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FERA Expands Enforcement Options

By Howard W. Goldstein

In the flurry of legislation Congress has passed during President Obama's first 100-plus days, the Fraud Enforcement and Recovery Act of 2009 (FERA), enacted in May, was easy to miss. Yet this small piece of legislation makes a number of significant changes to the federal money laundering and criminal fraud statutes — changes about which lawyers who represent clients accused of white-collar crimes will want to be aware.

In short, FERA eases the prosecution's burden under the money laundering statute and increases the punishments for frauds affecting mortgage lending businesses or involving the sale of commodities. It amends the federal money laundering statute to extend the definition of "proceeds" under that statute to include the gross receipts of illegal activity rather than just profits derived from it, revises the definition of a "financial institution" as used throughout federal criminal law to include a mortgage lending business, and expands the federal securities fraud statute to apply to frauds involving commodities futures and options.

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'Proceeds' of Money Laundering

Under the federal money laundering statute, it is a crime to conduct a financial transaction involving "the *proceeds* of specified unlawful activity" if the conductor of the transaction knows that the property involved "represents the *proceeds* of some form of unlawful activity" and meets certain other statutory requirements. 18 U.S.C. § 1956(a)(1)(A)-(B) (emphases added). Cross-border transport of the "*proceeds* of some form of unlawful activity" under a similar set of circumstances is also prohibited. 18 U.S.C. § 1956(a)(2) (emphasis added).

From the time the money laundering statute became law in 1986, it was generally understood that "proceeds" covered not only profits, but also the gross receipts from a specified unlawful activity. That was how courts consistently interpreted § 1956 until the Seventh Circuit ruled otherwise in *United States vs. Scialabba*, 282 F.3d 475 (7th Cir. 2002). Last year, a divided Supreme Court sided with the Seventh Circuit. *United States v. Santos*, 128 S. Ct. 2020, 2025, 2031 (2008) (plurality opinion); *Id.* at 2033-34 (Stevens, J., concurring in the judgment). The plurality announced a general rule that "proceeds" under § 1956 should be construed to mean only net income. Justice Stevens' concurrence, which rested on a narrower ground than the plurality, limited the Court's holding to cases where legislative history could not demonstrate that "proceeds" meant gross income for the particular unlawful activity at issue. The plurality and Justice Stevens agreed that if Congress intended "proceeds" to mean receipts in all cases, Congress would have "to speak more clearly"; absent such clarity, the ambiguity of "proceeds" in the statute should be resolved in favor of the defendant under the rule of lenity.

Santos significantly increased and complicated the prosecution's burden in money laundering cases, and the Senate Judiciary Committee report on FERA called for it to be overruled. "Proceeds of 'Ponzi schemes' like the Bernard Madoff case, which by their very nature do not include any profit, would be out of the reach of the money laundering statutes under this decision. This flawed decision needs to be corrected immediately, as dozens of significant money laundering cases have already been dismissed." S. Rep. No. 111-10, at 4 (2009).

In FERA, Congress accepted the Court's invitation to clarify "proceeds" as used throughout § 1956. FERA added a new paragraph 9, which states that "the term 'proceeds' means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, including the gross receipts of such activity." This definition is similar (although not identical) to the definition of "proceeds" under the leading treaty governing international money laundering: "any property derived from or obtained, directly or indirectly, through the commission of an offence." United Nations Convention Against Transnational Organized Crime, Nov. 15, 2000,

2225 U.N.T.S. 209 (Treaty No. I-39574), Art. 2(e)) at 275. *See also Santos*, 128 S. Ct. at 2036 & n.3 (Alito, J., dissenting).

Thus, any prior ambiguity as to the meaning of "proceeds" under § 1956 has now unequivocally been resolved, and the Supreme Court's ruling in *Santos* is legislatively overruled. The fact that the crime didn't pay is no longer a viable defense.

A Mortgage Lending Business Is a 'Financial Institution'

FERA amends the definition of a "financial institution" throughout federal criminal law to include mortgage lending businesses. A "mortgage lending business" is defined as "an organization which finances or refinances any debt secured by an interest in real estate, including private mortgage companies and any subsidiaries of such organizations, and whose activities affect interstate or foreign commerce." 18 U.S.C. § 27. The Senate Judiciary Committee report noted that such companies "were responsible for nearly half the residential mortgage market before the economic collapse" and concluded that those "who engage in frauds on mortgage lending businesses should be held to the same standards that apply to traditional financial institutions, given the impact of these businesses on federally-insured and federally-regulated institutions." S. REP. NO. 111-10, at 3, 6-7 (2009).

The classification as a "financial institution" matters, because a number of federal criminal statutes apply only to financial institutions or set out different penalties or limitations periods when a financial institution is affected by a generally applicable crime. *See* 18 U.S.C. § 3293(1)-(3) (list of financial-institution offenses). For example, fraud affecting a "financial institution" is treated more severely than other frauds. Under 18 U.S.C. § 1341, the punishment for mail fraud is a fine of an unspecified amount and/or up to a 20-year prison sentence, but if the violation "affects a financial institution," then the punishment is raised to a fine of not more than $1 million and/or up to a 30-year prison sentence. The same is true under the wire fraud statute. 18 U.S.C. § 1343. The penalties for mail or wire fraud affecting a financial institution track the penalties for bank fraud under § 1344, which by its terms is only applicable if a financial institution is affected.

Besides the greater punishment, the government has more time to investigate the crime if a financial institution is affected. Under 18 U.S.C. § 3282, the statute of limitations for mail and wire fraud, like most federal crimes, is five years, but if the offense "affects a financial institution," then it's 10 years, as is true for bank fraud. 18 U.S.C. § 3293.

Consequently, crimes involving a mortgage lending business now are subject to the more onerous punishments and longer statute of limitations for many criminal violations..

Commodities Fraud

Fraud in connection with a security is covered in the federal criminal code by 18 U.S.C. § 1348, where it is punishable by a fine and/or imprisonment of up to 25 years. This is greater than the penalties for most other frauds. *See, e.g.*, 18 U.S.C. §§ 1341 and 1343 (mail and wire fraud, generally 20 years); 7 U.S.C. § 13(b) (frauds under the Commodity Exchange Act (CEA), 10 years). There are few reported criminal fraud cases under the CEA, perhaps because the scope of the CEA's anti-fraud provisions is unclear, as noted experts have observed. *See* 6 Alan R. Bromberg & Lewis D. Lowenfels, Securities Fraud & Commodities Fraud (2d ed. 1994) § 15:32 (the "syntactical mess" of § 4b of the CEA "makes it difficult to answer some basic questions about coverage").

Under FERA, henceforth frauds involving options and futures in commodities will violate the securities fraud statute. The caption to § 1348 has been amended to cover "Securities and commodities fraud," and the text has been amended to state that whoever "knowingly executes, or attempts to execute, a scheme or artifice (1) to defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery … or (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any commodity for future delivery, or any option on a commodity for future delivery … " shall be subject to the same punishments as those for securities fraud. Therefore, frauds in connection with commodities futures and options are now subject to a 25-year prison sentence, and it is likely that prosecutors will no longer limit themselves to using the mail and wire fraud statutes in prosecuting alleged perpetrators of commodities fraud.

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