

New Use of Wiretaps In Insider Trading Cases

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As 2008 ended with the arrests of Marc Dreier and then Bernard Madoff nine days later, it seemed unlikely that 2009 would prove as significant. Then, on Oct. 16, 2009, federal agents arrested Raj Rajaratnam, the founder of hedge fund Galleon Group, in an alleged insider trading scheme that involved well known public companies and thus far 20 defendants, including lawyers, stock traders, management consultants, and executives inside the issuers themselves. Unlike the Dreier and Madoff cases, these arrests proved shocking not simply because highly placed members of the financial, business and legal world were seen in handcuffs, but also because of how they got there.

The Department of Justice (“DOJ”) relied heavily on wiretapped telephone conversations to build its case. According to Preet Bharara, the U.S. Attorney for the Southern District of New York, the case against Rajaratnam and his co-defendants is the “first time that court-authorized wiretaps have been used to target significant insider trading on Wall Street,” and all defendants charged “were ultimately caught committing their alleged crimes over phones that [law enforcement was] listening to.” The technique proved fruitful: in addition to the 20 arrests from across the country, DOJ suggests that more are forthcoming. As of this writing, five hedge fund managers and an attorney have pled guilty.

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HOW THE CASES UNFOLDED

The complaints show how the cases unfolded. The Rajaratnam complaint, for example, initially describes the government’s discussions with a cooperating witness — identified as Roomy Khan by those familiar with the case — who was a hedge fund manager and former Galleon Group employee. Faced with criminal charges arising out of her own illicit trades, Khan became a cooperating witness in November 2007 and not only provided information concerning the tips she gave Rajaratnam, but also recorded her telephone conversations with him.

Subsequently, the government obtained court orders authorizing wiretaps — first of Rajaratnam’s cell phone, then of the phones of an unindicted co-conspirator — and intercepted conversations between Rajaratnam and alleged insiders concerning trading in the stock of public companies. For example, conversations between Rajaratnam and co-defendant Anil Kumar — a director at a management consulting firm retained by Advanced Micro Devices (“AMD”) — allegedly involved non-public information about AMD’s forthcoming multibillion dollar reorganization. Rajaratnam is alleged to have purchased AMD shares for Galleon before the reorganization was announced.

THE USE OF WIRETAPS

While wiretaps have long been a successful law enforcement weapon against drug trafficking and organized crime, the Galleon case may portend their increased use in white-collar cases. Insider trading cases can be difficult to build and prove. They are typically historical accounts of past trades built on inferences from painstaking analysis of trading and telephone records. Even those cases involving an informant rely heavily upon such records. Since a cooperator’s motives are often suspect, the government likes to tell the jury

that it can convict solely upon the documentary evidence without relying on the cooperator’s testimony.

Moreover, the charge of insider trading requires that the government establish the defendant’s state of mind — that the defendant traded while in “knowing possession of material, non-public information that has been gained in violation of a fiduciary duty to its source.” *SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009) (citation omitted). Historically, the government has attempted to prove this through circumstantial evidence. Because the government must prove that a defendant knew both that the information was non-public and that it was disclosed in breach of a fiduciary relationship, audio recordings of defendants discussing non-public information in real time will make such proof far easier for the government.

The Galleon complaints describe at length the defendants’ paranoia concerning their activities, thereby evidencing, in the government’s view, their guilty knowledge that they were breaking the law. Co-defendant Danielle Chiesi, whose telephone was tapped during the investigation and who was arrested the same day as Rajaratnam, is recorded in various conversations cautioning: “Don’t put anything on e-mail,” “Don’t e-mail even Raj or anybody,” “Be careful.” In a different conversation, she reportedly said that she’s going to “get a new cell phone” because “I’m paranoid,” to which a co-defendant allegedly responds, “Well don’t keep talking about it on the phone.” In another alleged call, Chiesi tells Rajaratnam that she is “glad that we talk on a secure line, I appreciate that,” to which Rajaratnam replies, “I never call you on my cell phone.” In an exchange reported widely in the press, Chiesi is quoted as saying: “You just gotta trust me on this ... Here’s how scared I am about what I’m gonna tell you on AMD ... I swear to you in front of God,

you put me in jail if you talk." Later, she is quoted as saying: "I'm dead if this leaks. I really am — and my career is over. I'll be like Martha f---ing Stewart."

A 'VERITABLE SMORGASBORD'

The government is, predictably, heartened by this evidence. At Rajaratnam's bail hearing the prosecutor described the evidence as "overwhelming" and a "veritable smorgasbord" of insider trading tactics, with cooperating witnesses prepared to provide "extensive" testimony and telephone and trading records that corroborated the evidence. The prosecutor repeatedly referenced the recordings as evidence of Rajaratnam's intent to commit the crimes charged.

Paradoxically, the defendants' evasive tactics may open the way for more wiretaps in white-collar cases. To obtain a wiretap warrant, the government must provide 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 or to be too dangerous." 18 U.S.C. § 2518. Such a showing has been difficult with white-collar crime because it is not as inherently dangerous as street crime, and prosecutors have traditionally relied on cooperating witnesses. Here, Rajaratnam was allegedly recorded counseling his colleagues on how to avoid detection of insider trading, advising them to create a fictitious e-mail trail showing innocent sources of the information, and suggesting ways to make it harder for the government to detect the illicit activity. A *modus operandi* of insider trading that would justify wiretaps may now be taking shape.

Indeed, the complaint filed against Galleon employee Zvi Goffer says he gave prepaid mobile phones to individuals whom he was paying for secrets about mergers and acquisitions, to make it more difficult for the calls to be traced. Goffer's mobile phone is one that had been tapped by the authorities in 2007 and 2008. The defendants have borrowed a "page from the drug dealers' play book," said U.S. Attorney Bharara. The increased sophistication of white-collar defendants in attempting to muddy up the paper trail of their illicit activity — perhaps learned from CSI and other TV crime shows — may provide sufficient

ammunition for the government to obtain wiretap warrants in the future.

RAJARATNAM'S DEFENSE

Rajaratnam's answer to the SEC's parallel civil complaint argues that the government's "unprecedented" use of the wiretaps violated both federal law and his constitutional rights. Providing a possible roadmap to a subsequent motion to suppress the recordings, Rajaratnam contends that the government cannot establish that other investigative techniques would have been unsuccessful. He argues that, at the time DOJ sought authorization to conduct electronic surveillance, the SEC had already interviewed numerous witnesses under oath, including Rajaratnam himself, under the "guise" of an investigation into an unrelated hedge fund; that Galleon had produced "tens of thousands of pages" of documents in the course of that investigation; and that the lead SEC staff attorney who participated in that investigation was assigned to the criminal case and submitted applications in support of DOJ's request for electronic surveillance. Faulting DOJ for failing to bring these facts to the court's attention when it submitted the wiretap application, Rajaratnam contends that the government's representations to the court were false when it stated that interviews of Rajaratnam and others could not be done, were too risky, and that a "failed interview" would compromise the insider trading investigation.

CONCLUSION

With court approval of the wiretaps in the Galleon cases, the door has been opened. Prosecutors will follow their colleagues' successful investigative techniques. Still, there are many open issues regarding wiretaps in white-collar cases, as Rajaratnam's answer in the civil case demonstrates.

Rajaratnam's challenge to the DOJ's wiretap application based upon conduct of the SEC investigation also may revive judicial scrutiny of coordinated civil and criminal proceedings, an issue that has periodically occupied the spotlight, leading at least one judge to dismiss an indictment. *See U.S. v. Stringer*, 408 F. Supp. 2d 1083 (D. Or. 2006), *vacated*, 521 F.3d 1189 (9th Cir. 2008).

Electronic surveillance in the white-collar context also raises practical issues. Even assuming that federal agents become as conversant in the jargon of the financial services industry as they claim to be with the lingo of drug deals, telephone talk by traders is subject to misinterpretation and will be hotly contested before the fact finder.

Finally, the transcripts of these conversations are discoverable in the parallel civil proceedings against Rajaratnam now pending before Judge Jed S. Rakoff, who has shown little patience with the SEC. (He recently rejected the SEC's settlement with Bank of America in connection with its merger with Merrill Lynch.) Judge Rakoff has denied the SEC's request to stay its civil action pending resolution of the criminal charges. The Galleon defendants will therefore learn details of the government's case and may find further grounds to contest the government's wiretap evidence in the criminal trial.

One thing is certain. Prosecutors and white-collar defense lawyers will be following the Galleon case closely to learn the ramifications of wiretaps in white-collar cases that will inevitably follow.