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Wiretaps Likely To Become More Popular

Law360, New York (July 01, 2013, 11:22 AM ET) -- *"Today, tomorrow, next week, the week after, privileged Wall Street insiders who are considering breaking the law will have to ask themselves one important question: Is law enforcement listening?"* —Preet Bharara, U.S. Attorney for Southern District of New York

While the Second Circuit's recent decision in the case of *United States v. Rajaratnam* has dominated media attention, it is in fact one of three criminal appeals recently brought before the Second Circuit Court of Appeals that raise the question of whether law enforcement has the right to listen to phone calls of Wall Street insiders under federal law. The court's affirmance of Rajaratnam's conviction reinforced the government's contention that traditional law enforcement methods are unlikely to lead to convictions in white collar insider trading cases and gave law enforcement a green light to continue using wiretaps in white collar insider trading investigations. This does not bode well for the two additional appeals pending before the Second Circuit or for those who become the subjects of future insider trading or other securities fraud investigations.

In 2011, Raj Rajaratnam, a former hedge fund manager and billionaire co-founder of the Galleon Group — at one point one of the largest hedge funds in the world — was convicted of 14 counts of conspiracy and securities fraud. This was the largest insider trading case in a generation. Prosecutors alleged that Rajaratnam gained \$63.8 million over the course of a seven-year conspiracy by trading on information provided by insiders. Prosecutors recommended a sentence between 19 and 24 years, but Rajaratnam was ultimately sentenced to 11 years, in part because of his medical condition. He was also fined over \$150 million in criminal and civil penalties.

Rajaratnam's case was one of the first insider trading cases brought by prosecutors in which wiretapped conversations played a significant role in securing the conviction. To obtain the wiretap authorization, law enforcement submitted that there was evidence — primarily statements of a cooperating witness — to support probable cause and argued that the wiretap was necessary because "normal investigative techniques," such as physical surveillance, federal grand jury subpoenas for witness testimony, review of trading records, witness interviews, use of confidential informants and placement of undercover agents, had been tried and had "failed or reasonably appear[ed] unlikely to succeed if tried."

The district court judge authorized the wiretap of Rajaratnam's cell phone and, on Oct. 16, 2009, based in large part on evidence obtained from the wiretap of Rajaratnam's cell phone, Rajaratnam was arrested and charged with multiple counts of securities fraud. He was indicted two months later.[1]

Rajaratnam's attorneys' attempt to suppress the wiretaps — based on the argument that the FBI obtained the evidence with a faulty warrant — was unsuccessful. During the trial, jurors heard more than 45 recordings of Rajaratnam and prosecutors replayed several of

the tapes during closing arguments. On one call, Rajaratnam explained that the stock price of one company was down because of bad press, but he stated that he knew the stock price was about to shoot up "because one of our guys is on the board."

Needless to say, this wiretap evidence was extremely damaging, and Rajaratnam's attorneys had little success trying to offer alternative explanations for the conversations. During a post-trial interview on final alternatives.com, one juror offered some insight into the impact that the wiretaps had on deliberations: "They were very, very helpful because you get to listen to the tone," she said. "It pieced everything together. It was a confirmation that this is definitely insider trading." [2]

In his appeal to the Second Circuit Court of Appeals, Rajaratnam argued that his conviction should be vacated because the government misled the district court judge that authorized the wiretaps. He claimed that, as an initial matter, insider trading is not an offense for which a wiretap is authorized, and argued as well that prosecutors and federal agents omitted key facts from their request to the court for wiretap authorization. These facts included information regarding a previous investigation by the U.S. Securities and Exchange Commission and that a cooperating witness plead guilty to a wire fraud charge in 2002 to avoid jail time. In a decision handed down on June 24, 2013, the Court of Appeals rejected these arguments in toto and affirmed the conviction. [3]

In enacting Title III of Omnibus Crime Control and Safe Streets Act of 1968, 18 U.S.C. § 2510, et seq., Congress included within Title III an enumerated list of offenses that may be investigated through the use of wiretaps. This limitation was imposed in order to restrict the government's ability to employ this intrusive investigative tool. The offenses of insider trading and securities fraud are not found among that list.

The legislative history of Title III suggests that the omission of insider trading and securities fraud offenses was intentional. The "major purpose" of Congress in enacting Title III was "to combat organized crime." [4] As Congress observed, participants in organized crime "do not keep books and records available for law enforcement inspection" and associates, coconspirators and victims of organized crime rarely cooperate with law enforcement because of the "fear, quite realistic, that death comes to him who talks," therefore rendering wiretap intercepts "the only effective method of learning about their activities." [5]

The securities industry is hardly one that is ever compared to organized crime. Indeed, the securities industry is so significantly regulated that participants regularly maintain copious records, record communications and public statements to the market and submit to agency investigations and provide testimony. It is perhaps for this reason that Congress did not include securities fraud on the list of Title III's enumerated offenses, nor seek to add securities fraud to that list any of the 13 times Congress has amended Title III since 1968.

In Rajaratnam and the other cases now pending before the Second Circuit, the government was clearly aware of this limitation. To avoid it, the government took the position that that insider trading often involves wire fraud and money laundering and, because those offenses are enumerated offenses for which a wiretap may issue, the lack of reference to insider trading or securities fraud is of no moment.

Rajaratnam challenged this contention in his brief on appeal, but did not address it specifically as an issue in his appeal. For that reason, in its decision, the Second Circuit assumed that the government's use of a wiretap in this type of case was authorized under the statute — an issue that is likely to be addressed in one or both of the other similar cases still pending in that court.

Instead, Rajaratnam focused on the deficiencies in the government's application for the wiretap authorization. Specifically, Rajaratnam challenged the so-called probable cause to

support the government's wiretap application as well as the government's evidence of necessity — that is, the required assertion that use of a wiretap is necessary because other less intrusive means of investigation have failed or would not be productive. With regard to necessity, Rajaratnam stressed that the government had failed to inform the judge who issued the wiretap authorization that the government had in fact already deposed Rajaratnam in an SEC proceeding, and that the SEC had obtained over 4 million documents from Rajaratnam.

This argument fell flat. In an ironic twist, the court found that such information actually supported the issuance of a wiretap: The court noted that law enforcement still lacked the evidence necessary to indict Rajaratnam despite the 4 million documents and the deposition testimony. In the court's view that lack of evidence itself demonstrated why the wiretap was necessary and properly authorized.

The Second Circuit's decision on "necessity" in Rajaratnam is not likely to have a profound effect on the use of wiretaps in white collar cases. While it may give the government an incentive to bring civil enforcement cases in order to create a basis to claim the necessity of wiretaps (if the enforcement proceeding does not provide sufficient evidence to indict), but after the commencement of an SEC investigation, most targets are likely to be more circumspect than Rajaratnam and his co-conspirators about the possibility that the government is monitoring their communications.

On the other hand, even though the court did not address it directly, the fact that the Second Circuit upheld Rajaratnam's conviction is likely a signal that the court views favorably the government's argument that the relationship between insider trading and the enumerated crimes of wire fraud and money laundering provides a basis to use wiretaps in such cases. If that is the case, the broad reach of the wire fraud and money laundering statutes may mean that there are few if any limitations on the government's ability to use wiretaps in white collar cases.

When the court decides the other two cases before it involving similar issues, it may provide greater clarity on this issue. And, as other cases percolate up through the federal appellate system, the viewpoints of other Courts of Appeal will be critical to the ability of the government to widen its use of wiretaps in this nontraditional area of law enforcement.

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[1] U.S. v. Rajaratnam, ___ F3d ___, 2013 WL 3155848 (2d Cir. 2013).

[2] <http://www.finalalternatives.com/node/16622>

[3] U.S. v. Rajaratnam, ___ F3d ___, 2013 WL 3155848 (2d Cir. 2013).

[4] S. Rep. 90-1097, at 41-45 (1968).

[5] *Id.* at 43-44 (emphasis added).

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