T O O U R F R I E N D S A N D C L I E N T S

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Fraud Enforcement and Recovery Act of 2009: Congress Amends Money Laundering and Criminal Fraud Statutes to Expand Their Scope and Penalties

On May 20, 2009, the President signed into law the Fraud Enforcement and Recovery Act of 2009 ("FERA"). In a prior client alert, we have discussed FERA's substantial amendments to the civil False Claims Act ("FCA"). *See* FraudMail Alert No. 09-05-21. Here, we address some of FERA's changes to federal money laundering and criminal fraud statutes.

Briefly, FERA 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. We will discuss each of these amendments in more detail below.

Extending the Definition of the "Proceeds" of Money Laundering

Under the federal money laundering statute, it is a crime to conduct (or attempt to conduct) a financial transaction involving "the proceeds of specified unlawful activity" if the conductor of the transaction knows that property involved "represents the proceeds of some form of unlawful activity" and a) possesses the intent to promote the carrying on of the specified unlawful activity, or b) possesses the intent to engage in conduct constituting a violation of section 7201 or 7206 of the Internal Revenue Code of 1986, or c) knows that the transaction is designed in whole or in part to conceal or disguise the nature, the location, the source, the ownership, or the control "of the proceeds of specified unlawful activity," or d) knows that the transaction is designed in whole or in part to avoid a transaction reporting requirement under State or Federal law. 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 under section 1956, as is conducting (or attempting to conduct) a financial transaction involving property "represented to be the proceeds of specified unlawful activity" with intent a) to promote the carrying on of specified

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unlawful activity, b) conceal the nature, location, source, ownership, or control of property "believed to be the proceeds of specified unlawful activity," or c) avoid a transaction reporting requirement under State or Federal law. 18 U.S.C. § 1956(a)(2)-(3) (emphases added).

From the time the money laundering statute became law in 1986, it was generally understood that the word "proceeds" as used throughout that statute covered not only the profits of the specified unlawful activity, but also the gross receipts from such activity as well. Such was how courts consistently interpreted section 1956 until the Seventh Circuit's decision in *United States vs. Scialabba*, 282 F.3d 475 (7th Cir. 2002) (Easterbrook, J.), *cert denied*, 537 U.S. 1071 (2002), which ruled otherwise. The Supreme Court granted certiorari in *United States v. Santos* to consider the issue, and a majority of a divided Court sided with the Seventh Circuit and ruled that only net income from unlawful activity, not gross income, was covered by the money laundering statute (except where legislative history indicates that Congress intended "proceeds" to mean gross income in relation to a particular underlying unlawful activity). 128 S. Ct. 2020, 2025, 2031 (2008) (plurality opinion); *id.* at 2032 & n.3 (Stevens, J., concurring in the judgment). The plurality explained that Congress would have "to speak more clearly" if it intends "proceeds" to mean receipts, because in the absence of clarification the ambiguity would be resolved in favor of the defendant under the rule of lenity. *Id.* at 2025 (plurality opinion).

Santos significantly increased and complicated the prosecution's burden in money laundering cases. In FERA, Congress acted to restore the status quo *ante* by responding to the Court's invitation to clarify the intended meaning of the term "proceeds" as used throughout section 1956. FERA adds a new paragraph 9 to the money laundering statute, 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" (emphasis added). Thus, any prior ambiguity as to the meaning of "proceeds" under section 1956 has now unequivocally been resolved, the Supreme Court's ruling in *Santos* is legislatively overruled, and alleged money launderers will no longer be able to defend themselves by arguing that they committed unprofitable criminal activities.

A Mortgage Lending Business is a "Financial Institution"

FERA amends the definition of a "financial institution," as that term is used throughout federal criminal law, to include a mortgage lending business as one kind of a financial institution. FERA adds a new paragraph 10 to the statute defining a financial institution. Paragraph 10 states that a "financial institution," among other things, means "a mortgage lending business (as defined in section 27 of this title) or any person or entity that makes in whole or in part a federally related mortgage loan as defined in section 3 of the Real Estate Settlement Procedures Act of 1974 [12 U.S.C. § 2602]."

Section 27 of title 18, referred to above, is also newly added:

> **Mortgage lending business defined**
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> In this title, the term 'mortgage lending business' means 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.

The classification as a "financial institution" matters because a number of federal criminal statutes either only apply to financial institutions or set out different penalties or statutes of limitation 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 of section 1341 "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 section 1344, which by its terms is only applicable if a financial institution is affected; a person violates the bank fraud statute if he or she "knowingly executes, or attempts to execute, a scheme or artifice—(1) to defraud a financial institution; or (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises" (emphases added).

Not only is the punishment for mail or wire fraud greater if a financial institution is affected, but prosecution is less constrained. 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 the statute of limitations is instead ten years, as is the statute of limitations for bank fraud. 18 U.S.C. § 3293.

Consequently, under FERA a mortgage lending business encompassed by the statutory definition is a financial institution, and a fraud affecting it is subject to the more onerous punishments and longer statute of limitations that applies when a financial institution is affected.

Securities Fraud Statute Amended To Include Commodities Fraud

Fraud in connection with a security is governed by the federal securities fraud statute, 18 U.S.C. § 1348, and is punishable by a fine of an unspecified amount and/or up to a 25 year prison sentence. This penalty is greater than the penalties for most other frauds (unless they affect a financial institution, as noted above). *See*, *e.g.*, 18 U.S.C. § 1341 (mail fraud generally punishable by a fine of an unspecified amount and/or up to a 20 year prison sentence); 18 U.S.C. § 1343 (wire fraud generally punishable by a

fine of an unspecified amount and/or up to a 20 year prison sentence); 7 U.S.C. § 13(b) (frauds under Commodity Exchange Act ("CEA") punishable by a fine of not greater than $1,000,000 and a 10 year prison sentence). There are very few reported criminal cases under the CEA, perhaps because, as noted experts have observed, the CEA's antifraud provisions are unclear as to their scope. *See* 5 ALAN R. BROMBERG & LEWIS D. LOWENFELS, SECURITIES FRAUD & COMMODITIES FRAUD, § 12:175 (2d ed. 1994) ("we have found almost no reported CEA criminal cases"); 6 *id.* § 15:32 ("While the intent to outlaw fraud is clear from the (A)–(C) subparagraphs [of section 4b of the CEA], the syntactical mess which precedes them 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 section 1348 has been amended to cover "Securities and commodities fraud" (emphasis added), and the body of that section has been amended to state as follows:

> Whoever knowingly executes, or attempts to execute, a scheme or artifice—
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> (1) to defraud any person in connection with any commodity for future delivery, or any option on a commodity for future delivery, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. § 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. § 78o(d)); or
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> (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, or any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. § 78l) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. § 78o(d)); shall be fined under this title, or imprisoned not more than 25 years, or both.

18 U.S.C. § 1348 (emphasis added). Therefore, frauds in connection with commodities for future delivery, or in connection with options on commodities for future delivery, are now subject to the securities fraud statute and the 25 year prison sentence which applies to those convicted of engaging in securities fraud.

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If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or the attorney listed below:

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