendant's Obligations

A. Except as otherwise provided in Paragraph 6 below in connection with the Defendant's cooperation obligations, the Defendant's obligations under the Agreement shall last and be effective for a period beginning on the date on which the Third Superseding Information is filed and ending three years from the later of the date on which the Third Superseding Information is filed or the date on which

the Monitor is retained by the Defendant, as described in Paragraph 15 below (the “Term”). The Defendant agrees, however, that, in the event the Offices determine, in their sole discretion, that the Defendant has failed specifically to perform or to fulfill each of the Defendant’s obligations under this Agreement, an extension or extensions of the Term may be imposed by the Offices, in their sole discretion, for up to a total additional time period of one year, without prejudice to the Offices’ right to proceed as provided in Paragraph 9 below. Any extension of the Term extends all terms of this Agreement, including the terms of the Monitorship in Exhibit 3, for an equivalent period. Conversely, in the event the Offices find, in their sole discretion, that there exists a change in circumstances sufficient to eliminate the need for the Monitorship in Exhibit 3 and that the other provisions of this Agreement have been satisfied, the Term may be terminated early, except for the Defendant’s cooperation obligations described in Paragraph 6 below.

B. The Defendant agrees to abide by all terms and obligations of this Agreement as described herein, including, but not limited to, the following:

1. to plead guilty as set forth in this Agreement;
2. to abide by all sentencing stipulations contained in this Agreement;
3. to appear, through its duly appointed representatives, as ordered for all court appearances, and obey any other ongoing court order in this matter, consistent with all applicable U.S. and foreign laws, procedures, and regulations;
4. to commit no further crimes;
5. to be truthful at all times with the Court and the Offices;
6. to pay the applicable fine and special assessments; . . .

15. Independent Compliance Monitor

A. Promptly after the Offices’ selection pursuant to Paragraph 15(B) below, the Defendant agrees to retain the Monitor for the term specified in Paragraph 15(C). The Monitor’s duties and authority, and the obligations of the Defendant with respect to the Monitor and the Offices, are set forth in Exhibit 3, which is incorporated by reference into this Agreement. The same Monitor shall serve as the Independent Auditor appointed pursuant to Paragraph 27(b) of the Third Partial Consent Decree in *In re: Volkswagen “Clean Diesel” Marketing, Sales Practices, and Products Liability Litigation*. No later than the date of execution of this Agreement, and after consultation with the Offices, the Defendant will propose to the Offices a pool of three qualified candidates to serve as the Monitor. If the Offices determine, in their sole discretion, that any of the candidates are not, in fact, qualified to serve as the Monitor, or if the Offices, in their sole discretion, are not satisfied with the candidates proposed, the Offices

reserve the right to seek additional nominations from the Defendant, The parties will endeavor to complete the monitor selection process within sixty (60) days of the execution of this Agreement. The Monitor candidates or their team members shall have, at a minimum, the following qualifications:

1. demonstrated expertise with respect to federal anti-fraud and environmental laws, including experience counseling on these issues;
 2. experience designing and/or reviewing corporate ethics and compliance programs, including anti-fraud policies, procedures and internal controls;
 3. knowledge of automotive or similar industries;
 4. the ability to access and deploy resources as necessary to discharge the Monitor's duties as described in the Agreement;
 5. sufficient independence from the Defendant to ensure effective and impartial performance of the Monitor's duties as described in the Agreement; and
 6. the qualifications set out in Paragraph 27(a) of the Third Partial Consent Decree in *In re: Volkswagen "Clean Diesel" Marketing, Sales Practices, and Products Liability Litigation*.
- B. The Offices retain the right, in their sole discretion, to choose the Monitor from among the candidates proposed by the Defendant, though the Defendant may express its preference(s) among the candidates. In the event the Offices reject all proposed Monitors, the Defendant shall propose an additional three candidates within twenty (20) business days after receiving notice of the rejection. This process shall continue until a Monitor acceptable to both parties is chosen. The Offices and the Defendant will use their best efforts to complete the selection process within sixty (60) calendar days of the execution of this Agreement. If, during the term of the monitorship, the Monitor becomes unable to perform his or her obligations as set out herein and in Exhibit 3, or if the Offices in their sole discretion determine that the Monitor cannot fulfill such obligations to the satisfaction of the Offices, the Offices shall notify the Defendant of the release of the Monitor, and the Defendant shall within thirty (30) calendar days of such notice recommend a pool of three qualified Monitor candidates from which the Offices will choose a replacement.
- C. The Monitor's term shall be three years from the date on which the Monitor is retained by the Defendant, subject to extension or early termination as described in Paragraph 5. The Monitor's powers, duties, and responsibilities, as well as additional circumstances that may support an extension of the Monitor's term, are set forth in Exhibit 3. The Defendant agrees that it will not employ or be affiliated with the Monitor or the Monitor's firm for a period of not less than two years from the date on which the Monitor's term expires. Nor will the

Defendant discuss with the Monitor or the Monitor's firm the possibility of further employment or affiliation during the Monitor's term.

16. Complete Agreement

This document states the full extent of the Agreement between the parties. There are no other promises or agreements, express or implied. Any modification of this Agreement shall be valid only if set forth in writing in a supplemental or revised plea agreement signed by all parties. . . .

EXHIBIT 2: STATEMENT OF FACTS

The following Statement of Facts is incorporated by reference as part of the Plea Agreement (the "Agreement") between the United States Department of Justice (the "Department") and Volkswagen AG ("VW AG"). VW AG hereby agrees and stipulates that the following information is true and accurate. VW AG admits, accepts, and acknowledges that under U.S. law it is responsible for the acts of its employees set forth in this Statement of Facts, which acts VW AG acknowledges were within the scope of the employees' employment and, at least in part, for the benefit of VW AG. All references to legal terms and emissions standards, to the extent contained herein, should be understood to refer exclusively to applicable U.S. laws and regulations, and such legal terms contained in this Statement of Facts are not intended to apply to, or affect, VW AG's rights or obligations under the laws or regulations of any jurisdiction outside the United States. This Statement of Facts does not contain all of the facts known to the Department or VW AG; the Department's investigation into individuals is ongoing. The following facts took place during the time frame specified in the Third Superseding Information and establish beyond a reasonable doubt the charges set forth in the criminal Information attached to this Agreement:

Relevant Entities and Individuals

1. VW AG was a motor vehicle manufacturer based in Wolfsburg, Germany. Under U.S. law, VW AG acts through its employees, and conduct undertaken by VW AG, as described herein, reflects conduct undertaken by employees. Pursuant to applicable German stock corporation law, VW AG was led by a Management Board that was supervised by a Supervisory Board. Solely for purposes of this Statement of Facts, unless otherwise indicated, references in this Statement of Facts to "supervisors" are to senior employees below the level of the VW AG Management Board.
2. Audi AG ("Audi") was a motor vehicle manufacturer based in Ingolstadt, Germany and a subsidiary approximately 99.55% owned by VW AG. Under U.S. law, Audi AG acts through its employees, and conduct undertaken by Audi AG, as described herein, reflects conduct undertaken by employees.
3. Volkswagen Group of America, Inc. ("VW GOA") was a wholly owned subsidiary of VW AG based in Herndon, Virginia. Under U.S. law, VW GOA acts

through its employees, and conduct undertaken by VW GOA, as described herein, reflects conduct undertaken by employees.

4. VW AG, Audi AG, and VW GOA are collectively referred to herein as “VW.”
5. “VW Brand” was an operational unit within VW AG that developed vehicles to be sold under the “Volkswagen” brand name.
6. Company A was an automotive engineering company based in Berlin, Germany, which specialized in software, electronics, and technology support for vehicle manufacturers. VW AG owned fifty percent of Company A’s shares and was Company A’s largest customer.
7. “Supervisor A,” an individual whose identity is known to the United States and VW AG, was the supervisor in charge of Engine Development for all of VW AG from in or about October 2012 to in or about September 2015. From July 2013 to September 2015, Supervisor A also served as the supervisor in charge of Development for VW Brand, where he supervised a group of approximately 10,000 VW AG employees. From in or about October 2011, when he joined VW, until in or about July 2013, Supervisor A served as the supervisor in charge of the VW Brand Engine Development department.
8. “Supervisor B,” an individual whose identity is known to the United States and VW AG, was a supervisor in charge of the VW Brand Engine Development department from in or about May 2005 to in or about April 2007.
9. “Supervisor C,” an individual whose identity is known to the United States and VW AG, was a supervisor in charge of the VW Brand Engine Development department from in or about May 2007 to in or about March 2011.
10. “Supervisor D,” an individual whose identity is known to the United States and VW AG, was a supervisor in charge of the VW Brand Engine Development department from in or about October 2013 to the present.
11. “Supervisor E,” an individual whose identity is known to the United States and VW AG, was a supervisor with responsibility for VW AG’s Quality Management and Product Safety department who reported to the supervisor in charge of Quality Management from in or about 2007 to in or about October 2014.
12. “Supervisor F,” an individual whose identity is known to the United States and VW AG, was a supervisor within the VW Brand Engine Development department from in or about 2003 until in or about December 2012.
13. “Attorney A,” an individual whose identity is known to the United States and VW AG, was a German-qualified in-house attorney for VW AG who was the in-house attorney principally responsible for providing legal advice in connection with VW AG’s response to U.S. emissions issues from in or about May 2015 to in or about September 2015.

U.S. NO_x Emissions Standards

14. The purpose of the Clean Air Act and its implementing regulations was to protect human health and the environment by, among other things, reducing emissions of pollutants from new motor vehicles, including nitrogen oxides (“NO_x”).

15. The Clean Air Act required the U.S. Environmental Protection Agency (“EPA”) to promulgate emissions standards for new motor vehicles. The EPA established standards and test procedures for light-duty motor vehicles sold in the United States, including emission standards for NO_x.

16. The Clean Air Act prohibited manufacturers of new motor vehicles from selling, offering for sale, introducing or delivering for introduction into U.S. commerce, or importing (or causing the foregoing with respect to) any new motor vehicle unless the vehicle complied with U.S. emissions standards, including NO_x emissions standards, and was issued an EPA certificate of conformity.

17. To obtain a certificate of conformity, a manufacturer was required to submit an application to the EPA for each model year and for each test group of vehicles that it intended to sell in the United States. The application was required to be in writing, to be signed by an authorized representative of the manufacturer, and to include, among other things, the results of testing done pursuant to the published Federal Test Procedures that measure NO_x emissions, and a description of the engine, emissions control system, and fuel system components, including a detailed description of each Auxiliary Emission Control Device (“AECD”) to be installed on the vehicle.

18. An AECD was defined under U.S. law as any element of design which senses temperature, vehicle speed, engine RPM, transmission gear, manifold vacuum, or any other parameter for the purpose of activating, modulating, delaying, or deactivating the operation of any part of the emission control system. The manufacturer was also required to include a justification for each AECD. If the EPA, in reviewing the application for a certificate of conformity, determined that the AECD “reduced the effectiveness of the emission control system under conditions which may reasonably be expected to be encountered in normal vehicle operation and use,” and that (1) it was not substantially included in the Federal Test Procedure, (2) the need for the AECD was not justified for protection of the vehicle against damage or accident, or (3) it went beyond the requirements of engine starting, the AECD was considered a “defeat device.” Whenever the term “defeat device” is used in this Statement of Facts, it refers to a defeat device as defined by U.S. law.

19. The EPA would not certify motor vehicles equipped with defeat devices. Manufacturers could not sell motor vehicles in the United States without a certificate of conformity from the EPA.

20. The California Air Resources Board (“CARB”) (together with the EPA, “U.S. regulators”) issued its own certificates, called executive orders, for the sale of motor

vehicles in the State of California. To obtain such a certificate, the manufacturer was required to satisfy the standards set forth by the State of California, which were equal to or more stringent than those of the EPA.

21. As part of the application for a certification process, manufacturers often worked in parallel with the EPA and CARB. To obtain a certificate of conformity from the EPA, manufacturers were required to demonstrate that the light-duty vehicles were equipped with an on-board diagnostic (“OBD”) system capable of monitoring all emissions-related systems or components. Manufacturers could demonstrate compliance with California OBD standards in order to meet federal requirements. CARB reviewed applications from manufacturers, including VW, to determine whether their OBD systems were in compliance with California OBD standards, and CARB’s conclusion would be included in the application the manufacturer submitted to the EPA.

22. In 1998, the United States established new federal emissions standards that would be implemented in separate steps, or Tiers. Tier II emissions standards including for NOx emissions, were significantly stricter than Tier I. For light-duty vehicles, the regulations required manufacturers to begin to phase in compliance with the new, stricter Tier II NOx emissions standards in 2004 and required manufacturers to fully comply with the stricter standards for model year 2007. These strict U.S. NOx emissions standards were applicable specifically to vehicles in the United States.

VW Diesel Vehicles Sold in the United States

23. In the United States, VW sold, offered for sale, introduced into commerce, delivered for introduction into commerce, imported, or caused the foregoing actions (collectively “sold in the United States”) the following vehicles containing 2.0 liter diesel engines (“2.0 Liter Subject Vehicles”):

- a. Model Year (“MY”) 2009–2015 VW Jetta;
- b. MY 2009–2014 VW Jetta Sportwagen;
- c. MY 2010–2015 VW Golf;
- d. MY 2015 VW Golf Sportwagen;
- e. MY 2010–2013, 2015 Audi A3;
- f. MY 2013–2015 VW Beetle and VW Beetle Convertible; and
- g. MY2012–2015 VW Passat.

24. VW sold in the United States the following vehicles containing 3.0 liter diesel engines (“3.0 Liter Subject Vehicles”):

- a. MY 2009–2016 VW Touareg;
- b. MY 2009–2015 Audi Q7;
- c. MY 2014–2016 Audi A6 Quattro;
- d. MY 2014–2016 Audi A7 Quattro;
- e. MY 2014–2016 Audi A8L; and
- f. MY 2014 2016 Audi Q5.

25. VW GOA's Engineering and Environmental Office ("EEO") was located in Auburn Hills, Michigan, in the Eastern District of Michigan. Among other things, EEO prepared and submitted applications (the "Applications") for a certificate of conformity and an executive order (collectively, "Certificates") to the EPA and CARB to obtain authorization to sell each of the 2.0 Liter Subject Vehicles and 3.0 Liter Subject Vehicles in the United States (collectively, the "Subject Vehicles"). VW GOA's Test Center California performed testing related to the Subject Vehicles.

26. VW AG developed the engines for the 2.0 Liter Subject Vehicles. Audi AG developed the engines for the 3.0 Liter Subject Vehicles and the MY 2013–2016 Porsche Cayenne diesel vehicles sold in the United States (the "Porsche Vehicles").

27. The Applications to the EPA were accompanied by the following signed statement by a VW representative:

The Volkswagen Group states that any element of design, system, or emission control device installed on or incorporated in the Volkswagen Group's new motor vehicles or new motor vehicle engines for the purpose of complying with standards prescribed under section 202 of the Clean Air Act, will not, to the best of the Volkswagen Group's information and belief, cause the emission into the ambient air of pollutants in the operation of its motor vehicles or motor vehicle engines which cause or contribute to an unreasonable risk to public health or welfare except as specifically permitted by the standards prescribed under section 202 of the Clean Air Act. The Volkswagen Group further states that any element of design, system, or emission control device installed or incorporated in the Volkswagen Group's new motor vehicles or new motor vehicle engines, for the purpose of complying with standards prescribed under section 202 of the Clean Air Act, will not, to the best of the Volkswagen Group's information and belief, cause or contribute to an unreasonable risk to public safety. All vehicles have been tested in accordance with good engineering practice to ascertain that such test vehicles meet the requirement of this section for the useful life of the vehicle.

28. Based on the representations made by VW employees in the Applications for the Subject Vehicles, EPA and CARE issued Certificates for these vehicles, allowing the Subject Vehicles to be sold in the United States.

29. Upon importing the Subject Vehicles into the United States, VW disclosed to U.S. Customs and Border Protection ("CBP") that the vehicles were covered by valid Certificates by affixing an emissions label to the vehicles' engines. These labels stated that the vehicles conformed to EPA and CARB emissions regulations. VW affixed these labels to each of the Subject Vehicles that it imported into the United States.

30. VW represented to its U.S. customers, U.S. dealers, U.S. regulators and others in the United States that the Subject Vehicles met the new and stricter U.S. emissions standards identified in paragraph 22 above. Further, VW designed a specific marketing campaign to market these vehicles to U.S. customers as “clean diesel” vehicles.

VW AG’s Criminal Conduct

31. From approximately May 2006 to approximately November 2015, VW AG, through Supervisors A–F and other VW employees, agreed to deceive U.S. regulators and U.S. customers about whether the Subject Vehicles and the Porsche Vehicles complied with U.S. emissions standards. During their involvement with design, marketing and/or sale of the Subject Vehicles and the Porsche Vehicles in the United States, Supervisors A–F and other VW employees: (a) knew that the Subject Vehicles and the Porsche Vehicles did not meet U.S. emissions standards; (b) knew that VW was using software to cheat the U.S. testing process by making it appear as if the Subject Vehicles and the Porsche Vehicles met U.S. emissions standards when, in fact, they did not; and (c) attempted to and did conceal these facts from U.S. regulators and U.S. customers.

32. In at least in or about 2006, VW AG employees working under the supervision of Supervisors B, C, and F were designing the new EA 189 2.0 liter diesel engine (later known as the Generation 1 or “Gen 1”) for use in the United States that would be the cornerstone of a new project to sell passenger diesel vehicles in the United States. Selling diesel vehicles in the U.S. market was an important strategic goal of VW AG. This project became known within VW as the “US ’07” project.

33. Supervisors B, C, and F, and others, however, realized that VW could not design a diesel engine that would both meet the stricter U.S. NOx emissions standards that would become effective in 2007 and attract sufficient customer demand in the U.S. market. Instead of bringing to market a diesel vehicle that could legitimately meet the new, more restrictive U.S. NOx emissions standards, VW AG employees acting at the direction of Supervisors B, C, and F and others, including Company A employees, designed, created, and implemented a software function to detect, evade and defeat U.S. emissions standards.

34. While, employees acting at their direction designed and implemented the defeat device software, Supervisors B, C, and F, and others knew that U.S. regulators would measure VW’s diesel vehicles’ emissions through standard U.S. tests with specific, published drive cycles. VW AG employees acting at the direction of Supervisors B, C, and F, and others designed the VW defeat device to recognize whether the vehicle was undergoing standard U.S. emissions testing on a dynamometer (or “dyno”) or whether the vehicle was being driven on the road under normal driving conditions. The defeat device accomplished this by recognizing the standard drive cycles used by U.S. regulators. If the vehicle’s software detected that it was being tested, the vehicle performed in one mode, which satisfied U.S. NOx emissions standards. If the defeat device detected that the vehicle was not being tested, it operated in a different mode, in

which the effectiveness of the vehicle's emissions control systems was reduced substantially, causing the vehicle to emit substantially higher NO_x, sometimes 35 times higher than U.S. standards.

35. In designing the defeat device, VW engineers, borrowed the original concept of the dual-mode, emissions cycle-beating software from Audi. On or about May 17 2006, a VW engineer, in describing the Audi software, sent an email to employees in the VW Brand Engine Development department that described aspects of the software and cautioned against using it in its current form because it was "pure" cycle-beating, i.e., as a mechanism to detect, evade and defeat U.S. emissions cycles or tests. The VW AG engineer wrote (in German), "within the clearance structure of the pre-fuel injection the acoustic function is nearly always activated within our current US '07-data set. This function is pure [cycle-beating] and can like this absolutely not be used for US '07."

36. Throughout in or around 2006, Supervisor F authorized VW AG engineers to use the defeat device in the development of the US '07 project, despite concerns expressed by certain VW AG employees about the propriety of designing and activating the defeat device software. In or about the fall of 2006, lower level VW AG engineers, with the support of their supervisors raised objections to the propriety of the defeat device, and elevated the issue to Supervisor B. During a meeting that occurred in or about November 2006, VW AG employees briefed Supervisor B on the purpose and design of the defeat device. During the meeting, Supervisor B decided that VW should continue with production of the US '07 project with the defeat device, and instructed those in attendance, in sum and substance not to get caught.

37. Throughout 2007, various technical problems arose with the US '07 project that led to internal discussions and disagreements among members of the VW AG team that was primarily responsible for ensuring vehicles met U.S. emissions standards. Those disagreements over the direction of the project were expressly articulated during a contentious meeting on or about October 5, 2007, over which Supervisor C presided. As a result of the meeting, Supervisor C authorized Supervisor F and his team to proceed with the US '07 project despite knowing that only the use of the defeat device software would enable VW diesel vehicles to pass U.S. emissions tests.

38. Starting with the first model year 2009 of VW's new engine for the 2.0 Liter Subject Vehicles through model year 2016, Supervisors A–D and F, and others, then caused the defeat device software to be installed in the 2.0 Liter Subject Vehicles marketed and sold in the United States.

39. Starting in or around 2006, Audi AG engineers designed a 3.0 liter diesel for the U.S. market. The 3.0 liter engine was more powerful than the 2.0 liter engine, and was included in larger and higher-end model vehicles. The 3.0 liter engine was ultimately placed in various Volkswagen, Audi and Porsche diesel vehicles sold in the United States for model years 2009 through 2016. In order to pass U.S. emissions tests, Audi engineers designed and installed software designed to detect, evade and defeat U.S. emissions standards, which constituted a defeat device under U.S. law.

40. Specifically, Audi AG engineers calibrated a defeat device for the 3.0 Liter Subject Vehicles and the Porsche Vehicles that varied injection levels of a solution consisting of urea and water (“AdBlue”) into the exhaust gas system based on whether the vehicle was being tested or not, with less NOx reduction occurring during regular driving conditions. In this way, the vehicle consumed less AdBlue, and avoided a corresponding increase in the vehicle’s AdBlue tank size, which would have decreased the vehicle’s trunk size, and made the vehicle less marketable in the United States. In addition, the vehicle could drive further between service intervals, which was also perceived as important to the vehicle’s marketability in the United States.

41. VW employees met with the EPA and CARB to seek the certifications required to sell the Subject Vehicles to U.S. customers. During these meetings, some of which Supervisor F attended personally, VW employees misrepresented, and caused to be misrepresented, to the EPA and CARB staff that the Subject Vehicles complied with U.S. NOx emissions standards, when they knew the vehicles did not. During these meetings, VW employees described, and caused to be described, VW’s diesel technology and emissions control systems to the EPA and CARB staff in detail but omitted the fact that the engine could not meet U.S. emissions standards without using the defeat device software.

42. Also as part of the certification process for each new model year, Supervisors A-F and others certified, and/or caused to be certified, to the EPA and CARB that the Subject Vehicles met U.S. emissions standards and complied with standards prescribed by the Clean Air Act. Supervisors A–F, and others, knew that if they had told the truth and disclosed the existence of the defeat device, VW would not have obtained the requisite certificates for the Subject Vehicles and could not have sold any of them in the United States.

43. In order to import the Subject Vehicles into the United States, VW was required to disclose to CBP whether the vehicles were covered by valid certificates for the United States. VW did so by affixing a label to the vehicles’ engines. VW employees caused to be stated on the labels that the vehicles complied with applicable EPA and CARB emissions regulations and limitations, knowing that if they had disclosed that the Subject Vehicles did not meet U.S. emissions regulations and limitations, VW would not have been able to import the vehicles into the United States. Certain VW employees knew that the labels for the Porsche Vehicles stated that those vehicles complied with EPA and CARB emissions regulations and limitations, when in fact, the VW employees knew they did not.

44. Supervisors A and C and others marketed, and caused to be marketed the Subject Vehicles to the U.S. public as “clean diesel” and environmentally friendly, when they knew the Subject Vehicles were intentionally designed to detect, evade and defeat U.S. emissions standards.

45. For example, on or about November 18, 2007, Supervisor C sent an email to Supervisor F and others attaching three photos of himself with California’s then-

Governor, which were taken during an event at which Supervisor C promoted the 2.0 Liter Subject Vehicles in the United States as “green diesel.”

46. Following the launch of the Gen 1 2.0 Liter Subject Vehicles in the United States, Supervisors C and F, and others, worked on a second generation of the vehicle (the “Gen 2”), which also contained software designed to detect, evade and defeat U.S. emissions tests. The Gen 2 2.0 Liter Subject Vehicles were launched in the United States in or around 2011.

47. In or around 2012, hardware failures developed in certain of the 2.0 Liter Subject Vehicles that were being used by customers on the road in the United States. VW AG engineers hypothesized that vehicles equipped with the defeat device stayed in “dyno” mode (i.e., testing mode) even when driven on the road outside of test conditions. Since the 2.0 Liter Subject Vehicles were not designed to be driven for longer periods of time in “Dyno” mode, VW AG engineers suspected that the increased stress on the exhaust system from being driven too long in “Dyno” mode could be the root cause of the hardware failures.

48. In or around July 2012, engineers from the VW Brand Engine Development department met, in separate meetings, with Supervisors A and E to explain that they suspected that the root cause of the hardware failures in the 2.0 Liter Subject Vehicles was the increased stress on the exhaust system from being driven too long in “Dyno” mode as a result of the use of software designed to detect, evade and defeat U.S. emissions tests. To illustrate the software’s function the engineers used a document. Although they understood the purpose and significance of the software, Supervisors A and E each encouraged the further concealment of the software. Specifically, Supervisors A and E each instructed the engineers who presented the issue to them to destroy the document they had used to illustrate the operation of the defeat device software.

49. VW AG engineers, having informed the supervisor in charge of the VW AG Engine Development department and within the VW AG Quality Management and Product Safety department of the existence and purpose of the defeat device in the 2.0 Liter Subject Vehicles, then sought ways to improve its operation in existing 2.0 Liter Subject Vehicles to avoid the hardware failures. To solve the hardware failures, VW AG engineers decided to start the 2.0 Liter Subject Vehicles in the “street mode” and, when the defeat device recognized that the vehicle was being tested for compliance with U.S. emissions standards, switch to the “Dyno mode.” To increase the likelihood that the vehicle in fact realized that it was being tested on the dynamometer for compliance with U.S. emissions standards, the VW AG engineers activated a “steering wheel angle recognition” feature. The steering wheel angle recognition interacted with the software by enabling the vehicle to detect whether it was being tested on a dynamometer (where the steering wheel is not turned), or being driven on the road.

50. Certain VW AG employees again expressed concern, specifically about the expansion of the defeat device through the steering wheel angle detection, and sought

approval for the function from more senior supervisors within the VW AG Engine Development department. In particular, VW AG engineers asked Supervisor A for a decision on whether or not to use the proposed function in the 2.0 Liter Subject Vehicles. In or about April 2013, Supervisor A authorized activation of the software underlying the steering wheel angle recognition function, VW employees then installed the new software function in new 2.0 Liter Subject Vehicles being sold in the United States, and later installed it in existing 2.0 Liter Subject Vehicles through software updates during maintenance.

51. VW employees falsely told, and caused others to tell, U.S. regulators, U.S. customers and others in the United States that the software update in or around 2014 was intended to improve the 2.0 Liter Subject Vehicles when, in fact, VW employees knew that the update also used the steering wheel angle of the vehicle as a basis to more easily detect when the vehicle was undergoing emissions tests, thereby improving the defeat device's precision in order to reduce the stress on the emissions control systems.

52. In or around March 2014, certain VW employees learned of the results of a study undertaken by West Virginia University's Center for Alternative Fuels, Engines and Emissions and commissioned by the International Council on Clean Transportation (the "ICCT study"). The ICCT study identified substantial discrepancies in the NOx emissions from certain 2.0 Liter Subject Vehicles when tested on the road compared to when these vehicles were undergoing EPA and CARB standard drive cycle tests on a dynamometer. The results of the study showed that two of the three vehicles tested on the road, both 2.0 Liter Subject Vehicles, emitted NOx at values of up to approximately 40 times the permissible limit applicable during testing in the United States.

53. Following the ICCT study, CARB, in coordination with the EPA, attempted to work with VW to determine the cause for the higher NOx emissions in the 2.0 Liter Subject Vehicles when being driven on the road as opposed to on the dynamometer undergoing standard emissions test cycles. To do this, CARB, in coordination with the EPA, repeatedly asked VW questions that became increasingly more specific and detailed, as well as conducted additional testing themselves.

54. In response to learning about the results of the ICCT study, engineers in the VW Brand Engine Development department formed an ad hoc task force to formulate responses to questions that arose from the U.S. regulators. VW AG supervisors, including Supervisors A, D, and E, and others, determined not to disclose to U.S. regulators that the tested vehicle models operated with a defeat device. Instead, Supervisors A, D, and E, and others decided to pursue a strategy of concealing the defeat device in responding to questions from U.S. regulators, while appearing to cooperate.

55. Throughout 2014 and the first half of 2015, Supervisors A, D, and E, and others, continued to offer, and/or cause to be offered, software and hardware "fixes" and explanations to U.S. regulators for the 2.0 Liter Subject Vehicles' higher NOx measurements on the road without revealing the underlying reason—the existence of software designed to detect, evade and defeat U.S. emissions tests.

56. On or about April 28, 2014, members of the VW task force presented the findings of the ICCT study to Supervisor E, whose supervisory responsibility included addressing safety and quality problems in vehicles in production. Included in the presentation was an explanation of the potential financial consequences VW could face if the defeat device was discovered by U.S. regulators, including but not limited to applicable fines per vehicle, which were substantial.

57. On or about May 21, 2014, a VW AG employee sent an email to his supervisor, Supervisor D, and others, describing an “early round meeting” with Supervisor A at which emissions issues in North America for the Gen 2 2.0 Liter Subject Vehicles were discussed, and questions were raised about the risk of what could happen and the available options for VW. Supervisor D responded by email that he was in “direct touch” with the supervisor in charge of Quality Management at VW AG and instructed the VW AG employee to “please treat confidentially” the issue.

58. On or about October 1, 2014, VW AG employees presented to CARB regarding the ICCT study results and discrepancies identified in NOx emissions between dynamometer testing and road driving. In response to questions, the VW AG employees did not reveal that the existence of the defeat device was the explanation for the discrepancies in NOx emissions, and, in fact gave CARB various false reasons for the discrepancies in NOx emissions including driving patterns and technical issues.

59. When U.S. regulators threatened not to certify VW model year 2016 vehicles for sale in the United States, VW AG supervisors requested a briefing on the situation in the United States. On or about July 27, 2015, VW AG employees presented to VW AG supervisors. Supervisors A and D were present, among others.

60. On or about August 5, 2015, in a meeting in Traverse City, Michigan, two VW employees met with a CARB official to discuss again the discrepancies in emissions of the 2.0 Liter Subject Vehicles. The VW employees did not reveal the existence of the defeat device.

61. On or about August 18, 2015, Supervisors A and D, and others, approved a script to be followed by VW AG employees during an upcoming meeting with CARB in California on or about August 19, 2015. The script provided for continued concealment of the defeat device from CARB in the 2.0 Liter Subject Vehicles, with the goal of obtaining approval to sell the Gen 3 model year 2016 2.0 Liter Subject Vehicles in the United States.

62. On or about August 19, 2015, in a meeting with CARB in El Monte, California, a VW employee explained, for the first time to U.S. regulators and in direct contravention of instructions from supervisors at VW AG, that certain of the 2.0 Liter Subject Vehicles used different emissions treatment depending on whether the vehicles were on the dynamometer or the road, thereby signaling that VW had evaded U.S. emissions tests.

63. On or about September 3, 2015, in a meeting in El Monte, California with CARB and EPA, Supervisor D, while creating the false impression that he had been unaware of the defeat device previously, admitted that VW had installed a defeat device in the 2.0 Liter Subject Vehicles.

64. On or about September 18, 2015, the EPA issued a public Notice of Violation to VW stating that the EPA had determined that VW had violated the Clean Air Act by manufacturing and installing defeat devices in the 2.0 Liter Subject Vehicles.

65. On or about January 27, 2015, CARB informed VW AG that CARB would not approve certification of the Model Year 2016 3.0 Liter Subject Vehicles until Audi AG confirmed that the 3.0 Liter Subject Vehicles did not possess the same emissions issues as had been identified by the ICCT study and as were being addressed by VW with the 2.0 Liter Subject Vehicles.

66. On or about March 24, 2015, in response to CARB's questions, Audi AG employees made a presentation to CARB, during which Audi AG employees did not disclose that the Audi 2.0 and 3.0 Liter Subject Vehicles and the Porsche Vehicles in fact contained a defeat device, which caused emissions discrepancies in those vehicles. The Audi AG employees informed CARB that the 3.0 Liter Subject Vehicles did not possess the same emissions issues as the 2.0 Liter Subject Vehicles when, in fact; the 3.0 Liter Subject Vehicles possessed at least one defeat device that interfered with the emissions systems to reduce NOx emissions on the dyno but not on the road. On or about March 25, 2015, CARB, based on the misstatements and omissions made by the Audi AG representatives, issued an executive order approving the sale of Model Year 2016 3.0 Liter Subject Vehicles.

67. On or about November 2, 2015, EPA issued a Notice of Violation to VW AG, Audi AG and Porsche AG, citing violations of the Clean Air Act related to EPA's discovery that the 3.0 Liter Subject Vehicles and the Porsche Vehicles contained a defeat device that resulted in excess NOx emissions when the vehicles were driven on the road.

68. On or about November 2, 2015, VW AG issued a statement that "no software has been installed in the 3-liter V6 diesel power units to alter emissions characteristics in a forbidden manner."

69. On or about November 19, 2015, Audi AG representatives met with EPA and admitted that the 3.0 Liter Subject Vehicles contained at least three undisclosed AECDs. Upon questioning from EPA, Audi AG representatives conceded that one of these three undisclosed AECDs met the criteria of a defeat device under U.S. law.

70. On or about May 16, 2016, Audi AG representatives met with CARB and admitted that there were additional elements within two of its undisclosed AECDs, which impacted the dosing strategy in the 3.0 Liter Subject Vehicles and the Porsche Vehicles.

71. On or about July 19, 2016, in a presentation to CARE, Audi AG representatives conceded that elements of two of its undisclosed AECDs met the definition of a defeat device.

72. Supervisors A–F and others caused defeat device software to be installed on all of the approximately 585,000 Subject Vehicles and the Porsche Vehicles sold in the United States from 2009 through 2015.

73. As VW employees prepared to admit to U.S. regulators that VW used a “defeat device” in the 2.0 Liter Subject Vehicles, counsel for VW GOA prepared a litigation hold notice to ensure that VW GOA preserved documents relevant to diesel emissions issues. At the same time, VW GOA was in contact with VW AG to discuss VW AG preserving documents relevant to diesel emissions issues, Attorney A made statements that several employees understood as suggesting the destruction of these materials. In anticipation of this hold taking effect at VW AG certain VW AG employees destroyed documents and files related to U.S. emissions issues that they believed would be covered by the hold. Certain VW AG employees also requested that their counterparts at Company A destroy sensitive documents relating to U.S. emissions issues. Certain Audi AG employees also destroyed documents related to U.S. emissions issues. The VW AG and Audi AG employees who participated in this deletion activity did so to protect both VW and themselves from the legal consequences of their actions.

74. Between the August 19, 2015 and September 3, 2015 meetings with U.S. regulators, certain VW AG employees discussed issues with Attorney A and others.

75. On or about August 26, 2015 VW GOA’s legal team sent the text of a litigation hold notice to Attorney A in VW AG’s Wolfsburg office that would require recipients to preserve and retain records in their control. The subject of the e-mail was “Legal Hold Notice—Emissions Certification of MY2009-2016 2.0L TDI Volkswagen and Audi vehicles.” The VW GOA legal team stated that VW GOA would be issuing the litigation hold notice to certain VW GOA employees the following day. On or about August 28, 2015 Attorney A received notice that VW GOA was issuing that litigation hold notice that day. Attorney A indicated to his staff on August 31 that the hold would be sent out at VW AG on September 1. Among those at VW AG being asked to retain and preserve documents were Supervisors A and D and a number of other VW AG employees.

76. On or about August 27, 2015, Attorney A met with several VW AG engineers to discuss the technology behind the defeat device. Attorney A indicated that a hold was imminent, and that these engineers should check their documents, which multiple participants understood to mean that they should delete documents prior to the hold being issued.

77. On or about August 31, 2015, a meeting was held to prepare for the September 3 presentation to CARE and EPA where VW’s use of the defeat device in the United States was to be formally revealed. During the meeting, within hearing of several participants, Attorney A discussed the forthcoming hold and again told the engineers

that the hold was imminent and recommended that they check what documents they had. This comment led multiple individuals, including supervisors in the VW Brand Engine Development department at VW AG, to delete documents related to U.S. emissions issues.

78. On or about September 1, 2015, the hold at VW AG was issued. On or about September 1, 2015, several employees in the VW Brand Engine Development department at VW AG discussed the fact that their counterparts at Company A would also possess documents related to U.S. emissions issues. At least two VW AG employees contacted Company A employees and asked them to delete documents relating to U.S. emissions issues.

79. On or about September 3, 2015, Supervisor A approached Supervisor D's assistant, and requested that Supervisor D's assistant search in Supervisor D's office for a hard drive on which documents were stored containing emails of VW AG supervisors, including Supervisor A. Supervisor D's assistant recovered the hard drive and gave it to Supervisor A. Supervisor A later asked his assistant to throw away the hard drive.

80. On or about September 15, 2015, a supervisor within the VW Brand Engine Development department convened a meeting with approximately 30–40 employees, during which Attorney A informed the VW AG employees present about the current situation regarding disclosure of the defeat device in the United States. During this meeting, a VW AG employee asked Attorney A what the employees should do with new documents that were created, because they could be harmful to VW AG. Attorney A indicated that new data should be kept on USB drives and only the final versions saved on VW AG's system, and then, only if "necessary."

81. Even employees who did not attend these meetings, or meet with Attorney A personally, became aware that there had been a recommendation from a VW AG attorney to delete documents related to U.S. emissions issues. Within VW AG and Audi AG thousands of documents were deleted by approximately 40 VW AG and Audi AG employees.

After it began an internal investigation, VW AG was subsequently able to recover many of the deleted documents.

Problem 17-1

- (a) Was VW fined an appropriate amount in its plea agreement? How would you develop an answer to that question?
- (b) Most recent corporate resolutions take the form of NPAs and DPAs. Why did the VW case end with a guilty plea? Does the form of the VW resolution matter, assuming all penalties and requirements remain the same?
- (c) What might explain the conduct at VW that led to this prosecution? Does the plea agreement promise to reduce future instances of that conduct, at VW and/or other companies in the industry?

Deferred Prosecution Agreement

United States v. The Boeing Company, No. 4:21-CR-005-O (N.D. Tex. Jan. 7, 2021)

Defendant The Boeing Company (the “Company”), pursuant to authority granted by the Company’s Board of Directors reflected in Attachment B, the United States Department of Justice, Criminal Division, Fraud Section (the “Fraud Section”), and the United States Attorney’s Office for the Northern District of Texas (the “USAO-NDTX”) enter into this deferred prosecution agreement (the “Agreement”). The terms and conditions of this Agreement are as follows:

1. The Company acknowledges and agrees that the Fraud Section will file the attached one-count criminal Information in the United States District Court for the Northern District of Texas charging the Company with Conspiracy to Defraud the United States, in violation of Title 18, United States Code, Section 371 (the “Information”). In so doing, the Company: (a) knowingly waives any right it may have to indictment on this charge, as well as all rights to a speedy trial pursuant to the Sixth Amendment to the United States Constitution, Title 18, United States Code, Section 3161, and Federal Rule of Criminal Procedure 48(b); and (b) knowingly waives any objection with respect to venue to any charges by the United States arising out of the conduct described in the Statement of Facts attached hereto as Attachment A (the “Statement of Facts”) and consents to the filing of the Information, as provided under the terms of this Agreement, in the United States District Court for the Northern District of Texas. The Fraud Section agrees to defer prosecution of the Company pursuant to the terms and conditions described below.

2. The Company admits, accepts, and acknowledges that it is responsible under United States law for the acts of its officers, directors, employees, and agents as charged in the Information, and as set forth in the Statement of Facts, and that the allegations described in the Information and the facts described in the Statement of Facts are true and accurate. The Company agrees that, effective as of the date it signs this Agreement, in any prosecution that is deferred by this Agreement, it will not dispute the Statement of Facts set forth in this Agreement, and, in any such prosecution, the Statement of Facts shall be

admissible as: (a) substantive evidence offered by the government in its case-in-chief and rebuttal case; (b) impeachment evidence offered by the government on cross-examination; and (c) evidence at any sentencing hearing or other hearing. In addition, in connection therewith, the Company agrees not to assert any claim under the United States Constitution, Rule 410 of the Federal Rules of Evidence, Rule 11(f) of the Federal Rules of Criminal Procedure, Section 1B1.1(a) of the United States Sentencing Guidelines (“USSG” or “Sentencing Guidelines”), or any other federal rule that the Statement of Facts should be suppressed or is otherwise inadmissible as evidence in any form.

3. This Agreement is effective for a period beginning on the date on which the Information is filed and ending three years from that date (the “Term”). The Company agrees, however, that, in the event the Fraud Section determines, in its sole discretion, that the Company has knowingly violated any provision of this Agreement or has failed to completely perform or fulfill each of its obligations under this Agreement, an extension or extensions of the Term may be imposed by the Fraud Section, in its sole discretion, for up to a total additional time period of one year, without prejudice to the right of the Fraud Section to proceed as provided in Paragraphs 26–30 below. Any extension of the Agreement extends all terms of this Agreement, including the terms of the reporting requirement in Attachment D, for an equivalent period. Conversely, in the event the Fraud Section finds, in its sole discretion, that there exists a change in circumstances sufficient to eliminate the need for the reporting requirement in Attachment D, and that the other provisions of this Agreement have been satisfied, the Agreement may be terminated early. If the Court refuses to grant exclusion of time under the Speedy Trial Act, Title 18, United States Code, Section 3161(h)(2), the Term shall be deemed to have not begun, and all the provisions of this Agreement shall be deemed null and void, except that the statute of limitations for any prosecution relating to the conduct described in the Statement of Facts shall be tolled from the date on which this Agreement is signed until the date the Court refuses to grant the exclusion of time plus six months, and except for the provisions contained within Paragraph 2 of this Agreement.

4. The Fraud Section enters into this Agreement based on the individual facts and circumstances presented by this case and by the Company, including:

a. The nature and seriousness of the offense conduct, which involved two of the Company’s 737 MAX Flight Technical Pilots deceiving the Federal Aviation Administration’s Aircraft Evaluation Group (“FAA AEG”) about an important aircraft part called the Maneuvering Characteristics Augmentation System (“MCAS”) that impacted the flight control system of Boeing’s 737 MAX. Through this deception, the Company interfered with the FAA AEG’s lawful function to evaluate MCAS and to include information about MCAS in the 737 MAX FSB Report, and fraudulently obtained from the FAA AEG a differences-training determination for the 737 MAX that was based on incomplete and inaccurate information about MCAS;

b. The Company did not receive voluntary disclosure credit pursuant to the Corporate Enforcement Policy in the Department of Justice

Manual 9-47.120, or pursuant to the Sentencing Guidelines, because it did not timely and voluntarily disclose to the Fraud Section the offense conduct described in the Statement of Facts;

c. The Company received partial credit for its cooperation with the Fraud Section's investigation into the Company's above-described deception of the FAA AEG; the Company's cooperation ultimately included voluntarily and proactively identifying to the Fraud Section potentially significant documents and Company witnesses and voluntarily organizing voluminous evidence that the Company was obligated to produce; such cooperation, however, was delayed and only began after the first six months of the Fraud Section's investigation, during which time the Company's response frustrated the Fraud Section's investigation;

d. The Company engaged in remedial measures after the offense conduct, including: (i) creating a permanent aerospace safety committee of the Board of Directors to oversee the Company's policies and procedures governing safety and its interactions with the FAA and other government agencies and regulators; (ii) creating a Product and Services Safety organization to strengthen and centralize the safety-related functions that were previously located across the Company; (iii) reorganizing the Company's engineering function to have all Boeing engineers, as well as the Company's Flight Technical Team, report through the Company's chief engineer rather than to the business units; and (iv) making structural changes to the Company's Flight Technical Team to increase the supervision, effectiveness, and professionalism of the Company's Flight Technical Pilots, including moving the Company's Flight Technical Team under the same organizational umbrella as the Company's Flight Test Team, and adopting new policies and procedures and conducting training to clarify expectations and requirements governing communications between the Company's Flight Technical Pilots and regulatory authorities, including specifically the FAA AEG. The Company also made significant changes to its top leadership since the offense occurred;

e. The Company ultimately provided to the Fraud Section all relevant facts known to it, including information about the individuals involved in the conduct described in the attached Statement of Facts and conduct disclosed prior to the Agreement;

f. The Company's prior history of misconduct includes a criminal conviction from 1989 for an employee illegally obtaining confidential military planning documents, and a criminal non-prosecution agreement from 2006 for an employee engaging in procurement fraud. The Company's history also includes a civil FAA settlement agreement from 2015 related to safety and quality issues concerning the Company's Boeing Commercial Airplanes business unit;

g. After the offense conduct, the Company undertook the remedial efforts described above and enhanced and has committed to continuing to enhance its compliance program and internal controls, including ensuring that

its compliance program satisfies the minimum elements set forth in Attachment C to this Agreement (Corporate Compliance Program);

h. The Fraud Section determined that an independent compliance monitor was unnecessary based on the following factors, among others: (i) the misconduct was neither pervasive across the organization, nor undertaken by a large number of employees, nor facilitated by senior management; (ii) although two of the Company's 737 MAX Flight Technical Pilots deceived the FAA AEG about MCAS by way of misleading statements, half-truths, and omissions, others in the Company disclosed MCAS's expanded operational scope to different FAA personnel who were responsible for determining whether the 737 MAX met U.S. federal airworthiness standards; (iii) the state of the Company's remedial improvements to its compliance program and internal controls; and (iv) the Company's agreement to meet with and report to the Fraud Section as set forth in Attachment D to this Agreement (Enhanced Reporting Requirements);

i. The Company has agreed to continue to cooperate with the Fraud Section as described in Paragraph 5, below;

j. Accordingly, after considering (a) through (i) above, the Fraud Section believes that the appropriate resolution in this case is a Deferred Prosecution Agreement with the Company; a criminal monetary penalty in the amount of \$243,600,000, which reflects a fine at the low end of the otherwise-applicable Sentencing Guidelines fine range; \$1,770,000,000 in compensation to the Company's airline customers; \$500,000,000 in additional compensation to the heirs, relatives, and/or legal beneficiaries of the crash victims of Lion Air Flight 610 and Ethiopian Airlines Flight 302; and the Company's agreement to meet with and report to the Fraud Section as set forth in Attachment D to this Agreement.

5. The Company and its subsidiaries and affiliates shall cooperate fully with the Fraud Section in any and all matters relating to the conduct described in this Agreement and the attached Statement of Facts and other conduct under investigation by the Fraud Section, until the later of the date upon which all investigations and prosecutions arising out of such conduct are concluded, or the end of the Term. At the request of the Fraud Section, the Company and its subsidiaries and affiliates shall also cooperate fully with other domestic or foreign law enforcement and regulatory authorities and agencies in any investigation of the Company, its subsidiaries, affiliates, or any of their present or former officers, directors, employees, and agents in any and all matters relating to the conduct described in this Agreement and the attached Statement of Facts and other conduct. The Company's and its subsidiaries' and affiliates' cooperation pursuant to this Paragraph is subject to applicable law and regulations, as well as valid claims of attorney-client privilege or attorney work product doctrine; however, the Company and its subsidiaries and affiliates must provide to the Fraud Section a log of any information or cooperation that is not provided based on an assertion of law, regulation, or privilege, and the Company and its subsidiaries and affiliates bear the burden of establishing the validity

of any such assertion. The Company and its subsidiaries and affiliates agree that their cooperation pursuant to this paragraph shall include, but not be limited to, the following:

a. Upon request of the Fraud Section, the Company and its subsidiaries and affiliates shall truthfully disclose all factual information with respect to their activities and those of their present and former directors, officers, employees, agents, and consultants, including any evidence or allegations and internal or external investigations, about which the Company and its subsidiaries and affiliates have any knowledge or about which the Fraud Section may inquire. This obligation of truthful disclosure includes, but is not limited to, the obligation of the Company and its subsidiaries and affiliates to provide to the Fraud Section, upon request, any document, record or other tangible evidence about which the Fraud Section may inquire of the Company and its subsidiaries and affiliates.

b. Upon request of the Fraud Section, the Company and its subsidiaries and affiliates shall designate knowledgeable employees, agents, or attorneys to provide to the Fraud Section the information and materials described in Paragraph 5(a) above on behalf of the Company and its subsidiaries and affiliates. It is further understood that the Company and its subsidiaries and affiliates must at all times provide complete, truthful, and accurate information.

c. The Company and its subsidiaries and affiliates shall use their best efforts to make available for interviews or testimony, as requested by the Fraud Section, present or former officers, directors, employees, agents, and consultants of the Company and its subsidiaries and affiliates. This obligation includes, but is not limited to, sworn testimony before a federal grand jury or in federal trials, as well as interviews with domestic or foreign law enforcement and regulatory authorities. Cooperation under this Paragraph shall include identification of witnesses who, to the knowledge of the Company and its subsidiaries and affiliates, may have material information regarding the matters under investigation.

d. With respect to any information, testimony, documents, records, or other tangible evidence provided to the Fraud Section pursuant to this Agreement, the Company and its subsidiaries and affiliates consent to any and all disclosures to other governmental authorities, including United States authorities and those of a foreign government of such materials as the Fraud Section, in its sole discretion, shall deem appropriate.

6. In addition to the obligations in Paragraph 5, during the Term, should the Company learn of any evidence or allegation of a violation of U.S. fraud laws committed by the Company's employees or agents upon any domestic or foreign government agency (including the FAA), regulator, or any of the Company's airline customers, the Company shall promptly report such evidence or allegation to the Fraud Section.

7. The Company and the Fraud Section agree that the Total U.S. Criminal Monetary Amount to be paid by the Company pursuant to this Agreement is \$2,513,600,000, which comprises the following components as further described below: (i) a criminal monetary penalty of \$243,600,000 (the “Criminal Monetary Penalty”); (ii) \$1,770,000,000 in compensation to Boeing’s airline customers (the “Airline Compensation Amount”); and (iii) \$500,000,000 in compensation to the heirs, relatives, and/or legal beneficiaries of the crash victims of Lion Air Flight 610 and Ethiopian Airlines Flight 302 (the “Crash-Victim Beneficiaries Compensation Amount”).

8. The Company acknowledges that no tax deduction may be sought in connection with the payment of the Criminal Monetary Penalty. The Company shall not seek or accept directly or indirectly reimbursement or indemnification from any source with regard to the Criminal Monetary Penalty or any other agreement entered into with any other enforcement authority or a regulator concerning the facts set forth in the Statement of Facts.

9. The Fraud Section and the Company agree that application of the Sentencing Guidelines to determine the applicable fine range yields the following analysis:

a.	The 2018 USSG are applicable to this matter.	
b.	Offense Level. Based upon USSG § 2B1.1, the total offense level is 34, calculated as follows:	
(a)(2)	Base Offense Level	6
(b)(1)(N)	Gain of More Than \$150,000,000	+26
(b)(10)	Sophisticated Means	+
		<u>2</u>
TOTAL		34

Base Fine. Based upon USSG § 8C2.4(a)(2), which imposes a base fine equal to the pecuniary gain to the organization from the offense if such gain is greater than the amount indicated in the Offense Level Fine Table, the base fine is \$243,600,000 (representing Boeing’s cost-savings, based on Boeing’s assessment of the cost associated with the implementation of full-flight simulator training for the 737 MAX).

Culpability Score. Based upon USSG § 8C2.5, the culpability score is 5, calculated as follows:

(a)	Base Culpability Score	5

- (b)(4) The organization had 50 or more employees and an individual within substantial authority personnel participated in, condoned, or was willfully ignorant of the offense

+2

- (g)(2) The organization cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct

-2

Calculation of Fine Range:

Base Fine	\$243,600,000
Multipliers	1.0 (min) / 2.0 (max)
Fine Range	\$243,600,000/ \$487,200,000

10. The Company agrees to pay the Criminal Monetary Penalty of \$243,600,000 to the United States Treasury no later than ten (10) business days after the Agreement is fully executed pursuant to payment instructions provided by the Fraud Section in its sole discretion. The Fraud Section and the Company agree that the Criminal Monetary Penalty is appropriate given the facts and circumstances of this case, including the Relevant Considerations described in Paragraph 4.

11. The Criminal Monetary Penalty is final and shall not be refunded. Furthermore, nothing in this Agreement shall be deemed an agreement by the Fraud Section that \$243,600,000 is the maximum penalty that may be imposed in any future prosecution, and the Fraud Section is not precluded from arguing in any future prosecution that the Court should impose a higher fine, although the Fraud Section agrees that under those circumstances, it will recommend to the Court that any amount paid under this Agreement should be offset against any fine the Court imposes as part of a putative future judgment.

12. The Company agrees to pay a total Airline Compensation Amount of \$1,770,000,000 to its airline customers for the direct pecuniary harm that its airline customers incurred as a result of the grounding of the Company's 737 MAX. The Airline Compensation Amount shall be offset by any payments already made by the Company, as of the date this Agreement is fully executed, to any of its airline customers for the direct pecuniary harm that its airline customers incurred as a result of the grounding of the Company's 737 MAX. The Company shall pay any remaining amounts due under the Airline Compensation Amount to its airline customers by the end of the Term and shall provide documentation to the Fraud Section evidencing the amounts paid.

13. The Company agrees to pay a total Crash-Victim Beneficiaries Compensation Amount of \$500,000,000 to the heirs, relatives, and/or legal beneficiaries of the crash

victims of Lion Air Flight 610 and Ethiopian Airlines Flight 302. No later than ten (10) business days after the filing of the Information, the Company shall establish an escrow account (“Escrow Account”) into which it shall deposit the full Crash-Victim Beneficiaries Compensation Amount. No monies will be paid out of the Escrow Account without prior approval by the Fraud Section.

14. The parties agree that the appointment of a Crash-Victim Beneficiaries Compensation Claims Administrator (the “Administrator”) is appropriate and necessary to determine the proper administration and disbursement of the Crash-Victim Beneficiaries Compensation Amount that the Company will pay to the beneficiaries of the crash victims.

15. The Administrator, consistent with a process imposed and required by the Fraud Section, will make recommendations to the Fraud Section regarding: (a) the individuals who should receive payments from the Crash-Victim Beneficiaries Compensation Amount; and (b) the compensation amounts that these individuals should receive. Only the Fraud Section shall be empowered to make final decisions regarding: (a) the individuals who should receive the victim payments from the Crash-Victim Beneficiaries Compensation Amount; and (b) the compensation amounts that these individuals should receive.

16. The Company agrees to pay for all costs, fees, and expenses incurred by the Administrator. The Company shall execute an engagement letter with the Administrator that must be approved, in advance of execution, by the Fraud Section.

17. Within twenty (20) business days after the filing of the Information, the Company shall submit a written proposal identifying three (3) candidates to serve as the Administrator, setting forth the candidates’ qualifications and credentials. The Fraud Section retains the right, in its sole discretion, to choose the Administrator from among the candidates proposed by the Company. Any submission or selection of the Administrator by either the Company or the Fraud Section shall be made without unlawful discrimination against any person or class of persons. The Fraud Section and the Company will use their best efforts to complete the selection process within thirty (30) calendar days of the execution of this Agreement.

18. The Company agrees that it will not employ or be affiliated with the Administrator for a period of not less than two years from the date on which the Administrator’s term expires. Nor will the Company discuss with the Administrator the possibility of further employment or affiliation during the Administrator’s term. Upon agreement by the parties, this prohibition will not apply to other claims administration responsibilities that the Administrator may undertake in connection with resolutions with foreign or other domestic authorities.

19. The Company agrees that it will not use the fact that any beneficiary of the crash victims of Lion Air Flight 610 and Ethiopian Airlines Flight 302 seeks or receives any compensation from the Crash-Victim Beneficiaries Compensation Amount to seek to

preclude such beneficiary from pursuing any other lawful claim that such beneficiary might have against the Company.

20. Subject to Paragraphs 26–30, the Fraud Section agrees, except as provided in this Agreement, that it will not bring any criminal or civil case against the Company relating to any of the conduct as described in the attached Statement of Facts or the Information filed pursuant to this Agreement. The Fraud Section, however, may use any information related to the conduct described in the attached Statement of Facts against the Company: (a) in a prosecution for perjury or obstruction of justice; (b) in a prosecution for making a false statement; (c) in a prosecution or other proceeding relating to any crime of violence; or (d) in a prosecution or other proceeding relating to a violation of any provision of Title 26 of the United States Code.

- a. This Agreement does not provide any protection against prosecution for any future conduct by the Company.
- b. In addition, this Agreement does not provide any protection against prosecution of any individuals, regardless of their affiliation with the Company.

21. The Company represents that it has implemented and will continue to implement a compliance and ethics program designed, implemented, and enforced to prevent and detect violations of the U.S. fraud laws throughout its operations, including those of its subsidiaries, affiliates, agents, and joint ventures, and those of its contractors and subcontractors whose responsibilities relate to the Company's interactions with any domestic or foreign government agency (including the FAA), regulator, or any of its airline customers, including, but not limited to, the minimum elements set forth in Attachment C.

22. In order to address any deficiencies in its internal controls, policies, and procedures, the Company represents that it has undertaken, and will continue to undertake in the future, in a manner consistent with all of its obligations under this Agreement, a review of its existing internal controls, policies, and procedures regarding compliance with U.S. fraud laws, focusing on the Company's interactions with domestic or foreign government agencies (including the FAA), regulators, and any of its airline customers. Where necessary and appropriate, the Company agrees to adopt a new compliance program, or to modify its existing one, including internal controls, compliance policies, and procedures in order to ensure that it maintains an effective compliance program, including a system of internal controls, designed to effectively detect and deter violations of U.S. fraud laws. The compliance program, including the internal controls system, will include, but not be limited to, the minimum elements set forth in Attachment C.

23. The Company agrees that it will report to the Fraud Section periodically, at no less than three-month intervals during the Term, regarding remediation, implementation, and testing of its compliance program and internal controls, policies, and procedures described in Attachment C. During the Term, the Company shall (i) conduct an initial review and

submit an initial report, and (ii) conduct and prepare at least two follow-up reviews and reports, as described in Attachment D.

24. In consideration of the undertakings agreed to by the Company herein, the Fraud Section agrees that any prosecution of the Company for the conduct set forth in the attached Statement of Facts or Information will be and hereby is deferred for the Term. To the extent there is conduct disclosed by the Company that is not set forth in the attached Statement of Facts or Information, such conduct will not be exempt from further prosecution and is not within the scope of or relevant to this Agreement.

25. The Fraud Section further agrees that if the Company fully complies with all of its obligations under this Agreement, the Fraud Section will not continue the criminal prosecution against the Company described in Paragraph 1 and, at the conclusion of the Term, this Agreement shall expire. Six months after the Agreement's expiration, the Fraud Section shall seek dismissal with prejudice of the Information filed against the Company described in Paragraph 1, and agree not to file charges in the future against the Company based on the conduct described in this Agreement, the attached Statement of Facts, or the Information. If, however, the Fraud Section determines during this six-month period that the Company breached the Agreement during the Term, as described in Paragraphs 26–30, the Fraud Section's ability to extend the Term, as described in Paragraph 3, or to pursue other remedies, including those described in Paragraphs 26–30, remains in full effect.

26. If, during the Term, (a) the Company commits any felony under U.S. federal law; (b) the Company provides in connection with this Agreement deliberately false, incomplete, or misleading information, including in connection with its disclosure of information about individual culpability; (c) the Company or its subsidiaries and affiliates fail to cooperate as set forth in Paragraphs 5 and 6 of this Agreement; (d) the Company fails to implement a compliance program as set forth in Paragraphs 21–22 of this Agreement and Attachment C; or (e) the Company and its subsidiaries and affiliates otherwise fail to completely perform or fulfill each of their obligations under the Agreement, regardless of whether the Fraud Section becomes aware of such a breach after the Term is complete, the Company and its subsidiaries and affiliates shall thereafter be subject to prosecution for any federal criminal violation of which the Fraud Section has knowledge, including, but not limited to, the charges in the Information described in Paragraph 1, which may be pursued by the Fraud Section in the United States District Court for the Northern District of Texas or any other appropriate venue. Determination of whether the Company has breached the Agreement and whether to pursue prosecution of the Company and its subsidiaries and affiliates shall be in the Fraud Section's sole discretion. Any such prosecution may be premised on information provided by the Company, its subsidiaries and affiliates, or their personnel. Any such prosecution relating to the conduct described in the attached Statement of Facts or relating to conduct known to the Fraud Section prior to the date on which this Agreement was signed that is not time-barred by the applicable statute of limitations on the date of the signing of this Agreement may be commenced against the Company, or its subsidiaries and affiliates, notwithstanding the expiration of

the statute of limitations, between the signing of this Agreement and the expiration of the Term plus one year. Thus, by signing this Agreement, the Company agrees that the statute of limitations with respect to any such prosecution that is not time-barred on the date of the signing of this Agreement shall be tolled for the Term plus one year. In addition, the Company agrees that the statute of limitations as to any violation of U.S. federal law that occurs during the Term will be tolled from the date upon which the violation occurs until the earlier of the date upon which the Fraud Section is made aware of the violation or the duration of the Term plus five years, and that this period shall be excluded from any calculation of time for purposes of the application of the statute of limitations.

27. In the event the Fraud Section determines that the Company has breached this Agreement, the Fraud Section agrees to provide the Company with written notice of such breach prior to instituting any prosecution resulting from such breach. Within thirty days of receipt of such notice, the Company shall have the opportunity to respond to the Fraud Section in writing to explain the nature and circumstances of such breach, as well as the actions the Company has taken to address and remediate the situation, which explanation the Fraud Section shall consider in determining whether to pursue prosecution of the Company.

28. In the event that the Fraud Section determines that the Company has breached this Agreement: (a) all statements made by or on behalf of the Company or its subsidiaries and affiliates to the Fraud Section or to the Court, including the attached Statement of Facts, and any testimony given by the Company or its subsidiaries and affiliates before a grand jury, a court, or any tribunal, or at any legislative hearings, whether prior or subsequent to this Agreement, and any leads derived from such statements or testimony, shall be admissible in evidence in any and all criminal proceedings brought by the Fraud Section against the Company or its subsidiaries and affiliates; and (b) the Company or its subsidiaries and affiliates shall not assert any claim under the United States Constitution, Rule 11(f) of the Federal Rules of Criminal Procedure, Rule 410 of the Federal Rules of Evidence, Section 1B1.1(a) of the USSG, or any other federal rule that any such statements or testimony made by or on behalf of the Company prior or subsequent to this Agreement, or any leads derived therefrom, should be suppressed or are otherwise inadmissible. The decision whether conduct or statements of any current director, officer, or employee, or any person acting on behalf of, or at the direction of, the Company or its subsidiaries and affiliates will be imputed to the Company for the purpose of determining whether the Company has violated any provision of this Agreement shall be in the sole discretion of the Fraud Section.

29. The Company acknowledges that the Fraud Section has made no representations, assurances, or promises concerning what sentence may be imposed by the Court if the Company breaches this Agreement and this matter proceeds to judgment. The Company further acknowledges that any such sentence is solely within the discretion of the Court and that nothing in this Agreement binds or restricts the Court in the exercise of such discretion.

30. On the date that the period of deferred prosecution specified in this Agreement expires, the Company, by the Chief Executive Officer of the Company and the Chief Financial Officer of the Company, will submit the certification set forth in Attachment E and certify to the Fraud Section that the Company has met its disclosure obligations pursuant to Paragraph 6 of this Agreement. Each certification will be deemed a material statement and representation by the Company to the executive branch of the United States for purposes of Title 18, United States Code, Sections 1001 and 1519, and it will be deemed to have been made in the judicial district in which this Agreement is filed. . . .

31. The Company expressly agrees that it shall not, through present or future attorneys, officers, directors, employees, agents, or any other person authorized to speak for the Company make any public statement, in litigation or otherwise, contradicting the acceptance of responsibility by the Company set forth above or the facts described in the attached Statement of Facts. Any such contradictory statement shall, subject to cure rights of the Company described below, constitute a breach of this Agreement, and the Company thereafter shall be subject to prosecution as set forth in Paragraphs 26–30 of this Agreement. The decision whether any public statement by any such person contradicting a fact contained in the attached Statement of Facts will be imputed to the Company for the purpose of determining whether it has breached this Agreement shall be at the sole discretion of the Fraud Section. If the Fraud Section determines that a public statement by any such person contradicts, in whole or in part, a statement contained in the attached Statement of Facts, the Fraud Section shall so notify the Company, and the Company may avoid a breach of this Agreement by publicly repudiating such statement(s) within five business days after notification. The Company shall be permitted to raise defenses and to assert affirmative claims in other proceedings relating to the matters set forth in the attached Statement of Facts provided that such defenses and claims do not contradict, in whole or in part, a statement contained in the attached Statement of Facts. This Paragraph does not apply to any statement made by any present or former officer, director, employee, or agent of the Company in the course of any criminal, regulatory, or civil case initiated against such individual, unless such individual is speaking on behalf of the Company. . . .

ATTACHMENT A

STATEMENT OF FACTS

1. The following Statement of Facts is incorporated by reference as part of the Deferred Prosecution Agreement (the “Agreement”) between the United States Department of Justice, Criminal Division, Fraud Section (the “Fraud Section”), the United States Attorney’s Office for the Northern District of Texas (the “USAO-NDTX”) and The Boeing Company (“Boeing” or the “Company”). The Company hereby agrees and stipulates that the following information is true and accurate. The Company admits, accepts, and acknowledges that it is responsible for the acts of its officers, directors, employees, and agents as set forth below. Should the Fraud Section or the USAO-NDTX pursue the prosecution that is deferred by this Agreement, the Company agrees that it will

neither contest the admissibility of, nor contradict, this Statement of Facts in any such proceeding. The following facts establish beyond a reasonable doubt the charge set forth in the Information attached to this Agreement:

At all times relevant to this Statement of Facts, with all dates being approximate and inclusive:

2. The Boeing Company (“Boeing”) was a U.S.-based multinational corporation that designed, manufactured, and sold commercial airplanes to airlines worldwide. Boeing operated from various locations, including in and around Seattle, Washington.

3. Boeing’s airline customers included major U.S.-based airlines headquartered in the Northern District of Texas and elsewhere.

4. The Boeing 737 was a commercial airplane that could seat approximately 200 passengers and was one of Boeing’s best-selling airplane models. Boeing began designing, manufacturing, and selling the Boeing 737 in the 1960s. Over time, Boeing designed, manufactured, and sold new versions of the Boeing 737 to its airline customers, including major U.S.-based airlines.

5. In or around June 2011, Boeing began developing and marketing a new version of its Boeing 737 called the 737 MAX. The 737 MAX was designed by Boeing as a competitive answer to a new version of an airplane developed by one of Boeing’s top rivals in commercial airplanes, Company-1. Like the new version of Company-1’s airplane, the 737 MAX promised increased fuel efficiency over its prior version, the 737 Next Generation (“737 NG”). With this increased efficiency, the 737 MAX offered fuel-cost savings for airlines.

6. Before any U.S.-based airline could operate a new commercial airplane, U.S. regulations required the Federal Aviation Administration (“FAA”), an organization within the United States Department of Transportation, to evaluate and approve the airplane for commercial use. Without this approval, a U.S.-based airline would not be permitted to operate the airplane.

7. As part of this evaluation and approval process, the FAA had to make two distinct determinations: (i) whether the airplane met U.S. federal airworthiness standards; and (ii) what minimum level of pilot training would be required for a pilot to fly the airplane for a U.S.-based airline. These two determinations were made by entirely different groups within the FAA that were composed of different personnel with different organizational structures and different reporting lines.

8. The FAA Aircraft Evaluation Group (“AEG”) was principally responsible for determining the minimum level of pilot training required for a pilot to fly the airplane for a U.S.-based airline. To make that determination, the FAA AEG compared the new version of the airplane (such as the 737 MAX) to a similar, prior version of the airplane (such as the 737 NG). After evaluating the differences between the new and prior versions

of the airplane, the FAA AEG mandated the minimum level of pilot training, known as “differences training,” for the new version.

9. Based on the nature and extent of the differences between the new and prior version of the airplane, the FAA AEG assigned a level of differences training ranging from “Level A” through “Level E.” These levels of differences training ranged in rigor, with “Level A” being the least intensive and “Level E” the most intensive. As relevant here, “Level B” differences training generally included computer-based training (“CBT”) training, and “Level D” differences training generally included full-flight simulator training.

10. At the conclusion of the FAA’s evaluation of the new version of the airplane, the FAA AEG published a Flight Standardization Board Report (“FSB Report”). Among other things, the FSB Report contained relevant information about certain airplane systems and parts that the airplane manufacturer was required to incorporate into airplane manuals and pilot-training materials for all U.S.-based airlines that would fly the airplane. The FSB Report also contained the FAA AEG’s differences-training determination.

11. Boeing’s 737 MAX Flight Technical Team was principally responsible for identifying and providing to the FAA AEG all information that was relevant to the FAA AEG in connection with the FAA AEG’s publication of the 737 MAX FSB Report. The 737 MAX Flight Technical Team was separate and distinct from another group within Boeing that was responsible for providing information to the FAA for certification of whether the airplane met U.S. federal airworthiness standards.

12. From in or around early 2012 until in or around early 2014, Boeing Employee-1 was a Technical Pilot for Boeing’s 737 MAX Flight Technical Team. In or around early 2014, Boeing Employee-1 became Boeing’s 737 MAX Chief Technical Pilot. In that role, Boeing Employee-1 led the 737 MAX Flight Technical Team. In or around July 2018, Boeing Employee-1 left Boeing to work for a major U.S.-based airline.

13. From in or around mid-2014 until in or around July 2018, Boeing Employee-2 was a Technical Pilot for Boeing’s 737 MAX Flight Technical Team. In or around July 2018, after Boeing Employee-1 left Boeing, Boeing Employee-2 became Boeing’s 737 MAX Chief Technical Pilot. In that role, Boeing Employee-2 led the 737 MAX Flight Technical Team.

14. Boeing Employee-1 and Boeing Employee-2 understood that the FAA AEG relied on them, as members of Boeing’s 737 MAX Flight Technical Team, to identify and provide to the FAA AEG all information that was relevant to the FAA AEG in connection with the FAA AEG’s publication of the 737 MAX FSB Report, including information that could impact the FAA AEG’s differences-training determination.

15. Boeing Employee-1 and Boeing Employee-2 also understood that, because flight controls were vital to flying modern commercial airplanes, differences between the flight controls of the 737 NG and the 737 MAX were especially important to the FAA AEG

for purposes of its publication of the 737 MAX FSB Report and the FAA AEG's differences-training determination.

16. From at least in and around November 2016 through at least in and around December 2018, in the Northern District of Texas and elsewhere, Boeing, through Boeing Employee-1 and Boeing Employee-2, knowingly, and with intent to defraud, conspired to defraud the FAA AEG.

17. At all times during the conspiracy, Boeing Employee-1 and Boeing Employee-2 were acting within the scope of their employment and with the intention, at least in part, to benefit Boeing. The purpose of the conspiracy was to defraud the FAA AEG by impairing, obstructing, defeating, and interfering with the lawful function of the FAA AEG by dishonest means in connection with its publication of the 737 MAX FSB Report and its differences-training determination for the Boeing 737 MAX, in order to bring about a financial gain to Boeing and to benefit Boeing Employee-1 and Boeing Employee-2 in connection with the Boeing 737 MAX.

18. As Boeing knew, "Level B" differences training was significantly less expensive for airlines to complete than "Level D." For example, a pilot could complete "Level B" differences training from anywhere in the world in a matter of hours using a computer or tablet. In contrast, a pilot could complete "Level D" differences training only by appearing in person wherever the pilot's airline operated a full-flight simulator. Apart from the cost of acquiring one or more multimillion-dollar simulators and other related expenses, airlines that were required by the FAA AEG to train pilots on a full-flight simulator could also lose revenue that the pilot might otherwise have generated from flying airline passengers during that time. Accordingly, if the FAA AEG required a less rigorous level—such as "Level B"—of differences training for the 737 MAX in the 737 MAX FSB Report, the 737 MAX would be a more attractive option for Boeing's airline customers already flying the 737 NG than switching to an entirely new airplane, such as the new version of Company-1's airplane, as such customers would save significant money in pilot-training costs by transitioning to the 737 MAX.

19. Principally for this reason, Boeing's stated objectives in designing the 737 MAX included securing the FAA AEG's determination to require no greater than "Level B" differences training in the 737 MAX FSB Report. Boeing Employee-1 and Boeing Employee-2 understood as much. For example, in or around November 2014, Boeing Employee-2 wrote in an internal Boeing electronic chat communication to Boeing Employee-1 that "nothing can jepordize [sic] level b[.]" In or around December 2014, Boeing Employee-1 wrote in an email to another Boeing employee that "if we lose Level B [it] will be thrown squarely on my shoulders. It was [Boeing Employee-1], yes [Boeing Employee-1]! Who cost Boeing tens of millions of dollars!"

20. To achieve its promised fuel efficiency, the 737 MAX used larger engines than the 737 NG. These larger engines, and their placement under the airplane's wings, meant that the aerodynamics of the 737 MAX differed from those of the 737 NG.

21. These different aerodynamics created a new handling characteristic for the 737 MAX that caused the 737 MAX's nose to pitch up during a certain flight maneuver called a high-speed, wind-up turn. A high-speed, wind-up turn generally involved sharply turning the airplane at high speed (approximately Mach 0.6-0.8) in a corkscrew-like pattern.

22. A high-speed, wind-up turn was a "certification" maneuver, that is, a maneuver outside the limits of what the 737 MAX would be expected to encounter during a normal commercial passenger flight. Nevertheless, if Boeing did not fix the 737 MAX's pitch-up characteristic in high-speed, wind-up turns, the FAA could determine that the 737 MAX did not meet U.S. federal airworthiness standards.

23. To fix this pitch-up characteristic, Boeing created MCAS and incorporated it as a part of the 737 MAX's flight controls. MCAS was an aircraft "part" within the meaning of Title 18, United States Code, Sections 31(a)(7) and 38. In operation, MCAS would automatically cause the airplane's nose to pitch down by adjusting the 737 MAX's horizontal stabilizer (a horizontal tail located near the rear of the airplane). As originally designed, MCAS could only activate during a high-speed, wind-up turn.

24. In or around June 2015, Boeing Employee-1 and other Boeing employees briefed the FAA AEG on MCAS. During this briefing, Boeing described MCAS as a system that could only activate during a high-speed, wind-up turn. After the briefing, Boeing Employee-1 and another Boeing employee further discussed MCAS with an FAA AEG employee ("FAA AEG Employee-1") and reiterated to FAA AEG Employee-1 the limited operational scope of MCAS.

25. Subsequently, Boeing expanded MCAS's operational scope, including the speed range within which MCAS could activate, significantly altering its original design. Among other things, when the airplane registered a high angle of attack, the change expanded the speed range within which MCAS could activate from approximately Mach 0.6-0.8 to approximately Mach 0.2-0.8—that is, from only high-speed flight to nearly the entire speed range for the 737 MAX, including low-speed flight, which generally occurs at a lower altitude and in and around takeoff and landing. Boeing disclosed this expansion to FAA personnel, but only to those personnel who were responsible for determining whether the 737 MAX met U.S. federal airworthiness standards. Boeing did not disclose the expansion to the FAA AEG personnel responsible for publishing the 737 MAX FSB Report and making the training-related determination.

26. On or about August 16, 2016, before the FAA AEG published the 737 MAX FSB Report, the FAA AEG issued a provisional "Level B" differences-training determination for the 737 MAX. At the time of this provisional determination, the FAA AEG was unaware that Boeing had expanded MCAS's operational scope.

27. On or about the same day, Boeing Employee-1 recognized Boeing's achievement in an email to Boeing employees, including Boeing Employee-2, and wrote that the FAA AEG's provisional determination "culminates more than 3 years of tireless and

collaborative efforts across many business units” and that the 737 MAX program management “is VERY happy.”

28. As Boeing Employee-1 and Boeing Employee-2 knew, the FAA AEG based its provisional “Level B” differences training for the 737 MAX in part on its understanding that MCAS could only activate during the limited operational scope of a high-speed, wind up turn.

29. Boeing Employee-1 and Boeing Employee-2 also understood, as Boeing Employee-1 acknowledged in his email on or about August 16, 2016, that the FAA AEG’s “Level B” differences determination for the 737 MAX was only a “provisional approval [. . .] assuming no significant systems changes to the airplane.”

30. For example, in an email to Boeing employees including Boeing Employee-2 discussing a potential change to another part of the 737 MAX’s flight controls on or about November 10, 2016, Boeing Employee-1 emphasized that “[o]ne of the Program Directives we were given was to not create any differences [. . .]. This is what we sold to the regulators who have already granted us the Level B differences determination. To go back to them now, and tell them there is in fact a difference [. . .] would be a huge threat to that differences training determination.”

31. On or about November 15, 2016, during a test flight of the 737 MAX in a simulator, Boeing Employee-1 experienced what Boeing Employee-1 recognized as MCAS operating at lower speed. Boeing Employee-1 further recognized that this lower-speed operation was different from what Boeing had briefed and described to the FAA AEG.

32. On or about that same day, Boeing Employee-1 and Boeing Employee-2 discussed MCAS in an internal Boeing electronic chat communication, writing in part:

Boeing Employee-1: Oh shocker alert! [sic] / MCAS is now active down to [Mach] .2 / It’s running rampant in the sim on me / at least that’s what [a Boeing simulator engineer] thinks is happening

Boeing Employee-2: Oh great, that means we have to update the speed trim description in vol 2

Boeing Employee-1: so I basically lied to the regulators (unknowingly)

Boeing Employee-2: it wasn’t a lie, no one told us that was the case

33. At this point, Boeing Employee-1 and Boeing Employee-2 recognized that the FAA AEG was under the misimpression that MCAS operated only during a high-speed, wind up turn and could not operate at lower Mach speeds, such as at Mach 0.2. Boeing Employee-1 and Boeing Employee-2 therefore knew, at least as of the time of this chat communication, that the FAA AEG’s provisional “Level B” differences-training determination had been based in part on outdated and inaccurate information about MCAS.

34. Boeing Employee-1 and Boeing Employee-2 also knew that MCAS's expanded operational scope was relevant to the FAA AEG's decisions about the content of the 737 MAX FSB Report, including whether to include information about MCAS. Boeing Employee-1 and Boeing Employee-2 similarly understood that it was their responsibility to update the FAA AEG about any relevant changes to the 737 MAX's flight controls—such as MCAS's expanded operational scope.

35. Despite knowing that the FAA AEG had issued its provisional “Level B” determination without any awareness that MCAS's operational scope had been expanded to include high angle of attack conditions in nearly the entire speed range of ordinary commercial flight, Boeing Employee-1 and Boeing Employee-2 did not correct the FAA AEG's understanding of MCAS's operational scope or otherwise ensure that the FAA AEG's “Level B” determination was based on an accurate understanding of MCAS's operation. Instead, Boeing—through Boeing Employee-1 and Boeing Employee-2—intentionally withheld and concealed from the FAA AEG their knowledge of MCAS's expanded operational scope.

36. For example, shortly after the simulated test flight described in paragraph 30, Boeing Employee-1 talked with FAA AEG Employee-1, who asked Boeing Employee-1 about the simulated test flight. Boeing Employee-1 intentionally withheld and concealed from FAA AEG Employee-1 the fact that MCAS's operational scope had been expanded beyond what the FAA AEG relied upon when it issued its provisional “Level B” differences-training determination for the 737 MAX.

37. Around the time that Boeing Employee-1 and Boeing Employee-2 discussed MCAS's expanded operational scope, Boeing Employee-1 asked a Boeing senior engineer assigned to the 737 MAX program about MCAS's operational scope. The senior engineer confirmed to Boeing Employee-1 that MCAS could activate beyond the limited operational scope of a high-speed, wind-up turn. The senior engineer suggested that Boeing Employee-1 contact certain subject-matter experts at Boeing for more specific information about MCAS's operational scope.

38. On or about November 17, 2016, the FAA AEG emailed three Boeing employees, including Boeing Employee-1, Boeing Employee-2, and another Boeing employee, a draft of the forthcoming 737 MAX FSB Report. That same day, Boeing Employee-1 asked Boeing Employee-2 and the other Boeing employee to review the draft 737 MAX FSB Report “for any glaring issues.”

39. On or about November 22, 2016, the other Boeing employee emailed the draft 737 MAX FSB Report back to the FAA AEG with proposed edits. Boeing Employee-1 and Boeing Employee-2 were included on this email. Boeing Employee-1 included a proposed edit to delete a reference to MCAS, and wrote, “We agreed not to reference MCAS since it's outside normal operating envelope.” Neither Boeing Employee-1 nor Boeing Employee-2 shared the fact of MCAS's expanded operational scope with the FAA AEG or otherwise corrected the FAA AEG's misimpression that MCAS's operational scope was limited to high-speed, wind-up turns.

40. In doing so, Boeing Employee-1 and Boeing Employee-2 deceived the FAA AEG into believing that the basis upon which the FAA AEG had initially “agreed” to remove any information about MCAS from the 737 MAX FSB Report—that MCAS could only activate during the limited operational scope of a high-speed, wind-up turn—remained the same. Boeing Employee-1 and Boeing Employee-2 withheld their knowledge of MCAS from the FAA AEG to avoid risking the FAA AEG taking any action that could threaten the differences-training determination for the 737 MAX.

41. On or about January 17, 2017, Boeing Employee-1 again reminded the FAA AEG in an email to delete any reference to MCAS from the forthcoming 737 MAX FSB Report, and wrote, “Flight Controls: Delete MCAS, recall we decided we weren’t going to cover it [. . .] since it’s way outside the normal operating envelope.” Again, Boeing Employee-1 deceived the FAA AEG into believing that the basis upon which the FAA AEG had initially “decided” to remove any information about MCAS from the 737 MAX FSB Report—that MCAS could only activate during the limited operational scope of a high-speed, wind-up turn—remained the same.

42. By concealing MCAS’s expanded operational scope from the FAA AEG, Boeing, through Boeing Employee-1 and Boeing Employee-2, defrauded, impaired, obstructed, defeated, and interfered with the FAA AEG’s lawful function to evaluate MCAS and to include information about MCAS in the 737 MAX FSB Report.

43. Based on Boeing’s misleading statements, half-truths, and omissions to the FAA AEG about MCAS, and in reliance on those statements and omissions, the FAA AEG agreed to delete all information about MCAS from the 737 MAX FSB Report.

44. From in or around January 2017 through in or around July 2017 (when the 737 MAX FSB Report was published), Boeing Employee-1 and Boeing Employee-2 sent and caused to be sent emails to representatives of various Boeing airline customers that had agreed to purchase the 737 MAX, including major U.S.-based airlines. In these emails, Boeing Employee-1 and Boeing Employee-2 or members of their 737 MAX Flight Technical Team referenced and included drafts of the forthcoming 737 MAX FSB Report and airplane manuals and pilot-training materials for Boeing’s 737 MAX airline customers. None of these items contained any information about MCAS, consistent with Boeing Employee-1’s and Boeing Employee-2’s efforts to deceive the FAA AEG into deleting information about MCAS.

45. On or about July 5, 2017, the FAA AEG published the first 737 MAX FSB Report, which included the FAA AEG’s “Level B” differences-training determination for the 737 MAX.

46. Because of Boeing’s intentional withholding of information from the FAA AEG, the final version of the 737 MAX FSB Report lacked information about MCAS, and relevant portions of this 737 MAX FSB Report were materially false, inaccurate, and incomplete. In turn, airplane manuals and pilot-training materials for U.S.-based airlines lacked

information about MCAS, and relevant portions of these manuals and materials were similarly materially false, inaccurate, and incomplete as a result.

47. After the FAA AEG published the final version of the 737 MAX FSB Report, Boeing continued to sell, and Boeing's U.S.-based airline customers were permitted to fly, the 737 MAX. Pilots flying the 737 MAX for Boeing's airline customers were not provided any information about MCAS in their airplane manuals and pilot-training materials.

48. On October 29, 2018, Lion Air Flight 610, a Boeing 737 MAX, crashed shortly after takeoff into the Java Sea near Indonesia. All 189 passengers and crew on board died.

49. Following the Lion Air crash, the FAA AEG learned that MCAS activated during the flight and may have played a role in the crash. The FAA AEG also learned for the first time about MCAS's expanded operational scope.

50. In and around the same time, Boeing employees, including Boeing Employee-2, met with personnel from the FAA AEG to discuss, among other things, MCAS's operational scope. After that meeting, Boeing Employee-2 told FAA AEG Employee-1 that he was previously unaware of MCAS's expanded operational scope and otherwise misled FAA AEG Employee-1 about Boeing Employee-2's prior knowledge of MCAS.

51. Also, in and around the same time, Boeing Employee-2 caused Boeing to present a false and misleading presentation to the FAA AEG about MCAS. Boeing investigated, among other things, what information Boeing Employee-1 and Boeing Employee-2 provided to the FAA AEG about MCAS. In connection with this investigation, Boeing Employee-2 caused Boeing to represent in a presentation to the FAA AEG that, during the training-evaluation process, Boeing and the FAA AEG had "discussed and agreed on [the] removal of MCAS" from the 737 MAX FSB Report and associated materials. This representation was misleading because Boeing Employee-2 had failed to disclose the "shocker alert" chat communication and the fact that the FAA AEG was deprived of relevant information about MCAS.

52. Following the Lion Air crash, Boeing proposed changes to the operational scope of MCAS, and the FAA AEG worked with Boeing to evaluate these changes to MCAS for purposes of pilot training.

53. On March 10, 2019, Ethiopian Airlines Flight 302, a Boeing 737 MAX, crashed shortly after takeoff near Ejere, Ethiopia. All 157 passengers and crew on board died. Following the Ethiopian Airlines crash, the FAA AEG learned that MCAS activated during the flight and may have played a role in the crash.

54. On March 13, 2019, the 737 MAX was officially grounded in the United States, indefinitely halting further flights of this airplane by any U.S.-based airline. . . .

ATTACHMENT C

CORPORATE COMPLIANCE PROGRAM

In order to address any deficiencies in its internal controls, compliance program, policies, and procedures relating to violations of U.S. fraud laws in connection with interactions with any domestic or foreign government agency (including the FAA), regulator, or any of its airline customers, The Boeing Company (the “Company”) agrees to continue to conduct, in a manner consistent with all of its obligations under this Agreement, appropriate reviews of its existing internal controls, policies, and procedures.

Where necessary and appropriate, the Company agrees to adopt a new or to modify its existing compliance program, including internal controls, compliance policies, and procedures in order to ensure that it maintains an effective compliance program that is designed, implemented, and enforced to effectively deter and detect violations of U.S. fraud laws. At a minimum, this should include, but not be limited to, the following elements to the extent they are not already part of the Company’s existing internal controls, compliance program, policies, and procedures:

1. The Company will ensure that its directors and senior management provide strong, explicit, and visible support and commitment to its corporate policy against violations of U.S. fraud laws and its compliance codes, and demonstrate rigorous adherence by example. The Company will also ensure that middle management, in turn, reinforces those standards and encourages employees to abide by them. The Company will create and foster a culture of ethics and compliance with the law in its day-to-day operations.
2. The Company will develop and promulgate clearly articulated and visible corporate policies against violations of U.S. fraud laws, which policies shall be memorialized in a written compliance code.
3. The Company will develop and promulgate compliance policies and procedures designed to reduce the prospect of violations of U.S. fraud laws and the Company’s compliance code, and the Company will take appropriate measures to encourage and support the observance of ethics and compliance policies and procedures against violation of U.S. fraud laws by personnel at all levels of the Company. These policies and procedures shall apply to all directors, officers, and employees and, where necessary and appropriate, outside parties acting on behalf of the Company, including, but not limited to, agents, consultants, and joint venture partners (collectively, “agents and business partners”). The Company shall notify all employees that compliance with the policies and procedures is the duty of individuals at all levels of the Company.
4. The Company will develop these compliance policies and procedures on the basis of a periodic risk assessment addressing the individual circumstances of the Company.
5. The Company shall review its compliance policies and procedures regarding U.S. fraud laws no less than annually and update them as appropriate to ensure their continued

effectiveness, taking into account relevant developments in the field and evolving industry standards.

6. The Company will assign responsibility to one or more senior corporate executives of the Company for the implementation and oversight of the Company's compliance code, policies, and procedures regarding U.S. fraud laws. Such corporate official(s) shall have the authority to report directly to independent monitoring bodies, including internal audit, the Company's Board of Directors, or any appropriate committee of the Board of Directors, and shall have an adequate level of stature and autonomy from management as well as sufficient resources and authority to maintain such autonomy.

7. The Company will implement mechanisms designed to ensure that its compliance code, policies, and procedures regarding U.S. fraud laws are effectively communicated to all directors, officers, employees, and, where necessary and appropriate, agents and business partners. These mechanisms shall include: (a) periodic training for all directors and officers, all employees in positions of leadership or trust, any positions that require such training (*e.g.*, internal audit, sales, legal, compliance, finance), and, where necessary and appropriate, agents and business partners; and (b) corresponding certifications by all such directors, officers, employees, agents and business partners, certifying compliance with the training requirements. The Company will conduct training in a manner tailored to the audience's size, sophistication, or subject matter expertise and, where appropriate, will discuss prior compliance incidents.

8. The Company will maintain, or where necessary establish, an effective system for providing guidance and advice to directors, officers, employees, and, where necessary and appropriate, agents and business partners, on complying with the Company's compliance code, policies, and procedures regarding U.S. fraud laws, including when they need advice on an urgent basis.

9. The Company will maintain, or where necessary establish, an effective system for internal and, where possible, confidential reporting by, and protection of, directors, officers, employees, and, where appropriate, agents and business partners concerning violations of U.S. fraud laws or the Company's compliance code, policies, and procedures regarding U.S. fraud laws.

10. The Company will maintain, or where necessary establish, an effective and reliable process with sufficient resources for responding to, investigating, and documenting allegations of violations of U.S. fraud laws or the Company's compliance code, policies, and procedures regarding U.S. fraud laws. The Company will handle the investigations of such complaints in an effective manner, including routing the complaints to proper personnel, conducting timely and thorough investigations, and following up with appropriate discipline where necessary.

11. The Company will implement mechanisms designed to effectively enforce its compliance code, policies, and procedures, including appropriately incentivizing compliance and disciplining violations.

12. The Company will institute appropriate disciplinary procedures to address, among other things, violations of U.S. fraud laws and the Company's compliance code, policies, and procedures regarding the U.S. fraud laws by the Company's directors, officers, and employees. Such procedures should be applied consistently and fairly, and in a manner consistent with the violation, regardless of the position held by, or perceived importance of, the director, officer, or employee. The Company shall implement procedures to ensure that where misconduct is discovered, reasonable steps are taken to remedy the harm resulting from such misconduct, and to ensure that appropriate steps are taken to prevent further similar misconduct, including assessing the internal controls, compliance code, policies, and procedures and making modifications necessary to ensure the overall compliance program regarding U.S. fraud laws is effective.

13. The Company will develop and implement policies and procedures for mergers and acquisitions requiring that the Company conduct appropriate risk-based due diligence on potential new business entities, including appropriate due diligence regarding U.S. fraud laws by legal, accounting, and compliance personnel.

14. The Company will ensure its compliance code, policies, and procedures regarding U.S. fraud laws apply as quickly as is practicable to newly-acquired businesses or entities merged with the Company, and will promptly (a) train the directors, officers, employees, agents, and business partners consistent with Paragraphs 7-8; and (b) where warranted, conduct an audit of all newly acquired or merged businesses as quickly as is practicable concerning compliance with U.S. fraud laws.

15. In order to ensure that its compliance program does not become stale, the Company will conduct periodic reviews and testing of its compliance code, policies, and procedures regarding U.S. fraud laws designed to evaluate and improve their effectiveness in preventing and detecting violations of U.S. fraud laws and the Company's code, policies, and procedures regarding U.S. fraud laws, taking into account relevant developments in the field and evolving industry standards. The Company will ensure that compliance and control personnel have sufficient direct and indirect access to relevant sources of data to allow for timely and effective monitoring and/or testing. Based on such review and testing and its analysis of any prior misconduct, the Company will conduct a thoughtful root cause analysis and timely and appropriately remediate to address the root causes. . . .

Problem 17-2

Only one individual was charged criminally in the Boeing matter, Mark Forkner ("Employee-1" in the statement of facts above). Following a trial, on March 23, 2022, a jury in Dallas federal court acquitted Forkner. Assume that Congress had passed a new statute requiring the government to obtain court approval for a DPA, after a hearing, under a standard directing the court to determine whether the DPA is "in the interests of justice" and "fair, reasonable, and proportionate." If you were the federal judge to whom the Boeing DPA had been assigned under such a law, would you have approved or rejected the DPA, and with what reasoning?

Compare these recent examples to the VW and Boeing cases:

1. Recall from Chapter 5 the facts of the FCPA matter involving **Goldman Sachs and the Malaysian investment fund 1MDB**. The matter was resolved with a plea agreement (in the form of a “C” plea) with Goldman’s Malaysia subsidiary and a deferred prosecution agreement (DPA) with Goldman itself. The Goldman subsidiary pled guilty to violating the anti-bribery provisions of the FCPA and the punishment was folded into the overall agreed penalties in the DPA with Goldman.

In the DPA, Goldman agreed, among other things, (1) that a criminal information would be filed in the Eastern District of New York charging Goldman with a violation of the anti-bribery provisions of the FCPA; (2) to admit the statement of facts reproduced in Chapter 5; (3) to pay a \$2.3 billion penalty; (4) to disgorge \$600 million in profits; (4) to implement and report on a new corporate compliance program (without an outside monitor); and (5) to continue full cooperation in the investigation.

The government agreed to dismiss the FCPA charge after three years if Goldman complies with its obligations under the DPA. In the DPA, the government described Goldman’s cooperation as receiving “partial credit,” because Goldman delayed in producing some useful information, and stated that Goldman received no voluntary self-reporting credit. *See* Press Release, U.S. Dep’t of Justice, Goldman Sachs Resolves Foreign Bribery Case and Agrees to Pay Over \$2.9 Billion (Oct. 22, 2020), <https://www.justice.gov/usao-edny/pr/goldman-sachs-resolves-foreign-bribery-case-and-agrees-pay-over-29-billion>.

2. Recall the **Purdue Pharma opioids matter** described in Chapter 6. Purdue and the DOJ entered into a plea agreement (in the form of a “C” plea), under which Purdue agreed (1) to plead guilty in the District of New Jersey to conspiring to defraud the U.S. government and conspiring to violate the FDCA, as well as two distinct conspiracies to violate the anti-kickback statute; (2) to admit to the statement of facts reproduced in Chapter 6; (3) to pay a \$3.5 billion fine and forfeit an additional \$2 billion (provided such payments are approved by the judge overseeing Purdue’s ongoing reorganization proceeding in bankruptcy court); and (4) to continue full cooperation with investigations, including by creating and maintaining an open document repository for all non-privileged evidence relating to the opioid scandal. The government agreed not to prosecute Purdue as a corporation further in opioid-related matters, except for an investigation of potential FCPA violations that is ongoing. *See* Press Release, U.S. Dep’t of Justice, Justice Department Announces Global Resolution of Criminal and Civil Investigations with Opioid Manufacturer Purdue Pharma and Civil Settlement with Members of the Sackler Family (Oct. 21, 2020), <https://www.justice.gov/opa/pr/justice-department-announces-global-resolution-criminal-and-civil-investigations-opioid>.

C. The Role of the Judiciary

Finally, return to the question of the judiciary’s role. Recall the court opinions from Chapter 1 discussing limits on the ability of judges to review the substantive merits of

settlements in the form of DPAs. In the following case, you can see the approach of a UK judge to a major settlement under the UK's regime governing DPAs, which statutorily requires judicial approval of such settlements.

SERIOUS FRAUD OFFICE v. ROLLS ROYCE ENERGY SYSTEMS INC., 2017 WL 00219524 (UK Crown Court at Southwark, Jan. 17, 2017)

Sir Brian Leveson P:

This is the third (and, by far, the largest) application for approval by the court of a deferred prosecution agreement (“DPA”) reached between the Serious Fraud Office (“SFO”) and two entities now ultimately owned by Rolls-Royce Holdings plc namely Rolls-Royce plc (“Rolls-Royce”) and its Delaware incorporated subsidiary, Rolls-Royce Energy Systems Inc (“RRESI”). It covers the conduct of Rolls-Royce and RRESI in Nigeria, Indonesia and Russia along with the conduct of Rolls-Royce alone in Thailand, India, China and Malaysia.

Rolls-Royce Holdings plc (listed on the London Stock Exchange and forming part of the FTSE 100 index) is properly considered to be a company of central importance to the United Kingdom, with a reputation in the field of engineering second to none. . . .

Rolls-Royce and its subsidiaries employ some 50,000 people, in more than 50 countries. This case concerns the conduct of its civil aerospace business which manufactures engines for the commercial large aircraft and corporate jet markets and generates approximately 50% of its revenue, defence aerospace business which manufactures engines for the military transport market and is the second largest provider of defence aero engine products and services in the world (generating approximately 20% of its revenue), and its former energy business concerned with the manufacture of gas turbines and compressors to power off-shore platforms, the transport of oil and gas through pipelines, and the generation of electricity which generates less than 10% of its revenue, part of which was conducted by RRESI.

Against that background, it can properly be described as devastating and of the very greatest gravity that the conduct of this institution should fall to be examined within the context of a criminal investigation and that the investigation (in very large part conducted and voluntarily revealed to the SFO by Rolls-Royce itself) should reveal the most serious breaches of the criminal law in the areas of bribery and corruption (some of which implicated senior management and, on the face of it, controlling minds of the company). It involves:

- i) agreements to make corrupt payments to agents in connection with the sale of Trent aero engines for civil aircraft in Indonesia and Thailand between 1989 and 2006;
- ii) concealment or obfuscation of the use of intermediaries involved in its defence business in India between 2005 and 2009 when the use of intermediaries was restricted;

- iii) an agreement to make a corrupt payment in 2006/7 to recover a list of intermediaries that had been taken by a tax inspector from Rolls-Royce in India;
- iv) an agreement to make corrupt payments to agents in connection with the supply of gas compression equipment in Russia between January 2008 and December 2009;
- v) failing to prevent bribery by employees or intermediaries in conducting its energy business in Nigeria and Indonesia between the commencement of the Bribery Act 2010 and May 2013 and July 2013 respectively, with similar failures in relation to its civil business in Indonesia;
- vi) failure to prevent the provision by Rolls-Royce employees of inducements which constitutes bribery in its civil business in China and Malaysia between the commencement of the Bribery Act 2010 and December 2013.

Further, in relation to the conduct of Rolls-Royce, there have been discussions between the SFO and the Department of Justice in the United States and discussions between the Department of Justice and the Brazilian Ministério Público Federal, to ensure a coordinated global resolution of the relevant conduct. Parallel to this DPA, it is intended that a similar type of agreement reached with the Department of Justice (which has been fully disclosed in these proceedings) and a settlement with the Brazilian authorities will be announced. The American agreement covers the conduct of Rolls-Royce's energy business (in Brazil, Kazakhstan and Thailand) and also addresses conduct relating to Rolls-Royce and RRESI arising from an investigation into its use of an intermediary called Unaoil.

Deferred Prosecution Agreements

Although the concept of a DPA has been fully explained in both judgments which follow the first two agreements (*SFO v Standard Bank plc* and *SFO v XYZ Ltd*), it is worth summarising the structure as prescribed by s. 45 and Schedule 17 of the Crime and Courts Act 2013 ("the 2013 Act"). In short, a DPA is potentially available for certain economic or financial offences to a body corporate, a partnership or an unincorporated association in respect of whom the only criminal sanction is financial: it does not cover (nor does it protect from prosecution) any individual. It provides a mechanism whereby, subject to the approval of the court, prosecution can be avoided by entering into an agreement on negotiated terms with a prosecutor designated by the 2013 Act.

The court's role is as follows. Following the commencement of negotiations and what might become an agreement, the scheme mandates that a hearing must be held in private for the purposes of ascertaining whether the court will declare that the proposed DPA is "likely" to be in the interests of justice and its proposed terms are fair, reasonable and proportionate: see paras. 7(1) and (4) of Schedule 17 of the 2013 Act. Reasons must be given and, if a declaration is declined, a further application is permitted (paras. 7(2) and

(3)). In that way, the court retains control of the ultimate outcome and, if the agreement is not approved, the possibility of prosecution is not jeopardised as a consequence of any publicity that would follow if these proceedings had not been held in private.

If a declaration has been granted pursuant to para. 7(1) of Schedule 17 and the DPA is finalised on the terms previously identified, para. 8 of Schedule 17 comes into play. This provides:

- (1) Where a prosecutor and P have agreed the terms of a DPA, the prosecutor must apply to the Crown Court for a declaration that
 - (a) the DPA is in the interests of justice, and
 - (b) the terms of the DPA are fair, reasonable and proportionate.
- (2) But the prosecutor may not make an application under sub-paragraph 1 unless the court has made a declaration under paragraph 7(1) (declaration on preliminary hearing).
- (3) A DPA only comes into force when it is approved by the Crown Court making a declaration under sub-paragraph (1).
- (4) The court must give reasons for its decision on whether or not to make a declaration under sub-paragraph (1).
- (5) A hearing at which an application under this paragraph is determined may be held in private.
- (6) But if the court decides to approve the DPA and make a declaration under sub-paragraph (1) it must do so, and give its reasons, in open court.
- (7) Upon approval of the DPA by the court, the prosecutor must publish—
 - (a) the DPA
 - (b) the declaration of the court under paragraph 7 and the reasons for its decision to make the declaration,
 - (c) in a case where the court initially declined to make a declaration under paragraph 7, the court's reason for that decision, and
 - (d) the court's declaration under this paragraph and the reasons for its decision to make the declaration,

unless the prosecutor is prevented from doing so by an enactment or by an order of the court under paragraph 12 (postponement of publication to avoid prejudicing proceedings).”

Thus, even having agreed that a DPA is likely to be in the interests of justice and that its proposed terms are fair, reasonable and proportionate, the court continues to retain control and can decline to conclude that it is, in fact, in the interests of justice or that its terms are fair, reasonable and proportionate. To that end, it remains open to continue the argument in private, again on the basis that, if a declaration under para. 8(1) is not forthcoming, a prosecution is not jeopardised although it has to be recognised that, absent a material change of circumstances between the para. 7 hearing and the para. 8 hearing, it is difficult to see how the court could conclude that a DPA which it considered likely to be in the interests of justice with terms fair, reasonable and proportionate was not, in fact, in the interests of justice with terms which are fair, reasonable and proportionate. . . .

In addition to examining the internal investigations (including the interviews, Rolls-Royce having waived any claim for legal professional privilege on a limited basis), the SFO, with what Sir Edward, for the SFO, recognised was “the extraordinary cooperation of Rolls-Royce”, has conducted its own extensive investigation. This investigation has included:

- i) obtaining from Rolls-Royce the key documents identified by the internal investigations including memoranda of interviews, along with access generally to Rolls-Royce hard copy documents;
- ii) obtaining from Rolls-Royce complete digital repositories or email containers where available of in excess of 100 key employees or former employees, without filtering the material for potential privilege, but, instead, permitting issues of privilege to be resolved by independent counsel;
- iii) obtaining documentary evidence through requests for mutual legal assistance;
- iv) arresting domestic and overseas intermediaries and former Rolls-Royce employees (including searches of their premises) and conducting numerous interviews of suspects and others whether voluntarily or under compulsion;
- v) making other targeted requests and review of material (all of which have been voluntarily provided), such as compliance material, including historic internal reviews; personnel files; employee notebooks; telephones; marketing services agent files; and accountancy records.

The full and extensive nature of this co-operation has led to the acquisition, and application of digital review methods to over 30 million documents. All this has been in the context of an investigation concerning conduct in multiple jurisdictions, across four business lines and spanning a long period of time. Sir Edward has made clear (and the Statement of Facts confirms) that the proactive approach to co-operation adopted by Rolls-Royce has led to the SFO receiving pertinent information which may not otherwise have come to its attention. Rolls-Royce’s approach has included:

- i) genuine cooperation with the SFO in the conduct of Rolls-Royce's own internal investigation, including deferring interviews until the SFO had first completed its interview, and the audio recording of interviews where requested;
- ii) disclosure of all interview memoranda was made (on a limited waiver basis), despite Rolls-Royce's belief that the material was capable of resisting an order for disclosure, on the basis that it was privileged;
- iii) providing all material requested by the SFO voluntarily, that is to say without requiring recourse to compulsory powers (in one case at least effectively relinquishing control to the SFO); and
- iv) consulting the SFO in respect of developments in media coverage, and seeking the SFO's permission before winding up companies that may have been implicated in the SFO's investigation.

I have recited the extent of the assistance provided by Rolls-Royce because it is highly material both to the interests of justice and the assessment of the balance between prosecution and DPA and also to the appropriate discount to allow from the financial penalty imposed. In both *SFO v Standard Bank* and *SFO v XYZ Ltd*, the DPA followed what was a self-report at a time that the SFO neither had knowledge of, nor known means of likelihood of learning about, the conduct which led to the DPA (see [27]–[28] of the decision dated 30 November 2015 and [24]–[25] of the redacted decision dated 8 July 2016 respectively). In this case, the SFO had been alerted because of the public internet posting and had initiated an inquiry.

The fact that an investigation was not triggered by a self-report would usually be highly relevant in the balance but the nature and extent of the co-operation provided by Rolls-Royce in this case has persuaded the SFO not only to use the word “extraordinary” to describe it but also to advance the argument that, in the particular circumstances of this case, I should not distinguish between its assistance and that of those who have self-reported from the outset. Given that what has been reported has clearly been far more extensive (and of a different order) than is may have been exposed without the co-operation provided, I am prepared to accede to that submission. . . .

I must consider the conduct covered by the proposed DPA in this case which [involves] . . . the following aggravating features:

- i) The conduct involved offences relating to the bribery of foreign public officials, commercial bribery and the false accounting of payments to intermediaries.
- ii) The offences were multi-jurisdictional, numerous and spread across Rolls-Royce's defence aerospace, civil aerospace and energy businesses.

- iii) The offences have caused and/or will cause substantial harm to the integrity/confidence of markets.
- iv) The offending was persistent and spanned from 1989 until 2013.
- v) The offending involved substantial funds being made available to fund bribe payments.
- vi) The conduct displayed elements of careful planning.
- vii) The conduct related to the award of large value contracts which, taken together, ultimately earned over £250 million of gross profit (although care must be used in relation to this term which is based on calculations reached by accountants instructed by the SFO and Rolls-Royce and agreed by the parties and does not necessarily reflect the way in which the accounting profession would approach gross profit for reporting standards).
- viii) The conduct involved senior (on the face of it, very senior) Rolls-Royce employees. . . .

Although entirely a consequence of its own conduct, for the sake of completeness, I record that the costs of the work done by Rolls-Royce in connection with its investigation and work with prosecutors in multiple jurisdictions, together with the cost of the intermediary review and the appropriate professional financial advice, as at December 2016, amounted to £123,115,643 and will doubtless continue to increase. . . .

Rolls-Royce has taken the following steps to enhance its ethics and compliance procedures such that organisation and governance has been improved by the recruitment of experienced compliance personnel in key positions (including Head of Risk and Head of Compliance) as well as additional Compliance Officers and the appointment of designated Local Ethics Advisers. There has been a significant re-organisation of reporting lines which ensures that compliance officers are independent of business divisions. In addition, there are:

- i) Enhanced policies and procedures covering high risk areas of Rolls-Royce's business divisions.
- ii) Top level commitment to ethics and compliance through improved communication and annual manager led ethics training.
- iii) Development of a risk assessment framework and implementation of risk assessment procedures into business divisions.
- iv) Improved due diligence in respect of intermediaries comprising business justification, external due diligence, approval by an Adviser Panel (consisting of Lord Gold and both the Head of Risk at Rolls-Royce and one of its senior external legal advisers) together with ongoing monitoring.

- v) Regular compulsory training on compliance issues for all staff with extensive monitoring of anti-bribery and corruption procedures including regular audit by Rolls-Royce's Audit Committee of anti-bribery and corruption procedures and investigations of issues.
- vi) Implementation of compliance procedures and training in respect of concessions provided in the Civil Aerospace industry.

Rolls-Royce has also specifically addressed the potential risks arising from its intermediaries by reviewing 250 intermediary relationships across the company. This has led to the suspension of 88 intermediaries and led to a material reduction in the number of intermediaries used across the Rolls-Royce Group.

Further, as a consequence of the internal investigation, Rolls-Royce has conducted disciplinary proceedings in respect of 38 employees in its Civil Aerospace, Energy and Marine divisions leading to 11 employees leaving RR during stages of the disciplinary process and decisions to dismiss six employees; others have suffered sanction short of dismissal.

I am told that, up to December 2016, these steps (excluding the intermediary review and disciplinary proceedings) have cost Rolls-Royce £15,175,331.46 and that the review is ongoing. In that regard, a term of the DPA deals with issues of compliance and the SFO has identified issues to be addressed which would be included within the conditions of the DPA. Suffice to say that I entirely accept that Rolls-Royce could not have done more to address the issues that have now been exposed. I comment only that it is a real tragedy that it did not do so following the well-known observations of Kofi Annan, in the foreword to the 2004 UN Convention against Corruption which spoke about it as "an insidious plague".

The cultural change is evidenced by the steps which I have just described but I have pressed Rolls-Royce to disclose its present constitution and, in particular, the membership of its Board. Had any member of the today's senior management who was implicated or been in a position where they should have been aware of the culture and practices which I have described and were clearly endemic at Rolls-Royce remained in his or her position, this, itself, would have been of real significance and could have affected my approach.

I am informed (and accept) that no current member of the Board was involved in any of the conduct described in the Statement of Facts and that conduct occurring after 1 July 2011 did not involve any of the (then) directors. The Group President (appointed in January 2016) was previously on the Board and now has responsibility for operational functions (e.g. IT, Group Property, Quality etc.); his focus as a director (since 2005) has been on engineering, technology and research. The Chief Executive, the Chief Financial Officer and the Company Secretary have all been appointed since January 2014.

As for the non-executive directors, none are or have been involved in the day to day running of the business. The Chairman (who was a non-executive director from 1 March 2013) was appointed in May 2013 and is not a member of the executive leadership team. Four non-executive directors were in post from 2008, 2011 (two) and 2012 and four have been appointed since January 2014. The Senior Independent Director was appointed in 2015.

This is the Board that has clearly authorised all that Rolls-Royce has done since 2012 and is to be highly commended for that. In the circumstances, I am satisfied that both the senior management and those responsible for the strategic direction of Rolls-Royce are different to those responsible for the running of the company (and its culture) during the period when the events which I have described occurred.

The final consideration identified in *SFO v XYZ Ltd* is the impact of prosecution on employees and others innocent of any misconduct or what might otherwise be described as the consequences of a conviction. To understand the extent of that impact, it is first necessary to consider the impact on Rolls-Royce.

First, a conviction would undeniably affect the ability of Rolls-Royce to trade in the world where, as I started this judgment by observing, it is a world leader and has a reputation for excellence. It is well known that many countries operate public sector procurement rules which would debar participation following conviction. Thus, I have no difficulty in accepting that which I am informed to the effect that, as at the end of 2014, a minimum in the order of 15% of the Rolls-Royce order book was from entities subject to public sector procurement rules in countries with mandatory debarment and, approximately, a further 15% was from entities subject to public sector procurement rules in countries with discretionary debarment pursuant to express legislation.

Furthermore, it is not difficult to visualize that the direct losses to revenue which would be caused by debarment would have a long term financial effect consequent upon losing contracts which, for commercial aircraft, can extend for 25 to 30 years. There would also be incumbency effects of a short term debarment, leading to longer term exclusion from other contracts and reduced research & development caused by the loss of a key revenue stream.

Debarment and exclusion would clearly have significant, and potentially business critical, effects on the financial position of Rolls-Royce. This could lead to the worst case scenario of a very negative share price impact, and, potentially, more serious impacts on shareholder confidence, future strategy, and therefore viability.

These repercussions for Rolls-Royce risk additional repercussions to third party interests, including:

- i) adverse effect to the UK defence industry, where Rolls-Royce has a critical role in supplying engines for UK military and naval vessels, nuclear propulsion technology for nuclear submarines, and aftermarket services;

- ii) consequential financial effects on the supply chain;
- iii) impairment of competition in highly concentrated markets, where there are limited alternative sources of supply and significant barriers to entry;
- iv) a potentially significant fall in share price, which is likely to be made more dramatic by the debarment consequences of a conviction;
- v) possible group-wide redundancies and/or restructuring; and potential weakening of Rolls-Royce's financial covenant for pensions.

I have no difficulty in accepting that these features demonstrate that a criminal conviction against Rolls-Royce would have a very substantial impact on the company, which, in turn, would have wider effects for the UK defence industry and persons who were not connected to the criminal conduct, including Rolls-Royce employees, and pensioners, and those in its supply chain. None of these factors is determinative of my decision in relation to this DPA; indeed, the national economic interest is irrelevant. Neither is my decision founded on the proposition that a company in the position of Rolls-Royce is immune from prosecution: it is not. It is not because of who or what Rolls-Royce is that is relevant but, rather, the countervailing factors that I have to weigh in the balance when considering the public interest and the interests of justice. As I have made clear before, and repeat, a company that commits serious crimes must expect to be prosecuted and if convicted dealt with severely and, absent sufficient countervailing factors, cannot expect to have an application for approval of a DPA accepted. . . .

My reaction when first considering these papers was that if Rolls-Royce were not to be prosecuted in the context of such egregious criminality over decades, involving countries around the world, making truly vast corrupt payments and, consequentially, even greater profits, then it was difficult to see when any company would be prosecuted. A possible exception could be the corporate vehicle for fraud, set up for that purpose and, in the public interest, requiring dissolution (although that also might be achieved in different ways). As for the non-penal consequences of conviction, the purpose of the procurement rules is specifically to discourage corruption and they should not be circumvented.

On the other hand, I accept that Rolls-Royce is no longer the company that once it was; its new Board and executive team has embraced the need to make essential change and has deliberately sought to clear out all the disreputable practices that have gone before, creating new policies, practices and cultures. Its full co-operation and willingness to expose every potential criminal act that it uncovers and the work being done on compliance and creating that culture goes a long way to address the obvious concerns as to the past.

So the question becomes whether it is necessary to inflict the undeniably adverse consequences on Rolls-Royce that would flow from prosecution because of the gravity of its offending even though it may now be considered a dramatically changed organisation. In any event, it will have to suffer the undeniably adverse publicity that

will flow from the facts of its business practices which will be exposed by the DPA so that the way in which it has done business will be obvious. Any public procurement exercise will be conducted in the light of its history and it will doubtless only win contracts on the merits of its products. That, of course, is as it should be. Neither will the conduct of Rolls-Royce escape sanction: it could only ever be fined and the DPA has to be approached on the basis that it must be broadly comparable to the fine that a court would have imposed on conviction following a guilty plea (see para. 5(4) of Schedule 17 of the 2013 Act).

In the circumstances, subject to the terms being fair, reasonable and proportionate, I have come to the conclusion that it is in the interests of justice that the conduct of Rolls-Royce be resolved through the mechanism of a DPA. It is to those terms that I now turn.

The essential basis of this DPA is that effective from the date of the declaration under paras. 8(1) and (3) of Schedule 17 to the 2013 Act for a period of five years (or four years if the SFO confirm in writing that the agreement has concluded by payment of the disgorgement and financial penalty and taking account of any remaining obligations), the SFO will agree, having preferred the indictment, to suspend it and, subject to compliance with the terms of the DPA, after its conclusion, will discontinue the proceedings.

Other conditions include the absence of any protection against prosecution of any present or former officer, employee or agent or against Rolls-Royce or RRESI for conduct not disclosed by them prior to the date of the agreement (or any future criminal conduct). There is also a condition that fresh proceedings may follow if Rolls-Royce provided inaccurate, misleading or incomplete information to the SFO and knew or ought to have known that it was inaccurate, misleading or incomplete.

Taken together, the requirements falling upon Rolls-Royce and RRESI which the court declared were likely to be in the interests of justice and were fair, reasonable and proportionate can be summarised as follows:

- i) Past and future co-operation with the relevant authorities (as further described) in all matters relating to the conduct arising out of the circumstances of the draft Indictment;
- ii) Disgorgement of profit on the transactions of £258,170,000;
- iii) Payment of a financial penalty of £239,082,645;
- iv) Payment of the costs incurred by the SFO (put at £12,960,754);
- v) At its own expense, completing a compliance programme following the recommendations of the reviews commissioned by Rolls-Royce from Lord Gold (formerly of Herbert Smith Freehills LLP now of Gold Associates) of the approach to anti- bribery and corruption compliance (as further described).

It is also acknowledged that no tax reduction shall be sought in relation to any part of the payments (ii), (iii) and (iv) above in the UK or elsewhere, with time to pay the disgorgement and financial penalty in four instalments subject to simple interest at an annual rate of 80 basis points over GBP 6m LIBOR on any sum unpaid calculated from 30 June 2017. . . .

Putting entirely to one side the £15 million cost of the compliance programme (which Rolls-Royce and RRESI—to say nothing of the other Rolls-Royce entities—required in any event), the risk of potential liability in jurisdictions not covered by this DPA and the agreements reached with the United States and Brazil and the legal and other costs incurred by Rolls-Royce in the investigation of its conduct in multiple jurisdictions, the intermediary review, expert advice and negotiation of these agreements (which as I have noted above amounted, in December 2016, to £123 million), the total financial penalty (including costs to the SFO) arising out of the DPA with which I am concerned exceeds £½ billion.

In addition, included for the sake of completeness, the deferred prosecution agreement reached with the Department of Justice requires a financial payment of \$169,917,710 and the leniency agreement with the Brazilian authorities a payment of US \$25,579,645. . . .

Putting to one side the reputational damage that will flow from the conduct of Rolls-Royce and their employees and agents, leading to the DPA, the total financial impact of the penalties and costs imposed exceeds £500 million and I am satisfied that it achieves the objectives of punishment and deterrence. The financial advisors to the SFO and DOJ have confirmed that, taking into account Roll-Royce's financial circumstances, the penalty is substantial enough to have a real economic impact: when added to the costs incurred by Rolls-Royce it amounts to a sum in the region of £650 million. Mr. Whittam, for the SFO agrees with this view and submits that the penalty will bring home to both management and shareholders the need to operate within the law without putting it out of business which outcome would be inappropriate in these circumstances. Mr. Perry, for Rolls-Royce, accepts the accuracy of that submission. . . .

Thus, as I have observed in relation to previous DPAs, there is no question of the parties having reached a private compromise without appropriate independent judicial consideration of the public interest: furthermore, publication of the relevant material now serves to permit public scrutiny of the circumstances and the agreement. Suffice to say that I am satisfied that the DPA fully reflects the interests of the public in the prevention and deterrence of this type of crime. . . .

A cynic (or irresponsible company) might look at the costs which Rolls-Royce have incurred in their own investigation and wonder whether it be more sensible to keep quiet and hope that its conduct does not fall under the eye of the authorities. Quite apart from the total failure to acknowledge the difference between right and wrong, that is to fail to understand that such an approach carries with it cataclysmic risks. Whatever the costs Rolls-Royce have incurred, they are modest compared to the cost of seeking to brazen

out an investigation which commences; absent self-disclosure and full co-operation, prosecution would require the attention of the company to be entirely focused on litigation at the expense of whatever business it is trying to conduct and conviction would almost inevitably spell a far greater disaster than has befallen Rolls-Royce. . . .

Problem 17-3

Does the UK system requiring judicial approval of DPAs appear superior to the current system for negotiated settlements in the U.S. under DOJ written policies and typical practices? Why or why not

18. SENTENCING

Now we come to the end of the criminal process, at which point someone often goes to prison—except that corporations cannot be imprisoned.

Over the past two decades in the white collar crime area, more people have gone to prison for more time than ever before in the U.S. This has been intentional. Legislators, prosecutors, the public, and many judges coalesced during the 1980s, and continuing through the 1990s and early 2000s, around the view that white collar sentences had been too lenient for too long, and that harsher sentences would promote deterrence and equity in punishment.

Most of this happened during a time when the United States Sentencing Guidelines were virtually mandatory—binding on federal judges as a matter of statute. In 2005, however, the Supreme Court held in *United States v. Booker*, 543 U.S. 220 (2005), that the Sixth Amendment right to jury trial is violated if Congress requires judges to follow any guidelines provision that increases a sentence based on a factual finding made by a judge in connection with a post-trial sentencing hearing (such as the amount of dollar loss in a fraud case, or the weight of the substance in a drug case). Unless sentencing-relevant facts (like dollar loss or drug weight) were proved to a jury beyond a reasonable doubt, the Guidelines would need to be non-binding—advisory only. As a result of the odd split opinion in *Booker* and subsequent inaction by Congress, the latter is what we now have—non-binding Guidelines that federal judges must consult and consider but can deviate from on any reasonable ground.

This state of doctrine has increased pressure on all actors in the system to think about and explain what kinds of sentences are appropriate for white collar offenders and for what reasons—a matter on which Americans as a whole are at least unsure if not downright ambivalent. This chapter will explore this problem, and also discuss how to sentence a corporation in the relatively rare event of a guilty plea or conviction after trial (as opposed to an NPA or DPA settlement).

A. Individual Sentencing

This is the federal sentencing statute. It describes the factors relevant to sentencing. Procedurally, the sentencing judge has to walk through this statute or it is reversible error. Substantively, are these factors simply a statement of what anyone would consider important to a criminal punishment? Are there any factors that the statute left out or should have left out?

18 U.S.C. § 3553

(a) **Factors To Be Considered in Imposing a Sentence.**— The court shall impose a sentence sufficient, but not greater than necessary, to comply with the purposes set forth in paragraph (2) of this subsection. The court, in determining the particular sentence to be imposed, shall consider—

- (1) the nature and circumstances of the offense and the history and characteristics of the defendant;
- (2) the need for the sentence imposed—
 - (A) to reflect the seriousness of the offense, to promote respect for the law, and to provide just punishment for the offense;
 - (B) to afford adequate deterrence to criminal conduct;
 - (C) to protect the public from further crimes of the defendant; and
 - (D) to provide the defendant with needed educational or vocational training, medical care, or other correctional treatment in the most effective manner;
- (3) the kinds of sentences available;
- (4) the kinds of sentence and the sentencing range established for—
 - (A) the applicable category of offense committed by the applicable category of defendant as set forth in the guidelines—
 - (i) issued by the Sentencing Commission pursuant to section 994 (a)(1) of title 28, United States Code, subject to any amendments made to such guidelines by act of Congress (regardless of whether such amendments have yet to be incorporated by the Sentencing Commission into amendments issued under section 994 (p) of title 28); and
 - (ii) that, except as provided in section 3742 (g), are in effect on the date the defendant is sentenced; or
 - (B) in the case of a violation of probation or supervised release, the applicable guidelines or policy statements issued by the Sentencing Commission pursuant to section 994 (a)(3) of title 28, United States Code, taking into account any amendments made to such guidelines or policy statements by act of Congress (regardless of whether such amendments have yet to be incorporated by the Sentencing Commission into amendments issued under section 994 (p) of title 28);
- (5) any pertinent policy statement—
 - (A) issued by the Sentencing Commission pursuant to section 994 (a)(2) of title 28, United States Code, subject to any amendments made to such policy statement by act of Congress (regardless of whether such amendments have yet to be incorporated by the Sentencing Commission into amendments issued under section 994 (p) of title 28); and
 - (B) that, except as provided in section 3742 (g), is in effect on the date the defendant is sentenced.

- (6) the need to avoid unwarranted sentence disparities among defendants with similar records who have been found guilty of similar conduct; and
- (7) the need to provide restitution to any victims of the offense. . . .
-

On the following pages are the most important provisions in the Sentencing Guidelines for individual white collar cases: the fraud guideline and the insider trading guideline. The former controls in virtually all fraud and theft cases of any sort, regardless of the statute charged. The object of the Guidelines is to create a series of metrics and factors that ensure that like cases are treated alike, and different cases are treated differently. Have the drafters chosen the right factors?

§ 2B1.1. Larceny, Embezzlement, and Other Forms of Theft; Offenses Involving Stolen Property; Property Damage or Destruction; Fraud and Deceit; Forgery; Offenses Involving Altered or Counterfeit Instruments Other than Counterfeit Bearer Obligations of the United States

(a) Base Offense Level:

- (1) 7, if (A) the defendant was convicted of an offense referenced to this guideline; and (B) that offense of conviction has a statutory maximum term of imprisonment of 20 years or more; or
- (2) 6, otherwise.

(b) Specific Offense Characteristics

- (1) If the loss exceeded \$6,500, increase the offense level as follows:

<u>Loss (Apply the Greatest)</u>		<u>Increase in Level</u>
(A)	\$6,500 or less	no increase
(B)	More than \$6,500	add 2
(C)	More than \$15,000	add 4
(D)	More than \$40,000	add 6
(E)	More than \$95,000	add 8
(F)	More than \$150,000	add 10
(G)	More than \$250,000	add 12
(H)	More than \$550,000	add 14
(I)	More than \$1,500,000	add 16

(J)	More than \$3,500,000	add 18
(K)	More than \$9,500,000	add 20
(L)	More than \$25,000,000	add 22
(M)	More than \$65,000,000	add 24
(N)	More than \$150,000,000	add 26
(O)	More than \$250,000,000	add 28
(P)	More than \$550,000,000	add 30

- (2) (Apply the greatest) If the offense–
 - (A) (i) involved 10 or more victims; (ii) was committed through mass-marketing; or (iii) resulted in substantial financial hardship to one or more victims, increase by **2** levels;
 - (B) resulted in substantial financial hardship to five or more victims, increase by **4** levels; or
 - (C) resulted in substantial financial hardship to 25 or more victims, increase by **6** levels.
- (3) If the offense involved a theft from the person of another, increase by **2** levels.
- (4) If the offense involved receiving stolen property, and the defendant was a person in the business of receiving and selling stolen property, increase by **2** levels.
- (5) If the offense involved theft of, damage to, destruction of, or trafficking in, property from a national cemetery or veterans’ memorial, increase by **2** levels.
- (6) If (A) the defendant was convicted of an offense under 18 U.S.C. § 1037; and (B) the offense involved obtaining electronic mail addresses through improper means, increase by **2** levels.
- (7) If (A) the defendant was convicted of a Federal health care offense involving a Government health care program; and (B) the loss under subsection (b)(1) to the Government health care program was (i) more than \$1,000,000, increase by **2** levels; (ii) more than \$7,000,000, increase by **3** levels; or (iii) more than \$20,000,000, increase by **4** levels.

- (8) (Apply the greater) If–
- (A) the offense involved conduct described in 18 U.S.C. § 670, increase by **2** levels; or
 - (B) the offense involved conduct described in 18 U.S.C. § 670, and the defendant was employed by, or was an agent of, an organization in the supply chain for the pre-retail medical product, increase by **4** levels.
- (9) If the offense involved (A) a misrepresentation that the defendant was acting on behalf of a charitable, educational, religious, or political organization, or a government agency; (B) a misrepresentation or other fraudulent action during the course of a bankruptcy proceeding; (C) a violation of any prior, specific judicial or administrative order, injunction, decree, or process not addressed elsewhere in the guidelines; or (D) a misrepresentation to a consumer in connection with obtaining, providing, or furnishing financial assistance for an institution of higher education, increase by **2** levels. If the resulting offense level is less than level **10**, increase to level **10**.
- (10) If (A) the defendant relocated, or participated in relocating, a fraudulent scheme to another jurisdiction to evade law enforcement or regulatory officials; (B) a substantial part of a fraudulent scheme was committed from outside the United States; or (C) the offense otherwise involved sophisticated means and the defendant intentionally engaged in or caused the conduct constituting sophisticated means, increase by **2** levels. If the resulting offense level is less than level **12**, increase to level **12**.
- (11) If the offense involved (A) the possession or use of any (i) device-making equipment, or (ii) authentication feature; (B) the production or trafficking of any (i) unauthorized access device or counterfeit access device, or (ii) authentication feature; or (C)(i) the unauthorized transfer or use of any means of identification unlawfully to produce or obtain any other means of identification, or (ii) the possession of 5 or more means of identification that unlawfully were produced from, or obtained by the use of, another means of identification, increase by **2** levels. If the resulting offense level is less than level **12**, increase to level **12**.
- (12) If the offense involved conduct described in 18 U.S.C. § 1040, increase by **2** levels. If the resulting offense level is less than level **12**, increase to level **12**.
- (13) If the defendant was convicted under 42 U.S.C. § 408(a), § 1011(a), or § 1383a(a) and the statutory maximum term of ten years' imprisonment

applies, increase by **4** levels. If the resulting offense level is less than **12**, increase to level **12**.

- (14) (Apply the greater) If the offense involved misappropriation of a trade secret and the defendant knew or intended—
- (A) that the trade secret would be transported or transmitted out of the United States, increase by **2** levels; or
 - (B) that the offense would benefit a foreign government, foreign instrumentality, or foreign agent, increase by **4** levels.

If subparagraph (B) applies and the resulting offense level is less than level **14**, increase to level **14**.

- (15) If the offense involved an organized scheme to steal or to receive stolen (A) vehicles or vehicle parts; or (B) goods or chattels that are part of a cargo shipment, increase by **2** levels. If the resulting offense level is less than level **14**, increase to level **14**.

- (16) If the offense involved (A) the conscious or reckless risk of death or serious bodily injury; or (B) possession of a dangerous weapon (including a firearm) in connection with the offense, increase by **2** levels. If the resulting offense level is less than level **14**, increase to level **14**.

- (17) (Apply the greater) If—
- (A) the defendant derived more than \$1,000,000 in gross receipts from one or more financial institutions as a result of the offense, increase by **2** levels; or
 - (B) the offense (i) substantially jeopardized the safety and soundness of a financial institution; or (ii) substantially endangered the solvency or financial security of an organization that, at any time during the offense, (I) was a publicly traded company; or (II) had 1,000 or more employees, increase by **4** levels.
 - (C) The cumulative adjustments from application of both subsections (b)(2) and (b)(17)(B) shall not exceed **8** levels, except as provided in subdivision (D).
 - (D) If the resulting offense level determined under subdivision (A) or (B) is less than level **24**, increase to level **24**.

- (18) If (A) the defendant was convicted of an offense under 18 U.S.C. § 1030, and the offense involved an intent to obtain personal information,

or (B) the offense involved the unauthorized public dissemination of personal information, increase by **2** levels.

(19) (A) (Apply the greatest) If the defendant was convicted of an offense under:

(i) 18 U.S.C. § 1030, and the offense involved a computer system used to maintain or operate a critical infrastructure, or used by or for a government entity in furtherance of the administration of justice, national defense, or national security, increase by **2** levels.

(ii) 18 U.S.C. § 1030(a)(5)(A), increase by **4** levels.

(iii) 18 U.S.C. § 1030, and the offense caused a substantial disruption of a critical infrastructure, increase by **6** levels.

(B) If subdivision (A)(iii) applies, and the offense level is less than level **24**, increase to level **24**.

(20) If the offense involved—

(A) a violation of securities law and, at the time of the offense, the defendant was (i) an officer or a director of a publicly traded company; (ii) a registered broker or dealer, or a person associated with a broker or dealer; or (iii) an investment adviser, or a person associated with an investment adviser; or

(B) a violation of commodities law and, at the time of the offense, the defendant was (i) an officer or a director of a futures commission merchant or an introducing broker; (ii) a commodities trading advisor; or (iii) a commodity pool operator,

increase by **4** levels. . . .

Application Notes: . . .

3. Loss Under Subsection (b)(1).—This application note applies to the determination of loss under subsection (b)(1).

(A) General Rule.—Subject to the exclusions in subdivision (D), loss is the greater of actual loss or intended loss.

(i) Actual Loss.—“Actual loss” means the reasonably foreseeable pecuniary harm that resulted from the offense.

- (ii) Intended Loss.—“Intended loss” (I) means the pecuniary harm that the defendant purposely sought to inflict; and (II) includes intended pecuniary harm that would have been impossible or unlikely to occur (e.g., as in a government sting operation, or an insurance fraud in which the claim exceeded the insured value).
- (iii) Pecuniary Harm.—“Pecuniary harm” means harm that is monetary or that otherwise is readily measurable in money. Accordingly, pecuniary harm does not include emotional distress, harm to reputation, or other non-economic harm.
- (iv) Reasonably Foreseeable Pecuniary Harm.—For purposes of this guideline, “reasonably foreseeable pecuniary harm” means pecuniary harm that the defendant knew or, under the circumstances, reasonably should have known, was a potential result of the offense.
- (v) Rules of Construction in Certain Cases.—In the cases described in subdivisions (I) through (III), reasonably foreseeable pecuniary harm shall be considered to include the pecuniary harm specified for those cases as follows:
 - (I) Product Substitution Cases.—In the case of a product substitution offense, the reasonably foreseeable pecuniary harm includes the reasonably foreseeable costs of making substitute transactions and handling or disposing of the product delivered, or of retrofitting the product so that it can be used for its intended purpose, and the reasonably foreseeable costs of rectifying the actual or potential disruption to the victim’s business operations caused by the product substitution.
 - (II) Procurement Fraud Cases.—In the case of a procurement fraud, such as a fraud affecting a defense contract award, reasonably foreseeable pecuniary harm includes the reasonably foreseeable administrative costs to the government and other participants of repeating or correcting the procurement action affected, plus any increased costs to procure the product or service involved that was reasonably foreseeable.
 - (III) Offenses Under 18 U.S.C. § 1030.—In the case of an offense under 18 U.S.C. § 1030, actual loss includes the following pecuniary harm, regardless of whether such pecuniary harm was reasonably foreseeable: any

reasonable cost to any victim, including the cost of responding to an offense, conducting a damage assessment, and restoring the data, program, system, or information to its condition prior to the offense, and any revenue lost, cost incurred, or other damages incurred because of interruption of service.

- (B) Gain.—The court shall use the gain that resulted from the offense as an alternative measure of loss only if there is a loss but it reasonably cannot be determined.
- (C) Estimation of Loss.—The court need only make a reasonable estimate of the loss. The sentencing judge is in a unique position to assess the evidence and estimate the loss based upon that evidence. For this reason, the court's loss determination is entitled to appropriate deference. *See* 18 U.S.C. § 3742(e) and (f).

The estimate of the loss shall be based on available information, taking into account, as appropriate and practicable under the circumstances, factors such as the following:

- (i) The fair market value of the property unlawfully taken, copied, or destroyed; or, if the fair market value is impracticable to determine or inadequately measures the harm, the cost to the victim of replacing that property.
 - (ii) In the case of proprietary information (e.g., trade secrets), the cost of developing that information or the reduction in the value of that information that resulted from the offense.
 - (iii) The cost of repairs to damaged property.
 - (iv) The approximate number of victims multiplied by the average loss to each victim.
 - (v) The reduction that resulted from the offense in the value of equity securities or other corporate assets.
 - (vi) More general factors, such as the scope and duration of the offense and revenues generated by similar operations.
- (D) Exclusions from Loss.—Loss shall not include the following:
 - (i) Interest of any kind, finance charges, late fees, penalties, amounts based on an agreed-upon return or rate of return, or other similar costs.

- (ii) Costs to the government of, and costs incurred by victims primarily to aid the government in, the prosecution and criminal investigation of an offense.
- (E) Credits Against Loss.—Loss shall be reduced by the following:
 - (i) The money returned, and the fair market value of the property returned and the services rendered, by the defendant or other persons acting jointly with the defendant, to the victim before the offense was detected. The time of detection of the offense is the earlier of (I) the time the offense was discovered by a victim or government agency; or (II) the time the defendant knew or reasonably should have known that the offense was detected or about to be detected by a victim or government agency.
 - (ii) In a case involving collateral pledged or otherwise provided by the defendant, the amount the victim has recovered at the time of sentencing from disposition of the collateral, or if the collateral has not been disposed of by that time, the fair market value of the collateral at the time of sentencing.
 - (iii) Notwithstanding clause (ii), in the case of a fraud involving a mortgage loan, if the collateral has not been disposed of by the time of sentencing, use the fair market value of the collateral as of the date on which the guilt of the defendant has been established, whether by guilty plea, trial, or plea of *nolo contendere*.

In such a case, there shall be a rebuttable presumption that the most recent tax assessment value of the collateral is a reasonable estimate of the fair market value. In determining whether the most recent tax assessment value is a reasonable estimate of the fair market value, the court may consider, among other factors, the recency of the tax assessment and the extent to which the jurisdiction's tax assessment practices reflect factors not relevant to fair market value. . . .

- (iv) Ponzi and Other Fraudulent Investment Schemes.—In a case involving a fraudulent investment scheme, such as a Ponzi scheme, loss shall not be reduced by the money or the value of the property transferred to any individual investor in the scheme in excess of that investor's principal investment (*i.e.*, the gain to an individual investor in the scheme shall not be used to offset the loss to another individual investor in the scheme). . . .

(ix) Fraudulent Inflation or Deflation in Value of Securities or Commodities.—In a case involving the fraudulent inflation or deflation in the value of a publicly traded security or commodity, the court in determining loss may use any method that is appropriate and practicable under the circumstances. One such method the court may consider is a method under which the actual loss attributable to the change in value of the security or commodity is the amount determined by—

- (I) calculating the difference between the average price of the security or commodity during the period that the fraud occurred and the average price of the security or commodity during the 90-day period after the fraud was disclosed to the market, and
- (II) multiplying the difference in average price by the number of shares outstanding.

In determining whether the amount so determined is a reasonable estimate of the actual loss attributable to the change in value of the security or commodity, the court may consider, among other factors, the extent to which the amount so determined includes significant changes in value not resulting from the offense (e.g., changes caused by external market forces, such as changed economic circumstances, changed investor expectations, and new industry-specific or firm-specific facts, conditions, or events). . . .

(C) Downward Departure Consideration.—There may be cases in which the offense level determined under this guideline substantially overstates the seriousness of the offense. In such cases, a downward departure may be warranted.

For example, a securities fraud involving a fraudulent statement made publicly to the market may produce an aggregate loss amount that is substantial but diffuse, with relatively small loss amounts suffered by a relatively large number of victims. In such a case, the loss table in subsection (b)(1) and the victims table in subsection (b)(2) may combine to produce an offense level that substantially overstates the seriousness of the offense. If so, a downward departure may be warranted. . . .

§ 2B1.4. Insider Trading

- (a) Base Offense Level: 8
- (b) Specific Offense Characteristics

- (1) If the gain resulting from the offense exceeded \$6,500, increase by the number of levels from the table in §2B1.1 (Theft, Property Destruction, and Fraud) corresponding to that amount.
- (2) If the offense involved an organized scheme to engage in insider trading and the offense level determined above is less than level **14**, increase to level **14**. . . .

Application Notes:

1. Application of Subsection (b)(2).—For purposes of subsection (b)(2), an “organized scheme to engage in insider trading” means a scheme to engage in insider trading that involves considered, calculated, systematic, or repeated efforts to obtain and trade on inside information, as distinguished from fortuitous or opportunistic instances of insider trading.

The following is a non-exhaustive list of factors that the court may consider in determining whether the offense involved an organized scheme to engage in insider trading:

- (A) the number of transactions;
 - (B) the dollar value of the transactions;
 - (C) the number of securities involved;
 - (D) the duration of the offense;
 - (E) the number of participants in the scheme (although such a scheme may exist even in the absence of more than one participant);
 - (F) the efforts undertaken to obtain material, nonpublic information;
 - (G) the number of instances in which material, nonpublic information was obtained; and
 - (H) the efforts undertaken to conceal the offense.
2. Application of §3B1.3.—Section 3B1.3 (Abuse of Position of Trust or Use of Special Skill) should be applied if the defendant occupied and abused a position of special trust. Examples might include a corporate president or an attorney who misused information regarding a planned but unannounced takeover attempt. It typically would not apply to an ordinary “tippee”.

Furthermore, §3B1.3 should be applied if the defendant’s employment in a position that involved regular participation or professional assistance in creating, issuing, buying, selling, or trading securities or commodities was used to facilitate significantly the commission or concealment of the offense. It would apply, for example, to a hedge fund professional who regularly participates in

securities transactions or to a lawyer who regularly provides professional assistance in securities transactions, if the defendant's employment in such a position was used to facilitate significantly the commission or concealment of the offense. It ordinarily would not apply to a position such as a clerical worker in an investment firm, because such a position ordinarily does not involve special skill. *See* §3B1.3, comment. . . .

The following general Guidelines provisions potentially apply in all federal criminal cases, including white collar cases.

§ 3B1.1. Aggravating Role

Based on the defendant's role in the offense, increase the offense level as follows:

- (a) If the defendant was an organizer or leader of a criminal activity that involved five or more participants or was otherwise extensive, increase by **4** levels.
- (b) If the defendant was a manager or supervisor (but not an organizer or leader) and the criminal activity involved five or more participants or was otherwise extensive, increase by **3** levels.
- (c) If the defendant was an organizer, leader, manager, or supervisor in any criminal activity other than described in (a) or (b), increase by **2** levels.

§ 3B1.2. Mitigating Role

Based on the defendant's role in the offense, decrease the offense level as follows:

- (a) If the defendant was a minimal participant in any criminal activity, decrease by **4** levels.
- (b) If the defendant was a minor participant in any criminal activity, decrease by **2** levels.

In cases falling between (a) and (b), decrease by **3** levels.

§ 3E1.1. Acceptance of Responsibility

- (a) If the defendant clearly demonstrates acceptance of responsibility for his offense, decrease the offense level by **2** levels.
- (b) If the defendant qualifies for a decrease under subsection (a), the offense level determined prior to the operation of subsection (a) is level **16** or greater, and upon motion of the government stating that the defendant has assisted authorities in the investigation or prosecution of his own misconduct by timely notifying authorities of his intention to enter a plea of guilty, thereby permitting the

government to avoid preparing for trial and permitting the government and the court to allocate their resources efficiently, decrease the offense level by 1 additional level.

Once the total offense level and criminal history have been calculated under the Guidelines, the court must consult the “Sentencing Table” to derive a sentencing range, expressed in months.

SENTENCING TABLE (in months of imprisonment)						
Offense Level	Criminal History Category (Criminal History Points)					
	I (0 or 1)	II (2 or 3)	III (4, 5, 6)	IV (7, 8, 9)	V (10, 11, 12)	VI (13 or more)
Zone A	1	0-6	0-6	0-6	0-6	0-6
	2	0-6	0-6	0-6	0-6	1-7
	3	0-6	0-6	0-6	2-8	3-9
	4	0-6	0-6	0-6	2-8	4-10
	5	0-6	0-6	1-7	4-10	6-12
	6	0-6	1-7	2-8	6-12	9-15
	7	0-6	2-8	4-10	8-14	12-18
	8	0-6	4-10	6-12	10-16	15-21
Zone B	9	4-10	6-12	8-14	12-18	15-21
	10	6-12	8-14	10-16	15-21	18-24
	11	8-14	10-16	12-18	18-24	21-27
Zone C	12	10-16	12-18	15-21	21-27	24-30
	13	12-18	15-21	18-24	24-30	27-33
	14	15-21	18-24	21-27	27-33	30-37
Zone D	15	18-24	21-27	24-30	30-37	33-41
	16	21-27	24-30	27-33	33-41	37-46
	17	24-30	27-33	30-37	37-46	41-51
	18	27-33	30-37	33-41	41-51	46-57
	19	30-37	33-41	37-46	46-57	51-63
	20	33-41	37-46	41-51	51-63	57-71
	21	37-46	41-51	46-57	57-71	63-78
	22	41-51	46-57	51-63	63-78	70-87
	23	46-57	51-63	57-71	70-87	77-96
	24	51-63	57-71	63-78	77-96	84-105
	25	57-71	63-78	70-87	84-105	92-115
	26	63-78	70-87	78-97	92-115	100-125
	27	70-87	78-97	87-108	100-125	110-137
	28	78-97	87-108	97-121	110-137	120-150
	29	87-108	97-121	108-135	121-151	130-162
	30	97-121	108-135	121-151	135-168	140-175
	31	108-135	121-151	135-168	151-188	140-175
	32	121-151	135-168	151-188	168-210	151-188
	33	135-168	151-188	168-210	188-235	168-210
	34	151-188	168-210	188-235	210-262	188-235
	35	168-210	188-235	210-262	235-293	210-262
	36	188-235	210-262	235-293	262-327	235-293
	37	210-262	235-293	262-327	292-365	262-327
	38	235-293	262-327	292-365	324-405	292-365
	39	262-327	292-365	324-405	360-life	324-405
	40	292-365	324-405	360-life	360-life	360-life
	41	324-405	360-life	360-life	360-life	360-life
	42	360-life	360-life	360-life	360-life	360-life
	43	life	life	life	life	life

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In the following decision that could have substantial consequences for white collar sentencing if followed by other courts, the Third Circuit ruled that “intended” loss cannot be used in calculating loss when applying the fraud guidelines.

UNITED STATES v. BANKS, 55 F.4th 246 (3d Cir. 2022)

ROTH, Circuit Judge:

A jury convicted Frederick Banks of wire fraud, and the District Court sentenced him to 104 months' imprisonment and three years' supervised release. On appeal, Banks argues that the District Court erred . . . by . . . applying the loss enhancement to the fraud guideline in the United States Sentencing Guidelines because there was no “actual loss.”

In January 2016, a federal grand jury indicted Frederick Banks for stalking, wire fraud, aggravated identity theft, and making false statements. The wire fraud charges “related to interlocking schemes . . . carried out by [Banks] to fraudulently gain the money and property of others in relation to the FOREX.COM international exchange system by submitting phony registration information for himself and then using those registrations to execute bogus trades that would drop money into bank accounts that he had set up.”

Banks’s scheme targeted Gain Capital Group, which did business as Forex.com. Gain Capital’s clients opened accounts, deposited funds, and then used those funds to invest in the foreign currency exchange market. Banks’s plot was to open Gain Capital accounts and make electronic deposits into those accounts, but his deposits were drawn on bank accounts with insufficient funds. He then tried to withdraw funds from these accounts, “with the goal being to complete the withdrawals/transfers before the lack of supporting funds could be detected.” To support his scheme, Banks made fraudulent representations through text message, telephone conversations, and emails. He misrepresented his identity, his income, his occupation, his net worth, and the balances in his bank accounts.

Importantly, Gain Capital suffered no actual loss. Banks made fraudulent deposits of \$324,000 and unsuccessfully executed 70 withdrawals/transfers totaling \$264,000. Gain Capital, however, did not transfer a single dollar to Banks. . . .

Banks’s offense level computation under the United States Sentencing Guidelines included a special offense characteristic for the attempted loss Banks intended to inflict on Gain Capital. According to the presentence investigation report:

The attempted loss, based on [Banks’s] fraudulent deposits, is \$324,000. Therefore, the base offense level is increased by 12 because the attempted loss was greater than \$250,000 but less than \$550,000. USSG § 2B1.1(b)(1)(G) (As a general rule, loss is the greater of actual loss or intended loss, pursuant to Application Note 3).

The 12-point increase raised Banks’s adjusted offense level from 7 to 19. During sentencing, the District Court explained that the Sentencing Guidelines define “loss to not only be actual loss, but to be intended loss. And the application notes indicate that the intended loss counts into the calculation of the loss amount, even if it’s determined to be improbable or impossible of occurrence.” The District Court found that the loss amount exceeded \$250,000, triggering the 12-point loss-amount enhancement. The

District Court explained that Banks “intended to cause a loss in a pecuniary amount in excess of \$250,000” and that Banks “by his conduct, intended to cause such a loss; and, therefore, it is appropriately added into the guidelines calculation under 2B1.1.”

The District Court sentenced Banks to 104 months’ imprisonment and three years of supervised release. . . .

The application of the intended-loss enhancement hinges on the meaning of the term “loss” as used in Guideline § 2B1.1. Because the United States Sentencing Commission has interpreted “loss” in its commentary, the weight afforded to that commentary may affect the meaning of “loss.”

Courts treat the Sentencing Guidelines as legislative rules, and the Sentencing Commission’s comments interpreting its Guidelines as interpretative rules. Historically . . . courts deferred to the Sentencing Commission’s interpretation of its own regulations . . . unless that interpretation was plainly erroneous or inconsistent with the Guideline.

Recently, however, the Supreme Court decided *Kisor v. Wilkie*, in which it made clear that, before according . . . deference, “a court must exhaust all the ‘traditional tools’ of construction,” and determine that a regulation is “genuinely ambiguous.” . . . [A] court must consider the “text, structure, history, and purpose of a regulation, in all the ways it would if it had no agency to fall back on.”

What’s more, a court must make an “independent inquiry” into the “character and context” of the reasonable interpretations of the regulation. . . .

The Guideline does not mention “actual” versus “intended” loss; that distinction appears only in the commentary. That absence alone indicates that the Guideline does not include intended loss.

The government concedes that “the presumption is that a word carries its ordinary meaning (and thus may resolve its ambiguity).” We agree. The ordinary meaning of “loss” in the context of § 2B1.1 is “actual loss.” This result is confirmed by dictionary definitions of “loss.” The 1993 edition of *Webster’s New International Dictionary* defines “loss” as:

- (a) the act or fact of losing;
- (b) a person or thing or an amount that is lost;
- (c) the act or fact of failing to gain, win, obtain, or utilize;
- (d) A decrease in amount, magnitude, or degree;
- (e) the state or fact of being destroyed or placed beyond recovery; and
- (f) the amount of an insured’s financial detriment due to the occurrence of a stipulated contingent event.

The 1988 edition of *Webster's Ninth New Collegiate Dictionary* defines “loss” as:

- 1a: the act of losing possession b: the harm or privation resulting from loss or separation c: an instance of losing
- 2: a person or thing or an amount that is lost . . .
- 3 a: failure to gain, win, obtain, or utilize b: an amount by which the cost of an article or service exceeds the selling price
- 4: decrease in amount, magnitude, or degree
- 5: destruction, ruin
- 6: the amount of an insured's financial detriment by death or damage that the insurer become liable for. . . .

Because the commentary expands the definition of “loss” by explaining that generally “loss is the greater of actual loss or intended loss,” we accord the commentary no weight. Banks is thus entitled to be resentenced without the 12-point intended-loss enhancement in § 2B1.1.

There is currently a circuit split on the question, discussed in the prior case, of whether courts should defer to the Sentencing Commission's commentary about how to calculate loss when applying section 2F1.1 in fraud cases. The issue appears ripe for Supreme Court review. *See United States v. Johnson*, 104 F.4th 662 (7th Cir. 2024) (contra *Banks*).

Problem 18-1

Your client was convicted of securities fraud for her involvement in an accounting fraud that, when revealed, resulted in a loss of \$500 million in market capitalization to a U.S. Fortune 100 public company—as measured by the difference in share price before and after the fraud was exposed publicly. She was the Chief Financial Officer of the company at the time of the fraud and has no prior criminal record.

- (a) What sentence might the above Guidelines recommend to the court in her case?
- (b) What else would you want to know to determine whether a court is likely to sentence her within the recommended Guidelines range?

Because the Guidelines are not strictly binding, the question of what constitutes a just sentence for white collar offenders can loom large. The following case contains a lively discussion of that matter, as well as some material expanding upon the manner in which the Guidelines remain relevant or, as some have put it, “exert gravitational pull.”

UNITED STATES v. TOMKO, 562 F.3d 558 (3d Cir. 2009) (en banc)

SMITH, Circuit Judge, with whom McKEE, BARRY, AMBRO, FUENTES, CHAGARES, JORDAN, and HARDIMAN, Circuit Judges, join.

The Government appeals the reasonableness of William Tomko’s below-Guidelines sentence of probation, community service, restitution, and fine for his tax evasion conviction. If any one of a significant number of the members of this Court—including some in today’s majority—had been sitting as the District Judge, Tomko would have been sentenced to some time in prison. But “[t]he fact that the appellate court might reasonably have concluded that a different sentence was appropriate is insufficient to justify reversal of the district court.” *Gall v. United States*. Gall reminds us that “[t]he sentencing judge is in a superior position to find facts and judge their import under § 3553(a) in the individual case. The judge sees and hears the evidence, makes credibility determinations, has full knowledge of the facts and gains insights not conveyed by the record.” See also *United States v. Dragon* (we afford “deference to the District Court because it is in the best position to determine the appropriate sentence in light of the particular circumstances of the case.”). This reality is why, post-*Booker*, “the familiar abuse-of-discretion standard of review now applies to appellate review of sentencing decisions.” *Gall*. Where, as here, a district court decides to vary from the Guidelines’ recommendations, we “must give due deference to the district court’s decision that the § 3553(a) factors, on a whole, justify the extent of the variance.” These principles require us to affirm Tomko’s sentence.

On May 11, 2004, Tomko pleaded guilty to a one-count information charging him with tax evasion in violation of 26 U.S.C. § 7201. Tomko was the owner and Chief Executive Officer of W.G. Tomko & Son, Inc. (“Tomko, Inc.”), a plumbing contractor. From 1995 to 1998, Tomko directed numerous subcontractors, who were building his multimillion dollar home in Washington County, Pennsylvania, to falsify information on billing invoices so that the invoices would show work being done at one of Tomko, Inc.’s many job sites instead of at Tomko’s home. As a result, Tomko, Inc. paid for the construction of Tomko’s home and illegally deducted those payments as business expenses. Tomko also did not properly report those payments as income on his personal tax return. All told, Tomko’s tax evasion scheme involved twelve different subcontractors and his general contractor, and resulted in a tax deficiency of \$228,557.

The United States District Court for the Western District of Pennsylvania conducted Tomko’s sentencing hearing on September 30, 2005. Using the 1997 edition of the United States Sentencing Guidelines Manual, the District Court calculated Tomko’s total offense level to be thirteen and his criminal history category to be I. Based on these calculations, the Guidelines recommended a range of imprisonment between twelve and eighteen months and a fine between \$3,000 and \$30,000.

Tomko, however, proposed that in light of the then-recent Hurricane Katrina catastrophe and his construction expertise, the Court should sentence him to probation and home detention, and require him to work for Habitat for Humanity. The Executive Director for

Habitat for Humanity's Pittsburgh affiliate testified that the organization would appreciate Tomko's help in its efforts to rebuild the Gulf Coast and that Tomko had performed well in past projects, including providing onsite assistance and advice.

Tomko also proffered testimony from Tomko, Inc.'s Chief Financial Officer that the company was in danger of losing its line of credit if he were imprisoned. If this happened, Tomko, Inc. would be in dire straits financially and the jobs of its 300-plus employees would be threatened.

Finally, Tomko submitted a Motion for Downward Departure. The motion argued that Tomko should be sentenced below his Guidelines range because 1) his incarceration could cause Tomko, Inc.'s innocent employees to lose their jobs; 2) he has performed exceptional charitable acts and good works; 3) he has demonstrated an extraordinary degree of acceptance of responsibility; and 4) a combination of these three factors. As exhibits, Tomko attached over fifty letters from family, friends, community leaders, and others attesting to his pre-indictment charitable activities and other good works. . . .

In response, the Government insisted that the Court impose a sentence that included a term of imprisonment. The Government did not challenge Tomko's factual assertions or submissions. Instead, it juxtaposed his criminal conduct with the patriotism of American soldiers fighting wars abroad and argued that greed, not community service and philanthropy, defined Tomko's character. It focused on the fact that Tomko coerced his subcontractors to file false documentation, and highlighted the "gilded cage" nature of a sentence of home detention. The Government claimed that it would be "absurd" to sentence Tomko to live in the same multimillion dollar mansion that the illegally obtained tax monies helped fund. According to the Government, the Court's failure to incarcerate Tomko would send a message that a rich defendant can buy his way out of prison, and would compromise the general deterrent effect that tax laws have on potential tax cheats.

Despite the Government's arguments, the District Court did not sentence Tomko to a term of imprisonment. Instead, the Court sentenced Tomko to three years of probation (the first of which would be served as home detention), participation in an alcohol treatment program, 250 hours of community service, full restitution, and the statutory maximum fine of \$250,000. The Court explained its sentence with the following colloquy:

The reason for the sentence is as follows: Defendant stands before us for sentencing after pleading guilty to tax evasion. A review of Defendant's financial condition paints a picture of a very wealthy man who had the means and wherewithal to easily pay whatever tax obligation is owing. He was a successful businessman earning a significant salary. There is simply no reason for him to have done this.

This being said, I also note his negligible criminal history, his record of employment, his support for and ties in the community, and the

extensive charitable work he has done. I have also—therefore, I have sentenced him to the period of probation, which I recognize is below the guideline range. I also recognize that the fine is above the guideline range. Given the Defendant’s wealth, the guideline range in fines is insufficient deterrence.

Therefore, I’ve done this mitigation of the sentence under the provisions set forth in 18 U.S.C. [§] 3553 for the reasons I stated. Taking all these factors into account, the Court sentences the Defendant to a period of probation, a substantial fine, and allows for repayment to the Internal Revenue Service of his outstanding tax obligation. The Court views that this sentence will address the sentencing goals of punishment, deterrence and rehabilitation. . . .

Before the implementation of a Guidelines-based sentencing system in 1984, “[s]tatutes specified the penalties for crimes but nearly always gave the sentencing judge wide discretion to decide whether the offender should be incarcerated and for how long, whether he should be fined and how much, and whether some lesser restraint, such as probation, should be imposed instead of imprisonment or fine.” *Mistretta v. United States*. Reviewing courts, in turn, recognized “that the sentencing judge ‘sees more and senses more’ than the appellate court; thus, the judge enjoyed the ‘superiority of his nether position,’ for that court’s determination as to what sentence was appropriate met with virtually unconditional deference on appeal.” (quoting Maurice Rosenberg, *Judicial Discretion of the Trial Court, Viewed From Above*, 22 SYRACUSE L. REV. 635 (1971)). According to the Supreme Court, appellate review “beg[an] with the general proposition that once it is determined that a sentence is within the limitations set forth in the statute under which it is imposed, appellate review is at an end.” *Dorszynski v. United States*.

Concerns over sentencing disparities and the continued viability of rehabilitation as a penological objective dogged this sentencing system. *Mistretta*. As a result, in 1984, Congress passed the Sentencing Reform Act which, among other things, established mandatory sentencing guidelines. This Act, however, “did not alter a court of appeals’ traditional deference to a district court’s exercise of its sentencing discretion.” *Williams v. United States*. As the Supreme Court explained in *Williams*, “[t]he development of the guideline sentencing regime has not changed our view that, except to the extent specifically directed by statute, ‘it is not the role of an appellate court to substitute its judgment for that of the sentencing court as to the appropriateness of a particular sentence.’” *Id.* (quoting *Solem v. Helm*).

In *United States v. Booker*, the Supreme Court concluded that the Sentencing Guidelines could only be advisory, and instructed courts of appeals to review the sentencing court’s “broad discretion in imposing a sentence within a statutory range,” for “unreasonableness.” Subsequently, *Gall* made it plain that we assess unreasonableness under the abuse-of-discretion standard. . . .

District courts must provide their explanations and justifications while going through three steps at sentencing. As we outlined in *Levinson*:

A district court must begin the process by first calculating the applicable Guidelines range. After that initial calculation, the court must then rule on any motions for departure and, if a motion is granted, state how the departure affects the Guidelines calculation. Finally, after allowing the parties an opportunity for argument, the court must consider all of the § 3553(a) factors and determine the appropriate sentence to impose, which may vary from the sentencing range called for by the Guidelines.

“Thus, the sentencing court subjects the defendant’s sentence to the thorough adversarial testing contemplated by federal sentencing procedure.” *Rita*.

Our appellate review proceeds in two stages. It begins by “ensur[ing] that the district court committed no significant procedural error, such as failing to calculate (or improperly calculating) the Guidelines range, treating the Guidelines as mandatory, failing to consider the § 3553(a) factors, selecting a sentence based on clearly erroneous facts, or failing to adequately explain the chosen sentence—including an explanation for any deviation from the Guidelines range.” *Gall*. We do not presume that a district court considered the factors solely because the sentence falls within the Guidelines range. *Cooper*. If a district court’s procedure passes muster, “we then, at stage two, consider its substantive reasonableness.” *Levinson*. Our substantive review requires us not to focus on one or two factors, but on the totality of the circumstances. *Gall*; *United States v. Howe*. Indeed, we cannot presume that a sentence is unreasonable simply because it falls outside the advisory Guidelines range. *Gall*. At both stages of our review, the party challenging the sentence has the burden of demonstrating unreasonableness. *Cooper*.

The abuse-of-discretion standard applies to both our procedural and substantive reasonableness inquiries. *Gall*; *United States v. Wise*. For example, an abuse of discretion has occurred if a district court based its decision on a clearly erroneous factual conclusion or an erroneous legal conclusion. *Wise*. This also means that, absent any significant procedural error, we must “give due deference to the district court’s determination that the § 3553(a) factors, on a whole,” justify the sentence. *Gall*; *see also United States v. Bungar* (stating that, as an appellate court, we are “highly deferential” to the sentencing court’s application of the § 3553(a) factors). In other words, if the district court’s sentence is procedurally sound, we will affirm it unless no reasonable sentencing court would have imposed the same sentence on that particular defendant for the reasons the district court provided.

Ultimately, “[t]he touchstone of ‘reasonableness’ is whether the record as a whole reflects rational and meaningful consideration of the factors enumerated in 18 U.S.C. § 3553(a).” *United States v. Grier*; *see also Cooper* (“[W]hat we must decide is whether the district judge imposed the sentence he or she did for reasons that are logical and consistent with the factors set forth in section 3553(a).”). “An estimation of the outer bounds of what is ‘reasonable’ under a given set of circumstances may not always be

beyond debate, but the abuse-of-discretion standard by which that estimation must be judged limits the debate and gives district courts broad latitude in sentencing.” *Levinson*.

...

The crux of the Government’s appeal is its claim that Tomko’s sentence is substantively unreasonable. At oral argument, the Government reaffirmed that it would not be satisfied even if the District Court corrected the alleged procedural error on remand, but imposed the same sentence. In the Government’s view, Tomko’s sentence is substantively unreasonable because 1) detention in the house that Tomko partially funded with the illegal tax proceeds is plainly unreasonable, 2) this is a mine-run tax evasion case undeserving of such a lenient sentence, and 3) the statutory maximum fine cannot cure the claimed substantive deficiencies.

We reject the Government’s first and third arguments with limited discussion. Concerning the first, the Government has narrowed its objections to too fine a point by focusing its objections solely on the location of Tomko’s home detention. The Government admitted at oral argument that had the District Court sentenced Tomko to serve his detention in a different house—for example, as the Government suggested, “one of those Habitat for Humanity buildings that he was building in New Orleans could do”—it may not have appealed. Although we agree with the Government that the sort of “gilded cage” confinement imposed here has a certain unseemliness to it, we do not believe that this condition of sentence, by itself, constitutes an abuse of discretion. Whether detention in a particular home is appropriate punishment is precisely the type of fact-bound inquiry that a sentencing court is better suited to make. Even the Guidelines leave this determination to the sound discretion of the sentencing court. *See* U.S. Sentencing Guidelines Manual § 5F1.2 cmt. 3 (1997) (“The defendant’s place of residence, for purposes of home detention, need not be the place where the defendant previously resided. It may be any place of residence, so long as the owner of the residence agrees to any conditions that may be imposed by the court” (emphasis added)). We are in no position to second-guess that decision here.

The Government’s third claim rests on a perceived link between the District Court’s variance to a probationary sentence and its imposition of the statutory maximum fine. According to the Government, the District Court permitted Tomko to buy his way out of prison. This is not simply an overly-pejorative characterization of the sentence; it is a misreading of the record that is unfair to the District Court. Indeed, the record exhibits no connection between the fine imposed and the failure to incarcerate. To the contrary, the District Court explicitly stated that the two served unrelated purposes. On the one hand, probation was warranted because of Tomko’s negligible criminal history, his record of employment, his community ties, and his extensive charitable works. On the other hand, the statutory maximum fine was necessary to effect deterrence in light of Tomko’s wealth. We cannot conclude that the District Court abused its discretion where there exists nothing more than an implication of impropriety arising out of simple coincidence.

The Government’s final argument—that this is an overly lenient sentence in a mine-run case—deserves more attention. At the outset, we address the Government’s characterization of this case as a “mine-run” case. To the extent that the typicality or uniqueness of a case is relevant, the Supreme Court has made clear that it does not alter our deferential standard of review when evaluating a district court’s sentencing determination. To that end, the Court observed in *Gall* that:

[i]t has been uniform and constant in the federal judicial tradition for the sentencing judge to consider every convicted person as an individual and every case as a unique study in the human failings that sometimes mitigate, sometimes magnify, the crime and punishment to ensue. The uniqueness of the individual case, however, does not change the deferential abuse-of-discretion standard of review that applies to all sentencing decisions.

Such deference acknowledges the district court’s “institutional advantage over appellate courts,” or what the Court in *Gall* labeled the “[p]ractical considerations.” Accordingly, we must apply the abuse-of-discretion standard uniformly, regardless of whether a particular case appears to be a “mine-run” case on appeal.

The Government points out that “closer review may be in order when the sentencing judge varies from the Guidelines based solely on the judge’s view that the Guidelines range fails to properly reflect § 3553(a) considerations even in a mine-run case.” *Kimbrough v. United States*. This case, however, is different from those like *Kimbrough*, which involved the “district court’s authority to vary from the . . . Guidelines based on policy disagreement with them, and not simply based on an individualized determination that they yield an excessive sentence in a particular case.” *Spears v. United States*. Here, the District Court did not vary from the Guidelines range “solely” based on a disagreement with its ability to properly reflect § 3553(a) considerations. *Kimbrough*. Instead, the Court made an individualized determination that the Guidelines range recommended an excessive sentence in this instance. As a result, we are not reviewing “an ‘inside the heartland’ departure (which is necessarily based on a policy disagreement with the Guidelines and necessarily disagrees on a ‘categorical basis’) [that] may be entitled to less respect” in this case. *Spears*.

In essence, the Government is asking this Court to apply the already-rejected “proportionality test” by a different name. The Government’s appeal boils down to a claim that Tomko’s criminal history, employment record, community ties, and charitable works do not differentiate him enough from the “mine-run” tax evasion case to justify his below-Guidelines sentence. Similarly, a “proportionality test” rests on “the proposition that the strength of the justification needed to sustain an outside-Guidelines sentence varies in proportion to the degree of the variance.” *Rita*. As applied by some courts of appeals, this meant that “a sentence that constitute [d] a substantial variance from the Guidelines [had to] be justified by extraordinary circumstances.” *Gall*. In *Gall*, the Supreme Court explicitly barred the application of such an approach because it

necessarily applies a “heightened standard of review to sentences outside the Guidelines range.” That, of course, is “inconsistent with the rule that the abuse-of-discretion standard of review applies to appellate review of all sentencing decisions—whether inside or outside the Guidelines range.”

To be sure, “we may look for a more complete explanation to support a sentence that varies from the Guidelines than we will look for when reviewing a sentence that falls within a properly calculated Guidelines range.” *Levinson*. We may also properly consider “the extent of any variance from the Guidelines range.” *Gall*. As the Supreme Court has explained, “it [is] uncontroversial that a major departure should be supported by a more significant justification than a minor one.” This does not mean, however, that we elevate our review of any variance and its accompanying explanation or justification beyond the abuse-of-discretion standard. The Supreme Court has unequivocally stated that “courts of appeals must review all sentences—whether inside, just outside, or significantly outside the Guidelines range—under a deferential abuse-of-discretion standard.” We must remain faithful to that clear instruction.

Based on our review of the record, we conclude that the District Court did not abuse its discretion here. At Tomko’s sentencing hearing, the District Court explicitly examined subsections (a)(1), (a)(2)(A), (a)(2)(B), (a)(2)(C), (a)(2)(D), (a)(3), (a)(4), and (a)(6) of § 3553. The District Court also ordered full restitution. *See* 18 U.S.C. § 3553(a)(7). After hearing argument from the Government concerning the need for a term of imprisonment, the Court reiterated its reasons for imposing a sentence without one. The District Court gave specific reasons for why Tomko’s sentence varies from the Guidelines range. This variance took into account his negligible criminal history, his employment record, his community ties, and his extensive charitable works as reasons for not incarcerating Tomko, while also factoring in his substantial wealth as a reason for imposing a fine far above the Guidelines range. Indeed, the District Court provided more than just a boilerplate recitation of the § 3553(a) factors; it detailed, step-by-step, its individualized assessment of the sentence that it believed appropriate in this particular case.

The District Court’s reasons are also “logical and consistent with the factors set forth in section 3553(a).” *Cooper*. They are fully supported by the record. The Government does not dispute that Tomko had a negligible criminal history and that, because of his prominence in the company, his incarceration would threaten the jobs of Tomko, Inc.’s over-300 employees. As for Tomko’s charitable works, even the Government conceded at oral argument that “[t]he district court was entitled to give it whatever weight the district court wanted.” Several dozen letters written on Tomko’s behalf prior to his sentencing also demonstrate Tomko’s community ties and extensive charitable works. These letters indicate that Tomko performed pre-indictment charitable acts that involved not only money, but also his personal time. For several years, Tomko participated in a holiday gift drive in Finleyville, Pennsylvania. He provided Christmas gifts for thirty needy families, provided gloves and scarves to inner city children at a daycare center, and also helped other families in Marianna, Pennsylvania during the holiday season. One letter stated that Tomko performed all of this work anonymously. On a more individual

basis, another letter noted how Tomko “helped a woman in the South Park area that had recently lost her husband and was left with four small children to raise by her[self].” He also went out of his way to accommodate his employees who needed extra time off for personal reasons. Tomko participated in other acts of charity for those in need. A pastor in the community noted Tomko’s pre-indictment proclivity for aiding the poor, and stated that “[b]y requiring him to perform . . . community service, in lieu of incarceration, not only will you help the impoverished lives of the poor, but you will also transform the life of Bill Tomko.”

Additionally, at Tomko’s sentencing proceeding, the Executive Director of Habitat for Humanity’s Pittsburgh affiliate testified on Tomko’s behalf. The Executive Director stated that the Pittsburgh affiliate had been in danger of being closed down by the national Board of Directors because of its precarious financial situation. The Executive Director testified that Tomko became personally involved in the construction and rehabilitation of several houses in the Pittsburgh area. Again, Tomko devoted not only a portion of his wealth, but also his personal time. The Executive Director stated that, for one house that had water runoff problems, “Mr. Tomko came and not only visited with the homeowner, inspected the basement to see what was the matter with the outside of the house, but also worked with the city to determine how best to redirect the water away from the yards. He put in the grading, he completed the front sidewalk, the back driveway, and put in a curb for the city.” The Executive Director gave other examples of Tomko’s providing his construction expertise to aid the Pittsburgh affiliate. The Executive Director then testified as to how Tomko could benefit Habitat for Humanity’s efforts to build houses for poor families whose residences were damaged or destroyed by Hurricane Katrina. The Executive Director of the New Orleans affiliate confirmed that Tomko would be useful in these efforts. The Pittsburgh Executive Director concluded her direct testimony by reading a portion of a letter she wrote to the District Court, which stated that “there is no one like Bill Tomko who provides timely, unselfish, and meaningful contributions to Pittsburgh Habitat for Humanity’s construction operations.”

. . . The Government claims that affirming Tomko’s sentence promotes sentencing disparities and, in turn, undermines general deterrence. Whatever the merits of this possibility, it does nothing to change our disposition. The Government’s concern is not new; it has been a point of constant focus throughout sentencing review’s evolution. Before the Guidelines existed, “[s]erious disparities in sentences . . . were common.” *Mistretta*. When Congress created the mandatory Guidelines system, it did so “to ‘provide certainty and fairness in meeting the purposes of sentencing, [while] avoiding unwarranted sentencing disparities . . . [and] maintaining sufficient flexibility to permit individualized sentences when warranted.’” *Booker* (quoting 28 U.S.C. § 991(b)(1)(B)). When the Supreme Court rendered the Guidelines advisory, it was fully aware that sentencing disparities would likely increase. *See id.* (“We cannot and do not claim that use of a ‘reasonableness’ standard will provide the uniformity that Congress originally sought to secure.”).

Despite that awareness, the Booker Court was confident that the advisory Guidelines system would “continue to move sentencing in Congress’ preferred direction, helping to avoid excessive sentencing disparities while maintaining flexibility sufficient to individualize sentences where necessary.” In *Gall*, the Court reaffirmed that “a more deferential abuse-of-discretion standard could successfully balance the need to ‘reduce unjustified disparities’ across the Nation and ‘consider every convicted person as an individual.’” 128 S. Ct. (quoting Koon).

If abuse-of-discretion review cannot strike such a balance, it is not our role as appellate judges to adjust the scales. “The National Legislature is equipped to devise and install, long term, the sentencing system, compatible with the Constitution, that Congress judges best for the federal system of justice.” *Booker* (“I continue to think that the best resolution of the tension between substantial consistency throughout the system and the right of jury trial would be a new Act of Congress: reestablishing a statutory system of mandatory sentencing guidelines (though not identical to the original in all points of detail), but providing for jury findings of all facts necessary to set the upper range of sentencing discretion.”). The risk of affirming an unwarranted sentencing disparity in this case is one we must accept while following the Supreme Court’s “pellucidly clear” command that we apply the abuse-of-discretion standard of review. *Gall*. . . .

FISHER, Circuit Judge, dissenting, with whom Chief Judge SCIRICA, Judge SLOVITER, Judge RENDELL and Judge COWEN join.

As the procedural history of this appeal clearly shows, this Court has wrestled with the decision in this case for close to two and one half years, during which time the judges on this Court have tried to determine whether the sentence given for this crime was substantively reasonable. The offense we encounter in this case is no garden variety tax evasion. The conduct underlying the offense involved an intricate scheme spanning several years and involved the coercion and coordination of numerous other individuals, all for the personal gain of one man, William G. Tomko, Jr., a successful business owner with the means to easily pay the taxes he owed to the Government.

Tomko’s fraudulent tax evasion scheme revolved around the construction of his luxurious new home in southwestern Pennsylvania. During the construction of this home, Tomko had subcontractors falsify their billing invoices to make it appear their work had been done for his construction company, W.G. Tomko, Inc. (“Tomko, Inc.”), at one of its job sites, rather than for Tomko, the individual, at his personal residence. The Internal Revenue Service–Criminal Investigation Division investigators interviewed seventeen individuals with respect to Tomko’s scheme. While the details varied from individual to individual, a consistent pattern of conduct emerged: At Tomko’s behest, subcontractors who performed work at his residence were instructed to write billing invoices that made it appear that their work had been done at one of five local area schools. Because Tomko, Inc. was working jobs at these local schools, the company could appear to be legitimately paying the invoices. As a result, the construction costs were diverted from Tomko personally to Tomko’s company, which

then deducted them as business expenses, while Tomko also failed to report as personal income the value of the services provided to him at no cost. Thus, Tomko's income was under-represented in two regards: The profits earned by his business appeared to be less and the substantial benefit he received as a result of the construction of a new 8,000-square-foot home went unreported.

Tomko's scheme resulted in a stipulated tax deficiency of \$228,557; however, a disputed portion of the record included evidence that the pervasiveness of his scheme was even more extensive. In particular, the Government presented evidence that Tomko on more than one occasion told individuals that his vacation home in Maryland was "a gift from Uncle Sam." Because the Government was unable to provide reliable figures to account for the impact of this alleged fraud with respect to the tax loss incurred by the Government, this disputed evidence apparently did not factor into the District Court's judgment of sentence, and we mention it solely to underscore the point that we are not faced with a garden variety case of tax evasion.

Tomko pleaded guilty to a one-count information charging him with tax evasion, in violation of 26 U.S.C. § 7201. His properly calculated Guidelines range was twelve to eighteen months of incarceration. . . .

In accordance with the standard announced by the Supreme Court in *United States v. Booker*, our task on appeal is to review the sentence imposed by the District Court for "reasonableness." In *Gall v. United States*, the Supreme Court clarified that appellate reasonableness review involves two steps: the first procedural and the second substantive. The Supreme Court categorized, *inter alia*, "failing to consider the § 3553(a) factors" and "failing to adequately explain the chosen sentence," as procedural errors under the first step of *Gall*. The Court then instructed:

"Assuming that the district court's sentencing decision is procedurally sound, the appellate court should then consider the substantive reasonableness of the sentence imposed under an abuse-of-discretion standard. When conducting this review, the court will, of course, take into account the totality of the circumstances, including the extent of any variance from the Guidelines range. If the sentence is within the Guidelines range, the appellate court may, but is not required to, apply a presumption of reasonableness. But if the sentence is outside the Guidelines range, the court may not apply a presumption of unreasonableness. It may consider the extent of the deviation, but must give due deference to the district court's decision that the § 3553(a) factors, on a whole, justify the extent of the variance."

Accord United States v. Wise ("As an appellate court, our role is two-fold. . . . If we determine that the district court has committed no significant procedural error, we then review the substantive reasonableness of the sentence under an abuse-of-discretion standard. . . .").

The Court in *Gall* also reaffirmed its decision in *Rita v. United States*, which emphasized the importance of reviewing sentences for substantive reasonableness. *See Gall*. As the Supreme Court stated in *Rita*: “In sentencing, as in other areas, district judges at times make mistakes that are substantive. At times, they will impose sentences that are unreasonable. Circuit courts exist to correct such mistakes when they occur.” Consequently, the substantive component of reasonableness review, while deferential, is not impotent.

For these reasons, we disagree with the Majority’s statement that “if the district court’s sentence is procedurally sound, we will affirm it unless no reasonable sentencing court would have imposed the same sentence on that particular defendant for the reasons the district court provided.” We recognize that “appellate review of sentencing decisions is limited to determining whether they are ‘reasonable,’” *Gall*, but we believe that encompassed within this limited role is the authority and the obligation to vacate sentences that are substantively unreasonable. Therefore, although the Supreme Court “made it pellucidly clear that the familiar abuse-of-discretion standard of review now applies to appellate review of sentencing decisions,” we cannot agree with the Majority’s characterization of the appellate courts’ role in reviewing sentences as “requir[ing] us to do nothing more and nothing less than to apply the deferential abuse-of-discretion standard.” We believe that when the Supreme Court instructed appellate courts to review for both procedural and substantive reasonableness, it meant what it said. Accordingly, because we conclude that this sentence is substantively unreasonable, we dissent. . . .

Viewed cumulatively, out of the three reasons offered by the District Court for mitigating Tomko’s sentence, only one—community support based on charitable work—even begins to justify a downward variance in this case. Thus, these considerations fall short of placing the sentence imposed within the albeit broad range of permissible choices, even when we add them together. Moreover, the “mitigating” circumstances relied upon by the District Court only address one of the § 3553(a) factors, namely “the history and characteristics of the defendant” under § 3553(a)(1), and therefore do not reflect the “totality of the circumstances” and the “§ 3553(a) factors, on a whole.” *Gall*. As a number of our sister courts of appeals have recognized, excessive reliance on a single § 3553(a) factor is indicative of an unreasonable sentence. *United States v. Hampton*; *United States v. Givens*, ; *see also Cavera* (considering whether a particular “factor relied on by a sentencing court can bear the weight assigned to it”). As the remainder of our analysis reveals, the District Court’s over-reliance on § 3553(a)(1) as justification for the significant qualitative and quantitative variance it granted pales in comparison to the numerous § 3553(a) factors which suggest that a term of imprisonment is warranted in a case of tax evasion as willful and brazen as Tomko’s. . . .

Problem 18-2

Under current law, what is the role of a federal trial judge during sentencing? What is the role of the appellate court when reviewing a sentencing decision?

Problem 18-3

- (a) List all deterrent arguments one could make for and against a sentence of probation for Tomko.
- (b) List all retributive arguments one could make for and against a sentence of probation for Tomko.

The following case contains another lively discussion of how to think about sentencing white collar offenders in light of the Guidelines.

UNITED STATES v. CORSEY, 723 F.3d 366 (2d Cir. 2013)

Per Curiam opinion.

This appeal arises out of a conspiracy to defraud a non-existent investor of three billion dollars. In the spring of 2006, defendants John Juncal, James Campbell, Rodney Sampson, and Emerson Corsey were arrested and charged with one count of conspiracy to commit mail fraud and wire fraud in violation of 18 U.S.C. §§ 1341, 1343, and 1349. Over the preceding four months, the defendants had attempted to lure a broker, Thomas Re, into procuring financing for an imaginary Siberian oil pipeline. The two sides exchanged information about possible partners, and the best structure for a loan. But in reality each side duped the other—Juncal and his colleagues had no plans to build a pipeline across the Russian tundra, and Re never represented a hedge fund interested in lending billions to the defendants to do so.

Re was the CEO of Universal Lending Group (“ULG”), a small brokerage firm based in Garden City, New York. Re acted as a “salesperson and networker” for the company; he solicited companies looking for financing and his associate, Joseph Bianco, then matched projects with a hedge fund or bank to act as lender. Re was also an informant for the FBI: Before he worked at ULG, Re sold vending machine routes to snack-food companies. On occasion, Re sold distributors a fake route—the distributors would arrive at a location and find no machine—and the FBI eventually caught up with him. In the hopes of receiving a lighter sentence, Re agreed to turn over information to the FBI about others participating in the vending machine scam.

Re encountered the defendants seven months after he began working with the FBI. Re received a call from an acquaintance, Charles Frazier, who told him to look out for a financier named Emerson Corsey—Juncal, Campbell, and Sampson’s co-defendant. Corsey called a few days later and explained that he was the Chief Operating Officer of Magnolia International Bank and Trust (“MIBT”), a bank that Corsey described as holding assets of sovereign wealth funds. Corsey said that MIBT wanted to borrow three

billion dollars to build a pipeline in Siberia and could offer five billion dollars in U.S. Treasury notes (“T-notes”) as collateral for the loan. Re said he would think about it.

Re told his associates about the proposal and, after a brief Google search, they told him the deal “smelled.” Re then reported the potential fraud to his FBI handler, who instructed Re to record his conversations with Corsey.

Over the next few months, Re recorded the defendants as they baited him with an escalating series of lies: Corsey explained that MIBT was the central bank for scores of Native American governments, including the Yamasee Indian tribe, a nation with trillions of dollars in assets. Corsey then said that the bank currently represented John Juncal, a “counsel extraordinaire” for the Republic of Buryatia who had been appointed “Vice Premier of Record under the Edict of the Ukase” by the Buryatian government, and the official charged with finding backers for the pipeline. When Re expressed skepticism, Corsey sent him an email with copies of “bond indentures.” The indentures bore the seal of the Vice-President of Buryatia, and stated that they were valued at five billion U.S. dollars and secured by T-Notes. The certificates were assigned to “the Great Siberian Pipeline Corporation,” which was “a Republic of Wyoming Corporation.” The email also contained proof that Juncal controlled the T-notes: Corsey included another certificate signed by Juncal that listed CUSIP numbers for the T-notes (as an expert would later testify, CUSIP numbers are alphanumeric code created by the U.S. Treasury to identify individual bonds).

Prompted by his handler to record statements by more of the defendants, Re asked to speak with Sampson, the purported Chief Financial Officer of MIBT. Sampson laid out the math behind the deal: MIBT’s client, John Juncal, would assign the T-notes to Re’s client. The T-notes would yield a minimum of 3.9% interest per year and generate over fourteen billion dollars in profit over the course of five years. When Re asked for additional evidence of the T-notes’ authenticity, Sampson sent Re an email from an AOL account for MIBT, rather than from MIBT’s own domain name. Attached to the email were unformatted files containing copies of the T-notes; Re had to use Word Pad to open those files. Sampson then e-mailed Re a “Letter of Acceptance” that re-explained the financing. The letter stated that, in exchange for a loan of three billion dollars, Re’s client would receive T-notes that would yield a 171% return on investment.

Re next pressed Corsey and Sampson to show him physical evidence of the T-notes’ existence. And at that point, Corsey put Re in touch with James Campbell, an associate of Juncal’s. Campbell explained that Juncal had hidden the bonds in Austria in order to prevent enemies from “basically steal[ing] these from him and bump[ing] him out of the corporation.” Re pretended to buy the excuse, but later asked if he could speak with Juncal directly. Juncal agreed, and sought to assuage Re’s fears by comparing his role to the historic secret mission of Christopher Columbus.

During his testimony at trial, Re admitted that much of the talk struck him as ridiculous, and that at some point he stopped believing the deal was real. But because of his relationship with the FBI, he continued working with the quartet of pipeline pipe-

dreamers. In March, it came time for the deal to close, and Re arranged to meet Campbell and Sampson in New York to sign documents memorializing their agreement. On the day of the closing, the FBI arrested all four defendants; Campbell and Sampson were arrested in New York, Corsey was arrested in Atlanta, and Juncal was arrested at his home, a motel in Whitefish, Montana. . . .

In each case, but for the statutory maximum term of imprisonment, the appellants' Sentencing Guidelines recommended range would have been a life sentence, because the offense level was driven off the Guidelines' Sentencing Table by an intended loss amount of three billion dollars. Though each appellant argued that the intended loss grossly overestimated the seriousness of the offense, the District Court disagreed. In March of 2010, the District Court sentenced all four defendants to twenty years' incarceration, the statutory maximum and the Guidelines recommended sentence.

The District Court gave a very brief explanation of the reasons for Campbell's sentence, and largely adopted the logic and recommendations in his Pre-Sentence Investigation Report ("PSR"). Under the Guidelines applicable in 2010, the PSR calculated Campbell's total offense level to be 47. Under U.S.S.G. § 2B1.1, his base offense level was 7. Thirty points were added because Campbell had intended to defraud an investor of over \$400 million. The PSR then added points for four additional enhancements: Campbell received four points because he oversaw five or more co-conspirators, U.S.S.G. § 3B1.1; two levels because he offered fake CUSIPs as an "authentication feature," U.S.S.G. § 2B1.1(b)(10)(A)(ii); two levels because Campbell misrepresented himself as a representative of a government or agency, U.S.S.G. § 2B1.1(b)(8)(A); and two levels because the scheme involved sophisticated means, U.S.S.G. § 2B1.1(b)(9)(C).

At the sentencing hearing, the government withdrew its request for a role enhancement pursuant to U.S.S.G. § 3B1.1. The District Court asked if that change affected the guideline range:

COURT: And where does it put the guidelines recommendation?

MR. MISKIEWICZ: We're not privy to the probation officer's recommendations to the Court. I believe that that is still, at least sent to your Honor. We're never given a copy.

COURT: Well, my question really is: the original guidelines calculation put it in the 240 month range. Correct?

THE PROBATION OFFICER: That would be the maximum, the statutory maxim.

The District Court then inquired why the Guidelines calculation was so far above the statutory maximum. The prosecutor answered:

MR. MISKIEWICZ: Our position, your Honor, and I think counsel has agreed with this; is a level 43, that is 47 minus 4, it is still life. If he were one point below that he would still be at a 360 to life sentence. So he is in many ways well over the statutory

maximum. And we, the government, has in our letter asked for the 20 years statutory maximum here.

THE COURT: And that is what I am inclined to give him.

The defense then presented its case against enhancements and for downward departures. The District Court rejected each one, explaining its general approach by referencing other recent financial fraud cases:

I don't know how you can say in this economic age, considering all of the people who have been scammed and defrauded—people of, one would say superior knowledge in finances—I don't know how we can say that hypothetically had Thomas [Re] not existed and not been available, and not been the contact, this scheme would not have been uncovered.

The District Court then explained the reason for imposing a 20-year sentence:

[T]he Probation Department's extensive report of your client's history, and the factors in 3553, and the fact that to date he still shows really no remorse for this crime—still blaming others, and depicting himself as a messenger—I believe this sentence will send a message of deterrence to the defendant, as well as to others.

Sampson's PSR contained an identical offense level score. His attorney objected to all five enhancements, but the District Court only accepted Sampson's arguments on the role enhancement (the government again withdrew its request for the enhancement). As with Campbell, the Court also dismissed the need to recalculate the Guidelines range, explaining that "the maximum is 20 years so it really has no effect."

Sampson was then asked if he wished to make a statement. Sampson said yes, and launched into an impassioned account of the trials of the Yamasee tribe. He stated that the tribe had waged a centuries-long battle against Western encroachment, only signing a treaty with Georgia in 2003. He referred to the people of Buryatia as a "sovereign aboriginal indigenous nation." He then explained the motive of the fraud scheme as "doing something to help the people of Buryatia and the people of the Yamasee nation in order to help as far as education, health, welfare, et cetera, to do for ourselves."

The District Court then sentenced Sampson. Unlike Campbell, Sampson had no prior convictions, but he had been charged with two additional counts of fraud perpetrated while out on bail—he attempted to secure \$100 million for a fake oil field, and actually secured \$35,000 from another investor through a "lifecycle fraud." But the Court did not mention these distinctions, nor any other details of Sampson's case. Instead, the Court made one curt reference to deterrence:

COURT: Anything else you wish to say? These are items counsel can raise on appeal.

MS. GAFFEY: Yes.

COURT: That being said, Mr. Sampson, I am going to sentence you at this time to 240 months in prison, three years supervised release with the following special conditions. . . . I believe this sentence, which is the maximum permissible under the law, will establish both respect for the law and deterrence to you and perhaps hopefully to others for efforts to engage in fraud.

The District Court again adopted the PSR's calculations, including the role enhancement, despite the fact that the government was no longer seeking it. The District Court also found that Juncal had a criminal history category of II. Juncal's only prior convictions were imposed over fifteen years before he tried to sell Re on the Siberian Pipeline, and thus were not countable. *See* U.S.S.G. § 4A1.2e. In his interview with probation, however, Juncal indicated that he had dreamed of building the Siberian pipeline project since the days of "Reagan." The District Court credited this statement, and found that he had commenced planning the Siberian fraud scheme decades before he was caught, and determined his prior convictions were countable. The District Court then calculated the Guidelines in a cursory way:

COURT: Well, I believe probation is right. They feel that your objections were not substantiated, and that the present guidelines range stands.

MR. WALLENSTEIN: I take it then, that the court has found that the guideline range noted by probation in the original presentence report is the guideline range that the court finds.

COURT: It is.

Juncal chose to speak on his own behalf. He explained that he suffered from a crippling bone marrow disease, and he only had a few years to live. "[T]here is no consequence to whether I die in jail or die outside," he lamented. He then went on to cite his extensive diplomatic service, most of it invented. As with his co-defendants, the District Court imposed the statutory maximum sentence:

COURT: As recommended by the probation department, 20 years of custody, plus three years of supervised release.

The Court made no mention of its consideration of any of the factors set forth in 18 U.S.C. § 3553(a) other than the Sentencing Guidelines and the need for deterrence. . . .

We review a district court's sentence for "reasonableness, which is 'akin to review for abuse of discretion, under which we consider whether the sentencing judge exceeded the bounds of allowable discretion, committed an error of law in the course of exercising discretion, or made a clearly erroneous finding of fact.'" *United States v. Leslie* (quoting *United States v. Williams*). This broad discretion is due to district courts because they are a better positioned institutionally to determine the appropriate sentence in a particular case. *United States v. Fernandez*.

We begin our analysis with a review of the sentences' procedural reasonableness. A district court will normally "begin all sentencing proceedings by correctly calculating the applicable Guidelines range," *Gall v. United States*, and will then consider the factors listed in 18 U.S.C. § 3553(a) before imposing a final sentence. *United States v. Preacely*. A judge need not utter "robotic incantations" repeating each factor that motivates a sentence. *United States v. Crosby*. Nonetheless, the judge must explain enough about the sentence for a reviewing court both to understand it and to assure itself that the judge considered the principles enunciated in federal statutes and the Guidelines. *Rita v. United States*. Here, appellants offer two critiques of the way the District Court imposed their sentences. First, they argue that the District Court either miscalculated the Guidelines range or failed to calculate the range entirely. Second, defendants claim that the District Court did not appropriately weigh the factors enunciated in 18 U.S.C. § 3553(a).

The District Court technically may have cut a corner when it glossed over the calculation of appellants' precise adjusted offense level, but that shortcut had no effect on appellants' ultimate Guidelines range. In each case, the amount of intended loss catapulted appellants' offense levels to 37, a number yielding a suggested period of incarceration above the statutory maximum of 20 years. Once the offense level crossed that threshold, any additional enhancement would have had at most an academic impact on the Guidelines range; the recommended term of incarceration would have always reverted back to twenty years. U.S.S.G. § 5G1.1 (a) ("[w]here the statutorily authorized maximum sentence is less than the minimum of the applicable guideline range, the statutorily authorized maximum sentence shall be the guideline sentence."). Rather than resolve technical arguments about each enhancement, the District Court chose a more pragmatic approach—it calculated the Guidelines in sufficient detail to know that the resulting sentencing range would inevitably equal 20 years regardless whether certain additional enhancements applied.

The District Court was free to prioritize efficiency over an exercise in futility. . . . But the District Court still had an obligation to weigh the factors listed in section 3553(a), and we are not certain that occurred. See *Fernandez* (declining to hold within-Guidelines sentence presumptively reasonable). Here, appellants' maximum sentences had an air of inevitability. Because appellants' Guidelines ranges prior to application of the section 5G1.1 limit soared past the statutory maximum, the District Court seemed to assume that imposing a statutory maximum sentence reflected a per se reasonable sentence. At Campbell's hearing, the District Court chastened the defense attorney by noting that "even without [an] enhancement there would still be a maximum of a life sentence. Correct?" After a confusing colloquy with the probation officer and the prosecutor, the Court then correctly noted that as a technical matter the Guidelines range would revert back to the statutory maximum. That unavailable life sentence, however, hung in the air and framed the Court's perfunctory analysis of the section 3553(a) factors. A similar dynamic occurred during Sampson and Juncal's sentencing hearings. The record, then, is muddled by the District Court's elision of two questions—how to understand the reversions of the Guidelines range to the statutory maximum of 240 months, and whether

a statutory maximum sentence was sufficient but not greater than necessary to serve the purposes of sentencing enunciated in section 3553(a).

If in fact the District Court treated 240 months as the only reasonable sentence (because the statutory maximum prohibited imposition of a true Guidelines sentence closer to life), then it committed procedural error. Even when section 5G1.1(a) ratchets down a range, the lower Guidelines range is still the recommendation, and should be treated as a starting point in a deeper analysis, not a revision that obviates the need to consider further what sentence to impose. . . . If, however, the District Court understood the effect of section 5G1.1(a), and still chose to impose the maximum sentence after considering the commands of section 3553(a), then the sentence may have been procedurally sound. But the record here is ambiguous, and we have often vacated and remanded sentences where a “the judge’s sentencing remarks create ambiguity as to whether the judge correctly understood an available option.” *United States v. Thorpe*. In a case clouded by the possibility of error, we feel it appropriate to give the District Court an opportunity to clarify its thinking.

Remand is also appropriate for two additional reasons. First, the sentencing court gave only a passing mention to any of the section 3553(a) factors. In each case, the District Court justified a maximum sentence by relying almost exclusively on one word—“deterrence.” Certainly, a judge need not chronicle the deliberative journey taken to arrive at a sentence, but she must still create enough of a record so that an appellate court can “be confident that the sentence resulted from the district court’s considered judgment as to what was necessary to address the various, often conflicting, purposes of sentencing.” *Cavera*. In other words, just as we do not insist upon “robotic incantations,” we require more than a few magic words.

This is especially true in light of the appellants’ arguments for lighter sentences. “[W]here the appellant or prosecutor presents nonfrivolous reasons for imposing a different sentence . . . the judge will normally go further and explain why he has rejected those arguments.” *Rita*. Here, appellants’ lawyers highlighted significant issues with the intended loss calculation both in their briefs and at sentencing. Given the low risk that any actual loss would result—what hedge fund would fall prey to a purported coalition of Buryatian nationals and Yamasee tribesmen using AOL email accounts to offer five billion dollars in collateral for a loan to build a pipeline across Siberia?—counsel argued that a 30-point mega-enhancement vastly overstated both the seriousness of the offense, and the danger of appellants to their community. The Guidelines acknowledge that potentiality; application note 19(C) to U.S.S.G. § 2B1.1 indicates that a downward departure may be warranted where the offense level resulting from a loss calculation overstates the seriousness of an offense. But the sentencing court never resolved appellants’ significant arguments. At Sampson’s hearing the District Court did draw a comparison between other financial crimes and this case, but it never resolved the question raised by the appellants—whether treating intended loss like actual loss under all the circumstances of this case leads to a sentence consistent with the dictates of section 3553(a). . . .

We affirm the appellants' convictions, but vacate their sentences and remand for resentencings consistent with this decision.

UNDERHILL, District Judge, concurring:

Although I agree that appellants' sentences should be vacated and remanded for procedural error, the real problem is that those sentences are shockingly high. For that reason, I would reach the question of substantive reasonableness and would reverse on the merits.

In my view, the loss guideline is fundamentally flawed, and those flaws are magnified where, as here, the entire loss amount consists of intended loss. Even if it were perfect, the loss guideline would prove valueless in this case, because the conduct underlying these convictions is more farcical than dangerous. If substantive review of sentences actually exists other than in theory, it must be undertaken at least occasionally. This would have been an appropriate case in which to do so, because it raises so starkly the problems with the loss guideline. Until this Court weighs in on the merits of the loss guideline, sentences in high-loss cases will remain wildly divergent as some district judges apply the loss guideline unquestioningly while others essentially ignore it. The widespread perception that the loss guideline is broken leaves district judges without meaningful guidance in high-loss cases; that void can only be filled through the common law, which requires that we reach the substantive reasonableness of these sentences.

Ordinarily, we review a sentence to determine whether there was a procedural error in a district court's sentencing before we consider "the substantive reasonableness of the sentence imposed under an abuse-of-discretion standard, taking into account the totality of the circumstances." *United States v. Rigas*. That approach is wholly appropriate in the vast majority of sentencing appeals. Nothing, however, "prevents us from reaching both the procedural and substantive reasonableness of the sentence in the course of an appeal where we find both types of error." *United States v. Dorvee*. Indeed, addressing both procedural and substantive reasonableness in the same appeal can serve the interest of judicial economy. It is also the only means of addressing systemic problems with the Sentencing Guidelines. In short, "because procedural error and substantive error are permeable concepts . . . postponing the consideration of substantive reasonableness [can be] a mistake and a missed opportunity." *United States v. Stewart*.

Substantive review of sentences provides "a backstop for those few cases that, [even if] procedurally correct, would nonetheless damage the administration of justice because the sentence imposed was shockingly high, shockingly low, or otherwise unsupportable as a matter of law." *Rigas* (citation and footnote omitted). Not surprisingly, we have only rarely held that a sentence is substantively unreasonable. *E.g.*, *Dorvee* (vacating "a within-Guidelines sentence"; "the amount by which a sentence deviates from the applicable Guidelines range is not the measure of how 'reasonable' a sentence is. Reasonableness is determined instead by the district court's individualized application of the statutory sentencing factors" (citing *Gall v. United States*). In sum, we will set aside a district court's substantive determination of the appropriate sentence only "in

exceptional cases where the trial court's decision cannot be located within the range of permissible decisions." *United States v. Cavera*. This is such a case.

The twenty-year sentences imposed on appellants are not merely harsh, they are dramatically more severe than can be justified by the crime the appellants committed. This was a clumsy, almost comical, conspiracy to defraud a non-existent investor of three billion dollars. That scheme never came close to fruition. During his first meeting with Thomas Re, Emerson Corsey described Magnolia International Bank and Trust as the central bank for scores of Native American governments, including the Yamasee Indian tribe, which a Wikipedia search would have revealed as a tribal confederation that was broken up and defeated early in the 18th century. It took only a brief Google search for Re and his associates to understand that the proposal "smelled"—which is why the appellants were recorded by Re for months before their arrest. At one point, Corsey provided Re with a certificate signed by John Juncal that listed CUSIP numbers for the T-notes; when Re shared the certificate with his colleagues, they responded by bursting into laughter. Even the terms of the proposed deal itself were laughable: the lender of three billion dollars would, according to the appellants, receive fourteen billion dollars in profit over five years. This scheme amounted to a series of absurd lies piled on top of even more absurd lies. Appellants' conduct was not dangerous because they had absolutely no hope of success.

A single factor—loss, specifically intended loss—drove the Guidelines calculation, and a single section 3553(a) factor—deterrence—provided the basis for accepting the Guidelines recommended sentence. A district court may not presume that a sentence within the Guidelines range is reasonable. *Cavera*. Although the District Court used the intended loss amount correctly for purposes of calculating the Sentencing Guidelines range, the Court erred by failing to dramatically discount that calculation when weighing the section 3553(a) factors against the totality of the circumstances of this case. This conspiracy to defraud involved no actual loss, no probable loss, and no victim. The scheme was treated as sophisticated, but could be more accurately described as a comedic plot outline for a "Three Stooges" episode. Because the plan was farcical, the use of intended loss as a proxy for seriousness of the crime was wholly arbitrary: the seriousness of this conduct did not turn on the amount of intended loss any more than would the seriousness of a scheme to sell the Brooklyn Bridge turn on whether the sale price was set at three thousand dollars, three million dollars, or three billion dollars. By relying unquestioningly on the amount of the intended loss, the District Court treated this pathetic crime as a multi-billion dollar fraud—that is, one of the most serious frauds in the history of the federal courts. See *United States v. Parris* (collecting sentences for major securities fraud convictions). . . .

The fraud guideline was initially set forth in Guideline section 2F1.1. The Sentencing Commission set the original 1987 Guidelines for economic offenses higher than historical sentences in order to further the deterrence and just punishment goals of sentencing. In 1989, in response to the savings and loan crisis, Congress passed legislation increasing the maximum penalties for financial fraud offenses and directing

the Sentencing Commission to include specific offense characteristic enhancements in the fraud guideline. See Robert S. Bennett, et al., *Taking it to the Banks: The Use of the Criminal Process to Regulate Financial Institutions*, 109 Banking L.J. (1992). In 2001, the Sentencing Commission amended the Guidelines to combine the fraud, theft and embezzlement, and property destruction guidelines into a single guideline, section 2B1.1. That change was accompanied by the publication of a new loss table that had the effect of increasing offense level calculations, especially for high-dollar-value crimes. See U.S. Sentencing Comm'n, Report to the Congress: Increased Penalties Under the Sarbanes–Oxley Act of 2002 (2003). Most recently, the fraud guideline was amended in 2003 in response to Congressional directives in the Sarbanes–Oxley Act. Those amendments included further changes to the loss table that added offense level points in the highest loss cases. U.S.S.G. app. C amend. 647 (Nov. 1, 2003). The three sets of amendments to the loss table of the fraud guideline alone have effectively multiplied several times the recommended sentence applicable in 1987 for large-loss frauds, which itself was set higher than historic sentences. Each of the three increases in the recommended Guideline ranges for fraud crimes was directed by Congress, without the benefit of empirical study of actual fraud sentences by the Sentencing Commission.

The history of bracket inflation directed by Congress renders the loss guideline fundamentally flawed, especially as loss amounts climb. The higher the loss amount, the more distorted is the guideline's advice to sentencing judges. As a well-known sentencing commentator has put it, "For the small class of defendants . . . convicted of fraud offenses associated with very large guidelines loss calculations, the guidelines now are divorced both from the objectives of Section 3553(a) and, frankly, from common sense. Accordingly, the guidelines calculations in such cases are of diminished value to sentencing judges." Frank O. Bowman, III, *Sentencing High-Loss Corporate Insider Frauds After Booker*, 20 Fed. Sent'g Rep. (2008).

When the Guidelines range zooms off the sentencing table, sentencing judges are discouraged from undertaking close examination of the circumstances of the offense and the background and characteristics of the offender. That certainly happened here. But the low marginal utility of the guideline in this very high intended loss case should have prompted greater, not lesser, reliance on the section 3553(a) factors other than the Guidelines. As one District Court applying the loss guideline put it, "Where the Sentencing Guidelines provide reasonable guidance, they are of considerable help to any judge in fashioning a sentence that is fair, just, and reasonable. But where, as here, the calculations under the guidelines have so run amok that they are patently absurd on their face, a Court is forced to place greater reliance on the more general considerations set forth in section 3553(a), as carefully applied to the particular circumstances of the case and of the human being who will bear the consequences." *United States v. Adelson*.

In this case, it is impossible to describe the sentences imposed on appellants as substantively reasonable. In my view, none of the section 3553(a) factors, singly or in combination, can justify these shockingly high punishments, which are far greater than necessary to punish or deter appellants' conduct. The District Court provided "no reason

why the maximum sentence of incarceration was required to deter [the appellants] and offenders with similar history and characteristics.” *Dorvee*. The bare assertion of the need to deter, unconnected to the background and characteristics of a defendant or the nature and circumstances of a crime, provides only superficial support for a sentence of imprisonment. Here, the factor of deterrence simply cannot “bear the weight assigned it under the totality of circumstances in the case.” *Cavera*. None of the appellants had ever served a significant term of imprisonment and two of the three had spent no time in prison whatsoever. This raised the question whether a statutory maximum sentence is necessary to deter future wrongdoing. See *United States v. Mishoe* (counseling district courts to consider previous terms of incarcerations and calibrating new sentences to reflect prior time behind bars). That is especially true here because appellants are older than most defendants and, accordingly, can be expected to have a lower risk of recidivism than most. See U.S. Sentencing Commission, *Measuring Recidivism: The Criminal History Computation of the Federal Sentencing Guidelines* 16 (2004). Indeed, one of the appellants will surely die in prison, if required to serve a sentence anywhere close to twenty years; although an effective life sentence, by definition, provides complete deterrence, imposing such a sentence for the conduct underlying this conviction would be senseless.

The absence of any actual loss whatsoever and especially the absence of a victim significantly undercut any argument that this crime was particularly serious. Outside the context of Sentencing Guidelines calculations, intended loss is always less serious than actual loss, so its value as a proxy for seriousness of a crime must be carefully examined. And not all actual loss is equally serious. A fraud that results in the loss of even a few thousand dollars by an elderly or sick person who, as a result of the loss, becomes unable to afford the necessities of life or medical care is much more serious than a fraud that results in ten or a hundred times that loss by a large corporation able to absorb the financial consequences without a need to close plants, fire employees, or even declare the loss as material in public financial reports. Simply put, contrary to the assumption underlying the loss guideline, not all dollars of loss are fungible.

Moreover, the convictions in this case were for conspiracy, which proscribes an agreement to commit fraud and punishes that agreement the same whether or not a fraud was actually committed. “[W]e punish unconsummated efforts to cause harm as ‘attempts’ or ‘conspiracies’ (albeit usually less severely than completed crimes) so long as the would-be-perpetrator has come close enough to success that we can be confident his malignant designs were real and not mere fantasy, and thus that his conduct was morally blameworthy.” Frank O. Bowman, III, *Coping with ‘Loss’: A Re-examination of Sentencing Federal Economic Crimes Under the Guidelines*, 51 Vand. L.Rev. (1998). The circumstances of these convictions put them very close to the boundary of mere fantasy (or perhaps the boundary of mental competence) and the sentences should have reflected that fact. As with most attempt crimes and unconsummated conspiracies, the actual loss here was zero. The wrongfulness of the appellants’ conduct does not turn in any meaningful sense on the amount that the conspirators *sought* to obtain; all other things equal, an effort to secure \$3 billion for construction of an imaginary pipeline is

not 100 times as serious as an effort to secure \$30 million for construction of an imaginary factory. Accordingly, factors other than intended loss become critical in distinguishing the seriousness of unconsummated criminal conduct. . . .

Problem 18-4

The following documents are abridged versions of the government and defense sentencing memoranda filed in connection with the sentencing of convicted Theranos founder Elizabeth Holmes. After considering these submissions, what sentence would you have imposed on Holmes and for what reasons?

GOVERNMENT SENTENCING MEMO, UNITED STATES v. ELIZABETH A. HOLMES, No. CR-18-00258-EJD (N.D. Cal. November 18, 2022)

Over the course of many years, Elizabeth Holmes defrauded dozens of investors of hundreds of millions of dollars. Time and again, she chose deceit over candor. She forged her own endorsements. She preyed on hopes of her investors that a young, dynamic entrepreneur had changed healthcare. She leveraged the credibility of her illustrious board. And, through her deceit, she attained spectacular fame, adoration, and billions of dollars of wealth.

When a journalist dared to ask questions about Theranos’ actual achievements, she tried to dupe him and then attacked him, along with his sources. After her fraud was revealed, she lied, obfuscated, and concealed. At trial, she blamed her COO (and longtime boyfriend), her board, her scientists, her business partners, her investors, her marketing firm, her attorneys, the media—everyone, that is, but herself.

She also put patients at risk. As money was drying up, she went to market with an unproven and unreliable medical device. When her lead assay developer quit as Theranos launched, she chillingly told the scientist: “she has a promise to deliver to the customer, she doesn’t have much of a choice but to go ahead with the launch.” As her lab director kept encountering issues with Theranos’ device and tests, she chose “PR and fundraising” over patient care. During her fraud scheme, women received wrong tests about their pregnancies, Theranos generated wrong results for cancer tests, and one victim was led to believe she had the virus that causes AIDS. Even after Theranos itself concluded that there was a possible patient impact for every single test run for patients on its “Edison” device and voided all Edison tests, Holmes minimized its primary regulator’s findings of immediate jeopardy and condition-level deficiencies as not “major.”

Holmes speaks eloquently about her desire to innovate and improve healthcare. She has demonstrated a strong work ethic, charisma, and ambition. But she is blinded by that ambition. Her reality distortion field put, and will continue to put, people in harm’s way. She stands before the Court remorseless. She accepts no responsibility. Quite the opposite, she insists she is the victim.

She is not. Holmes was the CEO and the Chairperson of Theranos. She repeatedly chose lies, hype, and the prospect of billions of dollars over patient safety and fair dealing with investors. Elizabeth Holmes' crimes were not failing, they were lying—lying in the most serious context, where everyone needed her to tell the truth.

The Sentencing Guidelines appropriately recognize that Holmes' crimes were extraordinarily serious, among the most substantial white collar offenses Silicon Valley or any other District has seen.

According to the Presentence Investigation Report ("PSR"), they yield a recommended custodial sentence beyond the statutory maximum. The factors set forth in 18 U.S.C. § 3553—notably the nature and circumstances of the offense, the need for the sentence to reflect the seriousness of the offense and promote respect for the law, and the need for both specific deterrence and general deterrence—demand a significant custodial sentence. With these factors in mind, the government respectfully recommends a sentence of 180 months in custody. The Court should also order Holmes to serve a three-year term of supervised release, pay full restitution to her investors (including Walgreens and Safeway), and pay the required special assessment for each count.

FACTS

I. THE OFFENSE CONDUCT

A. The Investor Fraud

Through numerous misrepresentations and half-truths, Holmes sold investors on the fact that Theranos had a customer-ready device—proven through its use and validation by several large pharmaceutical companies, the Department of Defense, and Walgreens—that analyzed tiny drops of blood taken from the finger to produce better, faster, cheaper, more accurate laboratory test results.

Specifically, Holmes secured dozens of investors in Theranos over several years by falsely claiming that Theranos had manufactured one single, proprietary blood analyzer device that could run any blood test that was run by conventional labs, all from a blood sample drawn via a fingerstick rather than the traditional draw from a vein, with higher accuracy and less variability than traditional methods, due in part to its more automated process that reduced human error inherent in running blood tests in a laboratory. To support her bold claims, Holmes repeatedly told potential investors that Theranos' technology had been comprehensively validated by multiple major pharmaceutical companies and was being used in the battlefield by the Department of Defense to treat wounded soldiers. Holmes also asserted that Theranos was a profitable company and had a healthy ongoing relationship with retail pharmacy company Walgreens, through which it provided blood tests to patients beginning in September 2013. Not only did several representatives of investors testify that Holmes made these

statements to them in meetings, Holmes also began providing written materials and binders to investors in 2014 and 2015 that contained these false statements.

In truth, scientists who had worked at Theranos testified that Theranos' proprietary device could never complete more than 12 types of blood tests, often with less accuracy, less automation, and more variability than traditional "predicate" machines manufactured by third-party companies, such as Siemens AG. Because of these shortcomings, pharmaceutical companies did very little work with Theranos and did not validate its technology, and the Department of Defense never used Theranos' analyzer to clinically treat soldiers. Theranos had zero revenue in 2012 and 2013 and desperately needed new sources of cash. Holmes hid the shortcomings of Theranos' proprietary device by using—without telling potential investors—modified and unmodified third-party machines to fulfill the remainder of Theranos' available blood test menu to patients at Walgreens stores. As a result, Theranos' relationship with Walgreens was faltering because the percentage of traditional venous draws was too high. But none of this information was shared with investors in Theranos.

As but a few examples of misrepresentations made by Holmes to Theranos investors:

- In April 2010, Holmes emailed executives of Walgreens reports with favorable conclusions about Theranos' technology that were emblazoned with logos of large pharmaceutical companies Pfizer, GlaxoSmithKline, and Schering Plough (now Merck) and Holmes described the attached reports as "three independent due diligence reports on Theranos systems" that were "from" those companies. However, at trial, Holmes admitted that she added the logos of the pharmaceutical companies to reports written by Theranos and enhanced the conclusions shortly before sending to Walgreens. And, while a Pfizer representative testified at trial that he told Holmes directly that Pfizer did not see a use for Theranos' technology in 2009, Holmes continued to send the doctored Pfizer report to investors throughout 2014 and 2015.

- In 2010, Holmes told Steve Burd, then-CEO of Safeway, that Theranos was cash flow neutral and projected revenue for 2011 of \$223 million when, in truth, Theranos' revenue was steadily declining from approximately \$2.8 million in 2009 to less than \$600,000 in 2011. Despite Theranos earning *zero* revenue in 2012 and 2013, Holmes and COO Ramesh Balwani provided investors with projections that Theranos would earn \$140 million in revenue for 2014 and nearly \$1 billion in 2015.

Indeed, Holmes told one investor in December 2013 that Theranos had historically earned over \$200 million from its work with the Department of Defense and pharmaceutical companies, when, in reality, Theranos had never earned more than \$10 million from both sources combined.

- In August and September 2013, internal Theranos scientists, including long-time employee Surekha Gangakhedkar and then-laboratory director Dr. Adam

Rosendorff warned Holmes that Theranos' proprietary device was not able to reliably test patient samples. They both testified that Holmes pressured and rushed the scientists to quickly validate assays for clinical use in advance of the launch with Walgreens. Ms. Gangakhedkar and other scientists ultimately resigned shortly before the Walgreens launch because of concerns with reliability of running patient tests on Theranos' proprietary device, but when Ms. Gangakhedkar informed Holmes of her concerns, Holmes responded that she had made a promise to deliver to the customer (Walgreens) that she must fulfill. Despite these internal concerns being voiced repeatedly to Holmes, Holmes reviewed and approved an article in *The Wall Street Journal* claiming Theranos' device could run 1,000 laboratory tests with more accuracy than conventional methods. Holmes shared the article with investors.

- In 2013 and 2014, Holmes repeatedly told investors that the Department of Defense was using Theranos' proprietary analyzer on medevac helicopters, in the battlefield, or to treat soldiers in Afghanistan or Iraq. In truth, the Department of Defense never used Theranos' device to clinically treat patients, nor did it ever move out of initial testing phases. One investor victim impact statement captures the depravity of Holmes' lies in this respect as follows: "I feel strongly that the sentencing should take into account Defendants' intentional decision to prey upon investors' reverence for our servicemen and servicewomen in the Armed Forces. Our country's freedom is protected everyday by the courageous and selfless service of these men and women, and the Defendants took advantage of investors' patriotic feelings for selfish gain through deceit. Indeed, Elizabeth Holmes lied to me about saving soldiers' lives through military contracts and Theranos' use of 'proprietary technology' on military helicopters. Simply put, Holmes's actions were loathsome and un-American."

- In August 2014, Balwani forwarded to Holmes an email from Walgreens executives expressing a desire to reduce venous draws to below 10% (whereas they had been hovering around 40% for most of the year) before expanding further. Nevertheless, Holmes presented financial projections to at least one investor in October 2014 that projected Theranos would increase from being in a few dozen Walgreens stores to being in 900 locations by 2015.

Holmes exploited investors' altruistic motives to dupe investors of all experience levels to invest in Theranos. Holmes fooled investors who were new to the healthcare investment sphere as well as investors with deep sophistication and experience in the healthcare and bio-tech sector, such as PFM, a regulated investment entity, led by managing partner and chief investment officer Brian Grossman, who had over twenty years of experience analyzing or investing in companies like Theranos. Mr. Grossman testified that he sent lengthy due diligence questions to Holmes and Balwani to ensure there was no ambiguity about the limitations of Theranos' proprietary technology, and yet he was shocked to learn more than eighteen months after his investment that Theranos used third-party commercial machines and not exclusively Theranos' proprietary device as Holmes had previously led him to believe. Former Secretary of State George Shultz invested in Theranos on behalf of his family members

and, as his son and daughter-in-law described in their victim impact statement, “[Holmes] succeeded by using my father (and others) and played him for the fool.”

Holmes often seized upon investors’ desire to make the world a better place in order to lure them into believing her lies. For example, Lisa Peterson, a representative of investor RDV Corporation, was moved by Holmes’ pitch because she could envision the benefits Holmes promised Theranos could deliver on her husband’s health condition. Holmes and Balwani knew this and even sent text messages to each other such as “[t]hey also care about our mission to do good because they are a religious org” to which Holmes responds “Good[.]”

Holmes’ fraud was spectacularly successful. At the peak, she was “one of the richest and most celebrated woman leaders in our [country’s] history.” Victim Impact Statement of Alex and Janel Shultz. By the end of 2014, Holmes’ shares in Theranos were valued at more than \$4 billion. She took home hundreds of thousands of dollars in annual salary. She traveled in a Theranos-paid private jet. She and Balwani ruled Theranos from a \$15 million mansion in Atherton. She donned the cover of *Fortune*, *Forbes*, *Inc.*, *Glamour*, and *T: The New York Times Style Magazine*. She dined at the White House; she gave the commencement address at Pepperdine University; she joined the Board of Fellows of Harvard Medical School; and at the peak of the fraud was named by *Time* as one of the 100 Most Influential People in the World.

Between 2010, when she induced Walgreens and Safeway to invest based on false pharmaceutical company endorsements and fantastical revenue projections, and March 2015, Holmes raised hundreds of millions of dollars. As the PSR notes, \$730,840,309 came from “Series C-1” and “Series C-2” investors who invested subsequent to Theranos’ public relations push in September 2013 during the conspiracy. . . .

B. The Impact on Patients

Throughout the relevant time period, Holmes touted Theranos as a company that would revolutionize blood testing, making health information more reliable and more accessible. Beginning in late 2013, Theranos actually offered clinical blood testing services to the public, first in the Bay Area, then in Arizona. To jumpstart the process of making its tests available to the public, and to reach as many patients as it could, Theranos partnered with retail pharmacy chain Walgreens—a company with a nationwide footprint that could make Theranos’ product accessible to most of the country’s population.

In so doing, Holmes and Balwani benefitted from goodwill and credibility associated with the Walgreens name. There can be no doubt that, as with investors, patients were more comfortable trusting Theranos because they assumed that an established business like Walgreens would not promote a service that was not similarly legitimate and reputable. Thus, Walgreens was not only Theranos’ launchpad but also

its de facto ambassador. Throughout the partnership with Walgreens, Defendants pushed for wider and faster expansion, with Walgreens holding back and expressing concerns over Theranos' inability to conduct much of its testing using its vaunted fingerstick method, among other things. Despite Walgreens' hesitations about expanding the Theranos partnership more rapidly, thousands of patients ended up receiving blood test services from Theranos between 2013 and 2015.

The evidence at trial revealed something Holmes and Balwani worked hard to hide from those patients: Theranos' proprietary testing was not reliable. Theranos' homegrown "TSPU" device—used for several important tests including HCG (to assess the presence and stage of a pregnancy), PSA (to check for potentially lethal prostate cancer), and TSH (a measure of thyroid health)—was plagued by issues. It broke down frequently and, when it did return results, it suffered from serious accuracy problems. Erika Cheung, a Theranos employee who operated the TSPU to generate patient test results, had the following to say about her faith in the technology: I was really stressed and uncomfortable with what was going on because I had at that point amassed a lot of evidence to suggest that the technology, the Edison device specifically, were not adequate to test on patients, and I did not feel comfortable running patient samples. Ms. Cheung went on to explain that she was concerned about patients, who "think that they're getting accurate results, and they're making very important medical decisions about what their treatments are, what their diagnoses are, what medications they take. . . ." Dr. Rosendorff agreed that the Edison device was flawed, explaining that he resigned from his job as Theranos lab director partly because he was being asked to vouch for tests that he did not have confidence in, and he felt that the testing platform "was not allowing [him] to function effectively as a lab director." Similar problems arose when Theranos used modified third-party devices to test finger-stick samples. *See* 10/6/21 Tr. (Dr. Rosendorff testifying that the Theranos modifications to third-party devices made them less accurate).

Erika Cheung and Dr. Rosendorff were not alone in their concerns about the reliability of Theranos technology. Surekha Gangakhedkar was a senior scientist who resigned from Theranos upon learning of the company's plan to use its Edison 3.0 and 3.5 devices to conduct clinical testing for patients. She explained that she knew of "reliability issues" with those devices that were not fully resolved, affecting their ability to return consistent results.

Given the dim view that Theranos' own scientists took of its technology, it is no surprise that a number of Theranos patients received results that were suspicious or demonstrably incorrect. For example, Dr. Mark Burnes testified at trial about a patient named Mehrl Ellsworth, who sought PSA (prostate specific antigen) testing from Theranos in advance of an international trip. Theranos reported Dr. Ellsworth's PSA levels to be extremely elevated compared to his previous results—a change that could have indicated prostate cancer if accurate. Dr. Ellsworth's next test from Theranos, however, showed normal PSA levels. The third test from Theranos was once again dramatically elevated, but subsequent testing returned normal results. It turned out that

the two unexpectedly elevated PSA results from Theranos had something in common: they were both run on a Theranos proprietary system, whereas the normal results had been generated by traditional, FDA-approved methods. Dr. Burnes was able to conclude that the elevated PSA levels indicated by the Theranos-specific tests were not valid. Theranos' repeated failure to return an accurate PSA test result after multiple attempts using its proprietary equipment speaks volumes about the reliability of Theranos technology.

Theranos patients also experienced problems with the company's PT/INR test, which relates to blood clotting. Patient "AT" suffered from atrial fibrillation (AFib) and her doctor instructed her to obtain a PT/INR test from Theranos. Although her PT/INR level was normally between two and three, Theranos returned an unusually low level of 0.08. "AT's" doctor did not believe the Theranos results could be accurate, and sent her to a traditional lab for confirmatory testing, which yielded a result of 2.8—in her typical range for that assay. "AT" told government investigators that, had she adjusted her medication in response to the erroneously low Theranos PT/INR value, she would have been at risk for internal bleeding, a common complication of AFib. Theranos' own employees were not immune from questionable results. "EG" was a Theranos phlebotomist who had been on blood-thinning medication for years due to a history of blood clots. When she went to Theranos for a PT/INR test, her results came back markedly different from her usual levels, and her doctor adjusted her medication in response. Due to skepticism over the validity of the Theranos results, "EG" had confirmatory testing performed at a traditional lab and received results matching her usual values, showing that the adjustment to her medication had been unnecessary.

Several Theranos patients received erroneous HCG tests providing inaccurate information about the status of their pregnancies. Brittany Gould and her treating nurse practitioner, Dr. Audra Zachman, testified at trial about multiple dubious HCG results provided by Theranos in October 2014. Ms. Gould, who had suffered multiple miscarriages in the past, obtained a series of HCG values from Theranos and traditional lab Quest Diagnostics over the course of a week. The Theranos results—which included a dramatic drop in HCG value—strongly indicated that Ms. Gould was having another miscarriage, but confirmatory testing by Quest indicated a viable pregnancy, and Ms. Gould went on to deliver a healthy baby. Dr. Zachman testified that she doubted the accuracy of both Theranos test results received by Ms. Gould, and stated that she had never had accuracy issues with HCG tests from other labs the way she did with the results for Ms. Gould. Unfortunately, Ms. Gould's experience with Theranos' HCG test was not unique. In May 2014, a physician had called Theranos about HCG results that turned out to be unexpectedly low and would have suggested a miscarriage if accurate, prompting the company to collect another sample and rerun the test. Five months later, a provider contacted Theranos to complain about Theranos HCG tests that had suggested that a pregnant patient was miscarrying. In response to that Theranos test value, the patient's doctor had her discontinue pregnancy medications and get ready for her next cycle. When the patient was tested again for HCG, however, her value was over 2000 and a subsequent scan detected a fetal heartbeat. When Holmes learned about this

erroneous test result, she asked Balwani, “How did that happen?”—a strange question from someone who had been aware of problems with Theranos’ HCG test for months.

It is impossible to know exactly how many times frightening scenarios like these played out in the lives of patients who trusted their blood testing to Theranos. The government’s investigation of Theranos did not reveal a centralized, comprehensive log of customer complaints. Instead, that information was apparently stored in multiple places and compiled as needed. Equally alarming is the high likelihood that numerous patients relied on inaccurate blood test results from Theranos without ever realizing that they were unreliable. It is likely that some portion of Theranos patients experienced harm to their health as a result of invalid Theranos test results without ever realizing the cause.

The evidence available paints a bleak picture of Theranos’ ability to return valid results using its TSPU analyzer. Internal quality control checks at Theranos provided a valuable objective measure of how accurate the analyzer was. Analyzing standardized samples, with known concentrations of the substance being tested, the Theranos machines would either pass or fail daily checks of individual assays. In March of 2014, records indicate that nearly 26% of quality control checks on the TSPU resulted in failures, i.e., inaccurate results. Some of the individual assays performed even worse. Theranos’ PSA test failed quality control nearly 30% of the time, and the company’s test for triiodothyronine failed more than 50% of the time. Because there is no guaranteed way to identify inaccurate patient test results, Theranos’ poor QC numbers are the best available method to estimate how frequently Theranos was sending incorrect values to patients.

When Centers for Medicare and Medicaid Services (CMS) inspected Theranos in the late summer and fall of 2015, the agency found systemic issues with quality control for the Theranos miniature analyzer or TSPU. In particular, CMS put Theranos on notice of “multiple and recurrent time periods (across all analytes tested) of abrupt shifts in [quality control] means, high rates of 1-2s QC rule failures, and QC CVs far exceeding limits for a stable testing process.” In other words, Theranos’ own quality control data revealed severe reliability problems with its testing systems, just as employees had warned Defendants years earlier. Faced with CMS’s findings, Theranos itself admitted that there had been “a global and long-term failure of the quality control program for this instrument,” and further concluded that “there is a possible patient impact for every test reported from the laboratory’s TPS 3.5 instruments.” Based on the scale of the problems highlighted by CMS, Theranos voided every patient test result ever run on its Edison device in the clinical lab. Of course, this step did nothing to mitigate the harm patients would already have suffered due to their reliance on inaccurate medical test information.

C. The Cover Up

In April 2015, Holmes learned that a *Wall Street Journal* reporter was working on a negative story about Theranos. She and Balwani scrambled to have the Phoenix

store prepared to perform only fingerstick tests rather than vein draws—hoping to avoid the possible impression Theranos was doing ordinary blood testing. (SB: “We need tomorrow to test and then the team can push production tomorrow night [redacted] So Wednesday it will trigger fs for gc18 [general chemistry] [s]o if he comes it may be 3 fs.”). Ultimately, Balwani told Holmes “[t]he team is not confident about pushing out fingerstick tonite we don’t want to rush this. We went thru hell.” Unable to dupe the reporter, they then hired David Boies to try to get him to drop the story. When that failed, Holmes personally appealed to the owner of *The Wall Street Journal*, who also was a significant investor in Theranos, to quash the story.

Holmes also attacked those she believed to be the reporter’s sources. See Victim Impact Statement of Alex & Janel Shultz at 1 (“[S]he sure did her best to intimidate and silence the truth tellers.”). In June 2015, she had a man sit all day outside of Erika Cheung’s new workplace to serve a letter from Boies Schiller Flexner LLP threatening her with legal action. (SB: “I am ok sending letter to Erika as in [General Counsel] heather [King’s] email”). After the reporter published a negative story, Holmes tried to dismiss Cheung as a low-level disgruntled employee. She also had Boies Schiller lawyers surprise Tyler Shultz at his grandfather George Shultz’s house to have him sign an affidavit identifying himself as a source for the reporter. Leach Decl.; (EAH: “If Tyler thinking abt George fyi at right time”); (SB: “You not calling George back also sends a message that we are about to suit”). The incident enraged George Shultz, which he described as “one of the worst little things he had seen anybody try to do.” Leach Decl.; (“George wants to know what Tyler has done. Would you ask David if I should say or tell him we’ll let him know la[t]er and txt me back”). During this time period, Holmes and Balwani also discussed “nail[ing] this mother fucker” “in CLIA” who they believed to be spreading negative information, and at various times contemplated action against “Tyler [Shultz],” “Erika [Cheug],” “Adam [Rosendorff],” and “Rochelle [Gibbons],” the wife of a Theranos scientist who committed suicide in 2013.

When the negative *Wall Street Journal* story broke, Holmes lied and dissembled. On October 15, 2015, when confronted on Jim Cramer’s *Mad Money* with the *Journal*’s claim that Edison could only do 15 out of 240 tests, Holmes falsely stated “every test that we offer in our laboratory can run on our proprietary devices.” At the time, Theranos was not using Edison (or any future iteration of its device) for *any* tests, and had never used Edison for more than 12. On October 21, 2015, she falsely stated at a public conference that Theranos “never used commercially available lab equipment for fingerstick based tests.” The comment so concerned Balwani that he texted: “Worried about your ‘all fingersticks on our technology’ comment.”

Months later, Holmes “continued to withhold information from [RDV] and other investors, which . . . made it impossible to make informed decisions about the status and value of our investment.” She insisted the issues CMS identified were not major and downplayed their significance.

Holmes’ coverup had lasting and devastating effects. According to one victim impact statement, Holmes “intentionally lied to [George Shultz] about Tyler to discredit him to prevent [George Shultz] from learning the truth,” creating a “permanent rift” within the family. *See* Victim Impact Statement of Alex & Janel Shultz (describing how Holmes “[took] a wrecking ball to [Shultz’s] family” and stating “[t]he most heart breaking of all is to hear your son describe that he contemplated suicide because he felt abandoned, isolated, threatened and hopeless, for doing the right thing.”). . . .

THE SENTENCING GUIDELINES CALCULATION

The PSR calculates the total offense level as follows:

a. Base Offense Level, U.S.S.G. § 2B1.1(a)(1)	7
b. Specific offense characteristics, U.S.S.G. § 2B1.1(b)	
Loss more than \$550,000,000, U.S.S.G. § 2B1.1(1)(P)	+30
Offense involving 10 or more victims, U.S.S.G. § 2B1(b)(2)(A)	+2
Offense involving the conscious or reckless risk of death or serious bodily injury, U.S.S.G. § 2B1.1(b)(16)	+2
c. Adjustment for Role in the Offense, U.S.S.G. § 3B1.1(c)	+4
d. Total Offense Level	43

Holmes falls within Criminal History Category I. Thus, for Offense Level 43, the Guidelines recommend a sentence beyond the statutory maximum of 80 years. The PSR recommends that the Court vary from Guidelines and impose a sentence of 108 months. . . .

For the reasons set forth above, the 30-point enhancement for a loss of more than \$550 million is warranted. In no event is the loss less than \$150 million.

II. OFFENSE INVOLVING 10 OR MORE VICTIMS

The PSR applies a two-point enhancement for the number of victims. This enhancement also is warranted. . . .

The PSR correctly finds that this enhancement applies. More than 10 individuals and entities invested in Theranos in the C-1 and C-2 rounds subsequent to September 2013, when Theranos issued a press release announcing its launch and induced *The Wall Street Journal* to falsely tout Theranos’ capabilities. Seven of those investors testified in the trials to the misrepresentations and half-truths they were told. An additional nine provided statements to the government or the SEC or submitted a victim impact statement. *See generally* Leach Decl. Representatives of Walgreens and Safeway also testified in the trial to how they were deceived into investing in Theranos. Under any

measure, more than 10 individuals or entities sustained a loss as a result of Holmes' conspiracy and wire fraud offenses.

III. OFFENSE INVOLVING CONSCIOUS OR RECKLESS RISK OF DEATH OR SERIOUS BODILY INJURY

A. Defendant's Conduct Created a Risk of Serious Harm to Theranos Patients

The Guidelines provide for a two-level increase in offense level if the conduct involved "the conscious or reckless risk of death or serious bodily injury." U.S.S.G. § 2B1.1(b)(16)(A). The evidence in this case establishes that this enhancement is warranted. Holmes could have founded any kind of business when she dropped out of Stanford. She chose to create a startup operating in the medical field, where the stakes are inevitably high. As described above, Holmes caused Theranos to market and perform blood tests that were not sufficiently accurate or reliable for clinical use. Despite knowing of the serious flaws in Theranos' testing, Holmes continued to promote and offer those tests to patients with the knowledge that those patients and their physicians would rely on the Theranos tests to make medical decisions. Her conduct created a significant risk of death or serious injury as a result of misdiagnosis; an inaccurate test result could cause a patient to undergo an unnecessary treatment that could harm them, or to forego a necessary treatment that could save them. As Dr. Rosendorff testified at trial, "Accuracy is critical. Physicians and other health care providers depend on the accuracy of a test to make medical decisions, sometimes life and death medical decisions." The obvious danger associated with inaccurate and unreliable medical tests is sufficient to warrant application of U.S.S.G. § 2B1.1(b)(16)(A), regardless of whether the government can show how much harm resulted. Courts recognize that this two-level enhancement "focuses on the defendant's disregard of risk, rather than on the result." *United States v. Henderson*. In other words, the government "need not show actual injury to any particular victim." Additionally, under Ninth Circuit law, a defendant cannot escape this enhancement by claiming ignorance of the risk created by his conduct. *United States v. Johansson* (interpreting similar provision in U.S.S.G. § 2F1.1, now consolidated with Section 2B1.1). "[A] defendant does not have to subjectively know that his conduct created the risk." Nor does the enhancement require that the defendant take some violent or direct action toward victims. Thus, in *Henderson*, it was enough that the government presented evidence that false entries in a computerized patient record system "could have delayed and influenced patient care." *Henderson*. In *United States v. Moran*, the enhancement was applied where defendants ran a healthcare facility and admitted elderly patients with dementia although the facility and staff were not equipped to meet those patients' needs. *United States v. Moran*. In *Popov*, the Ninth Circuit affirmed application of the standard where a doctor signed patient charts and Medicare reimbursement forms indicating he had supervised medical examinations when he had not. *United States v. Popov*. The risk to Theranos patients created by Holmes' conduct is at least as serious and certain as the dangers posed by the criminal conduct in the above cases.

Moreover, the evidence shows that Holmes was fully conscious of the risks caused by Theranos' unreliable tests—starting years before the company launched its testing service and continuing through the point when they finally discontinued it. As early as 2010, Holmes laughed off a dire warning she received from an outside consultant evaluating Theranos technology. Kevin Hunter was hired by Walgreens in May or June 2010 as a laboratory consultant to advise Walgreens on its incipient partnership with Theranos. Hunter participated in regular meetings with Holmes and Balwani, during which they told him that the Theranos Edison analyzer could perform approximately 193 tests. Hunter's team wanted to perform comparison testing of Theranos against a lab at Stanford, but Holmes and Balwani would not agree. Nor would Holmes allow Hunter to take a tour of the Theranos lab. As Hunter asked more pointed questions, Holmes and Balwani began to take him out of the loop in conversations with Walgreens. Eventually, Hunter's frustration with the lack of substantiation for Theranos' claims moved him to confront Holmes during a video teleconference. He admonished her that her company was going to offer lab tests that people would use to make medical decisions, and warned her of the risk that she could be responsible for killing someone if the lab put out bad tests, and that she might go to jail as a result Holmes reportedly responded with something to the effect of, "They don't put pretty people like me in jail." Hunter eventually separated from the Theranos-Walgreens project.

Holmes's lax attitude toward patient safety continued into 2013 and beyond. Leading up to the launch of Theranos' testing services, Theranos' lab director spoke to Holmes personally in order to "raise alarm bells" about assays that he "didn't feel were ready for launch." During that time period, Holmes and Balwani had set a schedule for assay validation that Dr. Rosendorff viewed as "rushed." In his communication to Holmes, Dr. Rosendorff suggested that Theranos might need to delay the launch and work on its calibrators or chemistry—essentially returning to the fundamentals to identify and solve "a basic problem" with the company's equipment. Dr. Rosendorff testified that Holmes did not seem surprised to hear of problems with Theranos' tests, but that the conversation seemed to make her very nervous. Ultimately, she refused to delay the launch as he recommended, suggesting instead that certain tests could be performed on traditional equipment. While Theranos' clinical lab was in operation, Holmes received reports of serious problems with the company's tests. In April 2014, Balwani received an email from a senior scientist at Theranos reporting that the company's proprietary potassium results were running high as a result of sample hemolysis, forcing the lab to review images of all samples to determine whether to rerun—a practice Balwani told Holmes was "not scalable." Earlier in that email chain, Balwani had questioned the accuracy of the test "given this is an ISE," indicating awareness of preexisting accuracy problems with Theranos' ion-selective-electrode blood tests. Also in April, employee Tyler Shultz sent Holmes a detailed email to alert her to several ways in which Theranos was overstating the accuracy of its tests and potentially masking problems. The points raised by Mr. Shultz gained no traction with Holmes. In late May 2014, Dr. Rosendorff halted all testing of HCG (a pregnancy hormone) on Theranos analyzer in light of inaccurate results, and Balwani immediately

passed along that news to Holmes. Dr. Rosendorff testified that the company resumed HCG testing on the Edison despite the fact that issues with that test persisted.

In August of that year, Dr. Rosendorff emailed Balwani to inform him that Theranos' bicarbonate test had lost all diagnostic value "and probably also reliability" due to the fact that the company voided all abnormal results in response to accuracy problems with this test. Balwani forwarded that notice to Holmes. Around that same time, another email exchange memorialized Balwani asking another Theranos scientist about the company's PT/INR test reporting inaccurately low numbers. When the scientist provided a theoretical explanation and proposed an internal study to address the problem, Balwani emailed Holmes complaining, "Always another study after the fact." In September 2014, Defendant's brother Christian Holmes sent her an individual email seeking a "candid conversation" because it was "pretty obvious" the company was having issues with the accuracy of its calcium, potassium, and sodium tests. In that message, Christian went so far as to suggest Theranos stop offering those tests until the problem was identified and solved. By late November 2014, Defendants' collective faith in their lab still had not improved, with Balwani texting Holmes that the Normandy lab (where Theranos conducted its proprietary testing) was a "f-ing disaster zone." Despite ample notice of serious issues plaguing Theranos' technology, Holmes and Balwani stubbornly continued to send out clinical test results from their "disaster zone" of a laboratory, forcing Theranos' patients to unknowingly incur a risk of death or injury. Ultimately, they had to void every single Edison test following extremely negative CMS findings and their own assessment of possible patient impact. . . .

IV. ROLE IN THE OFFENSE

Holmes should also receive an additional enhancement due to her role as a manager and leader of the extensive criminal activity that occurred in connection with the company she founded. Under the Guidelines, a four-level increase is warranted if a defendant was an "organizer or leader" of criminal activity that either (1) involved five or more participants or (2) was otherwise extensive. U.S.S.G. § 3B1.1(a). The commentary for that section of the Guidelines defines "participant" as "a person who is criminally responsible for the commission of the offense," although that person "need not have been convicted." In this case, the Court need not determine whether the offense involved five or more participants. Section 3B1.1(a) applies because, regardless of the number of culpable participants, the criminal activity here was "otherwise extensive." The Guidelines commentary advises that, in determining whether criminal activity was extensive under this provision, a court should consider "all persons involved during the course of the entire offense." Even if a fraud involves fewer than five participants, it still can qualify as extensive under section 3B1.1(a) if it "used the unknowing services of many outsiders." That language perfectly describes the way Holmes and Balwani used the many employees of Theranos—along with Walgreens personnel, marketing experts, journalists, and others—to carry out their scheme to defraud investors. . . .

[The] government respectfully recommends a sentence of 180 months in custody.

The factors the Court should consider in determining the appropriate sentence include (i) the nature and circumstances of the offense and the history and characteristics of the defendant, (ii) the need for the sentence imposed to reflect the seriousness of the offense, to provide just punishment for the offense, to afford adequate deterrence to criminal conduct, to protect the public from further crimes of the defendant, and to provide the defendant with needed correctional treatment, (iii) the Sentencing Guidelines and related Sentencing Commission policy statements, (iv) the need to avoid unwarranted sentence disparities among similarly-situated defendants, and (v) the need to provide restitution to the victim of the crime. 18 U.S.C. § 3553(a).

As described above, Holmes' Total Offense Level (43) and Criminal History Category (I) yield a sentence within Zone D. Zone D sentences shall be satisfied with a custodial sentence. § 5C1.1(f). The applicable sentencing custodial range is capped at 960 months' imprisonment. This range assumes a sentence of 240 months' imprisonment (the statutory maximum) would be imposed for each of the four counts of conviction, run consecutively. Considering the extensiveness of Holmes' fraud, the sentencing factors support a sentence of 180 months' imprisonment, as it would reflect the seriousness of the offenses, promote respect for the law, provide for just punishment for the offenses, and deter Holmes and others. . . .

The nature and circumstances of Holmes' crimes are aggravating factors for several reasons. First, Holmes' crimes were not isolated events. They were not the result of poor choices on a single day. They were not limited to her interactions with one investor or a single patient. Instead, Holmes developed a complex scheme, and executed it over the course of many years. Holmes presented a fake story about Theranos' technology day after day in meeting after meeting. Holmes maintained this façade of accomplishments, after making the calculated decision that honesty would destroy her company. She ignored innumerable opportunities to choose a lawful path.

Second, each investment in Theranos came with opportunity cost. Money invested with Holmes' company was money not invested in legitimate, promising technology. Holmes' scheme not only diverted valuable funding to her fraudulent purposes, but it also has the effect of discouraging investments generally in new technologies, as investors reasonably remain skeptical that the next investment pitch is too good to be true. In short, Holmes' criminal activities were serious, extended, and extremely damaging. The nature and circumstances of Holmes' criminal activity are significant aggravating factors in determining an appropriate sentence.

In addition to the nature of the offenses, Holmes' history and characteristics militate in favor of a significant custodial sentence. Some defendants have difficult childhoods filled with obstacles that must be overcome. Holmes did not. Some defendants have few formal educational opportunities, and instead are left to receive their

educations informally, where they can find them. Holmes had many educational opportunities. Some defendants have no support networks, and instead must fend for themselves. Holmes had and continues to have a substantial one. While some defendants certainly deserve consideration from a sentencing court for the obstacles they have overcome and the regrettable criminal motivations they adopt, Holmes does not. Holmes, with strong family support, exceptional educational opportunities, and financial stability, chose to commit fraud, repeatedly. Holmes' history and characteristics are aggravating factors that should lead this Court to impose a significant custodial sentence. Similarly, the presence of these aggravating factors should discourage the Court from varying substantially from the applicable Guidelines range.

This Court should send a clear message to the community that white collar crime is serious and deserving of significant punishment. Through this sentencing proceeding, the public will observe the law, through this Court, treat fraudsters fairly for significant crimes. Statements from victims in this prosecution provide additional support for the argument that a significant custodial sentence is needed to promote respect for the law. In his statement, investor Craig Hall wrote, "I urge you, first and foremost, to consider the broader and more significant impact this sentencing will have on our society moving forward. Given the high-profile nature of this case, the sentencing will undoubtedly send a message to the community at large. That messaging should, in my opinion, clearly and unequivocally communicate that there is no justification for or tolerance of fraud in the business world. Deterring similar debacles is critical to avoid society's future loss of hundreds of millions of dollars, amounts which could otherwise be used to aid in the entrepreneurial efforts of hard-working, honest Americans, bolstering the economy and fostering the American Dream." Craig Hall Letter, dated Sept. 6, 2022. In Brent Bingham's victim impact statement, he wrote, "I feel sentencing should reflect a standard that medical related technology shouldn't be Beta tested by patients without consent. Medical technology companies should receive a very clear message that placing finance and 1st to market considerations above engineering and science is not acceptable." In Elizabeth R. Daoust's victim impact statement, she wrote, "Penalties for white collar crime seem too often to be slap[]s on the wrist. People/companies perpetuating financial fraud often get light, if any, sentences in a minimum security prison and keep most of the stolen money. This system of 'justice' has alienated a large swath of our citizens, weakened values, and turned more people against our government. It is a serious problem that both the courts and legislatures need to remedy." These, and many other, victim impact statements demonstrate the need for this sentence to reflect the seriousness of the offenses and promote respect for the law. . . .

For these reasons, the government recommends the Court sentence the defendant to 180 months in custody and order her to pay \$803,840,309 in restitution and a \$400 special assessment.

ELIZABETH HOLMES SENTENCING MEMO, UNITED STATES v. ELIZABETH A. HOLMES, No. CR-18-00258-EJD (N.D. Cal. November 18, 2022)

I. PRELIMINARY STATEMENT

Elizabeth Holmes stands before the Court having been convicted of conspiracy to commit wire fraud and three individual counts of wire fraud with respect to certain sophisticated investors in her company, Theranos. In sentencing her, the Court’s task is a heavy one. Ms. Holmes was 19 when she founded her company, her first business experience; in 2010, the beginning of the charged period, she was 25 and turned 26; and when her company shut down in 2018 she was just 34 years old. She founded and built Theranos for indisputably good reasons. She worked tirelessly along with hundreds of brilliant and committed employees to improve access to affordable health information. The company achieved incredibly valuable inventions for which the United States government is still issuing patents as recently as July of *this year*. She suffered substantial trauma throughout the time period of the offense. When criticisms arose, she committed fully to identifying, acknowledging, and fixing errors. She never cashed out, and she went down with the ship when the company failed. And regardless of the sentence the Court imposes, for the rest of her life, she and her family will be punished. As her partner knows all too well, “[t]here is no avoiding the scorn that accompanies Elizabeth Holmes.”

Among the countless people in our society who do not know Elizabeth Holmes yet think they know about her case from the unusually intense media coverage of it, Ms. Holmes has become a caricature to be mocked and vilified. The Court has the opportunity (and obligation) here to look beyond that caricature, as it has throughout this case, and examine Ms. Holmes the human being. More than 130 individuals who actually know Ms. Holmes have written to the Court to help in that process. Among them are friends, family, Theranos investors, Theranos Board members, and former employees who served in a variety of roles at Theranos, all of whom submit these letters despite the risk that they will be criticized for their support. These are people who know Ms. Holmes and her character, remorse, and capacity to do good.

The real Elizabeth Holmes is “a compassionate friend who is there for the people around her—to support, comfort, cheer on, problem solve, and connect.”

The real Elizabeth Holmes is the friend who writes “letters that I still keep and read again anytime I need to be reminded of my purpose and inner strength.”

The real Elizabeth Holmes is a devoted mother who “turns . . . ordinary moments into magical experiences of unbounded love and wonder” for her son.

The real Elizabeth Holmes is “[e]xtremely genuine, giving, and selfless,” “unlike anyone else I’ve met in Silicon Valley.”

The real Elizabeth Holmes was an “approachable, attentive, and supportive” “employee focused CEO[.]”

The real Elizabeth Holmes faced the challenges at Theranos from 2016 to 2018 with “steadfast ethical principles, complete dedication to what was best for Theranos, and admirable courage.”

The real Elizabeth Holmes is “driven by a single and simple purpose; she wants to make the world a better place than it would have been without her.”

The real Elizabeth Holmes “has within her a sincere desire to help others, to be of meaningful service, and possesses the capacity to redeem herself.”

* * *

Section 3553(a) requires the Court to fashion a sentence “sufficient, but not greater than necessary,” to serve the purposes of sentencing. If a period of confinement is necessary, the defense suggests that a term of eighteen months or less, with a subsequent supervised release period that requires community service, will amply meet that charge. But the defense believes that home confinement with a requirement that Ms. Holmes continue her current service work is sufficient. We acknowledge that this may seem a tall order given the public perception of this case—especially when Ms. Holmes is viewed as the caricature, not the person; when the company is viewed as a house of cards, not as the ambitious, inventive, and indisputably valuable enterprise it was; and when the media vitriol for Ms. Holmes is taken into account. But the Court’s difficult task is to look beyond those surface-level views when it fashions its sentence. In doing so, we ask that the Court consider, as it must, the real person, the real company and the complex circumstances surrounding the offense conduct, and the important principle that “no defendant should be made a martyr to public passion.” *United States v. Gupta* . As discussed in more detail in the pages that follow, this is a unique case and this defendant is a singular human with much to give.

II. MS. HOLMES’ PERSONAL HISTORY AND CHARACTERISTICS

As the more than 130 letters submitted on her behalf attest, Ms. Holmes is a warm, thoughtful friend; a loving and dedicated mother and partner; a good listener; a mentor to young women and entrepreneurs; a boss who cared about the company’s employees; a chief executive dedicated to her company’s mission; an intelligent and inventive problem solver; and a humble, hardworking, and compassionate woman who deeply wants to give what she can to the world. Her positive impact on her friends, family, and former employees and advisors is evident in this outpouring of support. Despite her current circumstances, she is an “ardently resilient optimist”—a person whose “devotion to constructive impact remains natural, profound, and inspirational” even as she faces the prospect of a profound loss of liberty.

A. Ms. Holmes' Personal History

1. Childhood

Ms. Holmes began developing her good qualities through a childhood for which she has always been grateful. Born in Washington, D.C. in 1984, Ms. Holmes was raised primarily in Washington, D.C. and Houston, Texas with her brother Christian, two years her junior. Her parents were both public servants. Her mother, Noel, worked on Capitol Hill for Members of Congress and Committees in the House of Representatives. Her father, Chris, spent years working at the Environmental Protection Agency, the United States Agency for International Development (USAID), and the State Department, focused on issues related to disaster relief. Chris was Ms. Holmes' personal hero. He would return from his work abroad with stories about responding to disease, genocide, war, and natural disasters and imparted the view that the most important thing he could do with his life was to help others. From her father, Ms. Holmes learned the lessons of stoicism and sacrifice in service of the greater good, and she took them to heart early in her childhood as a foundational trait.

Ms. Holmes was a studious and hard-working child. She had, as her mother describes, a "gritty determination." She was naturally curious with "a deep hunger for knowledge," which she explored as a young child through talking about nature and the world with her parents. As a teenager, she poured that curiosity into schoolwork and extracurriculars, such as spending part of her Saturdays taking Chinese lessons from the time she was a pre-teen. Ms. Holmes' brother Christian describes her focus and work ethic as a teenager:

She was driven and goal-oriented and thrived in whatever she set her mind to, whether it was academics, personal challenges she set for herself, developing a new skill, etc. She had an extraordinary work ethic and has always excelled as a student. She never cut corners. . . . It was critical to her to apply herself fully to whatever she took on. She especially valued the relationships with people she felt she could learn from and be challenged by. Teachers and mentors were just as important as friends, and she actively sought out direction from people with experience who she could learn from. . . .

2. College

Ms. Holmes began attending college at Stanford University in the fall of 2002. Consistent with her longtime interest in science, Ms. Holmes focused on chemical engineering with an eye toward combining several engineering disciplines. She brought to those difficult classes her deep work ethic and sound moral compass. As her college friend Lauren Stat describes, Ms. Holmes insisted that there was no need to rely on study groups who had inherited the answers to problem sets, "those relics of dubious morality. And so with her leadership, we proceeded to learn the right way, the hard way." Ms.

Holmes started auditing graduate-level courses and working in the laboratory of Professor Channing Robertson, where she was part of a team developing microfluidic sensors.

Ms. Holmes also enjoyed the social aspects of college life, including the friends she made there. Her mother describes that in her regular calls “she was full of joy and enthusiasm about her life.” Her brother Christian recalls how she came out of her academic shell towards the end of high school and that in the first year at Stanford “she seemed happy and well-adjusted to college life.” Her friends describe her as a caring person who believed in the genuine goodness of people and loved to talk about ideas. She was “full of vibrancy, curiosity, kindness, and warmth,” “extremely intellectual yet unpretentious and always looking to better herself and those around her.” As friend Prerna Gupta describes:

We spent countless hours traversing the Stanford hills and discussing the meaning of life. She was raised as a Christian, and I as a Hindu, but we found common ground in our explorations of Buddhism. We shared a belief that we were meant to do good in the world. That the purpose of life was love. That we could achieve anything we set our mind and hearts to, as long as we didn’t give up. And that, most of all, we must dedicate our lives to having a positive impact on the world.

Ex. A; *see id.* (“While fraternity boys puked on carpets and tried to coerce us into endless games of beer pong, Elizabeth whispered in the corner about things like philosophy, psychology, consciousness, and the meaning of life.”). This period was one of the happiest of Ms. Holmes’ life.

The summer following her freshman year at Stanford, Ms. Holmes interned at the Genome Institute in Singapore. Putting together concepts from various types of research she had conducted, she came up with the idea that would form the basis for her first patent application. When she returned home from the summer abroad, she holed up in her room with her research and filed the provisional patent application with a mind to build something from the invention that would make early detection of disease easier.

Stanford’s autumn quarter began in September 2003. Ms. Holmes had moved into her sorority house at Kappa Alpha Theta, surrounded by friends. Less than two weeks into the quarter, Ms. Holmes attended a fraternity party with some of her sorority sisters. While intoxicated and initially unconscious, she was raped by a friend who was a member of one of the Stanford-affiliated fraternities.

Following the rape, Ms. Holmes experienced acute self-blame, isolation, and depression, and struggled with suicidal thoughts. Her demeanor “instantly changed.” She moved out of the sorority house to a smaller dorm across campus, where she lived alone. As a coping mechanism, Ms. Holmes devoted all of her energy and focus into starting a company based around her invention. Her brother observes that after the assault, she

“became more withdrawn, less social, and mono-focused on the next venture.” “After her rape, she was both broken and resolute, using her anger and hurt as an impetus to make the changes she so strongly believed in.” Rather than seeking to heal, she came to view the assault as a crucible that would help drive her work as she turned to the higher purpose of helping solve difficult health care challenges through the company she was forming.

After the winter quarter of 2004, Ms. Holmes chose to take a leave of absence from Stanford to focus on building the nascent company she was forming around her invention. That company, originally called RealTime Cures, became Theranos.

3. CEO of Theranos

When Ms. Holmes started the company that became Theranos, she was a teenager who had four quarters of college and some laboratory research experience under her belt but no business or management experience. She learned how to navigate that complex world without the benefit of completing college, studying for a Masters in Business Administration, or obtaining years of industry experience, like most CEOs. She relied instead on her personal determination, advisors, employees, and lessons learned from her own mistakes and successes. She served as CEO from the company’s founding until her June 2018 indictment. At the time she was indicted, two and a half years after significant public controversy about Theranos had arisen, Ms. Holmes was just 34 years old, still a relative newcomer to the business world.

Though she lacked business and management experience, Ms. Holmes brought to Theranos the qualities she had developed in her childhood—a deeply held interest in improving lives and doing good; an unmatched work ethic; a creative mind and willingness to learn; and kindness, compassion, and gratitude. Ms. Holmes recognized (at least some of) her limits and sought out advice from those who could provide the expertise that she lacked. Sunny Balwani was one of them, and became her most important advisor. But there were others as well. A consultant who worked with Ms. Holmes in 2004 observes that Ms. Holmes “was very good to acknowledge where she did have expertise but also to respect when she didn’t and to defer to those who did.” As time went on, Ms. Holmes hired experienced scientists and other personnel with appropriate experience. Over the company’s life, it had hundreds of employees: dozens of scientists and engineers with Ph.Ds, M.D.s, and Masters degrees; employees who had previously worked at medical device, pharmaceutical, and software companies; manufacturing personnel who worked on machining, injection molding, and assembly; experienced marketing personnel; and in-house lawyers who had worked at major law firms. Theranos also hired outside law firms, including Wilson Sonsini, Boies Schiller, and Hyman Phelps for corporate, intellectual property, and regulatory work; outside accounting firms; a leading laboratory consultant to help start and advise on Theranos’ clinical laboratory; and outside marketing firms. Ms. Holmes accepted recommendations for Board members whom she believed would provide an appropriate mix of business, public policy, legal, and medical expertise, and who also had experience making

sweeping changes to institutional structures that could help Theranos in its journey to fulfill its grand but challenging aspirations. Ms. Holmes was a visionary without a college degree who was learning how to be a CEO, but she surrounded herself with employees, directors, advisors, mentors, and consultants whom she believed had the right experience to make Theranos successful.

People who worked with her describe Ms. Holmes as an enthusiastic, inspiring, compassionate, and humble CEO. Ms. Holmes' "drive and ambition was infectious." During some of Theranos' most difficult periods, "[w]hile there were without question more difficult days than not, Elizabeth came to the office every single day with a highly engaging and positive energy that created the foundation of an environment that allowed us to focus on 'doing our very best work.'" Dr. Fabrizio Bonanni, a former Amgen executive who served on Theranos' Board of Directors from 2016 to 2018, was "struck" by Ms. Holmes' ability to listen: "She is really interested in hearing feedback, particularly when the feedback is critical of her, her actions, or her company. She listens intently and internalizes the message for further processing. She may ask clarifying questions but never interjects biases or defensiveness." Craig Josephson, who was a member of Theranos' executive team in the last year of the company, echoes these sentiments, describing Ms. Holmes as focused on making decisions with integrity, doing the right thing for the patient, and being responsive to suggested changes.

Former Theranos employees observe that Ms. Holmes genuinely cared about the people who worked for her company. Former Theranos Vice President of Hardware Manufacturing Tim Cooper notes: "Her display of genuine care for employees drove a tremendous sense of value and worth within many of us." "She also reached out, to her best ability, to thank the employees for their dedication to the company." Whether it was addressing an employee's health or personal loss or considering difficult staffing decisions at key points in the company's history, Ms. Holmes demonstrated "care and compassion" about individual employees. One former employee describes how, when Ms. Holmes heard about Holmes heard about [redacted] she "came to the Newark facility where I worked, sought me out, embraced me and said she would completely support me in every way possible."

When staffing reductions were necessary, "Elizabeth struggled with the implications of these decisions on the individual and was never comfortable with the negative consequences for those affected, regardless of the business rationalization or justification." This care did not go unnoticed. A former security supervisor for Theranos' Arizona operations recalls: "Elizabeth was there for every employee, especially when Theranos closed. Elizabeth made it a point to be there and show significant support during a sudden and arduous job search. Theranos provided every employee with a separation package, resume support services, and job placement before it closed its doors." Former Theranos Laboratory Director Donald Tschirhart summed it up: "Everyone at Theranos liked her; she was strong, she fought for us and she treated us well until the last moments."

Ms. Holmes did not build Theranos for nefarious reasons—indeed, the opposite is true. The company’s mission was to provide access to actionable health information to improve human health on an equitable basis. Ms. Holmes was fundamentally committed to this lofty purpose, and not to her own monetary gain. As former Board Member Bill Foege, former Director of the Centers for Disease Control and Prevention (CDC), puts it in his letter to the Court: “Ms. Holmes was not interested in money.” Former Vice President of Hardware Manufacturing Tim Cooper notes that through his many interactions with Ms. Holmes, “it is my view and strong belief that she has never been motivated by anything other than realizing this vision. She never brought financial considerations into our discussions and always placed a heavy emphasis and focus on ensuring that a positive experience and outcome for the individual (patient) was at the forefront of our work.”

Ms. Holmes did not personally profit from the investments of others into Theranos. Those investments were used to pay for research and development of groundbreaking inventions and the company’s operations—not to enrich Ms. Holmes or anyone else. Although Ms. Holmes was touted as a billionaire in the media, her purported “fortune” was entirely on paper based on the Theranos stock she owned. She never cashed in that ownership; in fact, she never sold a share of stock, despite the opportunity to do so at several points over the years. *See* Ex. A (“In the 2015 timeframe, Ms. Holmes was offered the opportunity to sell hundreds of millions of dollars in her stock holdings in Theranos. She turned down that opportunity because she felt that she should not profit until all of her investors had returned their investment profitably.”). She asked to be paid in Theranos shares rather than cash for her work as CEO, a request that the Theranos Board denied. *See also* Ex. A (describing how Ms. Holmes was “far from being the most compensated employee” at Theranos and the Board’s efforts to increase her compensation were met by “her strong resistance”). Near the end of the company’s life, “she volunteered even to give up her ownership of the company in hopes of saving it. . . . and voluntarily gave investors a “good portion of her own shares.” Nor did Ms. Holmes use corporate resources inappropriately for her own benefit. Dr. Foege, who was a member of the Board of Directors from 2014 through 2018, recalls: “The Board had an audit performed which found no evidence of fraud nor diversion of money.”

“She always put the interests of the company ahead of her own,” notes Daniel Warmenhoven, a technology industry executive who served on Theranos’ Board from 2016 to 2018. Dr. Fabrizio Bonanni, also a Board member from 2016 to 2018, observes: “In my almost fifty years in business, I have not seen or heard of a more selfless CEO.”

4. Relationship with Mr. Balwani

It is impossible to understand Ms. Holmes’ experience at Theranos, and particularly with respect to the offense conduct, without closely examining her relationship with Sunny Balwani. In the wake of her rape, around the time she was considering leaving Stanford, Ms. Holmes reconnected with Mr. Balwani. Ms. Holmes

first met Mr. Balwani just after she graduated from high school on the Stanford-sponsored trip to China. She was eighteen, and he was thirty-eight. She understood that he was a successful businessman who had built and sold his own company and had worked with Microsoft, and she viewed him as a potential advisor and mentor during that summer. As Ms. Holmes was thinking about leaving Stanford, she responded to outreach from Mr. Balwani. Mr. Balwani encouraged and supported her decision and offered his business advice. Ms. Holmes confided her trauma and depression to him. He told her she was safe now that she was with him. They began a romantic relationship.

The relationship between Ms. Holmes and Mr. Balwani was characterized by severe emotional, psychological, and sexual abuse perpetrated by Mr. Balwani.

Mr. Balwani expressed his desire to help Ms. Holmes develop as a person and a leader. As time went on, that expressed love and desire manifested as progressively controlling behavior. . . .

Mr. Balwani demanded that Ms. Holmes follow a series of prescriptions, including keeping a strict schedule with little sleep, limiting her food intake, refraining from alcohol, and maintaining a particular manner and personality style. Mr. Balwani prescribed tenets for Ms. Holmes to follow, which he wrote for her, and Ms. Holmes was required to write out her schedule regularly and confirm her commitment to his teachings,

Mr. Balwani also insisted, in the form of verbal and written berating, that Ms. Holmes was incompetent, fundamentally flawed as a person and a leader, and needed to change who she was—in his words, “kill” the current Elizabeth and become a new one—to become a worthy leader. The “advice” he provided was large and small—from live criticisms of her manner of speaking, (“You are speaking with everyone in your giddy voice”), (“U r rambling now. Let’s stay focused”), to lengthy diatribes that went to her core as a leader. Ms. Holmes’ assistant from 2014 through 2018 confirms: “[Mr. Balwani] would constantly go into her office, shut the door, and then kick out whoever was in her office. He would then scream at her. I could overhear the screaming.” Because Mr. Balwani insisted that she write down and repeat back to him what he was saying, Ms. Holmes captured some of these tirades in iPhone notes, such as one modified April 5, 2015. (“Toughen up. Become masculine be in battle [sic]. Masculine game. Business masculine game.”); (“I’m so sick and tired of his mediocrity you create. It’s astonishing. You’ll never hold anybody responsible for any actions. You’ll never do that. . . . Monkey’s [sic] can’t fly spaceships.”). Text messages also show Ms. Holmes seeking Mr. Balwani’s approval as she repeated back his lessons. (Ms. Holmes: “My new life as of this night and forever more: —total confidence in myself best business person of the year—focus—details excellent—don’t give what anyone thinks—engage employees in meetings by stories and making it about them (ie prepare well)” . . . Mr. Balwani: “Awesome. U r listening and paying attention.”).

Ms. Holmes believed Mr. Balwani’s criticisms of her and sought to do better. She likewise believed he was fundamentally important to the company: in her mind, as in his screeds, setbacks were due to her failures, but success was due to him—after all, according to him: “I have molded you.” Although the precise contours evolved over time, this pattern played out on a regular basis throughout the relationship, including when Mr. Balwani was at the company. Dynamics such as these are common in abusive relationships and especially effective at creating a culture of control. . . .

Over the first several years of their relationship, Ms. Holmes became increasingly isolated from friends and family. Friends describe losing contact with Ms. Holmes. Ex. A (“She also fell into an all-consuming relationship with Sunny, who seemed to pull her farther away from me. She became reserved and withdrawn, and strangely secretive. I was worried about the effect Sunny was having on her, and I urged her to take caution, but to no avail.”); *id.* (“Sunny was significantly older than we were, to an alarming degree, but Elizabeth was very taken in by him. He struck me at the time like a father figure, someone she trusted, who could guide and mentor her, who could validate her, as she shouldered this incredible undertaking she felt was necessary for the world. I lost contact with Elizabeth after that.”).

Ms. Holmes’ parents recall their own discomfort and concern with their daughter’s relationship with Mr. Balwani. They were aware that Mr. Balwani insisted on listening when they spoke with their daughter on the phone, and they witnessed Mr. Balwani criticize and yell at Ms. Holmes until she cried, along with other behavior that made them uncomfortable. Noel Holmes recalls a trip she took with Ms. Holmes:

In January 2007, we were finally able to go away to Big Sur for two days over the weekend with just our family. Although it was difficult to connect by phone there[,] Sunny kept calling and berating Elizabeth. He had her in tears and she insisted we needed to leave. When we started driving back and the connection was better, I could hear him yelling at her for not working. She became very nervous and kept asking if we could somehow drive faster to get home.

Ex. A. Ms. Holmes’ brother Christian similarly recalls how his relationship with Ms. Holmes changed after she began her relationship with Mr. Balwani:

In the years that followed, my relationship with my sister was reduced to a series of formalities around her work. She spent all her time with Sunny and rarely included our family. She stopped coming to family gatherings and became more remote. I lived within driving distance from Elizabeth for about 5 years during this time period and worked with her for a number of years, and can’t remember sharing a meal with just the two of us more than a handful of times, let alone many meaningful conversations.

Ex. A ; (“Elizabeth was not allowed to have lunch or dinner with anyone but Mr. Balwani because Mr. Balwani would not allow otherwise.”); Isolating behavior is a hallmark abuse tactic.

Mr. Balwani’s abuse involved severe sexual elements that caused Ms. Holmes particular distress, including thoughts of suicide. These events occurred in the home they shared. Contemporaneous records corroborate the aftermath: after a February 2015 incident, Ms. Holmes both expressed her personal despair in an iPhone note, and also apologized to Mr. Balwani for her inability to be strong for him. (Ms. Holmes: “I’m sorry I wasn’t stronger for you this morning. That is my responsibility and my role. I will never let that happen again.” . . . Ms. Holmes: “My job is to love you when you’re stressed.” Mr. Balwani: “I know.”). . . .

The severe abuse Ms. Holmes suffered at the hands of Mr. Balwani affected her deeply, including in her role as CEO of Theranos. As she testified, the abuse occurred throughout the relationship, including during the period when they both worked at Theranos and in the course of and with regard to that work. At Theranos, Mr. Balwani took primary responsibility for “operational” aspects of the company. That included preparing the company’s financial statements (including revenues and revenue projections), managing the retail partnership with Walgreens, overseeing operations of the clinical laboratory, as well as manufacturing operations and general personnel matters. Mr. Balwani was also responsible for following up with potential investors after an initial meeting, as he was the best positioned to answer questions about Theranos’ financial model and projections, as well as the operational issues that are often the topics of due diligence requests. Mr. Balwani not only ran Theranos’ operations but was also Ms. Holmes’ most important advisor, and he had outsized influence given the circumstances of their relationship. That is reflected in the government’s most recent assessment of the relationship:

Besides his position that we talked about, you can also infer that his close relationship with Ms. Holmes would have given him a lot of influence over her, more than just his title alone would provide. Remember also that Mr. Balwani was older and more experienced than Ms. Holmes. So it would be no surprise that his advise [sic], his input would carry a lot of weight with her. And that’s what showed up in the text messages.

Until late 2015 or early 2016, Ms. Holmes trusted Mr. Balwani completely. As Ms. Holmes explained, between 2010 and 2016, Mr. Balwani “had taught me everything that I thought I knew about business, and I thought he was the best business person that I knew. And I think that I didn’t question him in the way that I otherwise would have.” Ms. Holmes is still processing what effect the relationship had on her. As she testified, Mr. Balwani “impacted everything about who I was, and I don’t fully understand that.” The fact that the abusive dynamic affected their workplace relationship and the fact that

Ms. Holmes deferred to Mr. Balwani, especially in areas where he was formally responsible, is consistent with research on intimate partner abuse. . . .

Ms. Holmes was finally able to leave her relationship with Mr. Balwani once he left the company. When he was on a trip abroad, Ms. Holmes enlisted her brother to help her move out of their shared residence. Once Mr. Balwani understood what was happening, he began to text and call Ms. Holmes—he insisted she wait until he came home, told her she was making a mistake, and moved up his international travel to fly back to California from Asia as soon as possible. Since leaving the relationship, Ms. Holmes has been able to begin processing its effects and healing from it. Part of that has been supporting friends and family who have had similar experiences as they work through their own trauma. . . .

IV. 18 U.S.C. § 3553(a) SUPPORTS SUBSTANTIAL LENIENCY FOR MS. HOLMES.

The Court’s task in sentencing is to identify and “impose a sentence sufficient, but not greater than necessary, to comply with the purposes” of sentencing. 18 U.S.C. § 3553(a). Although the Sentencing Guidelines are the starting point for the calculation of an appropriate sentence, a district court “may not presume that the Guidelines range is reasonable.” *Gall v. United States*. Instead, the Court “must make an individualized assessment based on the facts” of each case, recognizing that a within-Guidelines sentence may be greater than necessary to serve the purposes of sentencing. *Kimbrough v. United States*; see *United States v. Gupta* (“Imposing a sentence on a fellow human being is a formidable responsibility. It requires a court to consider, with great care and sensitivity, a large complex of facts and factors.”). If the Guidelines calculation in a given case results in an “inordinate emphasis” on “putatively measurable quantities,” like financial loss, a court should focus more on the statutory factors set forth in 18 U.S.C. § 3553(a) to determine an appropriate sentence. *United States v. Adelson*. Indeed, the Court “may vary [from Guidelines ranges] based solely on policy considerations, including disagreements with the Guidelines.” *Kimbrough*.

The Court must make an assessment of what sentence is reasonable based on all the factors, including: (1) the nature and circumstances of the offense and history and characteristics of the defendant; (2) the purposes of sentencing, including the need for deterrence and to protect the public; (3) the kinds of sentences available; (4) the Sentencing Guidelines; (5) any relevant policy statements issued by the Sentencing Commission; (6) the need to avoid unwarranted sentence disparities; and (7) the need to provide restitution to any victims of the offense. 18 U.S.C. § 3553(a). “[T]he amount by which a sentence deviates from the applicable Guidelines range is not a measure of how ‘reasonable’ a sentence is. Reasonableness is determined instead by the district court’s individualized application of the statutory sentencing factors.” *United States v. Dorvee* (citing *Gall*). These factors support a sentence with no to minimal incarceration.

A. The Nature and Circumstances of the Offense Strongly Support Leniency.

Ms. Holmes has been convicted of defrauding certain sophisticated investors who knew they were investing in a company with a big, world-changing dream and substantial potential that had not yet been, and might never be, realized. Far from a house of cards, Theranos was well on its way to achieving its mission: it was a technology company that developed substantial, innovative technology over its fourteen-year life through the research and development efforts funded by investments and performed by Theranos' many qualified, brilliant scientists and engineers. Ms. Holmes, whose first real job was CEO of this company she founded at 19, was all-in on the company's mission to increase access to health information: she worked constantly, never sold any stock, and remained firmly committed to the company's mission until the company's end. For the reasons discussed below, the circumstances of the offense strongly support a lenient sentence.

1. The Offense Conduct Occurred Within a Unique World of Investments in Start-Up Companies.

Theranos was never a public company. It had limited operational history and had never paid dividends to its shareholders. Both Theranos and the offense conduct are best understood through the lens of a Silicon Valley start-up company. That is the environment in which Theranos was founded, in which it was built, and in which investors decided whether and how much to invest. Theranos had massive potential, but its success was uncertain—even highly unlikely, in light of the overall odds for start-ups. The company and Ms. Holmes faced the typical challenges that confront such companies and their inexperienced CEOs. No one is arguing these factors excuse fraud, but they do situate the offense conduct in context, as § 3553(a) requires.

It is common sense that investing in any uncertain venture brings with it substantial risk. Investors know that is especially true with investments in startups, the majority of which fail. Tim Draper is a venture capitalist with 35 years of experience whose company backed some of Silicon Valley's greatest technology success stories and was an early investor in Theranos. Mr. Draper makes the simple observation that some companies succeed and some fail. David Sokol, an experienced venture capital investor who has built and led several companies, including for Berkshire Hathaway, echoes that sentiment: "Through my career, I have invested in venture capital transactions which have been failures and successes." He goes on to explain that because a venture investment usually relies on estimates of the business's value if it succeeds, "[v]enture capital is inherently very risky investing and often only 1 out of 10 such investments prove successful. The reason is obvious in that most venture capital ideas are attempting to do something never before tried or achieved." Yinne Yu, an investor in early-stage companies, similarly observes: "A few of my first-time founders made it; most did not. Even with the best of intentions, all can go wrong." Alex Moore, also a venture capitalist,

agrees: “90% of my ‘bets’ (they are bets, nothing is certain) fail and go to 0. This is expected.” . . .

Ms. Holmes’ conduct should also be considered in the context of this world, and filtered through her role as a young, first-time founder without independent business experience. Venture investors, advisors, and founders describe the unique challenges faced by a founder and CEO and the unique perspective required to bring a new venture to success. “Inventing the future is hard. Founders are called upon to strike the incredibly difficult balance between painting a picture of the world as it could be, and as it actually is.” “The CEO and founder must carry the torch of the vision through every obstacle and terrain and protect its flame from naysayers, doubters, and challengers day in and day out to create an environment for innovation to take hold.”

Set against that backdrop is the role that optimism and lack of experience play in business challenges faced by start-up founders, who may not anticipate the setbacks. “Most first-time founders are visionary but naïve about how to build a business and how long it takes to build a business”—especially the latter. “For example, recently one of my companies gave me a set of financial projections to review before fundraising. I cut the numbers by over 50% because I see operational hiccups that the first time CEO doesn’t yet have the foresight to see.” See Paul A. Gompers et al., *How Do Venture Capitalists Make Decisions?*, 135 J. of Fin. Econ. (2020) (“VCs report that fewer than 30% of the companies meet projections.”). Dr. Susan Evans, a member of Theranos’ Scientific and Medical Advisory Board (SMAB) beginning in 2016, has spent her career in product development and technology assessment in the diagnostics industry. She writes: “I have met many young entrepreneurs who have a dream and many if not most, oversell what they have, and when it will be ready for market. This optimism is what often drives innovation, and the development of new products that go beyond what is the norm.” See *id.* (“Venture-backed startup companies often announce and deliver products to the market before they are ready.”).

These challenges are only compounded for female founders, as letters by female founders explain in sharing those writers’ experiences. For example:

Liz and I attended some of the same entrepreneurship events in Silicon Valley while she was at Theranos. These events often featured panels and fireside chats, where prominent people in business would make the case that a key reason less than 2% of venture capital goes to women is because female founders don’t present bold enough visions. The advice at these conferences was to picture what massive success would look like in 5 or 10 years, and sell that vision, because that’s what male founders were doing, and that’s what venture capitalists expect to see. When I think back on my younger days as a CEO, I was frequently told that my financial projections were too conservative.

Ex. A. Likewise:

Speaking as a woman who has raised \$60M in venture capital, I can confirm it is not easy. It is not easy for anyone, but I feel it's worth noting that approximately 3% of venture capital goes to women CEOs. The only scientific evidence I have encountered between men and women when it comes to raising capital is that men are more frequently asked about opportunities and women are more frequently asked about risks.

Ex. A. "The nuanced elements of Elizabeth being a female CEO cannot be overstated."
...

2. Theranos Developed Innovative Technology and Provided Real Services to Real Customers in Furtherance of Its Mission to Improve Access to Healthcare.

Also crucial to understanding the nature and circumstances of the offense is the fact that Theranos "was a real company." This was not an empty vehicle for Ms. Holmes' gain. Money that was invested went into the research and development and operations of the company with real results.

a. Theranos developed real, valuable technology.

Theranos spent most of its efforts developing products and improving the products it had developed. Financial records show that the majority of the company's funds were spent on research and development and operations.). Theranos also built and improved its sophisticated manufacturing capabilities in California to have the infrastructure to build its inventions as products. The technology Theranos invented can be broadly categorized into three categories:

- Assays: Assays include the chemicals and processes for testing blood samples for particular substances. Theranos developed hundreds of small sample assays over its many years of research and development, and also developed the ability to manufacture the chemicals in-house.

- Hardware: This set of technology included the various versions of Theranos Sample Processing Units ("TSPU"), as well as the small sample collection device (called the nanotainer) and various other hardware and components that Theranos developed to perform analysis of blood, urine, swabs, and other samples (and to complete other tasks). Between 2010 and 2015, the time period at issue here, Theranos was working to build, perfect, and continuously improve its 4-series TSPU (the minilab), which had the capability to run a host of different types of assays at once. Theranos submitted an application for approval of this device and one blood test to the FDA in 2014, and the FDA approved that application in 2015. Theranos planned to put the 4-series TSPU into operation when a sufficient number of assays were approved. Other hardware inventions, including other versions of the TSPU, were also developed.

- Software: Theranos' software developments included medical recordkeeping software, laboratory applications, diagnostic tracking, patient- and doctor-specific applications, and infectious disease modeling.

The company obtained hundreds of patents in the United States and across the world covering many of its inventions. The company chose to protect other innovative breakthroughs as trade secrets. To receive such protection under California law, Theranos was required to make "efforts that are reasonable under the circumstances" to ensure the continued secrecy of its technology. Cal. Civ. Code § 3426.1(d)(2). Theranos employed common methods, including nondisclosure agreements, security measures, limiting knowledge to "need to know," and legal enforcement of breaches of nondisclosure agreements. *See* 1 Melvin F. Jager, Trade Secrets Law §§ 5:21, 5:26, 13:3 (2022); 1 Roger M. Milgrim & Eric E. Benson, Milgrim on Trade Secrets § 1.04 (2020).

b. Theranos was on its way to achieving its mission to make health information more accessible through its commercial activities.

The company also executed real contracts and provided real services to real customers. In its early years, it worked with 10 pharmaceutical companies. Many of the pharmaceutical companies praised what Theranos had developed. Theranos also ran studies in conjunction with leading academic medical institutions, including the Mayo Clinic. It ultimately formed retail partnerships with Walgreens and Safeway in 2010 and, beginning in fall 2013, offered tests to customers in retail stores.

Theranos worked toward its goal of making health information more accessible through a number of different avenues. Making the process of drawing blood more comfortable and humane, including by drawing smaller samples, was one. Advocating to allow patients to order their own tests directly, without a doctor's visit, was another. Working to bring the lab testing equipment to retail locations was a third. While Theranos' brand symbol became the small sample collection device known as the nanotainer, Theranos learned that what was most important to patient-consumers was cost. In that arena, Theranos was revolutionary: Theranos offered tests at substantially lower prices than the industry leaders; it offered the same price to insured and uninsured patients; and it posted the prices on its website—a practice that was unusual at the time. Theranos' offering was so groundbreaking with regard to cost that customers flew from other states to get their blood tested at Theranos, and still paid less (including airfare) than what they would have paid to the industry incumbents. Ex. U ("[Bot Anecdote] Mother and daughter came from California for a day to visit there [sic] Dr. and he sent them here for labs because at Quest Diagnostics the labs were \$2,400 (she showed me the print out of the cost!) and they paid \$177.00 and \$192.00. With there [sic] plane tickets, taxi, and labs they spent a total of 300.00 they said. That isn't even half of what there [sic] labs would have been. They were so thankful and love everything about Theranos[.]"). The vast majority of Theranos' tests were processed using FDA-approved machines and processes. All tests were processed in government-certified Theranos

laboratories. Customers raved about the experience in feedback provided to Ms. Holmes. *See, e.g.*, Ex. U (“The main reason I went was because of the cost. I am often sent a high bill for my bloodwork with insurance. When I got there, the service was fast, the ladies were super and professional and I must say, it was the best experience I have ever had. Plus, no bruising whatsoever! I will continue going there for my bloodwork from now on and thank you!”).

c. Theranos employed hundreds of employees.

These technological and commercial accomplishments were the work of hundreds of individual members of the community employed by Theranos over its life. Investments in Theranos also paid the salaries of the many brilliant, talented, and committed members of the Theranos employee family working to achieve its mission. As former employees describe, Ms. Holmes was personally invested in the well-being of these individuals and their families, and took their personal circumstances and professional accomplishments seriously.

d. Theranos’ technology and operations involved scientific and regulatory complexity.

Theranos operated in a space that involved serious scientific and regulatory complexities- challenges that were known or knowable to investors through public research, beyond the information they got from Theranos (if any). Ms. Holmes did not work to address these complexities alone. Company scientists-all more highly educated and experienced than she was-reported on the state of the technology, including successes, efforts to resolve challenges, and response to criticisms or questions from those now considered whistleblowers. The company worked through regulatory questions and solutions with sophisticated partners and experienced outside lawyers. And policies and procedures were also in place. None of this is to say that Theranos operated without error; it is simply context to understand (i) that Ms. Holmes did not sit at the top of a company that simply implemented her commands and (ii) that Ms. Holmes understood there were teams and processes in place to address issues. This ambitious venture was full of the complications that come with launching any business, with the added complexities of scientific advancement and government regulatory schemes.

One regulatory challenge was how Theranos and its retail partners would operate the testing as a practical matter. Early in the retail partnerships, the parties had envisioned putting Theranos devices in retail locations. Those partners and Theranos soon recognized the potential regulatory barriers to that approach-namely, a risk the devices might need to be FDA-approved or each retail location would need to be certified as a high-complexity CLIA laboratory—and shifted the rollout strategy. Theranos and Walgreens agreed that Phase I of the company’s retail operations would involve shipping samples back to certified central CLIA laboratories and Phase II, putting Theranos devices in retail locations, would occur once the Theranos devices had been FDA-approved. As a result of this shift, during Phase I, because the samples were being

shipped to the Theranos laboratory for processing, the device used for testing a sample was less important to the commercial project than the experience customers had in stores. Theranos shared the details of this strategic plan with the FDA shortly after it publicly announced its partnership with Walgreens.

Laboratory testing is also highly regulated. By 2015, Theranos had two laboratories certified by authorities in California and Arizona (working under the authority of federal agency CMS (Centers for Medicaid & Medicare Studies)). Those laboratories, which were staffed with qualified employees, processed blood samples collected at retail locations (such as the Walgreens locations). The vast majority of the eight million-plus test results produced by Theranos were generated on FDA-approved methods; tests performed on lab-developed methods had been validated under appropriate standards, with validation reports signed by a qualified laboratory director. Ms. Holmes, who does not have a college degree, was not qualified to and did not process patient samples. Nor did she determine what methods were appropriate for patient use.

In addition to being highly regulated, blood testing is scientifically complex. Laboratory testing has inherent imprecision and imperfections. Even FDA-approved tests can produce inaccuracies for a particular patient at a particular time. Government regulations indicate that test results can be considered “accurate” even if they differ from a target by large percentages. Every test has some expected inaccuracy rate, as its associated FDA labeling information makes clear. Even among well-accepted testing methodologies, different measurement procedures can lead to different results that are difficult to compare. *See* Myers, Gary L. & W. Greg Miller, *The International Consortium for Harmonization of Clinical Laboratory Results (ICHCLR)—a pathway for harmonization*, *The Journal of the International Federation of Clinical Chemistry and Laboratory Medicine* (2016) (“A basic problem in laboratory medicine is that different laboratory measurement procedures that intend to measure the same measurand may give different results for the same specimen.”). And for some tests the risks of inaccuracy are common enough that physicians’ groups recommend against giving the test in many circumstances because the risks of an inaccurate test outweigh the benefits. Ex. Q Additionally, even companies that make FDA-approved assays sometimes produce faulty chemicals or errant calculations that lead to erroneous results. Whether and why any particular laboratory test result is incorrect is a deeply technical scientific issue. These scientific complexities provide context for the impact that any anecdotal potential errors and inaccuracies that were brought to Ms. Holmes’ attention may have had on her own beliefs in the state of Theranos’ laboratory when she spoke to investors. . . .

4. The Circumstances Show Ms. Holmes To Be a Founder and CEO Deeply Committed to the Company’s Mission, Rather Than Her Own Personal Gain.

Ms. Holmes’ actions showed her to be a selfless CEO focused on the success of the company and its mission, and not on increasing her own wealth. As the Court

knows, Ms. Holmes did not personally profit from the investments Theranos received, never sold any of her stock, and was, as Dr. Bonanni described it, a “selfless CEO.” Additionally, Ms. Holmes’ actions in the wake of criticism that began in late 2015 show a CEO interested in identifying errors, fixing them, and learning from them—not running from them. She did not flee the enterprise when the company faced criticism. To the contrary, as described in section III(E), above, Ms. Holmes embarked on a broad, resource-intensive effort to bring outside voices into Theranos and to identify, acknowledge, and correct errors or missteps, and went down with the ship when the company shuttered. Ms. Holmes’ extensive efforts in this regard are relevant to consider when weighing the circumstances of the offense, especially given her youth and the fact that her role as CEO of Theranos was her first business experience. The fact that Ms. Holmes was not motivated by personal gain or greed is a mitigating factor under § 3553(a)(2). *See, e.g., United States v. Prosperi* (affirming district court’s sentence, including based on finding that the defendants had not “sought to enrich themselves”); *United States v. Connors* (considering as a mitigating factor the fact that the defendant was “motivated by a desire to save the company and to save the jobs of its employees,” in contrast to “greed and pure personal gain,” which “are usually the driving force for many, if not most, fraud offenders”).

5. Because of Their Extreme Focus on Loss, the Guidelines Are Unhelpful in Fashioning a Fair, Just, and Reasonable Sentence.

But in the event the Court finds the government has proven loss under § 2B1.1, the Court should decline to impose any sentence primarily driven by the calculation of loss.

First, this is the type of case where the impact of the loss enhancement means that the Guidelines fail to “provide reasonable guidance,” and are of no “help to any judge in fashioning a sentence that is fair, just, and reasonable.” *United States v. Adelson*. “For the small class of defendants. . . convicted of fraud offenses associated with very large guidelines loss calculations, the guidelines now are divorced both from the objectives of Section 3553(a) and, frankly, from common sense. Accordingly, the guidelines calculations in such cases are of diminished value to sentencing judges.” Frank O. Bowman, III, *Sentencing High-Loss Corporate Insider Frauds After Booker*, 20 Fed. Sent’g Rep. (2008). Across the country, judges seem to agree: the Sentencing Commission’s own data shows that there is an “increasing divergence between the average Guidelines minimum and the average sentence actually imposed as loss amount grows.” Mark H. Allenbaugh, “*Drawn from Nowhere*”: A Review of the U.S. Sentencing Commission’s White-Collar Sentencing Guidelines and Loss Data, 26 Fed. Sent’g Rep. (2013); *see* Jillian Hewitt, *Fifty Shades of Gray: Sentencing Trends in Major White-Collar Cases*, 125 Yale L. J. (2016) (concluding that review of the post-*Booker* sentencing data “empirically corroborate[d] scholarly criticism that the loss table often vastly overstates the seriousness of an offense”).

Second, more generally, the loss guideline does not bear the weight the Sentencing Guidelines give it. Under § 2B1.1, in any modern white-collar case, loss has an inordinate and inappropriate effect on the calculation of a Guidelines sentence that flies in the face of the statutory considerations in 18 U.S.C. § 3553(a). The loss table “frequently produces arbitrary and unduly severe sentences for two related reasons”: (1) loss is “defined so broadly that it can produce lifelong sentencing ranges for defendants who neither cause much economic harm nor derive much economic benefit from their crimes” and (2) “the loss table’s enhancements are so large that, in practice, they dwarf other potentially more relevant considerations.” Hewitt, 125 Yale L.J. As result, like with narcotics sentences, “[s]omewhere between 50 and 70 percent of the Sentencing Guidelines calculation . . . is based on a single factor[.]” Jed S. Rakoff, Why the Federal Sentencing Guidelines Should Be Scrapped, 29 Fed. Sent’g Rep. (2017). “But it should be obvious that in a great many, perhaps most, cases, . . . the amount of the loss does not fairly convey the reality of the crime or the criminal.” “By making a Guidelines sentence turn, for all practical purposes, on this single factor, the . . . Commission. . . effectively guaranteed that many such sentences would be irrational on their face.” *United States v. Gupta*; see also *United States v. Johnson*; *United States v. Parris*. As a result, “[t]he higher the loss amount, the more distorted the guideline’s advice to sentencing judges.” *United States v. Corsey*. These issues are compounded by the fact that the loss Guideline “was not developed by the Sentencing Commission using an empirical approach based on data about past sentencing practices.” See *id.* (describing the history of amendments to the Guideline and noting that “[t]he history of bracket inflation directed by Congress renders the loss guideline fundamentally flawed”).

As Judge Rakoff has observed:

Where the Sentencing Guidelines provide reasonable guidance, they are of considerable help to any judge in fashioning a sentence that is fair, just, and reasonable. But where, as here, the calculations under the guidelines have so run amok that they are patently absurd on their face, a Court is forced to place greater reliance on the more general considerations set forth in section 3553(a), as carefully applied to the particular circumstances of the case and of the human being who will bear the consequences.

Adelson; see also *id.* (Guidelines place an “inordinate emphasis” on “putatively measurable quantities, such as . . . the amount of financial loss in fraud cases,” but they have failed to “explain[] why it is appropriate to accord such huge weight to such factors.”); *Corsey* (“[T]he low marginal utility of the guideline in this very high intended loss case should have prompted greater, not lesser, reliance on the section 3553(a) factors other than the Guidelines.”). Ms. Holmes urges the Court to focus on the § 3553(a) factors that allow the Court to engage in the “uniform and constant” exercise “in the federal judicial tradition” of “consider[ing] every convicted person as an individual and every case as a unique study in the human failings that sometimes mitigate, sometimes magnify, the crime and the punishment to ensue.” *Koon v. United States*.

B. Ms. Holmes' Personal History and Characteristics Strongly Support Leniency.

"[I]f ever a [person] is to receive credit for the good [she] has done, and [her] immediate conduct assessed in the context of [her] overall life hitherto, it should be at the moment of [her] sentencing, when [her] very future hangs in the balance." *Adelson*. Described by over [130] different letters as a compassionate, honest, and humble woman with much to give the world and a deep commitment to doing so, Ms. Holmes' personal history and characteristics (outlined in section II, above) strongly counsel against a lengthy incarceration. "Anyone who knows Liz recognizes that she is a genuine and generous person who cares deeply for those around her," someone to rely on "for an honest opinion, words of encouragement, and a selfless interest in [their] life and well-being."

Ms. Holmes asks the Court to consider the words of those who know her when weighing the importance of § 3553(a)(1) in this case, including on the following points:

- Ms. Holmes is no danger to the public. She has no criminal history, has a perfect pretrial services compliance record, and is described by the people who know her repeatedly as a gentle and loving person who tries to do the right thing.
- Ms. Holmes is deeply devoted to her partner and son, and plays an integral and irreplaceable role in their lives.
- Ms. Holmes has lived her life with a purpose to change the world for the better, on scales large and small. These basic qualities motivated her in founding and leading Theranos, and they continue to shine in the way she lives her life today. She is the person her friends turn to when they need support, regardless of what is going on in her life.
- Ms. Holmes lives with this kindness, purpose, and selflessness despite significant personal trauma that occurred before and during the time period of the offense, and from which she is still recovering.
- Friends and family note with admiration that she has handled her indictment and trial with grace and without expressing and indeed discouraging ill-will towards the prosecutors who seek to incarcerate her, the media that has vilified her, or those who have been unwilling to stand by her. Additionally, the letters are striking in showing how Ms. Holmes wholeheartedly commits to the things that matter to her—today, the people she loves and the service work she cares about. Courts in other cases have exercised their discretion to impose non-Guidelines sentences based on the personal characteristics of the defendant. *E.g., United States v. Gupta* (premising downward variance, in part, on defendant's "big heart and helping hand, which he extended without fanfare or self-promotion, to all with whom he came in contact"); *Adelson* (premising downward variance, in part, on letters from "persons from all walks

of life . . . attesting, from personal knowledge, to [defendant's] good works and deep humanity," his "generosity of spirit," and his "integrity and generosity"). Similar considerations are present here. Ms. Holmes' mother "beg[s] you to see her goodness, her unique circumstances and her promise."

C. Incarceration Is Not Necessary to Afford Adequate Deterrence or Protect the Public.

The needs "to afford adequate deterrence to criminal conduct" and "protect the public from further crimes of the defendant," 18 U.S.C. § 3553(a)(2)(B)-(C), are not served by a custodial sentence for Ms. Holmes.

1. Incarceration Is Not Necessary for Specific Deterrence.

Incarceration is not necessary to either protect the public from Ms. Holmes or to deter her from committing future offenses. Ms. Holmes is not a danger to society. She has been out of custody, with a perfect pretrial services record, for more than four years. And there is no reason to believe she would commit another fraud—or that she will ever be in a position to do so. Ms. Holmes has readily and repeatedly acknowledged the many mistakes she made while serving as CEO of Theranos—in interviews, to the SEC, on the witness stand in front of the jury, and to friends and family.

"Elizabeth understands what has been lost." Ms. Holmes has suffered the consequences of the offense daily for years, in ways large and small. She has been formally penalized for her mistakes in other forums—through the administrative state by CMS and by this Court in connection with her settlement with the SEC. Ms. Holmes spent her entire adult life building Theranos until its collapse—a personal and public failure she feels deeply. Beyond that failure and loss of this company she loved so much, eight years of investigations and lawsuits have taken their toll. Having never cashed in on the value of Theranos to her own benefit, Ms. Holmes has incurred substantial debt from which she is unlikely to recover. She is unable to get a job and was prevented from investing what money she did have when her trading accounts were repeatedly closed by financial institutions as a result of her indictment. She has lost personal friendships to the process surrounding investigations, lawsuits, and lawyers, and it is difficult to make new ones. . . .

Moreover, the incessant drum of media criticism has ensured Ms. Holmes will be punished for the rest of her life. The Court is well aware of the unusually intense media attention on this case before, during, and after Ms. Holmes' trial. The coverage of her as a person is universally negative. Portrayals of Ms. Holmes are at best unflattering caricature and at worst dehumanizingly cruel. Almost all depict her—inaccurately, as the scores of letters submitted with this filing make clear—as unfeeling and self-absorbed. Even putting aside the fact that her appearance and voice are considered appropriate for mockery (a gender-specific punishment), her worst personal traumas have been treated as appropriate for derision as well. Following Ms. Holmes' testimony

about the psychological and sexual abuse she endured at the hands of Mr. Balwani, one outlet ran a humor column in which the author wondered whether she would have been able to comply with Mr. Balwani's demands. Alexandra Petri, "Opinion: I tried the Elizabeth Holmes schedule, and here is how it went," Wash. Post (Dec. 3, 2021). Ms. Holmes will never be able to seek another job or meet a new friend without the negative caricature acting as a barrier. She worries about how her notoriety affects friends and family—and those effects are meaningful. Several letters describe how Ms. Holmes avoids friends' life events and social occasions because she does not want to be a distraction. "I cannot overemphasize the degree to which Liz is ostracized by people who do not know her and the degree to which this social isolation has affected Liz, Billy, and their families."

Ms. Holmes has also suffered a substantial loss of privacy, despite her best attempts to stay out of the public eye and to respect the legal process around this case. Mr. Evans describes the precautions he and Ms. Holmes have taken in furtherance of their own privacy and safety, from dressing in hats and glasses to using P.O. boxes for mail to living in private buildings or a secluded location. Yet members of the press have taken dramatic steps to identify and publish Ms. Holmes' address, leading to cameras, visits from the press and the public (as well as a recent visit from a key government witness), and threats. Ms. Holmes and Mr. Evans have moved several times as a result. Threats are also ever-present online.

These forms of punishment, including the extrajudicial collateral consequences going well beyond "civil death" that Ms. Holmes will endure for the rest of her life regardless of her sentence, make clear why incarceration is unnecessary and unhelpful in achieving specific deterrence in this case. . . .

D. Just Punishment and Respect for the Law Are Not Served by a Lengthy Incarceration.

Section 3553(a)(2)'s goals "to promote respect for the law" and "to provide just punishment for the offense" are likewise not achieved by the incarceration of Ms. Holmes. "Where offenders appear to have been unfairly singled out, respect for the law and law enforcement suffers." Frase, *Punishment Purposes*, 58 Stanford L. Rev.

The prosecutorial and cultural focus on punishing Ms. Holmes stands out. As numerous letters observe, the decision to prosecute Ms. Holmes and the associated vilification of her stands in stark contrast to the treatment of other prominent entrepreneurs who have been accused in media of fraud. Take Adam Neumann, the founder of WeWork, who was accused of diverting millions of corporate assets for personal gain and walked away from his first company with hundreds of millions of dollars. Mr. Neumann recently received a *\$350 million investment* in his next venture. Even observers who believe Ms. Holmes was rightly the subject of prosecution cannot help but notice the discrepant treatment. And within the Theranos story, Ms. Holmes has borne the brunt of the vitriol despite the fact that many factors—some failures of

judgment on her part, some simply the operational hurdles of a complex endeavor, and some no doubt the missteps of others—contributed to Theranos’ failures. The government’s decision to charge Ms. Holmes personally with wire fraud in connection with Theranos’ laboratory practices is one example of that singling-out, given the regulatory and personnel structures that governed Theranos’ laboratory operations. Its attempt to paint Theranos’ trade secrets practices as nefarious when such practices are commonplace and required by law is another. *See, e.g.*, 1 Melvin F. Jager, Trade Secrets Law §§ 5.21, 5.26, 13.3; 1 Roger M. Milgrim & Eric E. Benson, Milgrim on Trade Secrets § 1.04 (2020).

E. Section 3553(a)(6) Supports a Downward Variance from the Guidelines.

The “need to avoid unwarranted sentence disparities among defendants with similar records who have been found guilty of similar conduct” counsels in favor of a below-Guidelines sentence. 18 U.S.C. § 3553(a)(6). In this district, the majority of defendants convicted of crimes for which the main Guideline is § 2B1.1 have received below-Guidelines sentences. From 2015 through 2021, in this district, the median sentence for a defendant convicted of fraud, with no criminal history, and in Zone D of the guidelines received a sentence that included a term of incarceration of 24 months. The national statistics are similar.

Even if the Court determines—over Ms. Holmes’ objection—that the government has proven a substantial loss, the Court would be in good and abundant company in varying downward from the Guidelines range. Given the numerous and duplicative enhancements that apply to cases driven by § 2B1.1, courts frequently sentence defendants with high loss figures and no criminal history to substantially below-Guidelines sentences. For example:

- In February 2021, the COO of a publicly traded biopharmaceutical company was sentenced after a trial guilty verdict on one count of wire fraud to 12 months in custody in light of the ongoing economic hardship he would face in the future, his general good works, his comparatively lower culpability than his codefendant, and the need for some prison time to address general deterrence; the “[b]izarre, barbaric,” and “absurd” Guidelines range was the statutory maximum of 20 years (on an initial range of 262 to 327 months). *United States v. Taylor*, 1:19.

- In November 2019, a hedge fund trader who was found guilty after trial of overinflating the hedge fund’s assets by \$100 million was sentenced to 40 months’ imprisonment; the government and the Probation Office had calculated a Guidelines range of 168 to 210 months. *See United States v. Shor*, 1:18.

- In November 2018, an individual who was convicted of securities fraud after trial in the District of Massachusetts, was sentenced to a term of six months’

imprisonment where the government had calculated a Guidelines prison sentence of 63 to 78 months. *See United States v. Wang*, 1:16.

- In October 2018, a former State Street executive who was convicted after trial of securities fraud, was sentenced to a term of 18 months' imprisonment; the government had calculated a Guidelines sentence of 14 to 17 years. *See United States v. McClellan*, 1:16.

- In October 2018, a serial fraudster who committed additional crimes while awaiting sentencing after his fraud guilty plea, was sentenced to 72 months' imprisonment where the government calculated a Guidelines sentence of 188 to 235 months and the government requested a sentence of 15 or more years. *See United States v. McFarland*, 1:17.

- In May 2018, a defendant convicted at trial of four conspiracies, including conspiracy to commit bank fraud, and facing a PSR Guidelines range of life and a Court-determined Guidelines range of 97 to 121 months was sentenced to 32 months based on his otherwise exemplary life and relative role. *United States v. Atilla*, 1:15. . . .

Ultimately, the touchstone of this factor is the idea of treating defendants who are found to have committed similar crimes similarly. It is nearly impossible to do that here given the unique circumstances of the offense—the sophisticated investors investing in a non-public, novel technology company with limited history seeking to change a complex, established industry and the indisputable value of that company regardless of the offense conduct—and of Ms. Holmes—her intent to do good, her lack of greed, her commitment to fixing her errors, and her positive personal qualities. “Whereas apples and oranges may have but a few salient qualities, human beings in their interactions with society are too complicated to be treated like commodities, and the attempt to do so can only lead to bizarre results.” *United States v. Gupta*. . . .

G. Ms. Holmes' Capacity to Do Good Supports a Sentence That, In Part, Orders Ms. Holmes to Engage in Significant Community Service.

Despite her mistakes, Ms. Holmes' personal characteristics—including her deeply held desire to make the world a better place, her self-reflection, her determination and work ethic, and her visionary and creative mind—leave her with capacity and potential to positively contribute to the world. While the over 130 letters attached to this memorandum are consistent in believing that “society is better off with her in it,” it is noteworthy how many different opportunities there are for Ms. Holmes to be a force for good. Whether it is working with individual survivors of sexual assault, teaching the lessons of her own errors, inventing new technologies, developing projects that have the potential to help solve social health problems, or something else entirely, the chorus of letters emphasize a belief among those who know her that society's best use of Ms. Holmes is “out in the world working on the next thing to improve the lives of others.” . . .

One meaningful approach would permit Ms. Holmes to continue the work she has done over the past several months volunteering in support of sexual assault survivors. [Redacted]welcomes Ms. Holmes' continued services helping "the ever-increasing number of callers on the statewide sexual assault helpline" and "research[ing] gaps in services and resources for victims, while working to increase access to services throughout the state." . Requiring Ms. Holmes to continue these efforts as part of her sentence would be a better use of society's resources than incarcerating her. . . .

B. Corporate Sentencing Guidelines

Corporations can't be imprisoned, of course, but the Sentencing Guidelines do provide alternative ways to punish corporations. As you read the following Guidelines provisions, note the major ways a corporation can be punished by a sentencing judge in a criminal case, and the main factors and rationales that appear to be driving the Guidelines on corporate sentencing. Do these Guidelines matter if the vast majority of corporate criminal cases settle via DPAs or NPAs and never see a judge?

UNITED STATES SENTENCING GUIDELINES MANUAL (Excerpts)

CHAPTER EIGHT - SENTENCING OF ORGANIZATIONS

Introductory Commentary

The guidelines and policy statements in this chapter apply when the convicted defendant is an organization. Organizations can act only through agents and, under federal criminal law, generally are vicariously liable for offenses committed by their agents. At the same time, individual agents are responsible for their own criminal conduct. Federal prosecutions of organizations therefore frequently involve individual and organizational co-defendants. Convicted individual agents of organizations are sentenced in accordance with the guidelines and policy statements in the preceding chapters. This chapter is designed so that the sanctions imposed upon organizations and their agents, taken together, will provide just punishment, adequate deterrence, and incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct.

This chapter reflects the following general principles:

First, the court must, whenever practicable, order the organization to remedy any harm caused by the offense. The resources expended to remedy the harm should not be viewed as punishment, but rather as a means of making victims whole for the harm caused.

Second, if the organization operated primarily for a criminal purpose or primarily by criminal means, the fine should be set sufficiently high to divest the organization of all its assets.

Third, the fine range for any other organization should be based on the seriousness of the offense and the culpability of the organization. The seriousness of the offense

generally will be reflected by the greatest of the pecuniary gain, the pecuniary loss, or the amount in a guideline offense level fine table. Culpability generally will be determined by six factors that the sentencing court must consider. The four factors that increase the ultimate punishment of an organization are: (i) the involvement in or tolerance of criminal activity; (ii) the prior history of the organization; (iii) the violation of an order; and (iv) the obstruction of justice. The two factors that mitigate the ultimate punishment of an organization are: (i) the existence of an effective compliance and ethics program; and (ii) self-reporting, cooperation, or acceptance of responsibility.

Fourth, probation is an appropriate sentence for an organizational defendant when needed to ensure that another sanction will be fully implemented, or to ensure that steps will be taken within the organization to reduce the likelihood of future criminal conduct.

These guidelines offer incentives to organizations to reduce and ultimately eliminate criminal conduct by providing a structural foundation from which an organization may self-police its own conduct through an effective compliance and ethics program. The prevention and detection of criminal conduct, as facilitated by an effective compliance and ethics program, will assist an organization in encouraging ethical conduct and in complying fully with all applicable laws. . . .

PART B - REMEDYING HARM FROM CRIMINAL CONDUCT, AND EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

Historical Note: Effective November 1, 1991 (see Appendix C, amendment 422). Amended effective November 1, 2004 (see Appendix C, amendment 673).

1. REMEDYING HARM FROM CRIMINAL CONDUCT

Historical Note: Effective November 1, 2004.

Introductory Commentary

As a general principle, the court should require that the organization take all appropriate steps to provide compensation to victims and otherwise remedy the harm caused or threatened by the offense. A restitution order or an order of probation requiring restitution can be used to compensate identifiable victims of the offense. A remedial order or an order of probation requiring community service can be used to reduce or eliminate the harm threatened, or to repair the harm caused by the offense, when that harm or threatened harm would otherwise not be remedied. An order of notice to victims can be used to notify unidentified victims of the offense.

Historical Note: Effective November 1, 1991.

§ 8B1.1. Restitution - Organizations

- (a) In the case of an identifiable victim, the court shall—
- (1) enter a restitution order for the full amount of the victim's loss, if such order is authorized under 18 U.S.C. § 2248, § 2259, § 2264, § 2327, § 3663, or § 3663A; or
 - (2) impose a term of probation or supervised release with a condition requiring restitution for the full amount of the victim's loss, if the offense is not an offense for which restitution is authorized under 18 U.S.C. § 3663(a)(1) but otherwise meets the criteria for an order of restitution under that section.
- (b) *Provided*, that the provisions of subsection (a) do not apply—
- (1) when full restitution has been made; or
 - (2) in the case of a restitution order under § 3663; a restitution order under 18 U.S.C. § 3663A that pertains to an offense against property described in 18 U.S.C. § 3663A(c)(1)(A)(ii); or a condition of restitution imposed pursuant to subsection (a)(2) above, to the extent the court finds, from facts on the record, that (A) the number of identifiable victims is so large as to make restitution impracticable; or (B) determining complex issues of fact related to the cause or amount of the victim's losses would complicate or prolong the sentencing process to a degree that the need to provide restitution to any victim is outweighed by the burden on the sentencing process.
- (c) If a defendant is ordered to make restitution to an identifiable victim and to pay a fine, the court shall order that any money paid by the defendant shall first be applied to satisfy the order of restitution.
- (d) A restitution order may direct the defendant to make a single, lump sum payment, partial payments at specified intervals, in-kind payments, or a combination of payments at specified intervals and in-kind payments. *See* 18 U.S.C. § 3664(f)(3)(A). An in-kind payment may be in the form of (1) return of property; (2) replacement of property; or (3) if the victim agrees, services rendered to the victim or to a person or organization other than the victim. *See* 18 U.S.C. § 3664(f)(4).
- (e) A restitution order may direct the defendant to make nominal periodic payments if the court finds from facts on the record that the economic circumstances of the defendant do not allow the payment of any amount of a restitution order, and do not allow for the payment of the full amount of a restitution order in the foreseeable future under any reasonable schedule of payments. . . .

§ 8B1.2. Remedial Orders - Organizations (Policy Statement)

- (a) To the extent not addressed under §8B1.1 (Restitution - Organizations), a remedial order imposed as a condition of probation may require the organization to remedy the harm caused by the offense and to eliminate or reduce the risk that the instant offense will cause future harm.
- (b) If the magnitude of expected future harm can be reasonably estimated, the court may require the organization to create a trust fund sufficient to address that expected harm.

Commentary

Background: The purposes of a remedial order are to remedy harm that has already occurred and to prevent future harm. A remedial order requiring corrective action by the organization may be necessary to prevent future injury from the instant offense, e.g., a product recall for a food and drug violation or a clean-up order for an environmental violation. In some cases in which a remedial order potentially may be appropriate, a governmental regulatory agency, e.g., the Environmental Protection Agency or the Food and Drug Administration, may have authority to order remedial measures. In such cases, a remedial order by the court may not be necessary. If a remedial order is entered, it should be coordinated with any administrative or civil actions taken by the appropriate governmental regulatory agency.

§ 8B1.3. Community Service - Organizations (Policy Statement)

Community service may be ordered as a condition of probation where such community service is reasonably designed to repair the harm caused by the offense.

Commentary

Background: An organization can perform community service only by employing its resources or paying its employees or others to do so. Consequently, an order that an organization perform community service is essentially an indirect monetary sanction, and therefore generally less desirable than a direct monetary sanction. However, where the convicted organization possesses knowledge, facilities, or skills that uniquely qualify it to repair damage caused by the offense, community service directed at repairing damage may provide an efficient means of remedying harm caused.

In the past, some forms of community service imposed on organizations have not been related to the purposes of sentencing. Requiring a defendant to endow a chair at a university or to contribute to a local charity would not be consistent with this section unless such community service provided a means for preventive or corrective action directly related to the offense and therefore served one of the purposes of sentencing set forth in 18 U.S.C. § 3553(a). . . .

2. EFFECTIVE COMPLIANCE AND ETHICS PROGRAM

§ 8B2.1. Effective Compliance and Ethics Program

- (a) To have an effective compliance and ethics program, for purposes of subsection (f) of §8C2.5 (Culpability Score) and subsection (b)(1) of §8D1.4 (Recommended Conditions of Probation - Organizations), an organization shall—

- (1) exercise due diligence to prevent and detect criminal conduct; and
- (2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.

Such compliance and ethics program shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.

- (b) Due diligence and the promotion of an organizational culture that encourages ethical conduct and a commitment to compliance with the law within the meaning of subsection (a) minimally require the following:

- (1) The organization shall establish standards and procedures to prevent and detect criminal conduct.
- (2)
 - (A) The organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight with respect to the implementation and effectiveness of the compliance and ethics program.
 - (B) High-level personnel of the organization shall ensure that the organization has an effective compliance and ethics program, as described in this guideline. Specific individual(s) within high-level personnel shall be assigned overall responsibility for the compliance and ethics program.
 - (C) Specific individual(s) within the organization shall be delegated day-to-day operational responsibility for the compliance and ethics program. Individual(s) with operational responsibility shall report periodically to high-level personnel and, as appropriate, to the governing authority, or an appropriate subgroup of the governing authority, on the effectiveness of the compliance and ethics program. To carry out such operational responsibility, such individual(s) shall be given adequate

resources, appropriate authority, and direct access to the governing authority or an appropriate subgroup of the governing authority.

- (3) The organization shall use reasonable efforts not to include within the substantial authority personnel of the organization any individual whom the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program.
- (4)
 - (A) The organization shall take reasonable steps to communicate periodically and in a practical manner its standards and procedures, and other aspects of the compliance and ethics program, to the individuals referred to in subparagraph (B) by conducting effective training programs and otherwise disseminating information appropriate to such individuals' respective roles and responsibilities.
 - (B) The individuals referred to in subparagraph (A) are the members of the governing authority, high-level personnel, substantial authority personnel, the organization's employees, and, as appropriate, the organization's agents.
- (5) The organization shall take reasonable steps—
 - (A) to ensure that the organization's compliance and ethics program is followed, including monitoring and auditing to detect criminal conduct;
 - (B) to evaluate periodically the effectiveness of the organization's compliance and ethics program; and
 - (C) to have and publicize a system, which may include mechanisms that allow for anonymity or confidentiality, whereby the organization's employees and agents may report or seek guidance regarding potential or actual criminal conduct without fear of retaliation.
- (6) The organization's compliance and ethics program shall be promoted and enforced consistently throughout the organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct.
- (7) After criminal conduct has been detected, the organization shall take reasonable steps to respond appropriately to the criminal conduct and to

prevent further similar criminal conduct, including making any necessary modifications to the organization's compliance and ethics program.

(c) In implementing subsection (b), the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth in subsection (b) to reduce the risk of criminal conduct identified through this process. . . .

PART C - FINES

1. DETERMINING THE FINE - CRIMINAL PURPOSE ORGANIZATIONS

§ 8C1.1. Determining the Fine - Criminal Purpose Organizations

If, upon consideration of the nature and circumstances of the offense and the history and characteristics of the organization, the court determines that the organization operated primarily for a criminal purpose or primarily by criminal means, the fine shall be set at an amount (subject to the statutory maximum) sufficient to divest the organization of all its net assets. When this section applies, Subpart 2 (Determining the Fine - Other Organizations) and §8C3.4 (Fines Paid by Owners of Closely Held Organizations) do not apply. . . .

2. DETERMINING THE FINE - OTHER ORGANIZATIONS . . .

§ 8C2.4. Base Fine

- (a) The base fine is the greatest of:
- (1) the amount from the table in subsection (d) below corresponding to the offense level determined under §8C2.3 (Offense Level); or
 - (2) the pecuniary gain to the organization from the offense; or
 - (3) the pecuniary loss from the offense caused by the organization, to the extent the loss was caused intentionally, knowingly, or recklessly.
- (b) *Provided*, that if the applicable offense guideline in Chapter Two includes a special instruction for organizational fines, that special instruction shall be applied, as appropriate.
- (c) *Provided, further*, that to the extent the calculation of either pecuniary gain or pecuniary loss would unduly complicate or prolong the sentencing process, that amount, i.e., gain or loss as appropriate, shall not be used for the determination of the base fine.

(d) Offense Level Fine Table

<u>Offense Level</u>	<u>Amount</u>	<u>Offense Level</u>	<u>Amount</u>
6 or less	\$5,000	23	\$1,600,000
7	\$7,500	24	\$2,100,000
8	\$10,000	25	\$2,800,000
9	\$15,000	26	\$3,700,000
10	\$20,000	27	\$4,800,000
11	\$30,000	28	\$6,300,000
12	\$40,000	29	\$8,100,000
13	\$60,000	30	\$10,500,000
14	\$85,000	31	\$13,500,000
15	\$125,000	32	\$17,500,000
16	\$175,000	33	\$22,000,000
<u>Offense Level</u>	<u>Amount</u>	<u>Offense Level</u>	<u>Amount</u>
17	\$250,000	34	\$28,500,000
18	\$350,000	35	\$36,000,000
19	\$500,000	36	\$45,500,000
20	\$650,000	37	\$57,500,000
21	\$910,000	38 or more	\$72,500,000.
22	\$1,200,000		

...

§ 8C2.5. Culpability Score

(a) Start with 5 points and apply subsections (b) through (g) below.

(b) Involvement in or Tolerance of Criminal Activity

If more than one applies, use the greatest:

- (1) If—
- (A) the organization had 5,000 or more employees and
 - (i) an individual within high-level personnel of the organization participated in, condoned, or was willfully ignorant of the offense; or
 - (ii) tolerance of the offense by substantial authority personnel was pervasive throughout the organization; or
 - (B) the unit of the organization within which the offense was committed had 5,000 or more employees and
 - (i) an individual within high-level personnel of the unit participated in, condoned, or was willfully ignorant of the offense; or
 - (ii) tolerance of the offense by substantial authority personnel was pervasive throughout such unit,
- add **5** points; or
- (2) If—
- (A) the organization had 1,000 or more employees and
 - (i) an individual within high-level personnel of the organization participated in, condoned, or was willfully ignorant of the offense; or
 - (ii) tolerance of the offense by substantial authority personnel was pervasive throughout the organization; or
 - (B) the unit of the organization within which the offense was committed had 1,000 or more employees and
 - (i) an individual within high-level personnel of the unit participated in, condoned, or was willfully ignorant of the offense; or
 - (ii) tolerance of the offense by substantial authority personnel was pervasive throughout such unit,
- add **4** points; or

- (3) If—
 - (A) the organization had 200 or more employees and
 - (i) an individual within high-level personnel of the organization participated in, condoned, or was willfully ignorant of the offense; or
 - (ii) tolerance of the offense by substantial authority personnel was pervasive throughout the organization; or
 - (B) the unit of the organization within which the offense was committed had 200 or more employees and
 - (i) an individual within high-level personnel of the unit participated in, condoned, or was willfully ignorant of the offense; or
 - (ii) tolerance of the offense by substantial authority personnel was pervasive throughout such unit,

add **3** points; or
 - (4) If the organization had 50 or more employees and an individual within substantial authority personnel participated in, condoned, or was willfully ignorant of the offense, add **2** points; or
 - (5) If the organization had 10 or more employees and an individual within substantial authority personnel participated in, condoned, or was willfully ignorant of the offense, add **1** point.
- (c) Prior History
- If more than one applies, use the greater:
- (1) If the organization (or separately managed line of business) committed any part of the instant offense less than 10 years after (A) a criminal adjudication based on similar misconduct; or (B) civil or administrative adjudication(s) based on two or more separate instances of similar misconduct, add **1** point; or
 - (2) If the organization (or separately managed line of business) committed any part of the instant offense less than 5 years after (A) a criminal adjudication based on similar misconduct; or (B) civil or administrative adjudication(s) based on two or more separate instances of similar misconduct, add **2** points.

(d) Violation of an Order

If more than one applies, use the greater:

- (1) (A) If the commission of the instant offense violated a judicial order or injunction, other than a violation of a condition of probation; or (B) if the organization (or separately managed line of business) violated a condition of probation by engaging in similar misconduct, *i.e.*, misconduct similar to that for which it was placed on probation, add **2** points; or
- (2) If the commission of the instant offense violated a condition of probation, add **1** point.

(e) Obstruction of Justice

If the organization willfully obstructed or impeded, attempted to obstruct or impede, or aided, abetted, or encouraged obstruction of justice during the investigation, prosecution, or sentencing of the instant offense, or, with knowledge thereof, failed to take reasonable steps to prevent such obstruction or impedance or attempted obstruction or impedance, add **3** points.

(f) Effective Compliance and Ethics Program

- (1) If the offense occurred even though the organization had in place at the time of the offense an effective compliance and ethics program, as provided in §8B2.1 (Effective Compliance and Ethics Program), subtract **3** points.
- (2) Subsection (f)(1) shall not apply if, after becoming aware of an offense, the organization unreasonably delayed reporting the offense to appropriate governmental authorities.
- (3) (A) Except as provided in subparagraphs (B) and (C), subsection (f)(1) shall not apply if an individual within high-level personnel of the organization, a person within high-level personnel of the unit of the organization within which the offense was committed where the unit had 200 or more employees, or an individual described in §8B2.1(b)(2)(B) or (C), participated in, condoned, or was willfully ignorant of the offense.

(B) There is a rebuttable presumption, for purposes of subsection (f)(1), that the organization did not have an effective compliance and ethics program if an individual—

- (i) within high-level personnel of a small organization; or
- (ii) within substantial authority personnel, but not within high-level personnel, of any organization,

participated in, condoned, or was willfully ignorant of, the offense.

(C) Subparagraphs (A) and (B) shall not apply if—

- (i) the individual or individuals with operational responsibility for the compliance and ethics program (*see* §8B2.1(b)(2)(C)) have direct reporting obligations to the governing authority or an appropriate subgroup thereof (*e.g.*, an audit committee of the board of directors);
- (ii) the compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonably likely;
- (iii) the organization promptly reported the offense to appropriate governmental authorities; and
- (iv) no individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.

(g) Self-Reporting, Cooperation, and Acceptance of Responsibility

If more than one applies, use the greatest:

- (1) If the organization (A) prior to an imminent threat of disclosure or government investigation; and (B) within a reasonably prompt time after becoming aware of the offense, reported the offense to appropriate governmental authorities, fully cooperated in the investigation, and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract **5** points; or
- (2) If the organization fully cooperated in the investigation and clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract **2** points; or
- (3) If the organization clearly demonstrated recognition and affirmative acceptance of responsibility for its criminal conduct, subtract **1** point. . . .

§ 8C2.6. Minimum and Maximum Multipliers

Using the culpability score from § 8C2.5 (Culpability Score) and applying any applicable special instruction for fines in Chapter Two, determine the applicable minimum and maximum fine multipliers from the table below.

<u>Culpability Score</u>	<u>Minimum Multiplier</u>	<u>Maximum Multiplier</u>
10 or more	2.00	4.00
9	1.80	3.60
8	1.60	3.20
7	1.40	2.80
6	1.20	2.40
5	1.00	2.00
<u>Culpability Score</u>	<u>Minimum Multiplier</u>	<u>Maximum Multiplier</u>
4	0.80	1.60
3	0.60	1.20
2	0.40	0.80
1	0.20	0.40
0 or less	0.05	0.20

§ 8C2.7. Guideline Fine Range - Organizations

- (a) The minimum of the guideline fine range is determined by multiplying the base fine determined under §8C2.4 (Base Fine) by the applicable minimum multiplier determined under §8C2.6 (Minimum and Maximum Multipliers).
- (b) The maximum of the guideline fine range is determined by multiplying the base fine determined under §8C2.4 (Base Fine) by the applicable maximum multiplier determined under §8C2.6 (Minimum and Maximum Multipliers).

Historical Note: Effective November 1, 1991.

§ 8C2.8. Determining the Fine Within the Range (Policy Statement)

- (a) In determining the amount of the fine within the applicable guideline range, the court should consider:
 - (1) the need for the sentence to reflect the seriousness of the offense, promote respect for the law, provide just punishment, afford adequate deterrence, and protect the public from further crimes of the organization;
 - (2) the organization's role in the offense;
 - (3) any collateral consequences of conviction, including civil obligations arising from the organization's conduct;
 - (4) any nonpecuniary loss caused or threatened by the offense;
 - (5) whether the offense involved a vulnerable victim;
 - (6) any prior criminal record of an individual within high-level personnel of the organization or high-level personnel of a unit of the organization who participated in, condoned, or was willfully ignorant of the criminal conduct;
 - (7) any prior civil or criminal misconduct by the organization other than that counted under §8C2.5(c);
 - (8) any culpability score under §8C2.5 (Culpability Score) higher than 10 or lower than 0;
 - (9) partial but incomplete satisfaction of the conditions for one or more of the mitigating or aggravating factors set forth in §8C2.5 (Culpability Score);
 - (10) any factor listed in 18 U.S.C. § 3572(a); and
 - (11) whether the organization failed to have, at the time of the instant offense, an effective compliance and ethics program within the meaning of §8B2.1 (Effective Compliance and Ethics Program).
- (b) In addition, the court may consider the relative importance of any factor used to determine the range, including the pecuniary loss caused by the offense, the pecuniary gain from the offense, any specific offense characteristic used to determine the offense level, and any aggravating or mitigating factor used to determine the culpability score. . . .

PART D - ORGANIZATIONAL PROBATION

§ 8D1.1. Imposition of Probation - Organizations

- (a) The court shall order a term of probation:
- (1) if such sentence is necessary to secure payment of restitution (§ 8B1.1), enforce a remedial order (§ 8B1.2), or ensure completion of community service (§ 8B1.3);
 - (2) if the organization is sentenced to pay a monetary penalty (*e.g.*, restitution, fine, or special assessment), the penalty is not paid in full at the time of sentencing, and restrictions are necessary to safeguard the organization's ability to make payments;
 - (3) if, at the time of sentencing, (A) the organization (i) has 50 or more employees, or (ii) was otherwise required under law to have an effective compliance and ethics program; and (B) the organization does not have such a program;
 - (4) if the organization within five years prior to sentencing engaged in similar misconduct, as determined by a prior criminal adjudication, and any part of the misconduct underlying the instant offense occurred after that adjudication;
 - (5) if an individual within high-level personnel of the organization or the unit of the organization within which the instant offense was committed participated in the misconduct underlying the instant offense and that individual within five years prior to sentencing engaged in similar misconduct, as determined by a prior criminal adjudication, and any part of the misconduct underlying the instant offense occurred after that adjudication;
 - (6) if such sentence is necessary to ensure that changes are made within the organization to reduce the likelihood of future criminal conduct;
 - (7) if the sentence imposed upon the organization does not include a fine; or
 - (8) if necessary to accomplish one or more of the purposes of sentencing set forth in 18 U.S.C. § 3553(a)(2).

§ 8D1.2. Term of Probation - Organizations

- (a) When a sentence of probation is imposed—
- (1) In the case of a felony, the term of probation shall be at least one year but not more than five years.

- (2) In any other case, the term of probation shall be not more than five years.

§ 8D1.3. Conditions of Probation - Organizations

- (a) Pursuant to 18 U.S.C. § 3563(a)(1), any sentence of probation shall include the condition that the organization not commit another federal, state, or local crime during the term of probation.
- (b) Pursuant to 18 U.S.C. § 3563(a)(2), if a sentence of probation is imposed for a felony, the court shall impose as a condition of probation at least one of the following: (1) restitution or (2) community service, unless the court has imposed a fine, or unless the court finds on the record that extraordinary circumstances exist that would make such condition plainly unreasonable, in which event the court shall impose one or more other conditions set forth in 18 U.S.C. § 3563(b).
- (c) The court may impose other conditions that (1) are reasonably related to the nature and circumstances of the offense or the history and characteristics of the organization; and (2) involve only such deprivations of liberty or property as are necessary to effect the purposes of sentencing. . . .

Problem 18-5

Recall the JP Morgan “London Whale” case from Chapter 3. If the government had proceeded against JP Morgan to a trial and conviction, rather than a settlement, estimate how the above Guidelines would have calculated JP Morgan’s recommended fine range, assuming that revelation of the mismarking in the London books caused a \$750 million loss in JP Morgan’s market capitalization.

C. Sentencing Firms Through Plea Agreements

UNITED STATES v. AEGERION PHARMACEUTICALS, INC., 2017 WL 5586728 (D. Mass. Nov. 20, 2017)

WILLIAM G. YOUNG, District Judge:

Let’s see if I’ve got this straight. Aegerion Pharmaceuticals, Inc. (“Aegerion”) developed an effective medicine, called Juxtapid, to treat high cholesterol in people with a rare genetic disease. The treatment did not come cheap. “At market launch in January 2013, Juxtapid cost roughly \$295,000 per patient per year. The annual cost of Juxtapid later increased to over \$330,000 per patient per year.”

Thereafter Aegerion engaged in a series of unfair and deceptive acts, including outright fraud, which pervaded corporate management, all designed to increase the use of Juxtapid in circumstances where such treatment was not medically indicated. Aegerion wrongfully received a great deal of money from this corporate criminal conduct. Still more important, it appears that Aegerion knowingly induced the prescription of Juxtapid to many patients for which it would do no good, thus crowding out more promising

therapies. Indeed, “[n]umerous HeFH, statin-intolerant, and diabetic patients, including elderly and pediatric patients suffered adverse events, including liver toxicity and gastrointestinal distress, and had to discontinue use of Juxtapid.”

Facing two misdemeanor counts of introducing misbranded drugs into interstate commerce, Aegerion now seeks to plead guilty, pursuant to Fed. R. Crim. P. 11(c)(1)(C) (the “C” plea). Under a “C” plea, the judge’s choice at sentencing is limited to imposing the sentence agreed between the government and the offender or rejecting the plea altogether. The judge, of course, is forbidden from engaging in the plea bargaining itself. These two requirements conflict whenever a court is inclined to reject a “C” plea since an unexplained rejection smacks of personal fiat and any explanation sounds like court interference in the parties’ good faith bargaining. There is no easy course. Seeking to avoid this difficulty, this Court in *United States v. Orthofix, Inc.*, thoroughly considered the issues and explained its conclusion that the “C” plea has no place, save in the rarest circumstances, in the context of corporate criminal pleas.

As this case illustrates, the issues presented by the “C” plea in the corporate context are more disquieting than I had originally thought.

To begin:

Here, there is much to commend the proffered plea; unfortunately much of it remains sealed so as not to compromise on-going criminal investigations. It suffices here to say that Aegerion’s top management has undergone a near complete makeover and that its cooperation with the government’s law enforcement efforts is truly extraordinary.

That said, in light of the larger issues discussed below, it is the duty of this Court candidly to explain the issues it has with this proffered “C” plea. This Court is not bargaining with the parties. None of these points—singly or together—is necessarily a deal breaker. Each one is a consideration—and perhaps I may well not yet have considered every relevant issue.

Oh, Aegerion amended “C” plea—

How do I dislike thee?

Let me count the ways:

- The government agrees that sentencing may take place immediately upon this Court’s acceptance of the “C” plea even without the preparation of a Pre-Sentence Report. Why? One can readily understand why Aegerion wants its plea and sentence to be a one-day story, soon forgotten. Why does the government agree? Isn’t it better to permit the Court to obtain a thorough Pre-Sentence Report from its own Probation Office the better to understand this complex case?
- Are the Sentencing Guidelines properly calculated? Why is there no enhancement for vulnerable victims? U.S.S.G. § 3A1.1(b)(1). One would think that the marketing of

misbranded drugs to a patient population in need of appropriate treatment would meet the quintessential definition of vulnerable victims. Is there no enhancement for the use of sophisticated means to commit the crimes? After all, the scheme here involved falsely marketing Juxtapid for off-label uses to sophisticated physicians. One can readily infer that such false marketing was itself sophisticated.

- Assuming without concluding that the Sentencing Guidelines are properly calculated, the recommended fine range is not less than \$18,542,192 to \$30,903,653. Even so, the “C” plea calls for a fine of only \$6,200,000 paid in installments and forfeiture of \$1,000,000. The parties justify the downward variance by pointing to the extraordinary cooperation of Aegerion’s new management and its present precarious financial condition.

What is left unexplained is why the government does not simply let Aegerion collapse in disgrace. Surely Aegerion is not too big to fail. After all, its stock apparently is now owned by Novelion, Inc., an innocent investor but one knowledgeable of Aegerion’s criminal conduct at the time of its investment. Couldn’t an asset sale to Novelion fund the civil settlement, the fine, and the forfeiture? Couldn’t Novelion pick up Aegerion’s employees? After all, Juxtapid is an FDA approved medicine with an appropriate therapeutic value.

Perhaps these questions do not make economic, real world sense. The point is, I do not know and the proffered “C” plea does not begin to explain the financial picture in detail. Apparently the parties think their representations suffice. They do not. I have a job to do—an independent judicial responsibility I may not delegate to others.

- Most problematic, this “C” plea provides not one cent of restitution to the actual victims. This result is justified say the parties by the multi-million dollar proposed settlement between Aegerion and the third-party payors, federal and state, who were fleeced into paying for misbranded drugs. Thus, governmental actors (who inferentially provided most of the purloined funds) get partial repayment but the actual victims, many of whom suffered medical complications and physical and emotional harm, get nothing.

How can I possibly justify such a result? The parties aver “that the complication and prolongation of the sentencing process that would result from an attempt to fashion a proper restitution order under 18 U.S.C. § 3663 outweighs the need to provide restitution to any non-governmental victims in this case.” Really?

Why? The parties are utterly silent on this point. Indeed, in light of this Court’s management of the *In Re Relafen Antitrust Litigation*, it hardly seems an insurmountable burden to find out who got Juxtapid when such medication was not clinically indicated. After all, the parties agree Aegerion’s gross gain is \$15,451,827.

- This “C” plea obligates the government not to undertake any further prosecution of Aegerion. What is the government trading away here? Why? What other companies may be implicated? None of this information is provided. Are we not concerned we may be

foisting misbranded drugs on innocent and unsuspecting victims in other nations without adequate notification to their regulatory authorities?

- This Court has already commended the new management of Aegerion for its truly remarkable cooperation. It appears to go far beyond the cooperation required in the plea agreement. Why, then, is the cooperation agreement portion of the proffered “C” plea so pallid? The language of the proffered “C” plea is hardly a template for other cases. It obligates the corporate defendant to do little more than could be required by a proper subpoena.

- The proffered “C” plea includes a comprehensive—and in this Court’s mind adequate—internal compliance and review program to prevent any recurrence of this wrongdoing. The problem is that the proposed program is entirely internal. There is no provision for the Court’s personnel (or some independent employee) independently to examine compliance much like an on-site bank examiner. Even with strict compliance, independent evaluation provides valuable insight. *See* Gretchen Morgenson, *The Fed Wants to Make Life Easier for Big-Bank Directors*, N.Y. TIMES (Aug. 11, 2017), (“[R]educing the information flow between bank boards and [bank examiners] just doesn’t seem smart.”); *see also* Katrice Bridges Copeland, *The Yates Memo: Looking for “Individual Accountability” in all the Wrong Places*, 102 IOWA L. REV. (2017) (“One of the principal problems with the government’s approach to corporate crime is that the government expects the corporation to police itself. The notion that the corporation should perform the prosecutor’s function of investigating, identifying, and providing evidence against the wrongdoer within the corporation is ludicrous. . . . If the government truly wants to achieve individual accountability, it must therefore conduct its own investigations from start to finish, rather than relying upon the corporation’s internal investigation.”).

- While the amended “C” plea now includes a period of probation, it still prohibits this Court from setting any special conditions beyond those set forth in the agreement.

- Perhaps Aegerion’s plea is premature. Maybe the Court ought stay its hand until the other criminal investigations have run their course. In that way, the Court fairly could evaluate the actual value of Aegerion’s cooperation. *Cf.* U.S.S.G. 5K1.1. . . .

Aware of the concern for promoting justice, Aegerion advances three reasons why this Court ought nevertheless here take a pass and accept this proffered “C” plea.

First, Aegerion argues that times have changed since *Orthofix, Inc.* Look, it says, today we have the “Yates Memo” within the Department of Justice “emphasizing the importance of prosecuting the individuals responsible for the underlying wrongdoing when combatting corporate crime.” Such prosecutions depend on corporate cooperation, Aegerion claims, and therefore “C” pleas must be granted to garner such cooperation. These are questionable premises. There has been no uptick in the prosecution of criminal executives since the issuance of the “Yates Memo” in 2015. Moreover, no responsible

analysis suggests that, given the government's extensive powers to secure cooperation, granting "C" pleas plays any role in aiding its law enforcement goals.

Second, Aegerion posits that "[e]ntering into a Rule 11(c)(1)(C) plea is often a corporation's only option to resolve criminal charges as the uncertainty in sentencing inherent in Rule 11(c)(1)(B) pleas causes too great a risk to innocent employees, shareholders, investors, and other interested parties." Say what? Why is a "C" plea often a corporation's only option to resolve criminal charges? Does Aegerion think district judges simply are not competent to sentence corporate criminals? Or is it that the interests of drug dealers' innocent wives, children, neighbors, and colleagues are somehow less important than those of a corporation's shareholders and investment bankers? A "C" plea is never a corporation's only option—it has the option of a fair and impartial trial before an American jury, the purest and most incorruptible justice humankind has ever conceived.

Finally, Aegerion argues forcefully that rejecting its "C" plea would result in impermissible disparity in our sentencing regime. It notes, with apparent accuracy, "[t]he vast majority of corporate criminal charges involve (C) pleas. Since Orthofix pled guilty in December 2012, at least 85 companies have had (C) pleas accepted by federal courts." Aegerion supports this general statement with a footnote carefully limited to detailing the practice concerning criminal pharmaceutical corporations in this district. . . .

Reduced to its essence, Aegerion's argument goes like this: Look at this roster of criminal pharmaceutical corporations sentenced in Massachusetts:

ROSTER OF CRIMINAL PHARMACEUTICAL CORPORATIONS

Warner Chilcott Sales U.S. (LLC)

GlaxoSmithKline LLC

Merck Sharp & Dohme Corp.

Elan Pharm., Inc.

SB Pharmco Puerto Rico, Inc.

Forest Pharm, Inc.

Ortho-McNeil Pharm., LLC.

Pharmacia & Upjohn Co.

Biovail Pharm. Inc.

Bryan Corp.

Schering Sales Corp.

Serono Laboratories, Inc.

Warner-Lambert Co. LLC

Bayer Corp.

TAP Pharm. Products, Inc.

Like these corporations, we [Aegerion] are a criminal pharmaceutical corporation. They all got “C” pleas. Therefore we should too—it’s forbidden disparity if we don’t.

This argument is silly—complete balderdash. The disparity addressed by the Sentencing Reform Act of 1984 and the jurisprudence that follows it deals with unwarranted disparity among sentences actually imposed, not the analyses the judges used to get there.

Aegerion has, however, proved a different type of unwarranted disparity—the shocking disparity between the treatment of corporations and individuals in our criminal justice system. I am ashamed I had not recognized this glaring inequity until this case. Passing without further comment the truly breathtaking extent of pharmaceutical corporate criminality revealed by the “roster” above, Aegerion proves beyond peradventure that a forbidden two-tier system pervades our courts. Corporations routinely get “C” pleas after closed door negotiations with the executive branch while individual offenders but rarely are afforded the advantages of a “C” plea. Instead, they plead guilty and face a truly independent judge. This is neither fair nor just; indeed, it mocks our protestations of “equal justice under law.”

It’s not hard to understand why corporations facing criminal charges seek “C” pleas. It gives them various advantages, including the most effective damage control.

Save when they are themselves on the attack, seeking to enforce their own property rights, corporations today seek to avoid the legal system altogether, *see In re Relafen Antitrust Litigation*; Mark Galanter, *The Hundred-Year Decline of Trial and the Thirty Years War*, 57 STAN. L. REV. (2005) (“The recent accelerated decline in the number of trials is . . . part of a much broader turn from law, a turn away from the definitive establishment of public accountability in adjudication . . .”), negotiating their differences with the administrative state in other fora, *see* William G. Young, *An Open Letter to U.S. District Judges*, 50-JUL FED. LAW. (2003) (“[Corporations have] a good chance of opting out of the legal system altogether. Today’s expansive reading of the Federal Arbitration Act allows the unilateral imposition of arbitration clauses to trump all sorts of civil rights and consumer protection legislation. Coupled with today’s expansive preemption jurisprudence, business can (and does) make a rational calculus that leads it to lobby for an ever-diminishing role for the federal district courts.”). They have been enormously successful. The insurance industry found it could largely immunize itself from suit due to the Employee Retirement Income Security Act (“ERISA”). In light of Supreme Court jurisprudence, many corporations found that through mandatory anti-consumer arbitration they could largely lock the little guy out of

the courthouse. Moreover, corporations frequently found they could make peace with many executive agencies without admitting liability (thus exposing them to related civil litigation) and, even more important, could compel the imprimatur of the courts thereon.

Small wonder, then, that corporations seek the same cozy model (and act as though it is their due) even when facing serious criminal charges. Consider the advantages to the corporation of the “C” plea: All negotiations are private. No charges are brought until the plea deal is finalized so the risk of investigative journalism is minimized. All aspects of the sanction are negotiated so there will be no surprises from the judiciary. As the record here makes clear, the likelihood of the judge turning down the “C” plea is virtually non-existent. In a best case scenario, the court will perform the plea colloquy with a lower level functionary and will immediately impose the agreed upon sanction. Case over—in the vernacular of the days of the print journalism, “a one day story, second section, below the fold.”

What is far more difficult to fathom is why the government negotiates a “C” plea with a corporation. In my experience, individuals are afforded “C” pleas only when the government’s case is weak and it is trying to lock in the plea or when it is trying to flip an implicated co-defendant and obtain evidence against others. Neither of these concerns apply in most corporate criminal prosecutions. A corporation has no Fifth Amendment privilege, *Braswell v. United States*, and it cannot testify. In my experience, the government never even commences a criminal prosecution against a corporation unless it has a very strong case.

So why does the government uniformly buckle on this point? Knowledgeable commentators have levelled harsh criticisms against prosecutors for such risk aversion. See e.g., JESSE EISINGER, *THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES* (Simon & Schuster 2017); Jed S. Rakoff, *Justice Deferred is Justice Denied*, N.Y. REVIEW OF BOOKS (Feb. 19, 2015). Lacking sufficient knowledge, this Court expresses no opinion.

I can, however, offer two observations prosecutors ought always keep in mind.

First, trials matter. “Every lawsuit—whether it is a dispute arising out of a contract, the purchase of a defective product, or the conduct of a government official—has the potential to change the rules that govern behavior going forward.” ALEXANDRA LAHAV, *IN PRAISE OF LITIGATION 6* (Oxford Univ. Press, 2017). The verdict of an American jury has a moral force incomparably greater than any plea. That’s why corporations are so desperate to avoid them. Corporate pleas involve well-educated elites talking to other equally well-educated elites. Things are said, sanctions imposed, nothing really happens. Prices do not come down. Consumers gain no perceptible benefit. Corporations march on, apparently impervious to government regulation or the law itself.

Contrast an actual trial: every trial is a public morality play—perhaps a story of greed and avarice or amoral chicanery, all of it played out live upon actual understandable evidence before twelve public judges largely chosen at random. The result is the fairest,

most incorruptible, democratic expression of justice humankind has ever known. “[L]itigation is a social good [which] enables people to promote the rule of law and affirms our citizen-centered political system.”

Litigation helps democracy function in a number of ways: it helps to enforce the law; it fosters transparency by revealing information crucial to individual and public decision-making; it promotes participation in self-government; and it offers a form of social equality by giving litigants equal opportunities to speak and be heard. . . .

Second, every corporate “C” plea diminishes the legitimacy of our independent judiciary. Even when prosecutors agree to bargain for a plea, why make it a “C” plea? What does a “C” plea add to the public good where prosecutors have a sound case? Face it, if used in strong cases the “C” plea delegitimizes the central role of the trial judge.

Any injustice rankles Americans, systemic injustice rankles them profoundly. Those of us who occupy the constitutional offices of the United States—in whatever branch we serve—must humbly acknowledge that there exists in America today a deep and pervasive sense of injustice. . . .

Upon this record and against this background, accepting this “C” plea simply is not in the public interest. There are just too many unknowns here and the “C” plea process itself unduly hobbles this Court’s sworn constitutional duty to “do equal right to the poor and to the rich.” 28 U.S.C. § 453.

I end as I began. I am not bargaining with anyone. The problem is the “C” plea process itself. Indeed, as I have already said, there is much in the proffered plea agreement to commend. Moreover, there is here not a scintilla of evidence of collusion among the parties. This does not appear to be a sweetheart deal. Were this Court to have a free hand, I might well sentence Aegerion to virtually the same sentence as the parties here urge on the Court (that’s what happened in Orthofix)—or I might not. I simply do not know because, as yet, the parties have deprived me of that responsibility, perpetuating an improper and unjust two-tier system that erodes public confidence in the sentence to be imposed in violation of 18 U.S.C. 3553(a) (if indeed it does not violate the Equal Protection clause of the 14th Amendment to the U.S. Constitution).

This case will stand for trial as previously ordered.

Problem 18-6
Let us end where we started, with a question of theory. How should the legal system punish corporations (assuming that one agrees that they are appropriate subjects of punishment)?

AUTHOR

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