Securities Regulation Daily Wrap Up, TOP STORY—2d Cir.: Jefferies broker's TARP-fraud conviction overturned, (Dec. 8, 2015)

Securities Regulation Daily Wrap Up

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By Anne Sherry, J.D.

The Second Circuit overturned the conviction of a former securities broker for TARP and securities fraud. The broker, who has since been barred from the securities industry, got in trouble for lying about the prices his firm paid and charged for securities. But the appeals court reversed in part and vacated in part, holding that the structure of the defrauded part-public funds meant that any misrepresentations did not affect Treasury's decisions and that an evidentiary error deprived the broker of a chance to defend against materiality (*U.S. v. Litvak*, December 8, 2015, Straub, C.).

Conviction. The broker was convicted of fraud for making material misrepresentations to increase the profitability of trades in residential mortgage-backed securities (RMBS). Because some of the counterparties were Public-Private Investment Funds (PPIFs), the conviction included charges of making false statements (18 U.S.C. § 1001) and fraud against the United States (18 U.S.C. § 1031).

Fraud against government. Under Second Circuit precedent, a conviction under 18 U.S.C. § 1001(a)(2) requires proof that the defendant, among other things, made a materially false statement. A statement is material if it can influence the decision of the decisionmaking body to which it was addressed. *U.S. v. Coplan* (2d Cir. 2012). The court also assumed, without deciding, that the materiality element of § 1031 was coextensive with that of § 1001.

Viewing the evidence in the light most favorable to the government, the court concluded that it was insufficient for a rational jury to conclude that the defendant's misstatements could have influenced a decision of the Treasury. Even if a rational jury could accept that the misstatements frustrated the Treasury's achievement of its investment goals, it could not infer from that that the misstatements were capable of influencing a decision by Treasury. In fact, the appeals court noted, the government's chief witness testified on cross-examination that the PPIFs were deliberately structured to keep the Treasury away from making buy and sell decisions.

Securities fraud. Having reversed the conviction on the §§ 1001 and 1031 counts, the court vacated the judgment of conviction on the remaining securities fraud counts and remanded for a new trial. While the defendants' misrepresentations were not immaterial as a matter of law and the district court did not err in refusing to provide an "intent to harm" instruction to the jury, the court did err in excluding certain portions of the defendant's experts' testimony. The proffered evidence on how investment managers value RMBS and the impact of a broker's statements on the final purchase price would have been highly probative of materiality, the central issue in the case.

In particular, the testimony could have educated the jury about the specialized field of RMBS trading and the use of analytical models to arrive at a valuation before a manager even approaches a dealer like Jefferies. With that information, a jury could reasonably find that a dealer's misrepresentations about the price paid for RMBS would not be material to a counterparty relying on its own sophisticated valuation methods and computer model. The district court's error in excluding the testimony was not harmless because it left the defendant with little opportunity to present his defense of non-materiality.

The case is No. 14-2902-cr.

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Companies: Jefferies & Co.

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