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## WHITE-COLLAR CRIME

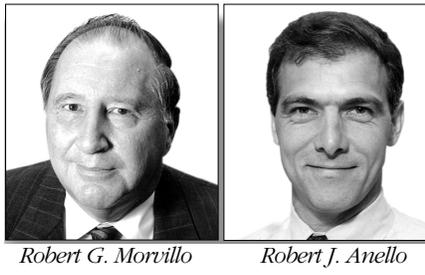
BY ROBERT G. MORVILLO AND ROBERT J. ANELLO

### *Increasing Use of Undercover Stings in White-Collar Investigations*

**I**N THE WAKE OF ENRON, Worldcom, Tyco, and multijurisdictional investigations of corrupt stock analysts, few members of the public and even fewer white-collar practitioners perceive that actual business crime should be difficult for law enforcement to detect and pursue.

Nevertheless, in recent years, prosecutors and their investigatory agents, eager to build cases from the ground up, have employed tactics more traditionally associated with organized crime and narcotics investigations. Elaborate sting operations, involving multiple undercover agents and cooperating individuals, have yielded mass arrests in cases charging telemarketing violations, software piracy, and securities fraud. When such investigations infiltrate and derail existing criminal operations, the societal benefit is obvious and laudable.

But sometimes the government uses its limited resources actually to create a sham criminal enterprise in order to flush out so-called corrupt actors and, in doing so, runs the risk of enticing into criminal behavior an individual who, but for the government's creative zeal, would not otherwise have engaged in illegal conduct. In such cases, under the guise of fighting crime, the government generates criminal conduct and new criminals, while diverting valuable and



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scarce investigative and prosecutorial resources from true crime detection or prevention.

#### **White-Collar Stings**

The line between a legitimate undercover operation and improper government-created criminal activity is not always easy to identify. At one extreme, where the undercover agent infiltrates an existing criminal organization or an ongoing enterprise, the governmental activism poses little cause for concern. The agent who buys drugs from a known dealer does little to encourage or facilitate the drug dealer's illegal activity. By intervening in preconceived criminal activity the government thwarts a crime that otherwise would have occurred, prevents future crime by the same perpetrator and offers some measure of deterrence for other potential wrong-doers. At the other extreme, the government plants the idea of criminal behavior in the mind of an otherwise law-abiding person, creates the opportunity for the criminal activity and then lures the individual to break the law. In some such instances, the defendant has

a viable entrapment defense. But a vast middle ground exists, where the elements of entrapment may be hard or even impossible to establish, but where the government's entanglement in the illegal activity is troublesome and unfair.

Two recent FBI-run stings targeting telemarketers may be illustrative of this distinction.

In "Operation Senior Sentinel," telephone numbers of elderly telemarketing fraud victims were transferred to local law enforcement offices where agents and volunteers (many of whom were recruited through the American Association of Retired Persons) posed as the targeted victim and recorded the telemarketer's fraudulent solicitations. In those cases, law enforcement merely intercepted calls initiated by the telemarketers.

#### **'Operation Disconnect'**

By contrast, the government took a far more aggressive approach in "Operation Disconnect," putting into the mouths of the telemarketers the very words for which they were later prosecuted. In that sting, agents posed as salespeople of an automated dialing system that promised telemarketers greater efficiency. Part of the service offered was a customized recorded sales pitch that required the telemarketers to explain to the agents the details of their operations. During the course of those explanations, some of the telemarketers admitted their fraudulent purposes. But it was not only those admissions that led

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to the more than 400 convictions in this operation. Rather, the FBI attributes the success of its prosecutions to the use of the fraudulent sales pitches the agents helped devise as evidence against the telemarketers.<sup>1</sup>

Even more troubling than putting incriminating words in a defendant's mouth are those instances where the undercover operation establishes a criminal enterprise out of whole cloth and then prosecutes those who take the bait. This type of sting recently has been used in a number of securities fraud cases brought in the Southern District of New York as well as in other venues.

In "Operation Uptick," the government netted a record-setting 120 securities fraud defendants through its creation and operation of a sham investment bank. In another recent Southern District prosecution, FBI agents posed as brokers willing to accept bribes to induce retail investors to purchase bulletin-board stocks at inflated prices. Prosecutors in the Southern District of Florida recently indicted more than 50 defendants caught in an elaborate sting in which an undercover FBI agent posed as a corrupt securities trader for a fictitious foreign mutual fund willing to purchase over-the-counter stocks in exchange for substantial kickbacks to be deposited into offshore accounts.<sup>2</sup> Often the impetus for such operations is not only a perceived need to clean up a corrupt business environment but, in large part, the availability of a cooperating criminal, who because of his own proven misdeeds is anxious for lenience at sentencing. In such circumstances, the anxious potential cooperator convinces the government that he can deliver new defendants to the prosecutor's door. Because many white-collar crimes are as much the result of tempting circumstances as they are simple greed, stings in white-collar cases should be closely scrutinized to prevent the misuse of this technique.

### **Undercover Guidelines**

Recognizing that such undercover operations "inherently involve an ele-

ment of deception and may require cooperation with persons whose motivation and conduct are open to question," the attorney general has issued guidelines governing the FBI's use of undercover operations.<sup>3</sup> Those guidelines direct that the benefits of any undercover operation be weighed against various risks, including the risk of injury, damage or loss (including reputational harm) to any individual or business, the risk of invasion of privacy or confidential relationship and the risk that those engaged in the operation will become involved in illegal conduct. The guidelines also require consideration of the "suitability of Government participation in the type of activity that is expected to occur during the operation."

Most undercover operations can be authorized and supervised at the field office level. Where an operation involves certain "fiscal circumstances," including deposit of funds into a bank or other financial institution, the use of operational proceeds to offset expenses or the reimbursement or compensation of cooperating individuals, FBI headquarters must approve the plan. Headquarters approval also is required for undercover investigations involving certain "sensitive circumstances" such as those targeting public officials, foreign officials or government, religious, political or news media organizations; operations that are likely to involve the undercover operative's commission of a serious crime or that require the government to supply goods or materials that are otherwise difficult to procure or those that are likely to intrude into confidential relationships. Any investigation that requires the use of a business entity operated on a commercial basis, where the FBI's involvement is concealed, also must be approved by headquarters.

The guidelines give at least lip service to the proposition that "[e]ntrapment must be scrupulously avoided." According to those agency rules, entrapment occurs when the government implants the idea of committing a crime in the

mind of a person not otherwise disposed to its commission and then entices the commission of the offense in order to prosecute. In order to "ensure ... that entrapment issues do not adversely affect criminal prosecutions," the guidelines instruct that approval for an undercover operation only should be given where (1) the illegal nature of the activity is reasonably clear to potential subjects; (2) the nature of any inducement offered is justifiable in view of the transaction in which the target is invited to engage; and (3) a reasonable expectation exists that offering the inducement will reveal illegal activities. In addition, the approving official generally must be satisfied that the subject is engaged, has engaged or is likely to engage in the type of illegal activity being proposed or that the opportunity for illegal activity has been structured so that persons drawn or brought to the activity are predisposed to engage in the contemplated illegal conduct.

### **Entrapment**

The attorney general's prohibitions on structuring stings so as to avoid ensnaring individuals who would not otherwise avail themselves of the business of crime is not entirely self-motivated. The Supreme Court repeatedly has cautioned that a legitimate undercover may only ensnare the "unwary criminal" and not the "unwary innocent."<sup>4</sup> Any defendant caught in a white-collar undercover sting, thus, should carefully consider whether he or she has a viable entrapment defense.

Under prevailing case law, the defendant asserting an entrapment defense bears the initial burden of establishing that he was induced to commit the crime by the government operative. Government conduct that merely offers the defendant the opportunity to commit a crime will not constitute inducement. Once the government undertakes to persuade the defendant to engage in the illegal activity, however, inducement is easier to establish.

The Second Circuit has held that inducement is “the Government’s initiation of the crime and not the degree of pressure exerted” and can be established by some evidence of “soliciting, proposing, initiating, broaching or suggesting the commission of the offense charged.”<sup>5</sup> Inducement can take many forms, including threats, harassment or coercion, or the promise of a monetary reward.

For example, the securities fraud stings recently operated by the government often have involved agents posing as corrupt brokers or fund managers offering to place large blocks of difficult-to-sell securities or to pay inflated prices for securities in exchange for kickbacks or bribes. In such cases, the monetary inducement is clear and should be undisputed.

Once a defendant shows that he was induced by the government, the burden shifts to the government to prove that the defendant was predisposed to commit the crime. In its most recent pronouncement on the entrapment defense, the Supreme Court in *Jacobson v. United States*,<sup>6</sup> made clear that the government cannot satisfy this burden merely by showing that the defendant was willing to commit the crime. Rather, the government must show that the defendant was willing to break the law prior to his or her initial contact with the government and independent of the attention directed at him by the government.

## The Second Circuit

The U.S. Court of Appeals for the Second Circuit has held that a defendant is predisposed to commit a crime if “he is ready and willing, without persuasion, to commit the crime charged and awaiting any propitious opportunity to do so.”<sup>7</sup> Some circuits assess whether a defendant is ready and willing to commit the crime even absent the government’s involvement on a case-by-case basis,<sup>8</sup> while others have adopted a more specific test for evaluating a defendant’s predisposition. The U.S. Court of Appeals for the Ninth Circuit considers

five factors, including the character of the defendant; whether the illegal activity was proposed by the government or the defendant; whether the defendant engaged in the activity for profit; whether the defendant demonstrated reluctance; and the nature and timing of the government’s inducement.<sup>9</sup> The U.S. Court of Appeals for the Seventh Circuit additionally requires the government to show that the defendant was not just psychologically prepared, but also that he had the experience, skills or contacts to commit the crime without government intervention.<sup>10</sup>

Although proving entrapment can be an uphill battle, some of the defendants in one of the Southern District of New York securities fraud stings recently prevailed on their entrapment defense. These defendants argued that a cooperating witness, working with the FBI following his arrest and guilty plea on earlier securities fraud charges, had stepped over the line in luring them into the scheme. They argued that by devising the scheme and then “insinuating impropriety into legitimate proposed transactions” the government, through its cooperator, had not only “set the table,” but “offered them a seat.” Although the district court rejected these arguments as a basis for dismissing the indictment,<sup>11</sup> the jury ultimately acquitted some of those who had argued they were entrapped.

## Other Considerations

Short of entrapment, several other arguments should be considered by defense counsel in defending a client caught in a government sting. Because of the difficulties in proving a defendant’s knowledge or intent (frequent elements in white-collar crimes), the government often relies on a conscious-avoidance theory rather than on more direct proof of the defendant’s mental state. Resort to such theories can be particularly unfair in the context of a sting, where the government orchestrates the details of the

operation and knows exactly how to script its conversations with the operation’s targets so as to establish the elements of such secondary concepts of guilt. Importuning a participant to keep quiet and avoid revealing the details of a transaction should be no substitute for direct evidence that the individual knew he was engaged in wrong-doing, particularly when the suggestion for secrecy comes from the government operative. Similarly, defense counsel should strenuously object to ambiguities in the sting operatives’ script that might have an impact on an element of the crime, and that are subject to manipulation by the government in designing the scheme. For example, in a mail or wire fraud case that depends on the breach of a fiduciary duty, the government should be put to the task of showing that the facts devised by the government clearly established that the relationship at issue was of a fiduciary nature and that the defendant was aware that he was breaching such a relationship.



(1) See, FBI Economic Crimes Unit, Criminal Fraud Cases, [fbi.gov/hq/cid/fc/ec/cases/criminalalecu.htm](http://fbi.gov/hq/cid/fc/ec/cases/criminalalecu.htm)

(2) See, Aug. 15, 2002 Press Release, United States Attorney for the Southern District of Florida, <http://www.usdoj.gov/usao/fls/fraudulent%20securities%20sales.htm>

(3) Undercover and Sensitive Operations Unit, Attorney General’s Guidelines on FBI Undercover operations, Revised Nov. 13, 1992, <http://www.usdoj.gov/ag/readingroom/undercover.htm>.

(4) See, *Jacobson v. United States*, 503 US 540 (1992), quoting *Sherman v. United States*, 356 US 369 (1958).

(5) *United States v. Dunn*, 779 F2d 157 (2d Cir. 1985).

(6) 503 US 540 (1992).

(7) See, *United States v. Bala*, 236 F3d 87 (2d Cir. 2000), quoting *United States v. Salerno*, 66 F3d 544 (1995).

(8) See, e.g., *United States v. Francis*, 131 F3d 1452 (11th Cir. 1997).

(9) See *United States v. Skarie*, 971 F2d 319 (9th Cir. 1992).

(10) *United States v. Hollingsworth*, 27 F3d 1196 (7th Cir. 1994). The addition of this “readiness” requirement has been criticized by other circuits. See, e.g., *United States v. Thickstun*, 100 F3d 1394 (9th Cir. 1997); *United States v. Squillacote*, 221 F3d 542 (4th Cir. 2000).

(11) *United States v. Labate, et al.*, No. S100 CR. 632, 2001 WL 533714 (S.D.N.Y. May 18, 2001).

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