

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 its 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, Jean Wilson-Stayton for assistance with the third and fourth editions, and Julia Searby for work on the fifth edition.

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 draws 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 early 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."

[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.	

INTRODUCTION

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.”

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.”

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.”

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 prblem 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 distroin 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 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.

INTRODUCTION

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 226 1A(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

INTRODUCTION

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 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.

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- 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 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.

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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 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

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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!)

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?

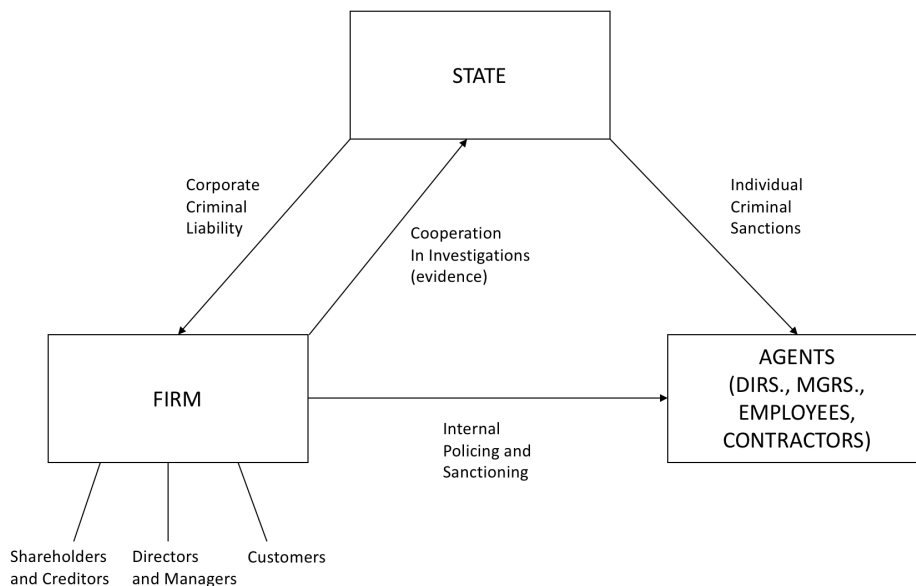
1. CRIMINAL LIABILITY OF BUSINESS FIRMS

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 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 Med. 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, Int’l Longshoremen’s Ass’n* (“[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 shifting the burden to 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, N.A., 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 provisions of the Justice Manual setting out DOJ policy on prosecution of corporations, together with recent policy updates issued by the Trump and Biden Administration DOJ’s; (2) the SEC’s “Seaboard Report,” which is the most explicit statement from the SEC on its policy regarding enforcement against firms; and (3) a recent judicial decision on the question of whether courts have any role in the current *de facto* enforcement process.

Note that the DOJ’s Justice Manual is the general handbook for all federal prosecutors containing the Department’s internal rules and policies. It does not have the force of statute or regulation (“The Justice Manual provides internal DOJ guidance. It is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter, civil or criminal. Nor are any limitations hereby placed on otherwise lawful litigation prerogatives of DOJ.”). In addition to the Justice Manual, the DOJ regularly issues memoranda, which often vary from administration to administration, setting out policies on enforcement, sometimes with the status of “pilot programs.”

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 economy and capital markets by enforcing the rule of law; (2) protecting consumers, investors, and business entities against bad actors that gain unfair advantage or cause economic harm by violating the law; (3) preventing violations of environmental and worker safety 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, the Department accomplishes multiple goals. First, the Department increases its 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, by focusing on individuals, the Department 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, the Department maximizes the likelihood that the criminal investigation appropriately identifies and holds accountable culpable individuals and not just the corporation.

These Principles provide internal Department of Justice guidance. They are not intended to, do not, and may not be relied upon to create any rights, substantive or procedural, enforceable at law by any party in any matter civil or criminal. Nor are any limitations hereby placed on otherwise lawful investigative and litigative prerogatives of the Department of Justice.

[updated March 2023]

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 prosecutors perform their jobs—including the professionalism and civility demonstrated, willingness to secure the facts in a manner that encourages corporate compliance and self-regulation, and appreciation that corporate prosecutions can cause harm to blameless investors, employees, and others—affects public perception of the Department's mission. Federal prosecutors must maintain public confidence in the way in which the Department of Justice exercises charging discretion. This endeavor requires the thoughtful analysis of all facts and circumstances presented in a given case.

[updated April 2023]

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. Holding corporations accountable 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: There is no DOJ policy establishing a presumption against or in favor of seeking an indictment against a corporation. Rather, in all cases involving corporate wrongdoing, prosecutors should consider each of the factors discussed in these guidelines in determining whether to charge a corporation or enter into a corporate resolution, including the appropriate structure and form of a resolution, the monetary penalty, compliance terms, and other provisions. In doing so, prosecutors should be aware of the public benefits that can flow from charging a corporation in appropriate cases. For instance, corporations are likely to take immediate remedial steps when another corporation is charged with criminal misconduct that is pervasive throughout a particular industry, and thus an criminal charges can provide a unique opportunity for deterrence on a broad scale. In addition, a corporate prosecution may result in specific deterrence by changing the culture of the charged 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 charging a corporation under such circumstances.

In certain instances, it may be appropriate to resolve a corporate criminal case by means other than an indictment or pre-indictment guilty plea. 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).

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."

When the Department enters into a plea agreement, a deferred prosecution agreement, or a non-prosecution agreement to resolve corporate criminal liability, the agreement should, to the greatest extent possible, include: (1) an agreed-upon statement of facts outlining the criminal conduct that forms the basis for the agreement; and (2) a statement of relevant considerations that explains the Department's reasons for entering into the agreement. Relevant considerations may, for example, include: the corporation's voluntary self-disclosure (or any self-reporting) to the Department, cooperation with the Department's investigation, and remedial efforts (or lack thereof); the basis for and extent of cooperation credit, if any, that the corporation is receiving; the seriousness and pervasiveness of the criminal conduct; the corporation's history of misconduct; the state of the corporation's compliance program at the time of the underlying criminal conduct and at the time of the resolution; the reasons for imposing an independent compliance monitor or any other compliance undertaking, if applicable; other relevant factors listed in JM § 9-28.300; and any other key considerations related to the Department's decision regarding the resolution. Absent exceptional circumstances, corporate criminal resolution agreements will be published on the Department's public website.

[updated April 2023]

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 outside the corporation. Because a corporation can act only through individuals, holding individual wrongdoers criminally liable may provide the strongest deterrent against future corporate wrongdoing. Provable individual criminal charges should be pursued, particularly if they implicate 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, or prosecution against individuals is not viable for other reasons, prosecutors must submit to the supervising United States Attorney or Assistant Attorney General a prosecution or resolution authorization memorandum that addresses the potential liability of individuals, a description of the current status of the investigation regarding their conduct and the investigative work that remains to be done, and, whenever warranted, an investigative plan to bring the matter to resolution expeditiously and prior to the end of any statute of limitations period. In such cases, prosecutors must obtain the approval of the supervising United States Attorney or Assistant Attorney General of both the corporate resolution and the memorandum addressing the investigation of responsible individuals and why it is not resolving before or concurrently with the corporate case.

At times, Department criminal investigations take place in parallel to criminal investigations in foreign jurisdictions into the same or related conduct. In such situations, the Department may learn that a foreign government intends to bring criminal charges against an individual whom the Department is also investigating. 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. In making that determination, 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 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.

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 their 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. A corporate prosecution may be viable even where a corporation has a policy against the particular activity.

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.

[updated April 2023]

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. *See id.* 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 individuals in corporate management (*see* JM 9-28.500);
3. the corporation’s history of misconduct, including prior criminal, civil, and regulatory enforcement actions against it, both domestically and internationally (*see* JM 9-28.600);
4. the corporation’s willingness to cooperate, including as to potential wrongdoing by its current and former employees, directors, officers, and agents, as well as other individuals and entities that engaged in the misconduct under investigation (*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 self-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, to execute financial compensation measures that punish wrongdoing, 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, domestically or internationally, 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 misconduct (*see* JM 9-28.1300); and
 11. the interests of any victims (*see* JM 9-28.1400), including what steps the corporation has taken to identify potential victims, or other persons or entities who were significantly, even if indirectly, harmed by the criminal conduct, and what steps the corporation has taken to mitigate such harm.

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 sufficiently aggravating 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.

[updated May 2024]

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: The Department encourages and rewards cooperation. Credit for cooperation takes many forms and is calculated differently based on the degree to which a corporation cooperates with the government's investigation and the commitment that the corporation demonstrates in doing so. A corporation's cooperation may, as part of a holistic analysis, impact the appropriate form of the resolution as well as the fine range and fine amount.

Companies that identify significant facts but delay their disclosure will place in jeopardy their eligibility for cooperation credit. Corporations seeking cooperation credit ultimately bear the burden of ensuring that documents and information are provided in a timely manner to prosecutors.

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

Likewise, production of evidence to the government that is most relevant for assessing individual culpability should be prioritized. 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.

In assessing a corporation's cooperation during a criminal investigation, prosecutors should consider the following non-exhaustive list of factors, exercising appropriate discretion regarding the weight to be attributed to each factor, as well as any additional factors that may be relevant for consideration given the facts of a particular case. The greatest amount of cooperation credit will generally be provided when companies cooperate through the following actions:

1. Timely disclosure of all facts relevant to the wrongdoing at issue, including:
 - a. facts gathered during a corporation's internal investigation, if the company chooses to conduct one;
 - b. attribution of facts to specific sources, rather than a general narrative of the facts; and
 - c. identification of all individuals involved in or responsible for the misconduct at issue, regardless of their position, status, or seniority, including the corporation's officers, employees, customers, competitors or agents and third parties, and all relevant facts relating to the misconduct and the involvement by those individuals;
2. Proactive cooperation, rather than reactive; that is, timely disclosure of all facts that are relevant to the investigation and, where the corporation is aware of

opportunities for the Department to obtain relevant evidence not in the corporation's possession and not otherwise known to the Department, timely identification of those opportunities;

3. Timely voluntary preservation, collection, and disclosure of relevant documents and information relating to their provenance, including (a) disclosure of documents located overseas, the locations in which such documents were found, their custodians, and who authored and found the documents, (b) facilitation of third-party production of documents, and (c) where requested, provision of translations of relevant documents in foreign languages;
 - a. Where a corporation claims that disclosure of overseas documents is prohibited due to data privacy, blocking statutes, or other reasons related to foreign law, the corporation bears the burden of establishing the prohibition and identifying reasonable alternatives such that the Department receives the necessary facts and evidence to continue its investigations and prosecutions. Moreover, a corporation should work diligently to identify all available legal bases to provide such documents;
 - b. Prosecutors also should consider the extent to which a corporation enforced effective document and data retention policies in order to preserve, collect, and disclose documents, data, and other evidence relevant to the government's investigation (including as to third-party messaging data, regardless of whether the data is kept on corporate or personal devices that are used for work purposes);
4. De-confliction of witness interviews and other investigative steps that a corporation takes as part of its internal investigation, should it conduct one, to prevent the corporation's investigation from conflicting or interfering with the Department's investigation; and
5. Where appropriate and possible, making corporate officers and employees who possess relevant information available for interviews by the Department; this includes, officers, employees, and agents located overseas, as well as former officers and employees, and, where possible, the facilitation of interview of third-party witnesses.

B. Comment: A cooperating corporation must earn credit for cooperation; it is not provided as a matter of course. In other words, a corporation starts at zero cooperation credit and then earns credit for specific cooperative actions, rather than starting at maximum available credit that is decreased based on deficiencies in cooperation. A lack of genuine cooperation will result in a corporation receiving no credit or minimal credit, depending on the extent to which the cooperation was lacking. Moreover, a corporation that fails to demonstrate timely and full cooperation at the earliest opportunity reduces its ability to earn cooperation credit. For avoidance of doubt, a corporation is not required to waive its attorney-client privilege or attorney work product protection to be eligible to engage in cooperation or satisfy any threshold.

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 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.

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. This leads to timely resolution of investigations, which promotes public confidence, maximizes deterrence, and allows ongoing deficiencies at the corporation to be corrected and preventive measures established. With cooperation by the corporation, the government may be able to reduce tangible losses, limit undue 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.

The requirement that companies cooperate completely as to individuals does not mean that prosecutors should wait for corporations to deliver the information about individual wrongdoers and then merely accept what companies provide. To the contrary,

prosecutors proactively investigate individuals at every step of the process—before, during, and after any corporate cooperation. Prosecutors 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, exaggerate, or otherwise misrepresent the behavior or role of any individual or group of individuals.

Prosecutors should strive to obtain from a cooperating corporation as much information as possible about responsible individuals before resolving the corporate case. In addition, the corporation'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 corporation to provide information about all individuals substantially involved in or responsible for the misconduct, 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.

[updated March 2023]

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 timely 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 timely 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. . . .

In short, the corporation may be eligible for cooperation credit regardless of whether it chooses to waive privilege or work product protection in the process, if it timely 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 JM 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. . . .

[updated March 2023]

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 all facts relating to misconduct 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. The nature of some crimes may be such that prosecutions of corporations are warranted notwithstanding the existence of a compliance program.

The adequacy of a corporation's compliance program, including its corporate culture, however, can have a direct and significant impact on the terms of any resolution with the Department. Prosecutors should evaluate a corporate compliance program as a factor in determining, *inter alia*, whether to charge the corporation, the terms of a corporate resolution, and the need for an independent compliance monitor. Prosecutors should evaluate the corporation's commitment to fostering a strong culture of compliance at all levels of the company. For example, as part of this evaluation, prosecutors should consider how the company has incentivized employee, executive, and director behavior, including through employee discipline, treatment of internal complaints of wrongdoing, and compensation plans, as part of its efforts to create an ethical and well-resourced compliance culture and organization.

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.

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*. 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."

When evaluating a compliance program in the context of an identified violation of law, prosecutors are necessarily examining a violation of law that a corporation failed to prevent. However, this does not necessarily mean that the compliance program was poorly designed, operated in bad faith, or lacked adequate resources. Failures may occur even in well-designed compliance programs, as a result of honest mistakes or deliberate circumvention by bad actors.

In evaluating the effectiveness of a compliance program, prosecutors should consider not only its comprehensiveness, but also, among other factors, the extent and pervasiveness of the criminal misconduct; the level of the corporate employees involved; the seriousness, duration, and frequency of the misconduct; and any prior remedial actions taken by the corporation, including, for example, disciplinary action against past violators uncovered by the compliance program, as well as those employees, officers, directors and third parties who may have tolerated, condoned, or encouraged criminal wrongdoing or failed to supervise adequately or install appropriate safeguards; and any revisions to corporate compliance programs in light of lessons learned. As part of assessing a corporation's culture and commitment to compliance, prosecutors should also consider the promptness of any disclosure of wrongdoing to the government; whether management disregarded the misconduct; and whether there was a failure to report any significant misconduct to corporate leadership or the board of directors.

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 permitting 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: (1) Is the corporation's compliance program well designed? (2) Is the program being applied earnestly and in good faith? In other words, is the program adequately resourced and empowered to function effectively? And (3) Does the corporation's compliance program work in practice?

Prosecutors should therefore attempt to determine whether a corporation's compliance program is merely a "paper program" or whether it was designed, implemented, resourced, reviewed, and revised, as appropriate, in an effective manner. In this regard, prosecutors evaluate a corporation's method for assessing and addressing applicable risks and designing appropriate controls to manage these risks. 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. Further, prosecutors should evaluate a corporation's methods for testing and measuring the effectiveness of its compliance program, including consideration of whether the corporation has sufficient resources to effectively monitor, audit, document, analyze, and utilize the results of the corporation's compliance efforts.

As part of this evaluation, prosecutors should consider whether the corporation has fostered a culture in which employees feel comfortable raising concerns, or one that discourages open discussion of such matters.

Careful consideration of these factors will enable prosecutors 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.

Compliance programs should be designed to detect and prevent the particular types of misconduct most likely to occur in a particular corporation's line of business. At times, corporations operate in complex regulatory environments outside the normal experience of criminal prosecutors. Accordingly, prosecutors should consult with relevant federal and state agencies with the expertise to evaluate the adequacy of a compliance program's design and implementation. For instance, state and federal banking, insurance, and medical boards, the Department of Defense, the Department of Health and Human Services, the Environmental Protection Agency, and the Securities and Exchange Commission have considerable experience with specialized compliance programs and can be helpful to prosecutors in evaluating such programs. In addition, the Fraud Section and Money Laundering and Asset Recovery Section of the Criminal Division, the Consumer Protection Branch of the Civil Division, the Commercial Litigation Branch of the Civil Division, and the Environmental Crimes Section of the Environment and Natural Resources Division can assist United States Attorneys' Offices in finding the appropriate agency office(s) for such consultation.

Use of Communication Platforms & Personal Devices

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 communication platforms, including third-party applications, to ensure that business-related electronic data and communications are preserved.

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 or deter risky behavior. 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 financial recoveries and penalties to be levied against current or former employees, executives, or directors whose direct or supervisory actions or omissions contributed to criminal conduct. Corporations can also foster 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.

Prosecutors should review a corporation's policies and practices regarding compensation and determine whether they are followed in practice. For example, 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.

[updated March 2023]

9-28.900 - Voluntary Self-Disclosures

In conjunction with regulatory agencies and other executive branch departments, the Department encourages corporations, as part of their compliance programs, to conduct internal investigations and to self-disclose discovered misconduct to the appropriate authorities. For the purposes of this Section, a "voluntary self-disclosure" occurs only when a company discloses misconduct to the Department promptly and voluntarily (*i.e.*, where it has no preexisting obligation to disclose, such as pursuant to regulation, contract, or prior Department or regulatory resolution), and when it does so prior to an imminent threat of disclosure or government investigation.

A. General Principle: Each Department component that prosecutes corporate crime must maintain a written and publicly available component policy on voluntary self-disclosure. That policy must set forth what constitutes a voluntary self-disclosure, including the component's expectations with regard to the timing of such disclosure and the need for the disclosure to be accompanied by timely preservation, collection, and production of relevant information, what benefits the corporation can expect to receive if they meet the standards for voluntary self-disclosure under the component's policy, and what circumstances constitute aggravating factors under the component's policy. All component voluntary self-disclosure policies shall share three common features:

1. Absent aggravating factors, the Department will not seek a guilty plea where a corporation is determined to have met the requirements of the applicable voluntary self-disclosure policy, fully cooperated, and timely and appropriately remediated the criminal conduct. Each Department component shall define such aggravating factors in their written policies.
2. The Department will not require the imposition of an independent compliance monitor for a cooperating company that is determined to have met the requirements of the applicable voluntary self-disclosure policy and, at the time of resolution, demonstrates it has implemented and tested an effective

compliance program. Such decisions will continue to be made on a case-by-case basis and at the sole discretion of the Department.

3. The Department will apply a presumption in favor of declining prosecution of a corporation that voluntarily self-disclosed, fully cooperated, and timely and appropriately remediated misconduct uncovered as a result of due diligence conducted shortly before or shortly after a lawful, bona fide acquisition of another corporate entity.
 - a. The prosecution team should apply this presumption in favor of declination only after concluding that the acquiror (i) voluntarily self-disclosed the misconduct in a timely manner, which generally means within 180 days of the closing date of the acquisition; (ii) fully remediated the misconduct in a timely manner, which generally means within 1 year of the closing date; and (iii) paid any disgorgement, forfeiture, and/or restitution arising from the misconduct at issue, in accordance with the applicable voluntary self-disclosure policy.
 - b. Prior to declining a prosecution, the prosecution team must (i) determine that the acquisition served a bona fide business purpose (*i.e.*, was not engineered to circumvent accountability for misconduct) and that both parties to the transaction were not coconspirators in the misconduct; and (ii) consult with the Antitrust and National Security Divisions to ensure that the potential declination would not interfere or be inconsistent with any civil or administrative process related to the acquisition.
 - c. When an acquiror discloses violations of the Sherman Act by the acquired entity, the prosecution team should apply this presumption of declination to the acquiror only when the parties (i) satisfy all relevant requirements of the Antitrust Division's leniency policy; (ii) voluntarily disclose the misconduct before the closing date of the acquisition; and (iii) suspend any review periods under the Hart-Scott-Rodino Act.

To be clear, a corporation's voluntary self-disclosure of misconduct is separate and distinct from its cooperation with an investigation, and they are to be treated as two separate and independent factors in connection with charging and resolution decisions. A company that self-discloses its misconduct can then be determined to be not fully cooperative; conversely, a company that does not self-disclose may later elect to fully cooperate with the government's investigation.

B. Comment: The Department's voluntary self-disclosure policies serve three complementary purposes: to help Department investigators and prosecutors identify corporate misconduct that they might not have otherwise discovered; to increase the likelihood of holding individual wrongdoers accountable through criminal prosecution; and to encourage corporations to promptly and thoroughly remediate misconduct that they unearth through internal compliance and audit functions.

With regard to Section 9-28.900(A)(3), prosecutors should apply a presumption in favor of declining prosecution only when the acquiror's voluntary self-disclosure relates to misconduct that the acquiror learned while conducting due diligence in connection with its acquisition of the acquired entity. If the prosecution team determines that the acquiror or its agents have presented false or misleading information to the Department, including about the extent of their prior knowledge of the acquiree's misconduct, the acquiror shall not qualify for a presumption of declination under this Section, and the prosecution team should determine whether a separate criminal investigation into the false statements is warranted.

Prosecutors may, in their discretion, apply a presumption of declination even when an acquiror voluntarily self-discloses the misconduct more than 180 days after the closing date, or when an acquiror requires more than 1 year after the closing date to fully remediate the misconduct, provided that prosecutors have a reasonable basis for extending such deadlines based on the specific facts and circumstances of the matter. Conversely, the Department expects that when a company possesses evidence of misconduct that endangers national security or presents an ongoing or imminent harm, the company will disclose that misconduct expeditiously rather than wait until the end of the 180-day post-closing window. As a result, prosecutors should not apply a presumption of declination when a company fails to disclose such misconduct expeditiously, and should consider the seriousness of the harm or potential danger when assessing how expeditious the disclosure should be.

The presumption of declination in Section 9-28.900(A)(3) applies only to the acquiror, not the acquired entity. To the extent that the acquired entity remains a distinct legal entity following the acquisition and faces potential criminal liability for its prior misconduct, prosecutors should credit the acquiring entity's timely disclosure and consider whether the acquired entity otherwise qualifies for benefits under the component's voluntary self-disclosure policies.

Although Section 9-28.900(A)(3) contemplates an acquiror and an acquiree, prosecutors may also in their discretion apply the policy to a corporate "merger of equals" or other transactional structure. In deciding whether to apply a presumption of declination in such cases, prosecutors should consider the extent to which the merged or consolidated company differs from the corporate entity where the misconduct occurred, including whether the new entity operates with a significantly more robust compliance function and under new management not associated with the prior misconduct. . . .

[updated March 2024]

9-28.1700 - Use of Independent Compliance Monitors in Corporate Resolutions

A. General Principle: Independent compliance monitors (monitors) can be an effective means of reducing the risk of further corporate misconduct and rectifying compliance

lapses identified during a corporate criminal investigation. Prosecutors should carefully assess the need for the imposition of a monitor on a case-by-case basis, without applying any presumption for or against such imposition. Two broad considerations should guide prosecutors when assessing the need for and propriety of a monitor, and the scope and duration of any monitorship: (1) the potential benefits that employing a monitor may have for the corporation and the public, and (2) whether the costs of a monitor and its impact on the operations of a corporation (which can be calibrated by tailoring the scope and duration of a monitorship) substantially outweigh the potential benefits of a monitor.

In evaluating the necessity and potential benefits of a monitor, prosecutors should consider, among other factors:

1. Whether the corporation voluntarily self-disclosed the underlying misconduct in a manner that satisfies the particular DOJ component's voluntary self-disclosure policy;
2. Whether, at the time of the resolution and after a thorough risk assessment, the corporation has implemented an effective compliance program and sufficient internal controls to detect and prevent similar misconduct in the future;
3. Whether, at the time of the resolution, the corporation has adequately tested its compliance program and internal controls to demonstrate that they would likely detect and prevent similar misconduct in the future;
4. Whether the underlying criminal conduct was long-lasting or pervasive across the business organization or was approved, facilitated, or ignored by senior management, executives, or directors (including by means of a corporate culture that tolerated risky behavior or misconduct, or did not encourage open discussion and reporting of possible risks and concerns);
5. Whether the underlying criminal conduct involved the exploitation of an inadequate compliance program or system of internal controls;
6. Whether the underlying criminal conduct involved active participation of compliance personnel or the failure of compliance personnel to appropriately escalate or respond to red flags;
7. Whether the corporation took adequate investigative or remedial measures to address the underlying criminal conduct, including, where appropriate, the termination of business relationships and practices that contributed to the criminal conduct, and discipline or termination of personnel involved, including with respect to those with supervisory, management, or oversight responsibilities for the misconduct;
8. Whether, at the time of the resolution, the corporation's risk profile has substantially changed, such that the risk of recurrence of the misconduct is minimal or nonexistent;
9. Whether the corporation faces any unique risks or compliance challenges, including with respect to the particular region or business sector in which the corporation operates or the nature of the corporation's customers; and

10. Whether and the extent to which the corporation is subject to oversight from industry regulators or is receiving a monitor from another domestic or foreign enforcement authority or regulator.

B. Comment: Department attorneys should determine whether a monitor is required based on the facts and circumstances presented in each case. 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. Monitorships should not be imposed for punitive purposes. The scope of any monitorship should be appropriately tailored to address the specific issues and concerns that created the need for the monitor.

In general, the Department should favor the imposition of a monitor where there is a demonstrated need for, and clear benefit to be derived from, a monitorship. Where a corporation's compliance program and controls are untested, ineffective, inadequately resourced, or not fully implemented at the time of a resolution, prosecutors should consider imposing a monitorship. This is particularly true if the investigation reveals that a compliance program is deficient or inadequate in numerous or significant respects. Conversely, where, at the time of a resolution, a corporation's compliance program and controls have been fully implemented, tested and demonstrated to be effective and adequately resourced, a monitor may not be necessary.

[added March 2023]

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 the second Trump Administration DOJ, are the most detailed statements to date about how it will approach corporate enforcement and settlement.

U.S. Department of Justice, Criminal Division, Memorandum of May 12, 2025

To: All Criminal Division Personnel

From: Matthew R. Galeotti, Head of the Criminal Division

Subject: Focus, Fairness, and Efficiency in the Fight Against White-Collar Crime

The core mission of the Department of Justice (Department) is to do justice, uphold the rule of law, protect the American public, and vindicate victims' rights. The Department's efforts to carry out this mission are multi-faceted. Prosecutors and investigators in the Criminal Division are currently working tirelessly to, among other things, pursue the Total Elimination of Cartels and Transnational Criminal Organizations (TCOs), dismantle human smuggling organizations, curb the flow of fentanyl and other dangerous drugs, and neutralize child predators and violent criminals, including by securing significant charges and prison sentences against the worst criminal actors.

White-collar crime also poses a significant threat to U.S. interests. Unchecked fraud in U.S. markets and government programs robs hardworking Americans and harms the public fisc. The deadly activities of Cartels and TCOs are enabled by international money laundering organizations and other financial facilitators. Illicit financial and logistical networks undermine our national security by enabling shadow-banking for and sanctions evasion by hostile nation states and terror regimes. The Criminal Division is committed to rooting out such insidious conduct.

However, overbroad and unchecked corporate and white-collar enforcement burdens U.S. businesses and harms U.S. interests. The vast majority of American businesses are legitimate enterprises working to deliver value for their shareholders and quality products and services for customers. Prosecutors must avoid overreach that punishes risk-taking and hinders innovation. For these reasons, the Division's policies must strike an appropriate balance between the need to effectively identify, investigate, and prosecute corporate and individuals' criminal wrongdoing while minimizing unnecessary burdens on American enterprise.

The purpose of this Memorandum is to outline the Criminal Division's enforcement priorities and policies for prosecuting corporate and white-collar crimes in the new Administration. In investigating and prosecuting these crimes, Criminal Division attorneys are to be guided by three core tenets: (1) focus; (2) fairness; and (3) efficiency. This Memorandum elaborates on these principles and amends several Criminal Division policies, as set forth below.

I. Areas of Focus

The Criminal Division must be laser-focused on the most urgent criminal threats to the country. Therefore, consistent with the enforcement policies and priorities of this Administration, the Criminal Division will prioritize investigating and prosecuting corporate crime in areas that will have the greatest impact in protecting American citizens and companies and promoting U.S. interests.

A. Harms to America Posed by White-Collar Crime

Dishonest actors exploit government programs, funded by American taxpayers, to enrich themselves through waste, fraud, and abuse. Rampant health care fraud and program and procurement fraud drain our country's limited resources. Corporations and individuals defraud important government initiatives, including Medicare, Medicaid, defense spending, and other programs intended to assist vulnerable citizens. Anyone who cares about good and effective government should be concerned about waste, fraud, and abuse at the hands of bad actors in government agencies. The Criminal Division will lead the fight in holding accountable those who exploit these programs and harm the public fisc for personal gain.

Complex frauds also victimize U.S. investors and weaken the integrity of markets. Schemes that defraud Americans—such as Ponzi schemes, investment fraud, elder fraud, and others—take advantage of investors and consumers, especially the most vulnerable. The victims of such fraudulent conduct are often left devastated, burdened by emotional pain and deprived of their hard-earned savings.

Crimes that exploit our monetary systems undermine economic development and innovation. For example, in the digital assets context, prosecutors should “focus on prosecuting individuals who victimize digital asset investors, or those who use digital assets in furtherance of criminal offenses[.]” Prosecution of these righteous cases will vindicate U.S. interests.

The Criminal Division must also focus resources on threats to the U.S. economy, American competitiveness, and our national security. Trade and customs fraudsters, including those who commit tariff evasion, seek to circumvent the rules and regulations that protect American consumers and undermine the Administration’s efforts to create jobs and increase investment in the United States. Prosecuting such frauds will ensure that American businesses are competing on a level playing field in global trade and commerce.

The exploitation of our financial system is detrimental to American interests in and of itself and can also enable underlying criminal conduct. Financial institutions, shadow bankers, and other intermediaries aid U.S. adversaries by processing transactions that evade sanctions. Corrupt companies and foreign officials help these sanctioned entities avoid appropriate restrictions and commit pernicious crimes, promoting the cycle of drugs and violence that has harmed so many Americans.

The National Security Presidential Memorandum/NSPM-3 (“the America First Investment Policy”) emphasizes the importance of investor protection against fraudulent practices connected to certain foreign adversary companies listed on U.S. exchanges. In particular, the Policy addresses variable interest entities (VIEs), which are typically Chinese-affiliated companies listed on U.S. exchanges that carry significant risks to the investing public for several reasons. These companies provide few protections to investors, facilitate the flow of U.S. investor funds into strategic industries in China, and can be used to facilitate fraud in the U.S. markets, including schemes such as “ramp and dumps” and other market manipulation targeting U.S. investors.

White-collar criminals also corrupt our financial system—the safest and most secure in the world—by laundering criminal funds. Sophisticated money laundering operations, including Chinese Money Laundering Organizations, aid criminal actors by moving their tainted money across borders to conceal it from law enforcement and facilitate more crime. These crimes undermine national security by exploiting our financial system and strengthening foreign criminal organizations. They also facilitate the flow of dangerous drugs and fentanyl precursors to our shores.

Foreign terrorist organizations target U.S. nationals living at home and abroad for terror attacks. They often cannot carry out their operations without assistance from foreign companies and financial networks. Businesses and financial institutions that provide material support to foreign terrorist organizations place the lives and safety of U.S. citizens at risk.

B. Prioritization and Associated Policy Changes

To combat these harms, the Criminal Division will prioritize investigating and prosecuting white-collar crimes in the following high-impact areas:

1. Waste, fraud, and abuse, including health care fraud and federal program and procurement fraud that harm the public fisc;
2. Trade and customs fraud, including tariff evasion;
3. Fraud perpetrated through VIEs, including, but not limited to, offering fraud, “ramp and dumps,” elder fraud, securities fraud, and other market manipulation schemes;
4. Fraud that victimizes U.S. investors, individuals, and markets including, but not limited to, Ponzi schemes, investment fraud, elder fraud, servicemember fraud, and fraud that threatens the health and safety of consumers;
5. Conduct that threatens the country’s national security, including threats to the U.S. financial system by gatekeepers, such as financial institutions and their insiders that commit sanctions violations or enable transactions by Cartels, TCOs, hostile nation-states, and/or foreign terrorist organizations;
6. Material support by corporations to foreign terrorist organizations, including recently designated Cartels and TCOs;
7. Complex money laundering, including Chinese Money Laundering Organizations, and other organizations involved in laundering funds used in the manufacturing of illegal drugs;
8. Violations of the Controlled Substances Act and the Federal Food, Drug, and Cosmetic Act (FDCA), including the unlawful manufacture and distribution of chemicals and equipment used to create counterfeit pills laced with fentanyl and unlawful distribution of opioids by medical professionals and companies;
9. Bribery and associated money laundering that impact U.S. national interests, undermine U.S. national security, harm the competitiveness of U.S. businesses, and enrich foreign corrupt officials; and

10. As provided by the Digital Assets DAG Memorandum: crimes (1) involving digital assets that victimize investors and consumers; (2) that use digital assets in furtherance of other criminal conduct; and (3) *willful* violations that facilitate significant criminal activity. Cases impacting victims, involving cartels, TCOs or terrorist groups, or facilitating drug money laundering or sanctions evasion shall receive highest priority.

Criminal Division prosecutors also will—consistent with the law—prioritize efforts to identify and seize assets that are the proceeds of, or involved in, such offenses and, where authorized under the law, use forfeited assets to compensate victims of these offenses. In all such investigations, prosecutors should prioritize schemes involving senior-level personnel or other culpable actors, demonstrable loss, and efforts to obstruct justice.

To demonstrate the Division’s focus on these priority areas, in consultation with Money Laundering and Asset Recovery Section and the Fraud Section, I have reviewed the Criminal Division’s existing pilot program relating to whistleblowers, consistent with the principles outlined above. Following discussion and consultation with relevant stakeholders, effective immediately, I am directing the following amendments to the Criminal Division’s Corporate Whistleblower Awards Pilot Program to reflect priority areas of focus.

Specifically, we are adding the following to Section II.3 (“Subject Areas”), where those tips lead to forfeiture:

- Violations by corporations related to international cartels or transnational criminal organizations, including money laundering, narcotics, Controlled Substances Act, and other violations.
- Violations by corporations of federal immigration law.
- Violations by corporations involving material support of terrorism.
- Corporate sanctions offenses.
- Trade, tariff, and customs fraud by corporations.
- Corporate procurement fraud.

II. Fairness – Prosecuting Corporations and Individuals

The Criminal Division has long been a leader in crafting policies to appropriately investigate and prosecute white-collar offenders. For instance, the Criminal Division’s Corporate Enforcement and Voluntary Self-Disclosure Policy (CEP) has applied across the Division since 2018. The CEP’s directives concerning self-disclosure, cooperation, and remediation have resulted in the Department bringing more cases against individual wrongdoers while rewarding good corporate citizens.

The Criminal Division developed these policies because justice demands the equal and fair application of criminal laws to individuals and corporations who commit crimes. The Department's first priority is to prosecute individual criminals. It is individuals—whether executives, officers, or employees of companies—who commit these crimes, often at the expense of shareholders, workers, and American investors and consumers. The Criminal Division will investigate these individual wrongdoers relentlessly to hold them accountable.

Not all corporate misconduct warrants federal criminal prosecution. Prosecution of individuals, as well as civil and administrative remedies directed at corporations, are often appropriate to address low-level corporate misconduct and vindicate U.S. interests. Prosecutors in the Criminal Division must consider additional factors when determining whether to charge corporations, including whether the company reported the conduct to the Department, its willingness to cooperate with the government, and its actions to remediate the misconduct.

It is critical to American prosperity to promote policies that acknowledge law-abiding companies and companies that are willing to learn from their mistakes and provide those companies with transparency from the Department. Companies that enter into agreements with the Criminal Division agree to implement corporate compliance programs, report relevant misconduct, cooperate with the government, and more. These obligations serve important functions for companies that have committed serious wrongdoing. But where corporate criminal resolutions are necessary, prosecutors should consider all forms—non-prosecution agreements, deferred prosecution agreements, and guilty pleas—in making a case-by-case analysis about the appropriate disposition. When applying these policies, prosecutors must conduct an individualized assessment of the facts and evidence in each case and make an appropriate determination based on the application of law to those facts. To ensure fairness and individualized assessments, I have directed the Criminal Division's Fraud Section and the Money Laundering and Asset Recovery Section to revise the CEP and clarify that additional benefits are available to companies that self-disclose and cooperate, including potential shorter terms. A fair justice system requires that the Department be maximally transparent so that companies—including directors, executives, employees, and counsel—can make appropriate decisions when faced with potential misconduct. We have thus refined the CEP such that its core components—the paths for potential declination, the available fine reductions for a company's cooperation and remediation, and relevant factors that determine the contours of a corporate resolution—are more easily understandable.

In addition, I have directed these Sections to review the length of terms of all existing agreements with companies to determine if they should be terminated early. Factors that may lead to early termination include, but are not limited to, duration of the post-resolution period, substantial reduction in the company's risk profile, extent of remediation and maturity of the compliance corporate program, and whether the company self-reported the misconduct. That review is ongoing, and the Criminal Division has determined in multiple matters that companies met the terms of their

agreements, and thus the Criminal Division has ended those agreements early.

Going forward, when entering into a corporate resolution with companies that cooperate and remediate, Criminal Division prosecutors must impose a term that is appropriate and necessary in light of, among other things, the severity of the misconduct, the company's degree of cooperation and remediation, and the effectiveness of the company's compliance program at the time of resolution. These terms should not be longer than three years except in exceedingly rare cases, and Criminal Division prosecutors should assess these agreements regularly to determine if they should be terminated early.

III. Efficiency – Streamlining Corporate Investigations

The work of Criminal Division attorneys to investigate and prosecute white-collar crime is essential to the Department's efforts to advance American interests, protect victims, and strengthen our national security. But federal investigations into corporate wrongdoing can be costly and intrusive for businesses, investors, and other stakeholders, many of whom have no knowledge of, or involvement in, the misconduct at issue. Federal investigations can also significantly interfere with day-to-day business operations and cause reputational harm that may at times be unwarranted.

To maximize efficiency in all corporate investigations, I am therefore directing the implementation of the following procedures in corporate investigations in the Criminal Division, effective immediately:

A. Efficient Investigations

White-collar schemes are complex and often cross borders. As a result, these schemes take substantial time and effort to unravel. Evidence may be located abroad and records can be voluminous. But from the company's perspective, investigations into corporate crime can linger for years and, at times, with little meaningful progress. While particular facts and circumstances may require an investigation that spans multiple years, prosecutors must take all reasonable steps to minimize the length and collateral impact of their investigations, and to ensure that bad actors are brought to justice swiftly and resources are marshaled efficiently.

Accordingly, I am directing that prosecutors must move expeditiously to investigate cases and make charging decisions. That means that my office will work closely with the relevant Sections to track investigations and ensure that they do not linger and are swiftly concluded.

B. Narrowly Tailored Use of Monitors

Independent compliance monitors must only be imposed when they are necessary, *i.e.*, when a company cannot be expected to implement an effective compliance program or prevent recurrence of the underlying misconduct without such heavy-handed intervention. When imposed, monitorships must be narrowly tailored to achieve the necessary goals

while minimizing expense, burden, and interference with the business.

Therefore, I am announcing a new monitor selection memorandum that (1) clarifies the factors that prosecutors must consider when determining whether a monitor is appropriate and how those factors should be applied; and (2) ensures that when a monitor is necessary, prosecutors narrowly tailor and scope the monitor's review and mandate to address the risk of recurrence of the underlying criminal conduct and to reduce unnecessary costs. In keeping with these principles, the Criminal Division, in coordination with Department leadership, has undertaken an individualized review of all existing monitorships to make case specific determinations of whether each monitor is still necessary. . . .

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 Biden Administration Justice Department announced the following "pilot" program designed to link enforcement against corporations with individual compensation paid to managers and employees. The second Trump Administration has not yet expressed its view on this program.

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

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>.

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 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 case takes 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. . . .

For a similar discussion of judicial authority, in which another federal appeals court reversed a trial judge for exceeding his authority in attempting to manage DPA-related procedures, see *United States v. HSBC Bank USA, N.A.*, 863 F.3d 125 (2d Cir. 2017).

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.

(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.)

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 focuses on the central matter of defining impermissible deception under 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 has 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 *Dial*? How does the point relate to his theory of when nondisclosure of facts may constitute fraud?
- (b) Was *Dial* correctly decided? *Finnerty*? 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.* . . .

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: Deception

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 misrepresentation, conduct, 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 can be confusing. Much of the confusion involves the relationship between this requirement and the elements of materiality and intent to defraud. The *Regent Office* 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 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 statute as requiring that the victim bank 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).

The Supreme Court has provided some clarity in the following recent wire fraud decision, although the Court focused here on the issues of “fraud in the inducement” and loss (or intended loss) not “intent to injure” per se.

KOUSISIS v. UNITED STATES, 145 S. Ct. 1382 (2025)

Justice BARRETT delivered the opinion of the Court.

Stamatios Kousisis and the industrial-painting company he helped manage, Alpha Painting and Construction Co., secured two government contracts for painting projects

in Philadelphia. Both contracts required the participation of a disadvantaged business—and in its bids for the projects, Alpha represented to the Pennsylvania Department of Transportation (PennDOT) that it would obtain its materials from a qualifying supplier. See 49 C.F.R. §§ 26.21(a), 26.5 (2024). This promise turned out to be an empty one: In addition to using the supplier solely as a pass-through entity, Alpha and Kousisis submitted multiple false certifications to cover up their scheme. So although Alpha's paint work met expectations, its adherence to the disadvantaged-business requirement did not.

The Government charged Alpha and Kousisis with wire fraud, asserting that they had fraudulently induced PennDOT to award them the painting contracts. Under the fraudulent-inducement theory, a defendant commits federal fraud whenever he uses a material misstatement to trick a victim into a contract that requires handing over her money or property—regardless of whether the fraudster, who often provides something in return, seeks to cause the victim *net* pecuniary loss. We must decide whether this theory is consistent with § 1343, which reaches only those schemes that target traditional money or property interests. See *Ciminelli v. United States*. It is, so we affirm.

When two Philadelphia landmarks, the Girard Point Bridge and the 30th Street Station, fell into disrepair, PennDOT began soliciting bids for their restoration. Kousisis, Alpha's project manager, submitted a bid for each project. His bidding proved successful: With respect to the Girard Point project, PennDOT awarded a \$70.3 million contract to a joint venture comprising Alpha and two other companies. And with respect to the 30th Street project, Alpha and another company (again operating as a joint venture) secured a \$15 million subcontract, which represented nearly a third of the \$50.8 million total winning bid.

Federal grants from the U. S. Department of Transportation (DOT) accounted for a large portion of the funding for each project. As a result, both the State and Federal Governments had a say in how the projects were completed. Relevant here, DOT requires that grant recipients like PennDOT establish and “actively implemen[t]” a disadvantaged-business program. 49 C.F.R. §§ 26.21, 26.39(c). A “[d]isadvantaged [b]usiness [e]nterprise,” according to DOT, is “a for-profit small business” that is majority owned and controlled by “one or more individuals who are both socially and economically disadvantaged.” Because DOT aspires to devote at least 10 percent of federal grant funding to such businesses, grant recipients must set “overall goal[s]” for disadvantaged-business participation in their “DOT-assisted contracts.”

Consistent with this rule, PennDOT required that bidders for the Girard Point and 30th Street projects commit to subcontracting a percentage of the total contract amount—six and seven percent, respectively—to a disadvantaged business. Failing to comply with this requirement would constitute “a material breach” and could “result in [contract] termination.” Accordingly, as part of the bidding process, Kousisis represented that Alpha would acquire approximately \$6.4 million in painting supplies from Markias, Inc., a prequalified disadvantaged business.

This was a lie. As later memorialized in a commitment letter, Alpha and Kousisis concocted a scheme in which Markias would function as a mere “pass-through” entity. The scheme operated as follows: Kousisis arranged for Alpha's actual paint suppliers, with whom he negotiated directly, to “generate purchase orders . . . billed to Markias.” When Markias received an invoice, it tacked on a few-percent fee and then forwarded the inflated invoice to Kousisis. He, in turn, issued two checks: one paid Markias for its mark up, and the other covered the actual cost of the supplies. In short, Markias was no more than a paper pusher, funneling checks and invoices to and from Alpha's actual suppliers. Not only did this arrangement contradict Kousisis's prior representations, it also contravened DOT's rule that a contributing disadvantaged business must “perfor[m] a commercially useful function.”

Kousisis's scheme initially went undetected. As the projects progressed, he falsely reported qualifying payments to Markias. PennDOT, satisfied with Alpha's paint and repair work, paid it accordingly. By the time the last coat of paint had dried, Alpha had turned a gross profit of over \$20 million. And Markias, for its “pass-through” services, had pocketed a total of about \$170,000.

Once the deception came to light, a grand jury indicted Alpha and Kousisis for wire fraud and conspiracy to commit the same. After a trial, the jury found them guilty of three counts of wire fraud and one count of conspiracy. . . .

To convict Alpha and Kousisis, the Government needed to prove that they used the wires to execute a “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. Despite the use of the disjunctive “or,” we have declined to interpret § 1343 as establishing alternative pathways to a conviction. Instead, reading the two clauses together, we have held that “the money-or-property requirement of the latter phrase” operates as a limitation on the former. *McNally v. United States*. A defendant commits federal wire fraud, in other words, only if he both ““engaged in deception”” and had ““money or property”” as ““an object”” of his fraud. *Ciminelli*. . . .

[From the mail and wire fraud precedents], Alpha and Kousisis attempt to glean another [rule]: A federal fraud conviction cannot stand, they argue, unless the defendant sought to hurt the victim's bottom line. Yet the theory under which petitioners were prosecuted—what they call the fraudulent-inducement theory—is devoid of an economic-loss requirement. As both parties describe it, the theory supports liability for federal fraud anytime a defendant ““us[es] falsehoods to induce a victim to enter into a transaction.”” In these situations, the defendant need not—and given the reciprocal nature of most transactions, often will not—aim to inflict economic loss. Because Alpha and Kousisis did not aim to do so here, they contend that their convictions are invalid.

We are not convinced. The fraudulent-inducement theory is consistent with both the text of the wire fraud statute and our precedent interpreting it. We therefore reject petitioners' proposed economic-loss requirement.

Start with the statute. To be guilty of wire fraud, a defendant must (1) “devis[e]” or “inten[d] to devise” a scheme (2) to “obtai[n] money or property” (3) “by means of false or fraudulent pretenses, representations, or promises.” The prototypical fraudulent-inducement scheme plainly satisfies each of these statutory elements. Under the theory, a defendant (1) “devise[s]” a “scheme” (2) to induce the victim into a contract to “obtai[n]” her “money or property” (3) “by means of false or fraudulent pretenses.” No matter how long we stare at it, the broad, generic language of § 1343 leaves us struggling to see any basis for excluding a fraudulent-inducement scheme.

Take the facts of this very case. By using Markias as a pass-through entity, petitioners “devised” a “scheme” to obtain contracts through feigned compliance with PennDOT’s disadvantaged-business requirement. goal? To “obtai[n] money” (tens of millions of dollars) from PennDOT. And how? By making a number of “false or fraudulent . . . representations”—first about their plans to obtain paint supplies from Markias and later about having done exactly that. Section 1343 requires nothing more.

Alpha and Kousisis’s contrary view rests on the premise that a scheme cannot constitute wire fraud if, as here, the defendant provides something—be it money, property, or services—of equal value in return. But the statute says otherwise. To “obtain” something means “to gain or attain possession” of it, usually “by some planned action or method.” Webster’s Third International Dictionary 1559 (2002). A thing is no less “obtained” simply because something *else* is simultaneously given in return. An art collector who acquires a rare sculpture can rightfully say that she “obtained” it, notwithstanding the six-figure price tag. And because the meaning of “obtain” does not turn on the value of the exchanged items, the art collector can still say that she “obtained” the sculpture even if it was not objectively worth the price she paid.

In short, the wire fraud statute is agnostic about economic loss. The statute does not so much as mention loss, let alone require it. Instead, a defendant violates § 1343 by scheming to “obtain” the victim’s “money or property,” regardless of whether he seeks to leave the victim economically worse off. A conviction premised on a fraudulent inducement thus comports with § 1343. . . .

At common law, “fraud” was a term with expansive reach. Rather than settle on a single form of liability, courts recognized at least three, and the particular elements and remedies turned on the nature of the plaintiff’s alleged injury.

To appreciate how the three forms differed, it may help to consider a variation of the facts here. Imagine that PennDOT discovered petitioners’ scheme soon after Alpha and Kousisis had begun work on the Girard Point and 30th Street projects. In such a circumstance, law and equity provided at least three avenues for relief: PennDOT could (1) seek to rescind the contracts; (2) refer the matter for indictment under the crime of false pretenses; or (3) bring a tort action against the fraudsters for the damages incurred.

If PennDOT had wanted to rescind the fraud-infected contracts, most courts would historically have permitted it to do so even without a showing of economic loss. To

obtain a rescission, PennDOT would have needed to establish only that it had “received property of a different character or condition than [it] was promised” (“although of equal value”) or, more relevant here, that the transaction had “prove[d] to be less advantageous than as represented” (“although there [was] no actual loss”). W. Keeton, D. Dobbs, R. Keeton, & D. Owen, *Prosser and Keeton on Law of Torts* § 110, p. 766 (5th ed. 1984) (Prosser & Keeton). Put differently, many courts would have awarded the equitable remedy of rescission simply because Alpha and Kousisis had tricked PennDOT into a bargain materially different from the one they had promised. . . .

The same no-loss-required rule applied with equal force to the crime of false pretenses. As many courts held, the crime “was complete when the property was fraudulently obtained.”. . . Thus, if someone purchased “a picture upon the assertion untruly made that it was from the brush of some distinguished painter,” the fact that “the picture was of value” would not relieve the seller of “the criminality of the false pretense.” *Bartlett v. State*, 28 Ohio St. 669, 672 (1876). . . .

The Maine Supreme Court's decision in *State v. Mills* is illustrative. [A] horse owner represented to a potential buyer that the horse “was called the Charley,” even though “he knew that it was not the horse called by that name.” Persuaded, the buyer exchanged his “colt and five dollars in money” for the horse. But as the buyer soon learned, the horse was not “the Charley,” though the seller claimed that it “was as good a horse” and “of equal or greater value” than the colt and money. The court, overruling the defendant's objections to the guilty verdict, explained that the facts constituted “a case literally within” the false-pretenses statute. Obtaining a conviction on false pretenses required proving simply “that one of the pretences [*sic*] was false, and that the injured party was induced thereby to part with his property.”. . .

As the cases and treatises discussed above confirm, it was the deception-induced deprivation of property—not economic loss—that common-law courts generally deemed injurious. . . .

[C]ases involving deceit are largely inapposite to the question presented here. Courts required economic loss not because it was inherent to the common-law understanding of fraud, but because a tort action for deceit “sound[ed] in damage” and thus was designed to compensate a plaintiff for her economic loss. . . .

To summarize, then, common-law courts did not uniformly condition an action sounding in fraud on the plaintiff's ability to prove economic loss. More specifically, if the action was one for rescission or a prosecution for false pretenses, the plaintiff's required “injury” ordinarily need not be financial. That sounds the death knell for Alpha and Kousisis's reliance on the common law. . . .

[A]t the right level of specificity, *anything* can be described as “unique” or “different from” something else. After all, “animal,” “horse,” “sound horse,” and “the horse called the Charley” are all accurate descriptions of the bargained-for property in *Mills*. Only the most specific of those descriptions, “the horse called the Charley,” distinguishes the

property promised from the property received, yet the court still had no trouble labeling the case as one of “false pretence [*sic*], fraudulently made.”

Tellingly, Alpha and Kousisis identify no source of authority that supports treating uniqueness as some kind of exception to the no-loss-required rule. That is probably because the common law has long embraced a different standard—namely, materiality—as the principled basis for distinguishing everyday misstatements from actionable fraud. . . . [A]s we explained in *Universal Health Services*, a misrepresentation is material if a reasonable person would attach importance to it in deciding how to proceed, or if the defendant knew (or should have known) that the recipient would likely deem it important. . . .

Petitioners insist that our precedent forecloses the fraudulent-inducement theory, but they are wrong: We have twice *rejected* the argument that a fraud conviction depends on economic loss. We did so first in *Carpenter v. United States*, a case in which the defendants had repeatedly leaked the contents of a newspaper's investment column. Although the scheme did not cause the newspaper “monetary loss,” it was sufficient, we held, that the newspaper “ha[d] been deprived of its right to exclusive use” of its proprietary information. Then, in *Shaw v. United States*, we affirmed a conviction under the bank fraud statute even though “no bank involved in the scheme” had “suffered any monetary loss.” The statute, we explained, “demands neither a showing of ultimate financial loss nor a showing of intent to cause financial loss.” . . .

No matter the underlying theory of fraud, § 1343 requires that “money or property” have been an object of the fraudster's scheme. So if the scheme is one to alter the exercise of regulatory power—say, by tricking the Government into handing over a gaming license—the fraudulent-inducement theory has no role to play. *Cleveland*. But if, as here, the fraudster seeks to induce the Government into a transfer of its money or property, that loss is sufficient to sustain a fraud conviction. The loss is not, as petitioners argue, a mere “incidental byproduct” of a scheme to manipulate the exercise of regulatory power. *Kelly*. If anything, the inverse is typically true: In the mine run of fraudulent-inducement schemes, undermining the Government's regulatory interests is merely “an incidental (even if foreseen) byproduct” of obtaining its money or property. Here, for example, Alpha and Kousisis had money in mind. Nothing suggests that they concocted their scheme with the goal of thwarting PennDOT's disadvantaged-business initiative. Such a result was downstream of their “object” to line their pockets. . . .

[T]he fraudulent-inducement theory is not a “repackag[ing]” of the right-to-control theory. In *Ciminelli*, we rejected the latter theory, which maintains that the term “‘property’ in § 1343” includes “‘the right to control the use of one's assets.’” According to this strained definition of “property,” a defendant violates § 1343 simply by “schem[ing] to deprive a victim of potentially valuable economic information necessary to make discretionary economic decisions.” Such a scheme, we held, does not implicate any “traditional property interes[t].”

Unlike the right-to-control theory, fraudulent inducement does not treat “mere information as the protected interest.” Rather, it protects money and property. And nothing we said in *Ciminelli* is at odds with our holding here. Although the Government urged us to affirm Ciminelli's conviction on an alternative ground—namely, the fraudulent-inducement theory—we declined to do so because it would have required us “to assume not only the function of a court of first view, but also of a jury.” We did not discuss, much less reject, the fraudulent-inducement theory. . . .

We will return shortly to the Court's important decisions in *Carpenter*, *Kelly*, and *Ciminelli*, all discussed in Kousisis. But first, the next case, dealing with the line between fraud and permissible deception in negotiations, is an 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.

The first 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. . . .

UNITED STATES v. CHASTAIN, 2025 WL 2165839 (2d Cir. July 31, 2025)

MENASHI, Circuit Judge:

Nathaniel Chastain appeals his judgment of conviction for wire fraud in violation of 18 U.S.C. § 1343 A jury found Chastain guilty . . . based on trades he made while employed at OpenSea, an online marketplace for non-fungible tokens ("NFTs"). As head of product, Chastain selected the NFTs that the company would feature in a section of its website. When an NFT was featured, its value increased. Chastain would purchase an NFT before it was featured and sell it afterward for a profit. He made about \$57,000.

The district court instructed the jury that Chastain's decision about which NFT to feature was OpenSea's property even if that information lacked commercial value to OpenSea. It further explained that the jury could find that Chastain engaged in a scheme to defraud if he "conducted himself in a manner that departed from traditional notions of fundamental honesty and fair play in the general and business life of society."

Chastain argues that the instructions were erroneous because the jury could have convicted Chastain of fraud based on unethical business dealings even if he did not intrude on anything resembling a traditional property interest of OpenSea. We agree. . .

OpenSea is an online marketplace for buying and selling NFTs. An NFT is a “unique digital artifact” that “can be bought and sold on the blockchain.” OpenSea itself does not buy or sell any NFTs that are traded on its platform. Instead, the company collects a fee of two-and-a-half percent for each transaction on the platform. In 2021, OpenSea added a section to its website that would promote user interest by highlighting specific NFTs. When an NFT was featured, the publicity typically led its price to increase. OpenSea did not receive payments from the creators of NFTs featured on the website. Nor did OpenSea engage in any trades of featured NFTs. Instead, for each transaction involving a featured NFT, OpenSea received its standard fee of two-and-a-half percent.

Chastain was the first head of product at OpenSea. In that role, he was “responsible for evaluating current and new features, to figure out how well they were doing.” He obtained “feedback” and conducted “user interviews” about the features, and he considered “new changes” that could “improve the site. He would help organize engineers to work on these projects and designers.” He also selected the NFTs that the website would feature.

Chastain purchased approximately fifteen NFTs that were then featured on the website. Chastain generally purchased and sold the featured NFTs using anonymous accounts. For each trade, he transferred cryptocurrency from his personal account into an anonymous account that he used to purchase the NFT. The anonymous account would sell the NFT after it was featured, and Chastain transferred the proceeds back into his personal account. He made about \$57,000.

Chastain did not always use anonymous accounts. On August 2, 2021, an OpenSea user noticed that Chastain had used his personal account to purchase an NFT before it was featured. The user posted to Twitter that it “[l]ooks like Nate from OS had the jump on everyone else,” adding an emoji of two eyeballs. Chastain responded to the post that he “just wanted to secure one of these [NFTs] before they all disappeared tbh.” At this point, no one at OpenSea told Chastain to stop purchasing featured NFTs.

On September 14, 2021, another OpenSea user posted about Chastain's trading, this time tagging OpenSea:

Hey @opensea why does it appear @natechastain has a few secret wallets that appears to buy your front page drops before they are listed, then sells them shortly after the front-page-hype spike for profits, and then tumbles them back to his main wallet ... ?

The next day, OpenSea asked Chastain to resign. . . .

Chastain argued that the NFT information was not property as a matter of law because (1) it had no commercial value to OpenSea and (2) the company did not take steps to protect its confidentiality. . . .

When instructing the jury about the property element of wire fraud, the district court said:

A company's confidential business information is a type of property. Information is confidential business information if it was acquired or created by a business for a business purpose, and the business both considered and treated that information in a way that maintained the company's exclusive right to that information Factors you may consider in determining whether OpenSea treated the information at issue as confidential include, but are not limited to: Written company policies and agreements, employee training, measures the employer has taken to guard the information's secrecy, the extent to which the information is known outside the employer's place of business, and the ways in which other employees may access and use the information. You may also consider whether the information had economic value to the employer, *but the government is not required to prove that the information had such value.*

(emphasis added). The district court rejected Chastain's argument that the jury should be instructed that information is property under the wire fraud statute “only if it is . . . confidential business information (which must be treated as such) *and has inherent value to the purported victim.*” (emphasis added).

For the scheme-to-defraud element of wire fraud, the district court instructed the jury:

Fraud is a general term that includes all efforts and means that an individual may devise to deprive another of money or property by trick, deception, swindle, or overreaching. In order to establish a scheme to defraud, the government need not show that the defendant made a misrepresentation. You may find the existence of a scheme to defraud if you find that the conduct of the defendant was deceptive or if you find that the defendant conducted himself in a manner that departed from traditional notions of fundamental honesty and fair play in the general and business life of society.

The district court disagreed with Chastain that it was “critically important to include a robust willfulness charge because without it the government could convict Mr. Chastain [of] wire fraud based solely on unethical workplace behavior.” . . .

We agree with Chastain that confidential business information must have commercial value to a company to qualify as its property under the wire fraud statute. The district court erred by instructing the jury that it could find Chastain guilty of wire fraud even if it found that he misappropriated information that lacked commercial value to OpenSea. The district court further erred by instructing the jury that it could find Chastain guilty

if it found his conduct to have departed from “fundamental honesty and fair play in the general and business life of society.” . . .

The Supreme Court has explained that the phrase “money or property” encompasses “property rights” that are both “tangible” and “intangible.” *Carpenter*. In either form, however, “the wire fraud statute reaches only traditional property interests.” *Ciminelli*. . . .

Like confidential business information, trade secrets are intangible and kept confidential but receive legal protection. A trade secret has commercial value. To be sure, we have said that “[i]nformation may qualify as confidential under *Carpenter* even if it does not constitute a trade secret.” *Mahaffy*. But while *Carpenter* “does not require that *all* confidential information must be of the same nature to be considered ‘property,’” to merit that designation it must be that “it ‘has long been recognized as property.’” *Grossman*. Information that lacks commercial value has not been so recognized. “The general rule has been that ideas or information are not subject to legal protection.” *Pearson*. But when “information is gathered and arranged at some cost and sold as a commodity on the market, it is properly protected as property,” and when “ideas are formulated with labor and inventive genius, as in the case of literary works or scientific researches, they are protected.” *Id.* The characteristic feature of information and ideas protected as property is that “they constitute instruments of fair and effective commercial competition,” so “those who develop them may gather their fruits under the protection of the law.” *Id.* Information cannot qualify as a traditional property interest if its holder has no economic interest in its exclusive use or in otherwise keeping the information confidential. . . .

The district court instructed the jury that the government did not need to show that OpenSea had a commercial interest in the featured NFT information as long as the information was “acquired or created by [OpenSea] for a business purpose” and OpenSea “both considered and treated that information in a way that maintained the company's exclusive right to that information.” That instruction allowed the jury to return a guilty verdict for wire fraud based on the misappropriation of the company's “exclusive right” to use information that had no economic implications for the company. . . .

The district court instructed the jury that it could find Chastain to have committed wire fraud if (1) he “conducted himself in a manner that departed from traditional notions of fundamental honesty and fair play in the general and business life of society,” and (2) used information his employer kept confidential even if “the government [did not] prove that the information had [economic] value” to the employer. Given these instructions, the jury could have returned a guilty verdict based on a determination that it was dishonest for Chastain to trade on the featured NFT information even if that information was tangential to OpenSea's business and its misuse could not have affected the company's economic interests.

In other words, the instructions allowed the jury to convict based the government's "view of[] integrity" in business conduct rather than the misappropriation of "property rights only." *Ciminelli*.

If the wire fraud statute criminalized conduct that merely departed from traditional notions of fundamental honesty and fair play, "almost any deceptive act could be criminal." *Ciminelli*. . . .

JOSÉ A. CABRANES, Circuit Judge, concurring in part and dissenting in part:

. . . I respectfully depart from the conclusion that the District Court's jury instructions were erroneous. To the contrary, the instructions in question both provided the jury with "the correct legal standard" and "adequately inform[ed] the jury on the law."² Accordingly, I would affirm the District Court's judgment of conviction for wire fraud and money laundering.

My colleagues begin by holding that the District Court's instruction on the property element of wire fraud was in error. In the process, they devise a new requirement that must be satisfied before confidential business information can be deemed property under 18 U.S.C. § 1343: a separate showing by the Government that the information possesses commercial value. This novel addition to our law ignores unambiguous and binding Second Circuit and Supreme Court precedents which hold that confidential business information, standing alone and without any separate showing of commercial value, is properly considered property for the purposes of the wire fraud statute.

In *Carpenter v. United States*, the Supreme Court held:

Petitioners cannot successfully contend based on *Associated Press* that a scheme to defraud requires a monetary loss, such as giving the information to a competitor; *it is sufficient* that the [Wall Street] 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.

This holding has dual significance. First, it establishes a sufficient condition—the company's possession of a right to the information's exclusive use—that, if satisfied, qualifies an identifiable item of confidential business information as property under 18 U.S.C. § 1343. Indeed, the Court's holding in *Carpenter* places beyond cavil the basic rule that a company's exclusive right to confidential business information is the be-all and end-all for determining whether that information is property under the federal wire fraud statute. An evaluation of that information's commercial value is beside the point. Relevant to the instant case, the *Carpenter* Court's rule was fully captured in the District Court's entirely proper jury instruction.

Second, *Carpenter* grounds that sufficient condition in a "traditional property interest." It observes that exclusivity is an important aspect of not only "confidential business information," but also "most private property." Accordingly, the sufficient condition recognized in *Carpenter* (1987) satisfies the Supreme Court's more recent holding in

Ciminelli v. United States (2023) that “the wire fraud statute reaches only traditional property interests.” The *Ciminelli* Court itself went so far as to cite *Carpenter* to support the proposition that, to constitute property under 18 U.S.C. § 1343, an interest must have “‘long been recognized as property’ when the wire fraud statute was enacted.” Guided by these teachings, I see no basis in the law to conclude that *Carpenter*’s holding is inapplicable in light of *Ciminelli*’s “traditional property interest” language, or to bootstrap a new requirement onto *Carpenter*’s holding that the *Ciminelli* Court itself did not come close to speculating upon when it invoked *Carpenter*. . . .

Nor was there error in the District Court’s instruction that the jury could “find the existence of a scheme to defraud if [it] find[s] that the conduct of the defendant was deceptive or if [it] find[s] that the defendant conducted himself in a manner that departed from traditional notions of fundamental honesty and fair play in the general and business life of society.” We have consistently defined fraud in substantially similar terms. Moreover, we have recognized that jury instructions are to be “taken as a whole.” The challenged instruction came shortly after the District Court’s charge that the jury was required to find “that there was a scheme or artifice to defraud OpenSea of its property.” We are not here dealing with an instruction classifying “a federal, common-law fiduciary duty.” Rather, this instruction concerns the federal statutory crime of misappropriating property. Indeed, the District Court immediately followed up the jury instruction in question by stating: “As is pertinent here, the alleged scheme to defraud is fraudulently embezzling or fraudulently misappropriating property belonging to another.” Taken as a whole, this is clearly an appropriate jury instruction that is free of error.

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 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

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.

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. Bindow*.

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 broader question for corporate and white collar from, of course, is how the Court’s decisions in public corruption cases such as *Kelly* and *Ciminelli* might affect prosecutions beyond government contexts. The next case provides one example, in 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 recent decisions.

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 2-4

(a) Having read the materials in the preceding section, how would you articulate what prosecutors must prove about the “object” of a defendant’s deceptive scheme in order to succeed under the mail and wire fraud statutes?

(b) If you were a justice of the Supreme Court reviewing the circuit court decisions in *McGlashan* and *Porat*, with the idea of voting to reverse both rulings, what might be your arguments that each case was wrongly decided?

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 the recent Supreme Court’s recent rulings in the preceding section.)

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 that “scheme or artifice to defraud” in the mail-fraud and wire-fraud statutes 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.” 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.” 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) given that 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 predictable 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, again in the context of the “Varsity Blues” scandal.

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.” . . .

[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. . . .

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. . . .

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. . . .

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. . . .

Problem 2-5

Set aside for the moment the *Abdelaziz* court's legal analysis and consider only the facts involving Abdelaziz's and Wilson's dealings with Singer. If you were the prosecutor at the charging stage of this case, how else might you have premised a charge that the defendants committed wire fraud?

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, the Second Circuit reversed a trial judge for ruling that the honest service statute does not apply to such conduct, at least on the facts of this case.

UNITED STATES v. LOPEZ, 2025 WL 1818945 (2d Cir. July 2, 2025)

John M. Walker, Jr., Circuit Judge:

Following a lengthy trial, Defendants-Appellees Hernán Lopez, a top executive at Twenty-First Century Fox, and Full Play Group, S.A., a South American sports marketing company, were each convicted of conspiracy to commit honest services wire fraud in connection with their involvement in a notorious FIFA corruption scandal. . . .

The district court reasoned that, following the Supreme Court's decisions in *Percoco* and *Ciminelli*, honest services fraud did not encompass Defendants' conduct and therefore the evidence adduced at trial was insufficient to sustain Defendants' convictions.

For the reasons that follow, we hold that the district court erred . . . ,

Defendant Lopez, an American citizen and resident, held, until 2016, top executive positions at Twenty-First Century Fox ("Fox"), an American media conglomerate. He ran Fox's Latin American division until he was promoted to run Fox's entire international division. Defendant Full Play is a private sports marketing company incorporated in Uruguay with its principal office in Argentina.

The Fédération Internationale de Football Association ("FIFA") is the international body governing organized soccer. FIFA is a nonprofit entity organized under Swiss law and headquartered in Zurich, Switzerland. It comprises over 200 member associations, each representing organized soccer in a particular nation or territory, including the United States. To become a member of FIFA, an association must first join one of six continental confederations, which include the Confederación Sudamericana de Fútbol ("CONMEBOL") (the South American confederation), headquartered in Paraguay, and the Confederation of North, Central American, and Caribbean Association Football ("CONCACAF"), headquartered in the United States.

As a condition of membership in FIFA, member associations agree to be bound by FIFA's statutes and code of ethics. FIFA's written code of ethics was introduced in 2004 and prohibits officials (defined to include executives of FIFA, its continental confederations, and member associations) from accepting bribes or otherwise abusing

their positions of power for personal gain. The code also imposes on officials a duty of “absolute loyalty” to FIFA. Many confederations, including CONMEBOL, have also adopted their own ethics codes that prohibit officials from using their positions to obtain personal benefits and require “absolute loyalty” to CONMEBOL, FIFA, and the associations. CONMEBOL's code of ethics was adopted in 2013.

Both FIFA and the continental confederations host and own the broadcast and media rights to popular international soccer tournaments. For example, FIFA hosts the World Cup tournament, the most watched sporting event in the world, in which teams from all six confederations compete every four years for the title of world champion. CONMEBOL hosts the Copa América tournament, another popular quadrennial event with teams from each of CONMEBOL's ten South American countries plus invited teams from outside the region. CONMEBOL also hosts the Copa Libertadores, an annual tournament involving the region's club teams. Additionally, the six confederations each organize World Cup qualifier matches (where teams compete to qualify for the World Cup), and individual national associations organize matches between national or club teams, referred to as “friendlies.”

FIFA, CONCACAF, CONMEBOL, and the individual member associations typically contract with sports marketing companies, such as Full Play, to transfer the highly lucrative rights to their soccer events. Those companies then sell the rights to television and radio networks, which broadcast games, as well as to sponsors and licensees.

Corruption in international soccer is not new. It was rampant for decades before the events at issue here. This case concerns Lopez's and Full Play's participation in bribery schemes for the media rights to the Copa América and the Copa Libertadores tournaments, as well as World Cup qualifiers and friendlies.

The government adduced evidence that, between 2009 and 2015, Full Play bribed the federation presidents of Paraguay, Bolivia, Colombia, Venezuela, Peru, and Ecuador (known as the “Group of Six”) in exchange for the media rights to their federations' respective World Cup qualifiers and friendly matches, some of which were played in the United States. Full Play used United States dollars and bank accounts to fund these bribes.

Between 2010 and 2015, Full Play also bribed the Group of Six and CONMEBOL officials in connection with the Copa América tournament. And, between 2000 and 2015, Full Play helped another media company, T&T Sports Marketing, Ltd. (“T&T”), transmit millions of dollars in bribes to the Group of Six in connection with Copa Libertadores media rights, so that Full Play could further solidify its relationships with the officials. Many of these payments were wired through United States bank accounts.

To conceal these bribes from authorities, Full Play used code names on ledgers and encouraged bribe recipients to move their bank accounts from American banks to overseas banks. Evidence also showed that Full Play's owners met in the United States to discuss how to make their illegal payments appear legitimate.

As for Lopez, the government alleged that he was involved only in the Copa Libertadores scheme. It submitted that he had studied T&T's Copa Libertadores media rights contracts and understood that T&T was likely paying bribes to secure those contracts, which he identified as being undervalued and containing unusually long terms. In 2011, after Lopez confirmed with the head of Torneos y Competencias, Alejandro Burzaco, that T&T was indeed using bribery to obtain media rights, Lopez's division of Fox acquired 75% of the economic rights to T&T. Lopez intervened in the due diligence process for the acquisition to ensure that auditors' red flags did not stymie the deal.

For the next three years, Lopez "perpetuated, protected, and hid the bribes," which were funded by Fox. Throughout this time, Lopez held meetings in the United States with coconspirators to effectuate the scheme. The government's evidence also demonstrated how Lopez exploited his relationship with bribed executives to benefit his own career. In late 2011, for example, Lopez obtained from a top FIFA executive inside information to help Fox outbid a competitor for the broadcasting rights to the 2018 and 2022 World Cups.

In 2014, Lopez attempted to cover up the bribes by bringing whistleblower allegations to Fox, resulting in an audit that he was, in large part, able to control. Later, with Carlos Martinez (a subordinate to Lopez) and Burzaco, he devised a contract to minimize the paper trail of bribes traceable to Fox while maintaining payments to soccer executives, but the government's first indictment was unsealed before the contract was finalized. . .

We draw several conclusions from the [recent honest services fraud] cases *First*, for § 1346 to apply, the conduct at issue must involve bribery and/or kickbacks.

Second, the requisite fiduciary relationship cannot be determined based on a test for dominance and control or reliance, but an employer-employee relationship, or a similar relationship, is a well-accepted example of a fiduciary relationship that falls within the scope of § 1346.

Third, a violation of local law is not required to establish a breach of a fiduciary duty, and an employee's violation of his employer's codes of conduct—including the exact codes at issue here—may establish such a breach.

Fourth, the presence of foreign defendants or an international component to a scheme does not categorically remove an offense from the ambit of § 1346. . . .

Intellectually curious jurists, and certainly law professors, can debate whether *Percoco* and *Ciminelli* "signal[ed]" limits on the scope of the honest services wire fraud statute." *Full Play Grp.*, 690 F. Supp. 3d at 8 (emphasis added). But in adjudicating the case before us, we must focus on the concrete holdings of the cases that currently bind us rather than on "signals" that may forecast future decisions. Here, those concrete holdings lead us to conclude that Defendants' conduct falls within the scope of § 1346. . . .

Lopez and Full Play essentially contend that because they cannot find exact replicas of the fact pattern we are confronted with here—including the specific sort of fiduciary relationship at issue here—in pre-*McNally* case law, foreign commercial bribery of the sort with which they were charged is not encompassed by § 1346. But such a methodology is unduly restrictive. To be sure, the Supreme Court endorsed the approach of looking to pre-*McNally* case law to determine the general conduct and duties encompassed by § 1346. Neither the Supreme Court nor this court, however, has held that whenever a *specific fact pattern* cannot be located in virtually identical form in pre-*McNally* case law, it is not covered by § 1346. . . .

Neither the Supreme Court nor this court has ever held that pre-*McNally* decisions are the only sources that inform our analysis of § 1346. Indeed, we have recognized well-accepted fiduciary duties as falling within the scope of § 1346 without looking to pre-*McNally* case law for factual analogies. *See, e.g., Avenatti* (stating that defendant “cannot . . . argue that he lacked notice that, as an attorney, he owed a fiduciary duty to his client” and citing *Chestman*, for proposition that attorney-client relationship was “hornbook fiduciary relationship”).

Rather than investigate whether pre-*McNally* case law contains perfectly analogous foreign commercial bribery prosecutions, we find it more useful to dissect the schemes before us into their salient components and look at each separately to determine whether any component takes the scheme outside the scope of § 1346. Such components include the conduct at issue; the players involved in the scheme; where the scheme took place; and the nature of the fiduciary duty that was purportedly breached. . . .

The fiduciary nature of the relationship between the bribed officials and their respective organizations, *i.e.*, an employer-employee relationship, is one that is commonly recognized, including by pre-*McNally* cases, as “beyond dispute.” *See Skilling*. And, like the United Nations in *Bahel*, FIFA and CONMEBOL had express rules proscribing the use of an employment position for personal gain and imposing on officials a duty of “absolute loyalty.” Indeed, Defendants do not dispute that an employer-employee relationship is a well-recognized fiduciary relationship that falls within the scope of § 1346; they argue instead that a *foreign* employee's duty to his *foreign* employer does not yield a cognizable duty under the honest services doctrine.

Yet *Bahel* counsels that the foreign identity of the officials and their employers does not remove the schemes from § 1346's reach. There, like here, the bribed official was a foreign national and the victim was a multinational organization with global operations. And there, like here, there was relevant misconduct within the United States contributing to the breach of duty. Moreover, *Bahel* explicitly observed “that fraud actionable under Section 1346 is limited to the nature of the offenses prosecuted in the pre-*McNally* cases (*i.e.*, bribery and kickback schemes)—not the identity of the actors involved in those cases.” . . .

We conclude, therefore, that the nature of Defendants' conduct (bribery), coupled with the character of the relationship between the bribed officials and the organizations to

whom they owed a duty of loyalty (employer-employee relationships), place the schemes presumptively within the scope of § 1346. Further, the foreign identity of certain organizations and officials does not remove the schemes from the ambit of § 1346, especially where, as here, relevant conduct occurred in the United States, for the benefit of United States-based executives and organizations (*e.g.*, Lopez and Fox), and the victims were multinational organizations with global operations and significant ties to the United States.

Lopez and Full Play argue that the limited scope of domestic bribery statutes, 18 U.S.C. §§ 201 and 666, in combination with Congress's "surgical precision" when extending other criminal statutes to foreign commercial bribery, indicates that § 1346 does not cover foreign commercial bribery. But the wire fraud statute is not a bribery statute, and although we may look to the bribery statutes to shed light on what Congress meant by "bribery" or "kickback" in the wire fraud context, that does not mean that we should read the statutes in a like manner. Further, we have specifically observed that the wire fraud "statute reaches *any* scheme to defraud involving money or property, [regardless of] whether the scheme . . . involves foreign victims and governments." *Trapilo*. . . .

In sum, we hold that the schemes at issue here fall under § 1346 and that, therefore, the district court erred in holding that foreign commercial bribery is excluded from § 1346's reach as a matter of law and vacating Defendants' convictions.

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.” 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.”

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. . . .

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.” . .

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 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 modern 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 in the banking industry—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-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 (discussed in Chapter 10) 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 (“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,

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.

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, 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 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 Second Circuit reversed on the ground that the trial court had erroneously permitted one of Litvak's counterparties to testify that he believed Litvak was acting as his "agent" in their securities dealings, potentially misleading the jury. The government had conceded that it could not prove any special relationship between the counterparty trader and Litvak. *United States v. Litvak*, 889 F.3d 56 (2d Cir. 2018) (Litvak II).

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—style “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, Ebbers 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 Ebbers either actually knew or was aware of the high probability that the financial statements were false was not limited to Sullivan's testimony, as Ebbers claims. Ebbers 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 Ebbbers' 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. . . .

Ebbbers 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 willful 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)(c) (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).

In light of this statement of the doctrine, was *Ebbers* a proper case for an instruction on willful blindness?

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 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 Delaine, 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

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?

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?

Is stock option compensation a good idea?

Problem 3-3

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

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); Samuel W. Buell, *The Limits of Individual Liability in Deterring Corporate Fraud*, 59 WAKE FOREST L. REV. 557 (2024). 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>.

portfolio of RMBS underlying the CDO was selected by ACA Management LLC (“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 INVESTORS

i. 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-AC1 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 Turre? 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 eld 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

CHAPTER THREE: Securities Fraud

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 tiber 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 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]

51. 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

52. 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.

53. 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.

54. 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!

55. 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.

56. 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.

57. 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.”

58. 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

59. 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

60. 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. Implications of The Derivatives Traders' Requests

61. 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.

62. 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.

63. 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.

64. 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.

65. 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.

66. 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.

67. 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. . . .

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. 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 in prison for their part in the fraud after jurors rejected the defense's argument that the defendants were "just doing [their] job."¹¹ 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."¹²

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

¹¹ 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>.

¹² For more on the Barclays traders' acquittals, see Jane Croft & Carol Binham, *Former Barclays Traders Acquitted in SFO Libor Case*, FINANCIAL TIMES (Apr. 6, 2017), <https://www.ft.com/content/77d5a24a-1aac-11e7-bcac-6d03d067f81f>.

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. court'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).¹³ Two former Deutsche Bank traders, Matthew 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.

Finally, let us consider rapidly emerging issues involving fraud in crypto currency markets. There are novel questions that need not be explored here regarding whether varieties of dealing in crypto assets count as "securities" or "commodities" dealing under federal statutory regimes. Fraud in this context can also be addressed as wire fraud, as the following case, with an illustrative crypto fact pattern, discusses.

UNITED STATES v. EISENBERG, 2025 WL 1489248 (S.D.N.Y. May 23, 2025)

ARUN SUBRAMANIAN, United States District Judge:

On January 9, 2023, the government charged [Avraham] Eisenberg in a three-count indictment for defrauding an exchange called Mango Markets and stealing over \$100 million worth of cryptocurrency. Mango Markets is a platform where investors can buy and sell both the platform's native crypto token, MNGO, and a derivative product called a "MNGO Perpetual." A MNGO Perpetual is essentially a futures contract—that is, an "agreement to purchase or sell a particular asset on a later date at a predetermined price." *Choi v. Tower Rsrch. Cap. LLC*. A futures contract allows investors to "take positions

¹³ 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>.

on future values of” an asset; the investor who holds the short position (i.e. agrees to sell) bets that the value of the asset will go down, while the investor who holds the long position (i.e. agrees to buy) bets that it will go up. Futures contracts can be settled by “price settlement,” in which “one party pays the other for the difference” in the price of the underlying asset on a predetermined date without exchanging the actual asset. To use the futures contract analogy, the “asset” underlying a MNGO Perpetual is the MNGO token.

Unlike a traditional futures contract, there is no predetermined settlement date for a MNGO Perpetual. Instead, the parties can realize profits during the pendency of the contract. For example, if the price of MNGO rises from the reference price (that is, the price of MNGO when the contract was formed), then the party holding the long position will have an unrealized gain. A “mechanism in the [MNGO Perpetual] contract” allows the winning party to force the losing party to pay them that unrealized gain. After that, the parties’ contract “continue[s] on” with a new reference price.

For these settlement payments, the contemporaneous price of MNGO is determined by reference to a pricing “oracle.” An oracle “aggregat[es] prices across a variety of other venues” to determine the “fair market value of an asset.” The MNGO Perpetuals oracle pulls data from three other cryptocurrency exchanges—FTX, AscendEX, and Serum—to determine the average spot price of MNGO, and thus the parties’ unrealized loss or gain.

MNGO Perpetuals have one other distinct feature. So that the futures market stays tethered to the price of the MNGO token, the parties exchange a series of payments based on the so-called “funding rate.” To understand the funding rate, it helps to understand how a perpetual contract is created. One party will enter a “bid,” or an offer to buy into the perpetual, at an opening reference price; the other party will enter an “ask,” or offer to sell. When the terms match, the exchange creates a contract between the buyer and seller. The average midpoint of these “bids” and “asks” sometimes deviates from the oracle price for MNGO. If the order-book mid-price is lower than the oracle price, the party holding the short position must pay the party holding the long position to induce them “to bid up the order-book price.” And vice versa: if the order-book mid-price is higher than the oracle price, the long position must pay the short. Those payments are exchanged in USDC. USDC is a “reserve collateralized stablecoin” pegged to the US dollar.

During the time in question, Mango Markets not only allowed investors to trade crypto assets and perpetuals but also to take out collateralized loans of cryptocurrency based on the value of their portfolio on the platform. Both digital assets (like MNGO) and derivative contracts (like MNGO Perpetuals) counted as collateral. The higher the value of an investor's portfolio, the larger a loan they could take out.

For all this complicated background, the basic contours of Eisenberg's scheme are straightforward and undisputed on this motion. On October 11, 2022, Eisenberg deposited approximately five million USDC into two wallets on Mango Markets. He

used one of the wallets to sell and the other to buy the same MNGO Perpetuals, such that he held both the long and short positions. He then bought MNGO on the three exchanges that fed into the oracle, which increased the oracle price of MNGO and, by extension, the value of his long position. Eisenberg then borrowed against his long position on the Mango Markets platform. A few minutes later, he sold MNGO on the same three cryptocurrency exchanges, which caused the oracle price of MNGO to plummet and, by extension, the value of his short position to rise. He then borrowed more from Mango Markets against his short position. In total, Eisenberg borrowed and then quickly withdrew over \$100 million in cryptocurrency from Mango Markets. . . .

Eisenberg challenges the sufficiency of the evidence on falsity and materiality for his commodities- and wire-fraud convictions. . . .

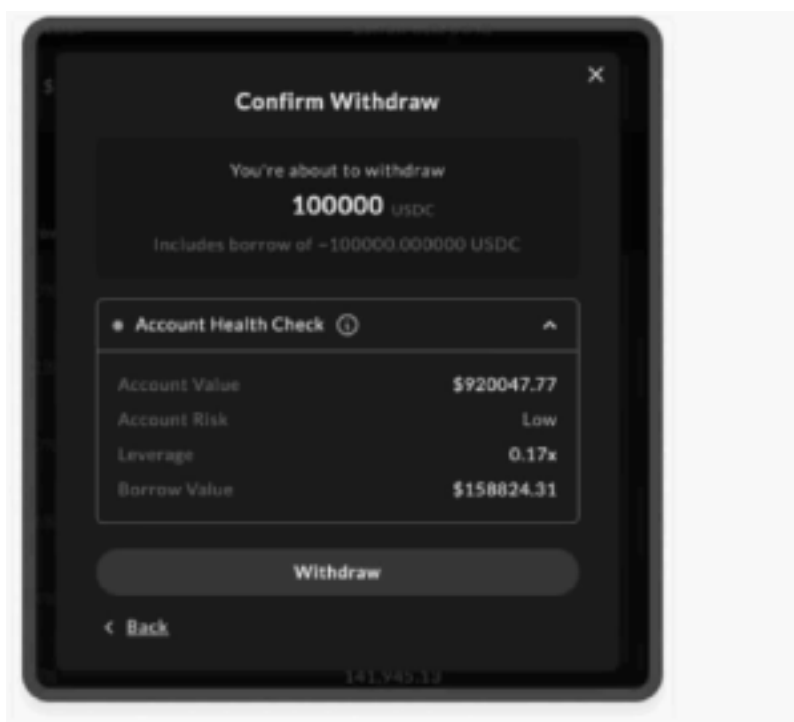
At trial, the government pointed to two alleged misrepresentations that Eisenberg made: First, he deceived Mango Markets into believing he was taking out a loan of cryptocurrency, when in fact he intended to steal it; and second, he misrepresented the value of his collateral, making Mango Markets believe it was valuable, when it was artificially inflated and worthless.

Before addressing whether there was sufficient evidence to support these alleged misrepresentations, here's a summary of what Eisenberg did. At the time in question, users on Mango Markets could take out a collateralized loan of cryptocurrency from the platform. Instead of withdrawing cryptocurrency from their own accounts, users could “borrow” against their assets, using those assets as collateral. It mechanically worked like this: A user who wanted to either withdraw their own assets, or borrow assets, would click “withdraw” or “borrow” on [an initial screen].

The user would then get taken to the screen below:



This screen allowed users to withdraw their own cryptocurrency assets, or to borrow cryptocurrency from the platform. By toggling the “borrow” switch, a user could indicate that they wanted to borrow cryptocurrency—as opposed to withdrawing their own crypto—and say how much. The evidence at trial showed that when a user wanted to borrow funds, the program would automatically conduct a risk calculation based on the user's account value to “ensure that [the user's] withdrawal is sufficiently collateralized and covered based on the other assets in [the] account.” After clicking “Next,” the user would be taken to this screen:



The screen indicates how much cryptocurrency is being withdrawn, how much of that is being “borrowed,” and provides the user with information concerning their “account health.” After clicking “Withdraw,” the user gets the cryptocurrency.

At the time of Eisenberg's offense, Mango Markets had no terms and conditions, policies, or rules regarding either manipulation or the borrowing of funds. The stated consequence of not repaying a loan was liquidation.

The government's theory of fraud was that Eisenberg, knowing his account value was artificially inflated, nevertheless toggled the “borrow” switch, which caused a “health check” to be performed to determine how much he could borrow. Because that health check was based on the inflated value of his Mango Perpetual positions, Eisenberg was able to withdraw more than he would have been allowed to absent his manipulation. Accordingly, the government says that Eisenberg “create[d] the false impression that his MNGO Perpetual position was an extraordinarily valuable asset[] against which he could borrow huge sums of cryptocurrency.”

Eisenberg argues that the government failed to prove that he made any material, false representation to Mango Markets. By and large, his arguments focus on the lack of any terms and conditions on the platform and the fact that Mango Markets was permissionless and automatic, so anything Eisenberg represented to the platform couldn't influence its decision to lend him cryptocurrency.

The Court agrees that there was insufficient evidence of falsity. First, the government argues that Eisenberg's act of borrowing funds when he intended to steal parallels signing a contract with no intent to honor one's obligations under that contract, which the Second Circuit has held can be fraudulent. *U.S. ex rel. O'Donnell v. Countrywide Home Loans*. But the contract analogy doesn't get the government far. There was no evidence at trial that Mango Markets required any user to promise that they would repay funds as a condition of borrowing against their assets, so this isn't a case where "a contractual promise was made, [but] the promiser had no intent ever to perform the obligation." To the contrary, as Eisenberg points out, the version of Mango Markets in use during Eisenberg's scheme "contained no specified terms of service, instructing users only that they were to 'use [the platform] at [their] own risk,'" Indeed, when a contributor to the platform, Brian Smith, was asked "When someone borrows from the platform, what is that user expected to do with respect to collateral," he answered that they are "generally expected to keep the collateral value positive *and, if not, they will be liquidated*." What happens if a user borrows funds but the value of their collateral plummets? They get liquidated. There was no evidence that the "borrow" function on Mango Markets entailed an obligation to repay—or any other obligation for that matter—even if that's how the term is conventionally understood.

So while in other contexts a contractual agreement to "borrow" might give rise to a claim of fraud if an individual intentionally misrepresents or omits something relevant to the terms of the agreement or the parties' negotiations, here there were no terms and no negotiations. There was just the word "borrow." That word could have been "Access Collateral," "Utilize Assets," or anything else for that matter. Inferring a "contractual promise" from the conventional understanding about what "borrow" means—especially in the unconventional context of a cryptocurrency platform running on an algorithm—stretches *O'Donnell* too far. . . .

Eisenberg also didn't make any false representations about the value of his assets on the platform. As noted above, when users on Mango Markets borrow against their collateral, the platform conducts an automated "account health check." The government argues that by prompting the borrowing process, and thus allowing Mango Markets to conduct this health check, Eisenberg created the false impression that his collateral was valuable. But as Eisenberg points out, the platform automatically measured the *actual* value of his collateral, so he didn't represent anything untrue.

Of course, Eisenberg knew that the value of his portfolio was the product of his market manipulation, and he knew it wouldn't stay valuable for long. So although the value of Eisenberg's portfolio may have been technically accurate at the specific moment in time

when he borrowed against it, the government argues that Eisenberg's representation about its value was deceptive. In support, the government points to testimony that the MNGO Perpetuals oracle was designed to pull data from exchanges like FTX and AscendEX because those exchanges had “some level of . . . anti-manipulation protection there, such that” investors could expect the “activity and trading activity” that happened on those exchanges to reflect “organic demand.” The government also points to testimony from Mango Markets users that not maintaining collateral and manipulating asset values would have “mattered” to them.

Based on these expectations and beliefs, the government argues that when Eisenberg borrowed, he implicitly represented to Mango Markets that the collateral in his account had not been manipulated, and that it was in fact valuable, both of which were false. But that theory runs into the Second Circuit's decision in *United States v. Connolly*. There, Deutsche Bank (DB) submitted daily reports to the British Bankers' Association (BBA) about “the rate at which DB could borrow cash in the interbank market.” Defendants, who were traders at the bank, sometimes requested that the LIBOR submitters make submissions beneficial to their positions. The evidence at trial included testimony from another DB employee and the LIBOR submitters themselves that “altering DB's LIBOR submissions to benefit DB trader positions was ‘wrong’ at the time they engaged in it.”

Among other things, the court rejected the government's argument that the submissions carried an “‘implied certification’ that there had in fact been no trader influence on the submission.” Even though there was evidence that market participants understood that trader influence on LIBOR submissions was improper, the absence of any rule or instruction prohibiting that conduct was dispositive. The court observed that while the BBA later adopted rules prohibiting this kind of conduct (just like Mango Markets did after Eisenberg's scheme), “during the earlier period at issue in the present case, there were no such guidelines or prohibitions.” So while “defendants' efforts to take advantage of DB's position as a LIBOR panel contributor in order to affect the outcome of contracts to which DB had already agreed may have violated any reasonable notion of fairness,” there was no actionable falsehood. Similarly, there was no evidence at trial that Mango Markets had any rules, instructions, or guidance addressing manipulation or requiring users to maintain sufficient collateral in their accounts. . . .

On a platform with no rules, instructions, or prohibitions about borrowing, the government needed more to show that Eisenberg made an implicit misrepresentation by allowing the algorithm to measure the actual value of his collateral. . . .

For these reasons, even when viewing the trial record in the light most favorable to the government, there was a failure of evidence on the element of falsity.

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 increased 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 “tipplers” and “tippees.” Section D covers the “misappropriation theory” of insider trading. Section E includes materials illustrating a 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 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:

[Ed: 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 (or "scienter") 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 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, "dupes" 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. Ass’n of the United States, Inc. v. State Farm Mut. Auto. 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 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 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, 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; 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 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, 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 wave of insider trading prosecutions in the hedge fund world. 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. . . .

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. . . .

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 mislead 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.¹⁴

¹⁴ 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),

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."

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

<https://www.bloomberg.com/news/articles/2013-10-16/billionaire-mark-cuban-found-not-liable-in-sec-lawsuit>.

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") 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[I] 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. . . .

Problem 4-8

You are an attorney at a major New York law firm. In light of *Newman*, *Salman*, and *Martoma*, 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 include overlapping issues 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

contents 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 in this case.] 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.” 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 *Blaszcak I* that, while not discussed by today's majority opinion because it is no longer outcome determinative, nevertheless deserves attention. In *Blaszcak 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[p]ed (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 discussion of what counts as “property,” the opinion in *Blaszczak I*, as the concurring opinion in *Blaszczak II* above 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 the elements 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.

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

Since the 1990s, a major campaign had been underway within the United States, and globally, to combat bribery in the conduct of international business. For nearly two decades, this effort had been producing vast amounts of work for law firms. As we will see it is possible that this campaign, at the initiative of the second Trump Administration, may be in retreat.

The primary legal locus of this activity, and the primary focus of our study, has been 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 (predating recent developments) 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)¹⁵

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

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2015, the government initiated 379 FCPA cases, reaching an annual high of 56 cases in 2010.

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. . . .

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

The second Trump Administration—sending shock waves through the field of corporate and white collar crime—announced in an executive order shortly after the 2025 inauguration that it would completely reevaluate the role of the United States in enforcing international anti-bribery laws. The result of this change of course, to date, is expressed in the following DOJ memorandum.

U.S. Department of Justice, Deputy Attorney General, Memorandum for Head of the Criminal Division

June 9, 2025

Subject: Guidelines for Investigations and Enforcement of the FCPA

On February 10, 2025, President Trump signed Executive Order 14209, titled *Pausing Foreign Corrupt Practices Act Enforcement to Further American Economic and National Security* (Feb. 10, 2025) (Order), to ensure that the FCPA is not “stretched beyond proper bounds and abused in a manner that harms the interests of the United States,” used “against American citizens and businesses . . . for routine

business practices in other nations,” or enforced in a manner that “harms American economic competitiveness and, therefore, national security.” The Order directs the Department of Justice (Department), through the Attorney General, for a period of 180 days, to “(i) cease initiation of any new FCPA investigations or enforcement actions, unless the Attorney General determines that an individual exception should be made; (ii) review in detail all existing FCPA investigations or enforcement actions and take appropriate action with respect to such matters to restore proper bounds on FCPA enforcement and preserve Presidential foreign policy prerogatives; and (iii) issue updated guidelines or policies [governing investigations and enforcement actions under the FCPA], as appropriate, to adequately promote the President's Article II authority to conduct foreign affairs and prioritize American interests, American economic competitiveness with respect to other nations, and the efficient use of Federal law enforcement resources.”

This memorandum establishes guidelines to ensure that FCPA investigations and prosecutions are carried out in accordance with President Trump's directive by (1) limiting undue burdens on American companies that operate abroad and (2) targeting enforcement actions against conduct that directly undermines U.S. national interests. Effective today, prosecutors shall focus on cases in which individuals have engaged in criminal misconduct and not attribute nonspecific malfeasance to corporate structures; proceed as expeditiously as possible in their investigations; and consider collateral consequences, such as the potential disruption to lawful business and the impact on a company's employees, throughout an investigation, not only at the resolution phase to evaluate whether to pursue FCPA investigations and enforcement actions, prosecutors shall consider the non-exhaustive factors set forth below. The initiation of all new FCPA investigations or enforcement actions must be authorized by the Assistant Attorney General for the Criminal Division (or the official acting in that capacity) or a more senior Department official. . . .

[O]ne primary consideration in deciding whether to pursue an FCPA investigation or enforcement action is whether the alleged misconduct (1) is associated with the criminal operations of a Cartel or TCO; (2) utilizes money launderers or shell companies that engage in money laundering for Cartels or TCOs; or (3) is linked to employees of state-owned entities or other foreign officials who have received bribes from Cartels or TCOs.

Economic growth and expansion of U.S. business opportunities abroad-including U.S. companies' competitiveness-is critical to safeguarding U.S. national security and economic prosperity. In addition to distorting markets and undermining the rule of law, companies that bribe foreign officials to obtain business can put their law-abiding competitors, including U.S. companies, at a serious economic disadvantage. By bribing foreign officials to obtain lucrative contracts and illicit profits-at times hundreds of millions of dollars-corrupt competitors skew markets and disadvantage law-abiding U.S. companies and others for many years.

The Department's FCPA enforcement will seek to vindicate these interests, not by focusing on particular individuals or companies on the basis of their nationality, but by identifying and prioritizing the investigation and prosecution of conduct that most

undermines these principles. Therefore, another important factor prosecutors shall consider is whether the alleged misconduct deprived specific and identifiable U.S. entities of fair access to compete and/or resulted in economic injury to specific and identifiable American companies or individuals. Similarly, in conducting investigations and prosecutions under the Foreign Extortion Prevention Act, 18 U.S.C. § 1352, which criminalizes the “demand side” of foreign bribery, prosecutors should consider whether specific and identifiable U.S. entities or individuals have been harmed by foreign officials' demands for bribes.

“American national security depends in substantial part on the United States and its companies gaining strategic business advantages whether in critical minerals, deep-water ports, or other key infrastructure or assets.” Order, § 1. As President Trump's National Security Strategy from 2017 correctly observed, “[t]errorists and criminals thrive where governments are weak, corruption is rampant, and faith in government institutions is low. Strategic competitors often exploit rather than discourage corruption and state weakness to extract resources and exploit their populations.” When this corruption occurs in sectors like defense, intelligence, or critical infrastructure, American national security interests may be harmed. FCPA enforcement will therefore focus on the most urgent threats to U.S. national security resulting from the bribery of corrupt foreign officials involving key infrastructure or assets.

The Order instructed that FCPA enforcement should not penalize “American citizens and business” for “routine business practices in other nations.” When conducting investigations, prosecutors must be mindful that the FCPA contains an exception for facilitating and expediting payments, *see, e.g.* 15 U.S.C. § 78dd-1 (b), and it provides affirmative defenses for reasonable and bona fide expenditures and payments that are lawful under the written laws of the foreign country, *see, e.g. id.* § 78dd-1 (c).

But beyond that, to best advance the priorities articulated above, FCPA investigations and enforcement actions shall not focus on alleged misconduct involving routine business practices or the type of corporate conduct that involves de minimis or low-dollar, generally accepted business courtesies. Rather, the focus of FCPA enforcement will be on alleged misconduct that bears strong indicia of corrupt intent tied to particular individuals, such as substantial bribe payments, proven and sophisticated efforts to conceal bribe payments, fraudulent conduct in furtherance of the bribery scheme, and efforts to obstruct justice. To prioritize cases that warrant investigation by U.S. authorities, FCPA prosecutors should also consider the likelihood (or lack thereof) that an appropriate foreign law enforcement authority is willing and able to investigate and prosecute the same alleged misconduct.

The guidelines set forth herein are not exhaustive. As with every criminal case, myriad factors must be considered when determining whether to investigate or prosecute. In addition to the factors outlined above, prosecutors must also follow other applicable policies and relevant factors. For instance, as in all matters, prosecutors are bound by the Principles of Federal Prosecution, *see* Justice Manual §§ 9-27.001, *et seq.*, which require consideration of the nature and seriousness of the

offenses and the deterrent effect of prosecution, among other factors. Such criteria may be considered when the Department determines whether to authorize particular new FCPA investigations and enforcement actions, consistent with the Order. Similarly, the Department's interests in pursuing cases that have already entered the judicial process-such as filed indictments and corporate resolutions-versus those that have not, may differ. The Department retains prosecutorial discretion to continue or terminate such actions based on the totality of the circumstances. . . .

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 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 & 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. L. 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 2024, Congress shifted course, enacting the following new provisions giving U.S. prosecutors authority to charge foreign officials who seek or accept business bribes.

18 U.S.C. § 1352

(a) Definitions.—In this section: (1) Foreign official.—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. . . .

(b) 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—

(A) from— (i) 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 the foreign official or person selected to be a foreign official, or a person acting on behalf of the foreign official or person selected to be a foreign official, is in the territory of the United States;

(ii) an issuer (as defined in section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a))), or any officer, director, employee, or agent of an issuer or any stockholder thereof acting on behalf of the issuer; or

(iii) a domestic concern (as defined in section 104 of the Foreign Corrupt Practices Act of 1977 (15 U.S.C. 78dd–2)), or any officer, director, employee, or agent of a domestic concern or any stockholder thereof acting on behalf of the domestic concern; and

(B) in return for— (i) being influenced in the performance of any act or decision of the foreign official or person selected to be a foreign official in the official capacity of the foreign official or person selected to be a foreign official;

(ii) being induced to do or omit to do any act in violation of the lawful duty of the foreign official or person selected to be a foreign official;

(iii) conferring any improper advantage; or

(iv) using the influence of the foreign official or person selected to be a foreign official with a foreign government or instrumentality thereof to affect or influence any act or decision of that government or instrumentality, 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.¹⁶ 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.¹⁷

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

¹⁶ 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>.

¹⁷ 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.

On May 29, 2025, U.S. District Judge Margo Brodie of the Eastern District of New York sentenced Leissner to two years in prison. She explained that her sentence resulted from a weighing of Leissner's extensive cooperation with investigations into the 1MDB matter and the seriousness of Leissner's crimes.

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.),¹⁸ 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

¹⁸ [Ed: the case caption has been edited to “Stichting” to make this party name easier to read and recall].

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 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?

Business Bribery as Securities and Wire Fraud? In a prosecution currently pending in the Eastern District of New York, *United States v. Adani et al.*, executives of a large Indian conglomerate are charged with various offenses in connection with an extensive scheme to bribe state-level Indian officials to obtain contracts to develop solar power projects. The company has a U.S. subsidiary, some personnel of which were involved in the scheme and have been charged with violating the FCPA. The Chairman of the conglomerate, Gautam Adani, who is reported to be the second wealthiest man in India, allegedly supervised the scheme. Adani, however, has not been charged with FCPA violations, likely because he could raise jurisdictional issues given that the conglomerate itself is neither doing business in the United States nor listed on a U.S. exchange. Instead, prosecutors have charged Adani with securities fraud and wire fraud, on the theory that he participated in false representations to investors in the U.S. recruited to participate in debt offerings—proceeds of which were used in part to bribe Indian officials. The allegedly fraudulent representations involved written assurances to the debt investors that the company had strict policies against bribery and did not engage in such activities.

The Money Flow from International Business Bribery. 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

vivid.) 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 cases 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

In the major scandal of a decade ago involving bribery within international football, numerous executives of FIFA and its regional affiliates were criminally charged in federal court in the Eastern District of New York. FIFA executives accepted bribes primarily in connection with two area of activity: (1) their selection of sites for the World Cup competition; and (2) their selection of marketing companies that were given the business of selling media rights to cover major regional FIFA-sanctioned football competitions. What legal theories might have been available to prosecutors in the FIFA matter?

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 several decades in penalties and settlements as a result of huge enforcement efforts in that sector. This 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 Nat. Res. 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”).¹⁹

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

¹⁹ 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.²⁰

²⁰ 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 Facticeau 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 Facticeau), 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)

A creative federal prosecutor can often find alternative statutes and theories to use with corporate wrongdoing, including in the pharmaceutical field.

For example, 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) [ed: based on predicate crimes of wire fraud, travel act violations (based on commercial bribery offenses), and distribution of controlled substances]. 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.

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." . . .

Like any major instance of corporate wrongdoing that causes widespread harm, the opioids scandal included responsibility spread across many actors. Consider, for example, the role of Pharmacy Benefit Managers (PBMs). These are companies such as Express Scripts that administer the drug coverage parts of health insurance policies, standing between drug manufacturers and patients. As reported in a 2024 *New York Times* investigation,

For years, the [PBMs] took payments from opioid manufacturers, including Purdue Pharma, in return for not restricting the flow of pills. As tens of thousands of Americans overdosed and died from prescription painkillers, the middlemen collected billions of dollars in payments. . . .

The P.B.M.s' power lies in their role as gatekeepers. They largely control the lists of drugs that insurance plans will cover, and drugmakers compete for position on those lists by offering rebates. The middlemen typically pass along most of these rebates to their clients, but they also keep a portion for themselves.

The drug lists, known as formularies, frequently include restrictions meant to save money by steering patients to cheaper drugs. But for some drugs, such as opioids, restrictions can serve a medical purpose — minimizing the risk of overdose and addiction and limiting the number of pills that could be diverted to the illicit market.

Yet time and again, documents show, the P.B.M.s bargained away safeguards in exchange for rebates. . . .

Purdue's strategy to ensure broad access to its blockbuster painkiller OxyContin was explicit: "Offer rebates to remove payer restriction," according to an internal presentation. The company didn't want doctors to have to provide additional justification for prescribing a powerful narcotic, and it didn't want strict limits on the number of pills that could be dispensed.

The approach worked. Purdue repeatedly boasted in internal reports that prescribers and patients faced few or no restrictions on access to the drug.

What could have been a backstop against overprescribing instead became a sales tool, records show. After striking deals with P.B.M.s, drugmakers touted the favorable coverage — no second-guessing or paperwork requirements from insurers — as part of an effort to get doctors to write more prescriptions.

Even as the epidemic worsened, the P.B.M.s collected ever-growing sums. The largest of the middlemen bought competitors and used their increasing leverage not to insist on safeguards but to extract more rebates and fees. From 2003 to 2012, for example, the amount Purdue was paying P.B.M.s in rebates roughly doubled to about \$400 million a year, almost all of it for OxyContin. . . .

In response to rising costs and news coverage about addiction and abuse, some insurers began restricting access to the drug, requiring doctors to seek authorization before they could write some prescriptions or limiting the number of pills that could be prescribed to a patient each month.

For Purdue, this posed a serious threat. The restrictions, the company noted in an internal planning document, will “create barriers to OxyContin being able to achieve significant growth.”

To knock down these barriers, Purdue needed to win over the middlemen, which held sway over insurers and other clients that counted on the rebates that the P.B.M.s shared with them.

Purdue forged what executives described internally as a “partnership” with Express Scripts and a “special arrangement” with Merck-Medco, one of the nation’s largest P.B.M.s at the time. Together, the drugmaker and the middlemen disseminated purportedly independent guidance on pain management, including a mailing to doctors from Express Scripts that was meant to, in Purdue’s words, “squelch the anti-OxyContin pushback.”

In 1999, when Purdue struck a similar deal with AdvancePCS, the third of the big P.B.M.s at the time, a Purdue sales executive, James Lang, celebrated: “We want to make OxyContin a billion-dollar drug in two years. This will help.”

“This is amazing,” Purdue’s president, Richard Sackler, replied.

Chris Hamby, *Giant Companies Took Secret Payments to Allow Free Flow of Opioids*, N.Y. Times, Dec. 17, 2024.

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.²¹

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

²¹ 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. Koczwar*. 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. 386 (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 (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

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