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Lessons from the Galleon Prosecution

By Mark S. Cohen, Jonathan S. Abernethy, and Elizabeth F. Bernhardt – July 28, 2011

The groundbreaking Galleon prosecution offers a number of lessons for white-collar practitioners. This first-ever use of wiretaps in an insider trading investigation is a game changer for prosecutors and the criminal defense bar. For Raj Rajaratnam, the 45 intercepted calls played for the jury were difficult proof to overcome, and in many ways, the government's biggest win came at the pretrial stage, when the judge denied his motion to suppress. That motion and the judge's ruling are important and bear careful consideration by white-collar defense lawyers.

In addition, Rajaratnam's trial strategy is worthy of study. Conceding the facial importance of the government's wiretap evidence, the defense argued that Rajaratnam nonetheless had an innocent state of mind, in that the information he received was not material or nonpublic, and he based all of his trades on a "mosaic" of information. This approach enabled the defense to present a wealth of positive background information about Rajaratnam and his business.

Wiretapping in Insider Trading Cases Is Here to Stay

Notwithstanding the result in his case, white-collar practitioners in future insider trading cases should consider following Rajaratnam's lead in moving to suppress wiretaps. Rajaratnam and his codefendant Danielle Chiesi raised a number of forceful arguments in this regard, the first of which was that wiretaps are not permitted in insider trading investigations. Judge Richard J. Holwell rejected this argument.

The defense argued that because insider trading is not a predicate offense under Title III, the government's use of the wiretaps was improper. But the judge held that the government could use this evidence because it fell under a provision of Title III allowing the use of intercepted calls relating to crimes "other than those specified" in the order authorizing the wiretap. *See* 18 U.S.C. § 2715(5). As Judge Holwell stated, the test is whether the government lawfully and in good faith applied for the original wiretap to investigate enumerated Title III crimes, and "not as a subterfuge for gathering evidence of other offenses," and whether the communications relating to those "other offenses" were "incidentally intercepted." Because the prosecution in the Galleon case had not engaged in subterfuge but had candidly indicated it was investigating insider trading and because it also indicated that its investigation would uncover evidence of wire fraud and money laundering (both of which are predicate Title III offenses), the judge found that the use of wiretapped calls relating to insider trading was permissible. *United States v. Rajaratnam*, No. 09 Cr. 1184 (RJH), 2010 WL 4867402, at *3–4 (Nov. 24, 2010).

Significantly, the district court found that it did not matter that the government's main objective was to investigate securities fraud, holding that "when the government

investigates insider trading for the bona fide purpose of prosecuting wire fraud, it can thereby collect evidence of securities fraud, despite the fact that securities fraud itself is not a Title III predicate offense." *Id.* at *6. Judge Holwell cited several cases from the Second and First Circuits that had allowed the use of wiretapped calls for non-Title III enumerated offenses when those calls were incidentally intercepted. *See In Re Grand Jury Subpoena Served on John Doe*, 889 F.3d 384, 387–88 (2d Cir. 1989); *United States v. Masciarelli*, 558 F.2d 1064, 1068–69 (2d Cir. 1977); *United States v. Marion*, 535 F.2d 697, 700–701 (2d Cir. 1976); *United States v. McKinnon*, 721 F.2d 19, 22–23 (1st Cir. 1983).

Insider trading almost always involves the use of interstate wires (typically the telephone), as the district court acknowledged. For that reason, the district court's ruling appears to invite an end run around Title III. Based on the court's rationale, all the government need do in future insider trading investigations is claim to be investigating wire fraud (an enumerated Title III offense), even if it really is only focused on and ultimately only charges insider trading (a *non*-Title III offense)—as it did in Rajaratnam's case. The district court's reasoning may also be questioned on a more basic level: How can interceptions revealing evidence of insider trading be deemed "incidental" when insider trading is, in fact, the *focus* of the investigation? These questions will likely be at issue in Rajaratnam's appeal.

These issues are, of course, not limited to the Rajaratnam case. Emboldened by its success in the Galleon prosecution, the government is sure to bring many more insider trading cases using wiretaps, and other courts will have to decide whether similar interceptions are "incidental," and therefore proper, or whether they constitute an impermissible end run around the wiretapping statute. At least until further clarity is gained through the appeal of the Rajaratnam case and issuance of other court rulings, wiretapping in insider trading cases appears to be here to stay. Thus, defense lawyers would to well to consider a multi-pronged strategy, including following Rajaratnam's lead in attempting to exclude the wiretaps at the pretrial stage, while also preparing to defend against them at trial.

The Government May Be Vulnerable to Necessity Challenges to Wiretaps

There is at least one other pretrial challenge that white-collar practitioners should consider in future wiretap cases, drawing on the experience of the Galleon case. Rajaratnam moved to suppress on the grounds that, in its wiretap affidavit, the government had not provided "a full and complete statement as to whether or not other investigative procedures have been tried and failed or why they reasonably appear to be unlikely to succeed if tried." 18 U.S.C. § 2518(1)(c). This statutory requirement forms a fundamental tenet of Title III—that a phone may only be tapped out of necessity—and limits the use of this highly intrusive tactic to situations where traditional law enforcement techniques are insufficient to expose fully the criminal conduct at issue. Although the government need not "exhaust all conceivable investigative techniques before resorting to electronic surveillance," in its wiretap affidavit it "must provide some

basis for concluding that less intrusive investigative procedures are not feasible." *Rajaratnam*, 2010 WL 4867402, at *14.

On this point, Judge Holwell took the government to task for recklessly failing to disclose in its wiretap application the numerous investigative procedures already employed—including the fact that the SEC had been investigating Rajaratnam for years, had collected over four million subpoenaed documents, and had interviewed and/or taken depositions of numerous Galleon employees, including Rajaratnam himself. The judge held a four-day hearing under *Franks v. Delaware*, 438 U.S. 154 (1978), which allows defendants challenging a wiretap to obtain an evidentiary hearing if they make "a substantial preliminary showing that the government recklessly or knowingly made a misleading statement or omission" in a wiretap affidavit. *United States v. Rajaratnam*, No. 09 Cr. 1184 (RJH), 2010 WL 3219333, at *1 (Aug. 12, 2010). The *Franks* hearing established that the government had made a "glaring omission" in failing to disclose its use of these more traditional techniques, thereby depriving the judge who had approved the first wiretap application "of the opportunity to assess what a conventional investigation of Rajaratnam could achieve by examining what the SEC's contemporaneous, conventional investigation of the same conduct was, in fact, achieving." In the end, however, Judge Holwell concluded that when the government's misstatements and omissions were corrected, the wiretap affidavit still established that it was necessary to tap Rajaratnam's phone to reveal the full nature of the insider trading conspiracy. *Rajaratnam*, 2010 WL 4867402, at *15, 17, 21–24.

There are at least a few valuable takeaways from this ruling for white-collar practitioners. First, when presented with a motion challenging the necessity of a wiretap, judges are likely to look critically at the wiretap affidavit and may not tolerate the use of mere boilerplate language often found in such affidavits to the effect that "alternative investigative techniques have been tried or appear unlikely to succeed if tried." *Id.* at *17. Second, recognizing that judges will closely scrutinize the necessity portion of an affidavit, the government is likely to provide more detail to try to avoid the type of lengthy *Franks* hearing that occurred in the Galleon case. Third, based on the court's response to Rajaratnam's necessity motion, in the future, the government should provide more discovery materials to defendants in insider trading cases involving wiretaps. Defendants must have a detailed accounting of all of the conventional investigative techniques that prosecutors and the SEC have used so that they can determine whether to move to suppress wiretaps on necessity grounds. And when the government is unwilling to give such expansive discovery, defense lawyers should move to compel it.

In light of the above, the government may indeed be vulnerable to necessity challenges in future insider trading cases. As Judge Holwell observed, "conventional [investigative] techniques have at least proven adequate" in prior insider trading investigations spanning decades. *Id.* at *22. Given the many ways insider trading has been investigated effectively in the past *without* the use of wiretaps, it is appropriate to speculate why this additional tool is now *necessary* for the government. Prosecutors cannot merely assert

that wiretaps are helpful to investigate this crime, which often occurs over the phone. They must show more to justify the highly intrusive use of wiretaps. Regardless, however, of whether a necessity challenge ultimately results in suppression of a wiretap, at a minimum, defense lawyers should use the prospect of litigation over this issue to extract more complete pretrial disclosures about the full range of investigative techniques used by the government in insider trading investigations.

Rajaratnam's Trial Strategy

At trial, the defense team did not dispute Rajaratnam's receipt of some confidential information, nor deny his trading in the affected companies. However, the defense did dispute whether the confidential information Rajaratnam received was truly "material" and "non-public" and whether he relied on this information to make specific trades. Thus, the defense made an issue of Rajaratnam's state of mind and intent when he traded.

As a direct result, a great deal of background evidence was admitted. For instance, the defense was able to introduce evidence that Galleon was staffed by teams of qualified, aggressive professionals, who traveled, interviewed executives, analyzed data, and conducted intensive research on companies in various sectors of the global economy—research that Rajaratnam scrutinized. The defense also presented evidence that Galleon kept careful records of all of its transactions, including trading, and that it had transparent procedures. The jury learned that Rajaratnam himself was disciplined, energetic, and decisive; that he was devoted to the interests of his investors; and that he consulted numerous sources of information before making trading decisions. In short, the jury learned that Galleon was a well-run, legitimate business. An expert defense witness testified that given the "mosaic" of publicly available information, a reasonable investor could have made the identical trading decisions that Rajaratnam made, all based on public sources.

Such evidence—sometimes called "reverse 404(b)" evidence—is usually excluded as irrelevant, collateral, or even forbidden "propensity" evidence. *See* Fed. R. Evid. 404(b) ("Evidence of other . . . acts is not admissible in order to . . . show action in conformity therewith"). But the strategy of placing a defendant's intent and state of mind (rather than his or her actions) at issue allows defense counsel to put this evidence before the jury and expand the context in which ostensibly inculpatory evidence is viewed. Rajaratnam's defense team did this repeatedly, reiterating in summation that the jury should consider "the complete picture of what happened and not the tiny sliver that the government" presented, "because the government's narrow view is very unfair." Transcript of Record at 5320:22–23; 5321: 2–3, *United States v. Rajaratnam*, No. 09 Cr. 1184 (RJH).

This approach makes for a logical strategy when the government has evidence of specific, apparently illegal acts, and the authenticity of the evidence cannot easily be challenged. In such cases then, it is possible for a defendant to admit the *actus reus* but still assert that his intent was innocent. If a defendant admits his actions, intent may be the only thing at issue at the trial.

Several federal circuit courts have approved the introduction of relevant background evidence, including "good acts," in such situations. For instance, in the seminal case *United States v. Shavin*, 287 F.2d 647, 653–54 (7th Cir. 1961), the Seventh Circuit held that contemporaneous honest transactions "shed light upon" the defendant's "intent and purpose" and could be used to show "lack of criminal intent." *See also United States v. Garvin*, 565 F.2d 519 (8th Cir. 1977) (finding reversible error in the exclusion of defendant's truthful statements where he asserted a good-faith defense); *United States v. Hayes*, 219 F. App'x 114, 117, 2007 WL 708984 (3d Cir. Mar. 8, 2007) (reversing a conviction because the trial judge erroneously excluded evidence of defendant's "good acts," such as his policies and directives to subordinates, when this evidence was relevant to whether defendant was a conspirator); *United States v. Sheffield*, 992 F.2d 1164 (11th Cir. 1993) (holding evidence of defendant's custom and practice was admissible to disprove his intent to embezzle); *United States v. Thomas*, 32 F.3d 418 (9th Cir. 1994) (reversing conviction because testimony from the satisfied customers, who were not cited in the indictment, was excluded from trial, and only the dissatisfied customers were permitted to testify); *United States v. Quattrone*, 441 F.3d 153, 188 (2d Cir. 2006) (holding that defendant could introduce "evidence of events" during the two-year period between the underlying events and his statement to the government, because events over these two years had "a tendency to make more or less probable the fact that [he] was simply mistaken when he spoke").

The Galleon defense team should be credited with contextualizing Rajaratnam's actions and showing the jury a more rounded picture, including good behavior at odds with criminality. Other defense lawyers would do well to follow their example.

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