

## TADC WHITE COLLAR NEWSLETTER

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*Lea Courington  
Stewart Courington Dugger Dean pllc*

***YATES V. UNITED STATES, \_\_U.S. \_\_,  
135 S. CT. 1074 (FEBRUARY 25, 2015)***

Obstruction of justice is the subject of a number of federal criminal statutes. When Congress passed the Sarbanes-Oxley Act in 2002, Congress added still another obstruction statute, 18 U.S.C. § 1519, entitled "Destruction, alteration, or falsification of records in Federal investigations and bankruptcy", to the federal criminal code.

Section 1519 provides that "whoever knowingly alters, destroys, mutilates, conceals, covers up, falsifies, or makes a false entry in any record, document, or tangible object with the intent to impede, obstruct, or influence the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States or any case filed under title 11, or in relation to or contemplation of any such matter or case, shall be fined under this title, imprisoned not more than 20 years, or both."

In *Yates vs. United States*, \_\_\_ U.S. \_\_\_, 135 S. Ct. 1074 (February 25, 2015), a plurality of the United States Supreme Court (Justice Ginsburg, joined by Chief Justice Roberts, Justice Breyer, and Justice Sotomayor) concluded that the undersized red grouper caught by a commercial fisherman and then thrown back into the sea following a search of his ship by a federal agent did not constitute a "tangible object" under 18 U.S.C. §1519.

Captain John Yates had been conducting a commercial fishing expedition in the Gulf of Mexico when Officer Jones of the Florida Fish and Wildlife Conservation Commission engaged in routine offshore patrol boarded Yates' boat to check on the vessel's compliance with fishing rules. (Officer Jones had authority to enforce both federal and state fishing laws because, while an officer of the Florida Fish and Wildlife Conservation Commission, he also had been deputized as a federal agent by the National Marine Fisheries Service.) Once on board the boat, the officer noticed three red grouper, which appeared to him to be undersized, hanging from a hook on the deck. Because of this, he suspected that other undersized fish might be on board as well and proceeded to inspect the ship's catch. At the time, Federal conservation regulations required immediate release of red grouper less than 20 inches long. Violation of those regulations was a civil offense punishable by a fine or fishing license suspension.

When Officer Jones inspected and measured those fish on board that appeared to him on visual inspection to be shorter than 20 inches, he ultimately determined that 72 of the fish were shorter than 20 inches. Most of those he measured were between 19 and 20 inches. Only three of them were less than 19 inches in length, and none were less than 18.75 inches. Officer Jones segregated the undersized fish into wooden crates and instructed Yates to leave that group of fish in the crates until the fishing vessel returned to port. Jones also issued Yates a citation for possession of undersized fish.

When Captain Yates' fishing vessel docked in Florida several days later, Officer Jones measured the fish contained in the

wooden crates. This time the fish he measured, while still less than 20 inches, slightly exceeded the lengths that he had recorded when he had been on board the ship several days earlier. In response to questioning, one of the crew members admitted that Yates had instructed the crew to throw overboard the fish Officer Jones had measured and segregated when he had boarded the ship and that the crew member and Yates had replaced the tossed grouper with fish from the rest of the catch.

Almost 3 years passed before criminal charges were filed against Yates. He was indicted for destroying property to prevent a federal seizure in violation of 18 U.S.C. §2232(a)<sup>1</sup>; for destroying, concealing, and covering up undersized fish to impede a federal investigation in violation of 18 U.S.C. §1519; and for making a false statement to federal law enforcement officers in violation of 18 U.S.C. §1001 (a)(2). By the time he was indicted, the minimum legal length for Gulf of Mexico red grouper had been lowered from 20 inches to 18 inches. None of the measured fish in Yates' catch were below that limit.

At trial, at the end of the government's case in chief, Yates moved for a judgment of acquittal on the §1519 charge. Yates acknowledged that there were sections in the federal criminal code under which it would have been appropriate for the government to prosecute him for tampering with evidence if the government had chosen to do so [the Supreme Court noted that 18 U.S.C. §2232(a) "fit that description," \_\_\_U.S. \_\_\_, 135 S. Ct. at 1080] but that §1519 was not one of those sections. Arguing that the statute's reference to "tangible objects" could only be properly read in the context of the obstruction statute

having been passed as a part of the Sarbanes-Oxley Act and that "tangible object" was part of a list of specific terms for items such as records or documents whose destruction the statute had been intended to prohibit, Yates further argued that while the term "tangible object" could apply to objects such as computer hard drives and log books, it did not apply to fish.

While the trial judge questioned the government's broad reading of the term "tangible object" in the context of the title and text of the statute and the motivation for the passage of §1519, he followed controlling Eleventh Circuit precedent, which had stated that "the broad language of" §1519 was not limited to corporate fraud cases and he, therefore, read "tangible object" as a term independent of "record" or "document". The trial judge then sentenced Yates to imprisonment for 30 days followed by supervised release for three years for his violations of §1519 and §2232(a).<sup>2</sup> And, as the Supreme Court pointed out, "[f]or life, he will bear the stigma of having a federal felony conviction." \_\_\_ U.S. \_\_\_, 135 S.Ct. at 1081. The Eleventh Circuit affirmed the convictions.

When the case reached the Supreme Court, the plurality rejected the government's argument and agreed with Yates, concluding that the term "tangible object" in §1519 "is better read to cover only objects one can use to record or preserve information, not all objects in the physical world." *Id.* In reaching this conclusion, the plurality noted, and the government conceded, that §1519, passed as part of Sarbanes-Oxley, "was intended to prohibit, in particular, corporate document shredding to hide evidence of financial wrongdoing." \_\_\_ U.S. \_\_\_, 135 S. Ct. at

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<sup>1</sup> Yates did not contest his conviction for violating §2232(a).

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<sup>2</sup> Yates was acquitted of the charge of making a false statement under 18 U.S. C. §1001(a)(2).

1081. The plurality also determined that while the dictionary definitions of “tangible” and “object” bore consideration, they were not dispositive in the case of §1519. \_\_\_ U.S. \_\_\_, 135 S. Ct. at 1082, and the justices looked to other “familiar interpretive guides” to aid construction. The plurality noted that the statute’s caption, “Destruction, alteration, or falsification of records in Federal investigations and bankruptcy” “conveys no suggestion that the section prohibits spoliation of any and all physical evidence, however remote from records,” nor did the title of the section of Sarbanes-Oxley in which §1519 was placed, §802, “Criminal penalties for altering documents.” \_\_\_ U.S. \_\_\_, 135 S.Ct. at 1083. Applying the *noscitur a sociis* rule of statutory construction, the plurality pointed to the fact that the term “tangible object” was the last in a list of terms that began “any record [or] document” and stated that “the term is therefore appropriately read to refer, not to any tangible object, but specifically to the subset of tangible objects involving records and document, i.e., objects used to record or preserve information.” \_\_\_ U.S. \_\_\_, 135 S. Ct. at 1085-86.

The plurality then reversed the judgment of the Eleventh Circuit affirming the conviction of fisherman John Yates under §1519 and remanded the case for further proceedings. Justice Alito, relying on rules of statutory construction, including *noscitur a sociis* and *ejusdem generis*, concurred in the judgment, although finding that the case could have been and should have been resolved on more narrow grounds than those on which the plurality had decided the case.

Notwithstanding the Supreme Court’s ruling regarding §1519, the case illustrates well the principle that obstruction can be and often is a more serious crime

than is the underlying substantive offense. Had Yates not instructed the crew member to throw the undersized fish overboard, Yates likely would have been subject only to a fine and/or suspension of his fishing license.

***UNITED STATES V. NEWMAN*, 773 F. 3D 438 (2D CIR. 2014)**

In December 2014, the Second Circuit issued its long-awaited opinion on tipper/tippee liability in insider trading cases in *United States v. Newman*, 773 F. 3d 438 (2d Cir. 2014), ruling that “in order to sustain a conviction for insider trading, the Government must prove beyond a reasonable doubt that the tippee knew that an insider disclosed confidential information *and* that [the insider] did so in exchange for a personal benefit.” *Id.* at 442. In addition, the Court stated, “to establish a criminal violation of the securities laws, the Government must show that the defendant acted ‘willfully’”, defined in this context “as a realization on the defendant’s part that he was doing a wrongful act under the securities laws” and that such an act “involved a significant risk of effecting the violation that occurred,” *id.* at 447, citing *United States v. Dixon*, 536 F. 2d 1388, 1395 (2d Cir. 1976).

Defendants Newman and Chiasson had been portfolio managers who came under scrutiny by the government in its investigation of suspected insider trading at hedge funds. Their indictment for securities fraud and conspiracy to commit securities fraud alleged, and the government presented evidence at trial, that a group of financial analysts received information from insiders at Dell and NVIDIA disclosing those companies’ earnings numbers before that information was publicly released. The government introduced evidence at trial that

the analysts then passed the inside information to their portfolio managers, including Defendants Newman and Chiasson, who then in turn executed trades in Dell and NVIDIA stock.

Newman and Chiasson moved for a judgment of acquittal at the close of the evidence, arguing that there was no evidence that the corporate insiders had provided inside information in exchange for a personal benefit, something Defendants argued the government had to prove under *Dirks v. S.E.C.*, 463 U.S. 646 (1983), to establish tipper liability. Defendants further argued that because a tippee's liability derives from the liability of the tipper, even if the corporate insiders had in fact received a personal benefit in exchange for the inside information, there was no evidence that Defendants knew about any such benefit and that, without such knowledge, they were not aware of, nor did they participate in, the tippers' fraudulent breaches of fiduciary duty to Dell or NVIDIA and could not, therefore, be convicted of insider trading.

The trial court reserved decision on the motions for acquittal until after the jury reached its verdict and declined to give the jury instructions requested by Defendants, indicating that it felt it was constrained by the Second Circuit's decision in *S.E.C. v. Obus*, 693 F. 3d 276 (2d Cir. 2012), in which the appellate court had listed the elements of tippee liability without listing knowledge of a personal benefit received by the corporate insider as a separate element. The jury returned a verdict of guilty on all counts, and the trial court then denied the Defendants' motions for acquittal. Defendants then appealed.

In deciding the appeal, the Second Circuit pointed to the Supreme Court's ruling in *Dirks*, 463 U.S. at 662, that the test

for determining whether a corporate insider who discloses material nonpublic information has breached his fiduciary duty to his company "is whether the insider personally will benefit, directly or indirectly, from his disclosure. Absent some personal gain, *there has been no breach of duty....*" *Id.* (emphasis the court's). The Second Circuit also noted that the Supreme Court in *Dirks* had rejected the SEC's theory that the recipient of the confidential information must refrain from trading any time the tippee receives inside information from an insider, *id.* at 655, saying that the tippee's duty to disclose or abstain is "derivative" of that of the insider's duty: "[b]ecause the *tipper's* breach of fiduciary requires that he 'personally will benefit, directly or indirectly, from his disclosure,'" *id.* at 662, "a tippee may not be held liable in the absence of such benefit." The court found that it follows from this that a tippee may be found liable "only when the insider has breached his fiduciary duty...*and* the tippee knows or should know that there has been a breach." *Id.* at 660.

The Second Circuit stated that while it had been accused of being "somewhat Delphic" in its discussions in earlier cases as to what is required to demonstrate tippee liability, the Supreme Court in *Dirks* had been "quite clear" on that topic: (1) the tippee's liability derives only from the tipper's breach of a fiduciary duty, not merely from trading on material, non-public information; (2) the corporate insider has committed no breach of fiduciary duty unless he receives a personal benefit in exchange for the disclosure; and (3) even if the tipper did in fact breach such a duty, a tippee is liable only if he knows or should have known of the breach. 773 F. 3d at 447.

Thus, the Second Circuit rejected the government's argument (ostensibly based on

what the appellate court viewed to be merely dicta in its earlier cases) that a tippee's knowledge of a breach of the duty of confidentiality but without knowledge of the personal benefit is sufficient to impose criminal liability, *id.* at 448, saying, "without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure, the Government cannot meet its burden of showing that the tippee knew of a breach." *Id.*

The appellate court noted that its conclusions in the case comported with well-settled principles of substantive criminal law in that under the common law, *mens rea*, "which requires that the defendant know the facts that make his conduct illegal, [and which] is a necessary element in every crime," makes the requirement that the defendant know of the personal benefit received by the insider particularly appropriate in insider trading cases where a trader could easily receive a tip and be unaware that his conduct was illegal and therefore wrongful. In addition, the court pointed out, "this is also a statutory requirement, because only 'willful' violations are subject to criminal provision." *Id.* at 450.

The Second Circuit then added,

The Government's overreliance on our prior dicta merely highlights the doctrinal novelty of its recent insider trading prosecutions, which are increasingly targeted at remote tippees many levels removed from corporate insiders. By contrast, our prior cases generally involved tippees who directly participated in the tipper's breach (and therefore had knowledge of the tipper's disclosure for personal benefit) or tippees who were explicitly

apprised of the tipper's gain by an intermediary tippee....We note that the Government has not cited, nor have we found, a single case in which tippees as remote as Newman and Chiasson<sup>3</sup> have been held criminally liable for insider trading. *Id.* at 448.

The Second Circuit then summed up the elements the government must prove beyond a reasonable doubt to sustain an insider trading conviction against a tippee:

- (1) the corporate insider was entrusted with a fiduciary duty;
- (2) the corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit;
- (3) the tippee knew of the tipper's breach, that is, he knew the information was confidential and divulged for personal benefit; and
- (4) the tippee still used that information to trade in a security or tip another individual for personal benefit.

*Id.* at 450.

## **PROPOSED AMENDMENTS TO FEDERAL SENTENCING GUIDELINES**

The current federal sentencing guidelines system has its roots in the Sentencing Reform Act of 1984, which established the U.S. Sentencing Commission and directed it to promulgate federal sentencing guidelines. Following the Supreme

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<sup>3</sup> The court's opinion describes the tipping chain, in which Newman and Chiasson were "three and four levels removed from the insider tipper, respectively." *Id.* at 443.

Court's decision in *United States v. Booker*, 543 U.S. 220 (2005), which held that the guidelines procedure violated the Sixth Amendment right to trial by jury, the application of the guidelines is not mandatory, but the guidelines continue to be applied in an advisory manner and are often given considerable weight by courts in imposing sentences.

The U.S. Sentencing Commission voted on April 9, 2015 to amend the federal sentencing guidelines in several respects.<sup>4</sup> The amendments will be transmitted to Congress on May 1, 2015. If Congress does not disapprove some or all of the amendments, they will go into effect on November 1, 2015.

Among the amendments are changes to the victim enhancement in the fraud guideline. According to the Sentencing Commission's April 9 press release, the purpose of doing so was to ensure that "where even one victim suffered a substantial financial harm, the offender would receive an increased sentence." The press release also states that while the Commission maintained the underlying principle of the fraud guideline "that the amount of loss involved in the offense should form a major basis of the sentence," the Commission made changes "to refocus economic crime penalties toward the offender's individual intent" and "to emphasize substantial financial harms to victims rather than simply the mere number of victims and recognize concerns regarding double-counting and over-emphasis on loss."

The sentencing commission also voted to provide additional guidance as to which offenders are eligible to receive a reduced sentence because they played only a minor or minimal role in the commission of an offense and/or were the "least culpable offenders, such as those who have no proprietary interest in a fraud," in comparison to the roles of the "leaders and organizers" of the offense.

The Sentencing Commission also voted to increase penalties for the illegal use of hydrocodone to make those penalties equivalent to those for illegal use of oxycodone.

Finally, the Sentencing Commission adjusted the monetary tables to account for inflation, something which will affect both the penalty and fine tables.

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<sup>4</sup> Further information about the amendments approved by the Sentencing Commission on April 9 can be found at [www.ussc.gov](http://www.ussc.gov).