What is Fraud_ with Professor Samuel Buell_10212020

CONNER COOK: We're thrilled to have you join us for this program. This is part of our Virtual Reunion week. Just a few housekeeping items before we begin. We will be recording today's video and the chat, and we will share the video online afterwards. Please mute your microphone when you're not speaking. If you experience any technical challenges like slow video, sometimes turning off your video can help improve your connection.

If you continue to experience any technical difficulties, you can email our office and one of our team members will assist you. We'll put the email address for our office in the chat. If you're dropped off the call at any time, please feel free to join back in. It's not disruptive to the program.

Today's program has been approved for one hour of North Carolina CLE credit. If you would like the credit and you have not yet sent us your North Carolina bar number, please email that to our office. If you're applying for CLE credit for a different state, you can also email our office and we will provide you with the necessary materials.

We will hold questions until the end of the presentation. At that time, we will use the Raised Hands feature. We'll put in the chat the details for how to use that feature when we get to that part of the program.

And today's speaker is Professor Samuel Buell. Samuel Buell is the Bernard M. Fishman Professor of Law at Duke University where his research and teaching is focused on criminal law and the regulatory state, particularly regulation of corporations and financial markets. He is the author of the 2016 book Capital Offenses: Business Crime and Punishment in America's Corporate Age, and his recent scholarship explores the conceptual structure of white collar offenses, the problem of behaviors that evolve to avoid legal control, and the treatment of the corporation and the white collar offender and the criminal justice system. Now please let me introduce Professor Buell.

SAMUEL BUELL: Thanks, Conner. Hi, everybody. Thanks so much for joining us in these difficult circumstances. You're looking at my classroom as it exists in a COVID world. This is my office at my house. I teach my students. I just got done with Criminal Law right before this. We talked about the impossibility doctrine today if you want to hearken back to stressful traumas during law school.

And I use this whiteboard here. I generally don't teach with PowerPoint. I use it very rarely, but it's working. The students are incredible this semester. I mean, they're just-- I'm teaching the first years, and their level of dedication, the work that they're putting in, and their focus on the idea of getting this legal education thing done and keeping their lives moving forward in these circumstances, it's just been remarkable to me.

I miss the classroom dearly. This is a dismal situation to be in for all of us. There's virtually nothing about Zoom that I'm learning that I really want to continue when we go back to normal,

but it's working much better than I expected. And I really wish that we were in a room together as we would be normally when I talk to alumni. And there's an impersonal quality to this that's really kind of a drag, but I'm glad that you're here. I'm glad we can at least have a chat.

My scholarship, as Conner said, is mostly about corporate crime and regulation of business industries, including the financial industry, but others as well. And I teach an upper level course, which I'll be teaching this spring in Corporate Crime. I'll be teaching out of my own materials, which I think I'll probably be publishing soon.

Likely when they are published, they'll be made available free through my website, so I hope at some point when that happens, the communication will go out to alumni about it and you'll be able to access those materials if they'd be helpful to you in your practice. I don't know whether we have any corporate crime practitioners on the Zoom today, but I'm hoping I'll find that out when we get to questions later.

What I'm going to talk to you about today-- and I will use a PowerPoint presentation-- is fraud. So one of the fun things that we do in my Corporate Crime class is we try to sort of delve under the surface of this idea of fraud, which is at the heart of so many business crimes in our day and age, and understand a little bit better about what it is and what some of the issues are that are complicated and contestable with regard to fraud.

And not only is that a fun thing to do for its own purposes, but it I think is very illuminating in general with regard to the problem of white collar crime and why it is that we don't have a white collar criminal justice system that looks like-- not that we would necessarily want it, but why it's so different than a criminal justice system we have for street crimes and violent crimes, because the very issue of crime definition is at the heart of white collar crime. And it is a complicated issue, and it reveals a lot about sort of the social norms and economic concepts and other ideas that really underlie some of, frankly, our country's ambivalence about the question of white collar crime.

The big story in corporate crime today is that a settlement has been announced with Purdue Pharma and the Sackler family around the opioid marketing case. That actually would be really interesting to talk about today, but I was teaching all morning and I haven't had a chance to read it yet. So all I saw was the headline that it's $8 billion. I'm a little bit skeptical about what might be going on given the timing, but I don't have anything informed to say about that today. All right. Conner, I'm going to put my slides up.

So normally, I do these presentations with a slightly Socratic style, because it's fun to get people involved in the conversation along the way. But I think that's going to be a little bit too tricky and halting to do via Zoom. So questions that I have as I go here, I'll kind of ask them rhetorically and then talk about them. And we'll have time at the end for a wide ranging discussion.

And I hope that you'll feel free to talk about any issue in this field or about Duke or about law teaching or about the industry right now that might be interesting and useful for us to talk about. By no means do your questions need to be limited to this presentation.

So the question is, what is fraud? And a lot of people think, well, that's pretty easy. It's been around for a long time. We all know what it is. And there's kind of a black letter law to this, right? If you look up the federal cases, there's obviously a wide array of fraud statutes and federal law. Most big ticket fraud cases are prosecuted in federal court, although there are some state jurisdictions active in this area.

And if you look at the bank fraud statute, the securities fraud statute, the mail wire fraud statutes, and so on, they don't say a whole lot. They say, don't commit fraud when you're doing a securities transaction, or don't commit fraud when you're dealing with a bank, or don't commit fraud and use the interstate wires.

What is this concept of fraud? Well, obviously, it was an old idea drawn from the common law. And if you read the federal cases, there's some significant differences, but they basically come down where the idea that this is a sort of three or four element concept, right?

And what I explain to the students, I say, look. Basically what you need to begin with is some kind of story about a scheme to defraud. What does that mean? I mean, that's a legal term. What's that mean?

Well, you know, it takes two to tango here. We need a perpetrator. We need a victim, real or imagined or anticipated. And we need some kind of deception, right? Fraud is the-- deception is at the core of the idea of fraud.

And then of course, we need to pass some kind of a materiality hurdle in this area of law. Small, unimportant things will not concern fraud statutes. The deception must be something that in the classic materiality formulation matters to the decision making of the victim. So we're trying to induce somebody to enter into some kind of a transaction. And the law has to be something that would make a difference in the person's decision to engage in the transaction or not.

This is criminal law. Mens rea is extremely important for serious crimes, including fraud crimes in federal court. And what we talk about when we talk about mens rea and fraud is we talked about the intent to defraud or the specific intent to defraud, right? A high level of mens rea, but not entirely clear what that means because of course, saying that someone's guilty of fraud if they have the intent to commit fraud begs the question, to a certain extent, what fraud is. How can you have the intent to commit fraud if you don't know what fraud is?

There needs to be some object of the fraud that is a corpus or a thing that the scheme is after. Money, property of other kinds, legal claims potentially, and even some kinds of rights, which we'll talk about a little bit later in my remarks.

We don't use fraud statutes to intervene in matters of social relationships, for example. So if I deceived somebody to gain an advantage in my relationship with them or to snub them in some regard, I could be-- if I engage in a pattern of that behavior over the course of my life, I might develop a reputation for being a quote, unquote, "fraud," you know? He's a fraud. Don't believe anything that guy has to say. But those would not necessarily be frauds. Lying to get my way into a party and things of that sort.

In criminal law, some things that we don't have in fraud are the idea of reliance, proof of damages, loss to a victim, or even success of the scheme to defraud. These are all in various ways concepts that might go to the issue of whether someone deserves compensation or is a lawsuit for fraud, but not to the issue of whether somebody is eligible for criminal punishment for committing or attempting to commit fraud. The very concept of fraud in criminal law basically incorporates the idea of attempt liability.

OK. So that all seems very straightforward, but then it gets very difficult when we start applying it to cases. So let's start with the easiest case, right? I think the easiest case or among the easiest cases with regard to the application for law fraud are Ponzi schemes, right?

So on the left is the famous Charles Ponzi after whom these schemes were named, and on the right, Bernard Madoff, the biggest Ponzi schemer in history. His case, probably everybody knows something about. Probably the white collar case that people are most familiar with in this day and age.

A Ponzi scheme can be complicated, but often, they're very simple, right? And the idea is simply to lie to somebody about what you're going to do with their money, how you're going to invest it, and what's going to happen with it so that they'll give you the money, and then you use that money to pay off future victims of the fraud. Or rather, you then recruit additional victims and use their money to pay off the earlier victims, thereby furthering the illusion that the investment scheme is actually legitimate when it's not.

So this is one step removed from theft. I lie to you about what I'm going to do with your money so that you will consensually give it to me. And then I take it and I use it for my own purposes. So it's just as if I had taken it out of your pocket, but instead of doing it physically, I've done it with a very simple deception. So note issues about whether these are frauds.

And I actually don't even teach the Madoff case on my Corporate Crime class, because it's interesting from a sociological and a psychological standpoint, and sometimes mentioning it for those reasons, the questions of sort of, why did the victims trust Madoff, and how did he get away with what he was doing for so long? And from a legal standpoint, there's not much interesting to talk about there.

We actually talk about the Madoff case. It's in my first year that-- it's not my book, but the book I use my first year Criminal Law course, it talks about the Madoff case in the very beginning of the book where it includes Judge Chin's remarks when he sentenced Bernard Madoff, and we talk about it in the context of retribution and criminal theory.

OK. So another version of sort of modern frauds that have become familiar to people is so-called accounting fraud. And one of the biggest accounting fraud cases to come along was a case from the early 2000s involving the gentleman on the right, Bernard Ebbers, who was a CEO of a company called WorldCom, which was a telecom company that had-- that was originally MCI. It became WorldCom. It went on an acquisition binge. It grew very rapidly during the late '90s, early 2000s when the first kind of tech explosion and bubble was going on, and they were involved in a lot of marketing of bandwidth to businesses during the first internet boom.

At a certain point that boom started to contract, and WorldCom found itself with trouble. Their income started going down dramatically. Their expenses were going up. The stock price had been rising rapidly. And Mr. Ebbers himself was highly leveraged off his own stock holdings in the company, such that when the price started going down, he was going to start to get margin calls from his personal lenders that he was in a pickle. He also had his identity wrapped up in this company and couldn't tolerate the idea of a bad story about the company's stock price, which had otherwise been a great success.

So he agreed with his CFO and some other people within the company that they would essentially take a billion dollars that had been categorized in their accounting statements as an expense and move it over into a different category and treat it as a capital expenditure, which had a massive impact on the quarterly earnings picture for that company at the time. And it was not a move that was transparent to anybody on the outside of the company who would have been reading the financial statements and going over them with a fine tooth comb.

So here, we have a former fraud in which a regulatory regime that is designed to protect investors by forcing information out into the market, compelling transparency, the securities regulations, and as supported by the industry standards within the accounting profession, Generally Accepted Accounting Principles, all designed to give investors clear and accurate information about the value of companies that they're making investment decisions about, that system is monkeyed with behind the scenes here in a way that creates a misleading picture about the value of the company in order to support the company's stock price.

So again, not terribly complicated from a conceptual standpoint in terms of the motive or what's going on. These are obviously forms of fraud. But they can get very complicated relative to Ponzi schemes, for example, in terms of the modus operandi or the mechanism that's used to carry out the fraud.

So the case of advanced accounting fraud, of course, was the Enron case. I had the great fortune of working for two years on the Enron case before I left the Justice Department and became a law professor many years ago.

And essentially, the executives of Enron found themselves in a somewhat similar situation to the situation that WorldCom was in in that they had created a-- they had taken a series of bets on some aspects of the market that were developing in the late '90s and early 2000s, including, by the way, broadband, although that was not their biggest play.

And they found themselves, as the tech bubble burst and there was contraction in the markets in 2000, into 2001, in a situation where they had also created a corporate financial structure that was essentially levered off the company's own stock price. And it would take me the rest of today's time to explain how that worked. There are some good books out there that go into it in pretty accessible detail. They've managed to get their outside accountants at Arthur Andersen to sign off on most but not all of what they were doing.

And essentially, Enron was a company that started as a kind of hard assets energy business in Houston and became a nationally celebrated innovative firm that appeared to be creating all

kinds of interesting new markets in broadband and energy and in other areas. But the way in which they were attempting to show positive returns from those new businesses, which really were not at least initially doing that well, was essentially a series of financial maneuvers involving a very sophisticated in-house finance department, a very sophisticated in-house accounting department, and some obeisance by a very unaggressive outside auditor.

The market at a certain point turned so sharply against them that they were unable to keep up the financial engineering anymore. And as the stock price of the company went down, it created a vicious circle because they had leveraged some of what they were doing off the company's own stock. And we all know what happened. In a very rapid period of time, the company went bankrupt.

Now, the complexity of the Enron accounting fraud ended up making this case not only harder to investigate and figure out than a case like WorldCom, which was a pretty simple, let's take a billion dollars from category A and put it over in category B. Enron was calculus to WorldCom's algebra, basically.

So it's very hard to unpack all of this, but it also made it difficult to figure out which parts of the case were prosecutable as criminal fraud and which weren't, because the very complexity of the accounting and the involvement of professionals such as lawyers and accountants in the matter raised really substantial issues about the intent to defraud or mens rea of the senior executives of the firm, including Kenneth Lay, who was the chairman and then CEO, and Jeffrey Skilling, the CEO who left the company in the midst of its troubles.

So it's often said, oh, Enron, the most flagrant kind of accounting fraud case ever. The whole company was a house of cards and the executives were prosecuted for basically lying about the whole thing. And that's a very inaccurate description of the Enron case.

There were many aspects of the Enron accounting complexity and engineering that turned out not to be provable as criminal fraud, even though they were arguably deceptive in certain respects, because the line between what a company does, especially at that time, given that securities regulatory regime that existed at the time, the line between what a company does to kind of burnish its numbers versus cooking the books, not always clear, and often had to do with, as I said, issues of mens rea.

So it turns out-- we didn't realize it at the time in 2001, 2002. We thought Enron was the biggest corporate scandal to ever come along and would never be eclipsed. Turns out it was merely the canary in the coal mine with respect to what happened in 2008, 2009. And in fact, some of the accounting maneuvers that were exploited by Enron and did not become part of the criminal case were in similar form, although not exactly the same, exploited by the large financial institutions during the height and then a collapse of the mortgage-backed securities market.

OK. So let's try to go back to some simple cases or some hypos and see if we can figure out what might be going on here. So you know, the used car dealer is, of course, everybody's stereotype of the kind of sharp, slick, dishonest businessman. What is it that helps us figure out when the used car dealer is committing fraud versus just selling used cars, right?

So if a used car dealer rolls back the odometer on his vehicles to physically misrepresent the mileage on the vehicles, I think everybody agrees, you know, that's a crime, right? We all know that used car dealers are slippery, but you can't do that. Actually, many jurisdictions have specific statutes with regard to automobile transactions that govern that. But even if they didn't, we just simply had the background rules about fraud, I think we'd all know, oh, that's a fraud, because why?

Well, because the buyer doesn't know that the used car dealer has rolled back the odometer. The buyer has reason to believe that whatever the used car dealer is going to do and say, he's not going to do that. He's not allowed to do that. And if he does, he's committing a crime.

Now I'm no expert in used car markets. If you're a lawyer who represents car dealers, maybe you have a more complicated story to tell me. But for purposes of the hypo, I think we can kind of go off of our common understanding of how these markets work.

Now if, on the other hand, a used car dealer paints over rust on a vehicle or doesn't disclose some engine defect that the used car dealer knows about-- you know, she runs like a dream. Only used by the little old lady to get back and forth to church, et cetera. And somebody buys the car and then ends up disappointed with it, we don't think those are going to be fraud cases, right? I think most people would agree with me. No, that doesn't sound like a fraud.

Why Not I mean, is this just kind of a gut test? No. It's because the issue here is a question of the norms and behaviors that apply in a particular market, right? So you might say, oh, well, it's a used car market. We all know that that's a caveat emptor situation. Buyer beware.

Why? Well, because we've developed a market around the buying and selling of used cars in our society in which the buyer goes in with a certain en garde expectation with regard to the behavior of the seller. And so the law fraud is not going to intervene there under normal circumstances, and everybody knows that is sort of the idea, right?

So the buyer knows to be careful. And if you want to make sure it's a good car, you take it to your own mechanic and you have it checked. And we're not going to hear you say you've been the victim of a fraud if it turns out not to be a good car, but the dealer said a lot of nice things about it.

And similarly, we look at the dealer and we say, well, that's just a used car dealer. That's not a criminal, because he's not engaging in the kind of deception that we think used car dealers don't engage in or aren't supposed to engage in. Therefore, we would say in terms of fraud doctrine, I think, he lacks the specific intent to defraud.

So let's take another simple example. It's a hypo that's sometimes used in the literature about this stuff. So suppose the little old lady invites a gentleman she meets at her church home for tea after church. He happens to be an antique dealer. There's a chest sitting in her living room, which he admires a great deal and says so.

And she says, oh, that old thing. It's in the way. I don't use it at all. So much clutter in here. And he says, well, I'll take it off your hands, and I'll even move it out of here for you and take it away in my truck for $100. Does that sound fair? She says, great. I'd practically pay you. $100 is great. In fact, the chest is worth $10,000. He knows it, and he sells it the next day for $10,000.

Now, is this a fraud? I think we can try to make the argument here, but it's a pretty weak one, right? Why? Well, because if we just sort of take away some of the window dressing about this being a sympathetic lady-- you know, she's so kind. She's having him over for tea. She's elderly.

But I didn't say anything about her having any kind of reduced mental capacity or any particular reason why we wouldn't treat her as a typical buyer or seller in an arm's length market. And just the fact that they happen to be in her living room, well, maybe that causes her to let her guard down a little bit, but that's on her, right? Does the antique dealer have an obligation to disclose his true knowledge about the value of the item? No. We think probably not.

And so this might be-- if you tried to style it as a fraud case, you might try to argue that it's a non-disclosure case. So he doesn't tell her that it's actually worth $10,000. But you also might try to style it as a misrepresentation case. That is, when he says, I'll give you $100 for it as an antique dealer, he's effectively making a false representation about the value.

But that's a bit of a stretch, and I think we could predict that in this situation, it's pretty obvious, I think to most of us, that if a lady went into the FBI and tried to initiate a fraud investigation here, she'd be told to turn around and go home. And the reason is because of the social norms that have developed around the idea of what counts as an arm's length transaction, what counts as a typical buyer-seller situation in which the rule is, well, caveat emptor, although here she's the seller, so it's not buyer beware. It's venditor emptor or something. Seller beware.

All right. How about this case? After the Great Recession of 2008, 2009, there were a number of these lawsuits. One of them was brought by a number of students who enrolled at New York Law School, not to be confused with NYU, my alma mater, in the 2005-2009 time frame, which was a very unlucky time to be coming out of law school.

And they sued-- and I'm probably talking to some people here who would rather not remember that time-- but they sued saying that they had been defrauded into attending New York Law School by misleading employment data. Now this was not a criminal case. So here, we've got potentially a lower bar to surmount for calling something a fraud. I mean, civil, obviously you have to prove damages and such, but the level of criminal intent or mens rea is not going to be there or need to be there in a civil suit.

And so what were the allegations? The allegations were that New York Law School had included part-time and temporary positions in its employment numbers and that it had calculated the mean salary of its graduates using a subset of graduates, and also that it had employed-- it hired some unemployed grads as research assistants and counted them in its employment numbers to make them look better. Now this was before the ABA stepped in post-financial crisis and I think appropriately and thankfully regulated the way in which law schools could report and disclose employment data.

It turned out that New York Law School had not said anything in any of its publications to contradict or assert that it wasn't counting its numbers in this particular way. There was no actual false statement in the numbers. And therefore, they could be taken by a reader as advertising, essentially, as the sort of spin that businesses engage in all the time in trying to present themselves to buyers.

And that left just the question really for the court. This was a New York state court case. It left a question for the court of, well, is there something special about students? And is there something special about law school?

And the court came down with the conclusion that, no. The prospective buyer of a university education, undergraduate or graduate school, is essentially an arm's length buyer. Yes, there are certain things about students and their psychology at that stage of life with regard to education that possibly makes them vulnerable. And that means, said the court, wagging its finger, we don't approve in any way of the use of marketing or spin doctoring by a law school in this context, but it's not illegal.

And so I'm not saying I agree or disagree with that decision, but notice that, again, just as with the used car dealer and the antique dealer, the analysis of whether we have a fraud seems to be coming down largely, or one might argue almost exclusively, on the question of, well, wait a minute. We need to know what market we're in and we need to know what the particular baseline of that market is in terms of the kinds of behaviors that are routine and expected.

Which, you know, as we begin to get down this road, and we'll now go down it further, becomes a kind of somewhat surprising and to some people perhaps odd way of determining what counts as a fraud. But it's actually understandable as we get deeper into the story.

OK. I want to add one more simple hypothetical, and then we'll talk about some more real cases. So we also have in fraud law this idea of what I call triangle frauds. I think that's the best way to understand them conceptually, even though these particular kind of fraud is most often spoken of with reference to federal criminal law. That's so-called honest services fraud.

But really, what we have here is whereas in every other example we've talked about so far, we essentially have a binary relationship or a linear relationship between assistant buyer and some seller, and either the buyer or the seller are engaged in some kind of deception-- it's designed to get money to move one way or another across that linear relationship-- we can also have situations like this where the relationship is not linear, but rather triangular.

So the simple hypo here is assume that a professor is teaching a class and two students in that class among many take the exam, just like everybody else. And the student on the top writes a B plus exam and receives a B plus. So the student on the top has taken the class that he paid for, he's gotten what he thought he bought, and he's done his best work, and he's gotten a legitimate grade.

However, the student on the bottom also in the class has written just the same exam as the student on the top. Also a B plus exam. But that student has received an A because he bribed the professor, and the professor is corrupt.

So the problem here is that the professor did not lie to the student on the top, and the student on the top got the grade he deserved. So it's difficult to say in any straightforward way that the student on the top has been deprived of anything of value, or at least it's very difficult to quantify what that might be.

Yet the student on the top, particularly in a professional school where relative grades may have some impact in the hiring market and curves apply and such in addition to potentially mandatory medians, it's clear that the student at the top, however, has been cheated. And the reason the student on the top has been cheated is because the person doing the cheating-- that is, the professor-- is being paid to cheat.

So it is actually quite sensible to say that the student on the top has been the victim of a deprivation by virtue of deception that's quite harmful, and that maybe we ought to call that a fraud. So the law's solution to this has been to say, well, the professor defrauded the B plus student by not disclosing to the B plus student that the grading process wasn't on the level. And the B plus student on the top had every reason to assume that the grading process was on the level in the absence of being told otherwise.

So by paying his tuition and attending the school and continuing to attend the school, he's sort of continually being deceived, because what's being withheld from him is a material, a damaging fact that if he knew it might cause him to stop relying on the school and stop relying on the professor to be conducting a process that's on the level, and might actually cause him to exit the relationship. So we are able to say that in this context because of, again, the nature of the market and the relationship.

So this is different than the student who's applying to a potential school and choosing whether to go there, right? Now we've got a student who is enrolled. And I think it's fair to say that in the institution-to-student relationship or the faculty-to-student relationship there is an element of trust and there is an element of good faith, which the violation of without it being disclosed is going to work a deception at this point. Because a person will continue to act in a certain way in reliance on a belief that the other person-- that is, the professor-- is conducting themselves accordingly when in fact they're not.

So this triangular fraud theory can be applied to lots of situations involving individuals who are being deprived of their rights or perpetrators who are violating various kinds of duties. But as some of you may know, the expansive potential of this theory has drawn a lot of controversy over the years, and ultimately led to a decision by the US Supreme Court interpreting the federal mail and wire fraud statutes which include the idea that a fraud can involve the deprivation of a right to honest services. Caused the Supreme Court to basically narrow the meaning of that statute some years ago in a case related to the Enron prosecutions in order to make it more difficult for prosecutors to work these triangular fraud theories.

Essentially, what the court has said is that in the absence of proof as I have in my hypo here of a bribe paid to or some kind of kickback, a thing of value paid to the individual who's engaged in the corrupt behavior, the honest services theory won't apply. And this ruling has some implications if you want to talk about it in the question and answer for the Supreme Court's decision last term in the famous Bridgegate prosecution out of the Christie administration in New Jersey.

All right. Let's go back to some actual cases and see how this plays out. So here's just a quick string of cases that I use in my course in which we try to illustrate real corporate crime the way in which this question about, what market are we in, and how do we decide what kind of a relationship we've got seems to very much drive results in fraud cases.

So there's a famous, excellent opinion by Judge Posner from the 1980s in a case called the United States versus Dial, which involved frontrunning on the Chicago Board of Trade, the commodities futures market in Chicago. And essentially, what happened was some brokers knew that they had a client who was going to place a very large order for silver futures, and they created an account for themselves and entered the market ahead of their client to buy up a bunch of silver futures and profit from the increase in price that they anticipated would be caused by their client's large block order.

So these brokers were engaged in a form of what we would call in the equities markets insider trading. They're trading ahead or frontrunning their clients, but there were no lies. They never made any representation to anybody about whether they were doing that. They simply just didn't tell the client, right?

And the question was, is this a fraud? At the time, the Chicago Board of Trade did not have an insider trading role. So there was no specific rule within the markets that actually prohibited this as a matter of administering the futures markets.

But the Seventh Circuit, they were convicted at trial, and Seventh Circuit affirmed, yes, this is a fraud. Why? Because of the fiduciary nature of the relationship between broker and client. As Posner puts it in the opinion, the client has "bought candor." That's what they're supposed to be getting for the broker fee. That's what they expect to get. They don't think that they have to kick the tires as if they were buying a used car to figure out whether the broker is trading ahead of them. They think they can rely on the fact that that's sort of backstabbing behavior with regard to the client isn't going to be occurring. Therefore, when it is occurring, the client is being deceived and it does count as a fraud.

Interestingly, Posner also said in the case that it was in a criminal prosecution of particular significance that these brokers, the defendants, had set up a special account on a computer system at their firm to do these trades and then deleted the account after the trades were done, showing what Posner called "consciousness of wrongdoing."

He goes to the issue of, what is the mens rea for fraud? What does it mean to have specific intent to defraud? Often in these cases, we'll see discussion of behaviors that show a kind of awareness

of wrongdoing and the idea that that is helpful in determining whether there was intent to defraud.

In part, it's indicative arguably of an indication that the individuals engaged in the behavior know that they're doing something that defies standards in the market, and therefore might be likely to deceive. But it also deals to some degree with what is a common objection in fraud prosecutions and a perfectly legitimate issue that needs to be worried about, which is if fraud is such a general concept, are we going to-- do we risk in fraud prosecutions ensnaring individuals who think that they're simply involved in creative business activity and aren't doing anything wrong and shouldn't be treated as criminals?

So here's a very similar case to Dial, a much more recent case out of the Southern District in the Second Circuit, a case called the United States versus Finnerty. Here, the individuals were specialists on the New York Stock Exchange. Those are the blue coated individuals who take the buy and sell orders on the floor for particular securities that are assigned to their firms.

This individual, Finnerty, I think worked for a specialist firm that was handling among other things General Electric stock, or maybe it was General Motors. I can't remember.

The idea of the specialists it's that they're market makers. They match sellers and buyers. And in fact, there's a rule in the New York Stock Exchange that the specialists are not allowed to hold the equities in the middle while the price changes and take a little bit of advantage in the lag between the buyer side and the seller side of the transaction. This is called interpositioning. And the rule says you're not allowed to interposition unless doing so is necessary to maintain liquidity, because you can't match a particular buyer with a particular seller at that moment.

So the allegation against Finnerty was that he interpositioned to a large extent when it was not necessary, significantly-- failed to match available buyer with available seller, even though both were at hand, and significantly profiting his firm and enhancing his own bonus. Now, this conviction was secured as a fraud on the clients who were using this specialist firm to engage in these transactions. It was convicted in the Southern District as a fraud.

The Second Circuit reversed this conviction. They reversed it on the grounds that the government had failed to establish sufficient evidence that clients using these specialist firms knew about or cared about the interpositioning rule. What difference does it make to them whether-- after all, they're going to end up getting the same price anyway. What difference does it make whether the firm is kind of holding the securities in its own account for a little while and getting some of the spread, as long as the spread's going to be the same either way?

The government really didn't have any evidence of expectations with regard to the buyers in this market other than the existence of the Stock Exchange rule itself, which the Circuit said standing alone without any evidence of what the clients expected or cared about wasn't enough to establish that the non-disclosure-- remember, this isn't a lying case. This is non-disclosure of interpositioning. Didn't establish that this was working any kind of a fraud.

And in fact, these interposition market makers, the specialists, in the analysis of the Second Circuit, they're not like the brokers in Dial. They're market makers. They're not fiduciaries.

OK. Here's a case out of the Seventh Circuit post-financial crisis. There's a bank in Wisconsin called Anchor Bank that's in trouble during the post-crisis collapse. And they have an investment in a commercial real estate project in Texas, and they would like to liquidate that investment to help with their problems. So they assign this fellow on the left, Mr. Weimert, who is a vice president, to go down to Texas and try to do a deal for their interest in this, I don't know, shopping center property or something.

So they say, go find a buyer. And he finds a buyer. He begins negotiating terms. And at some point during the negotiations, Mr. Weimert, who works for Anchor Bank, suggests to the buyer that he stay involved in managing the property once the buyer has acquired it because of his useful knowledge of the property in exchange for a 4% management fee.

The buyer likes this idea, and he agrees to it. It has no effect whatsoever on the price. There's no proof it has any effect on the sale price that Weimert is negotiating for Anchor Bank-- on behalf of Anchor Bank with the buyer in Texas.

But he goes back to the board of the bank with the deal, and he discloses his-- because it's a term in the deal that he's going to stay on in a management capacity in exchange for a fee. And he says to the board that the buyer was insisting on this as a condition of closing the sale.

And the board says, oh, OK. Well, we like the deal. Gee, I guess we need to waive the conflict of interest. They vote to waive the conflict of interest on the advice of the lawyer and they approve the deal.

The US attorney's office in Chicago finds out about this-- I guess the bank finds out about it at some point. They find out that Weimert wasn't really telling the truth about that, and they take it to the US attorney's office. They prosecute him for fraud. He's convicted.

And the Seventh Circuit reverses. They say, this is not a fraud, because all the terms of the deal, all the material terms of the deal were truthfully disclosed to the board, and the only misleading thing Weimert did had to do with the fact about somebody's negotiating position. That is that the buyer will walk away without this term, a term that had no effect on the bottom line price.

And the Seventh Circuit said, well, that's no different than you having a walk away number in any deal you're negotiating that you say is your walk away number when you know that, in fact, you'll move off it. That's a lie that gets told all the time in negotiation, and nobody thinks that's fraud. Therefore, this wasn't fraud. OK?

Here's a guy, Jesse Litvak. He was prosecuted for fraud in connection with selling distressed mortgage-backed securities in the period after the collapse of the market in 2008, 2009. Now, to the extent that there were always issues about what these MBSs were really worth, there were really issues in the distressed market because there wasn't a lot of liquidity and the whole market

for MBS had blown up on everybody. So there's a lot of back and forth in these deals about how to come to price terms.

And Litvak was trading these distressed MBSs for a dealer called Jefferies and Company. He was alleged in this prosecution to have told a few different kinds of lies. One, he inflated the number of what he had paid for securities he was holding and trying to sell to someone else. He inflated numbers about prices that he said he had available in deals that he could do with other parties. And he sometimes said that he was holding securities for third parties when they were really being held on his own books. And he was prosecuted for securities fraud.

Long saga involving two appeals to the Second Circuit and lots of fights about the admission of expert and other testimony about this distressed MBS market, and whether during this period the kinds of things that Litvak was saying were sort of sales tactics that everybody knew that everyone was doing it. And the question in the Litvak case, which was actually, I think, quite difficult for the courts was, you know, just because this is a securities market doesn't mean that this isn't a used car market, you know?

That these aren't kind of the used car equivalent of securities. They're kind of used securities, and everybody knows who's going into this distressed MBS market, but no one really knows what these things are worth, and there's tons of spin doctoring going on. And therefore, even these kinds of lies that Litvak told were not fraud.

Now, as far as I can recall, the cases do not reach an ultimate conclusion on that, but they do say that there were errors at the trial level in precluding him from making that argument. Which is interesting, because often the argument in the securities-- in the fraud context of sort of, well, everyone was doing it gets dismissed as not a relevant kind of defense.

For example, in the Goldman Sachs MBS matter, which predated the collapse, the individual on the top, Fabrice Tourre, was not criminally prosecuted, but had a case, an enforcement case brought against him by the SEC for structuring a particular MBS deal that was sold to a bank in Europe, the bank in Europe taking a long position on a basket of securities that Goldman had put together. The short position on that was taken by the individual at the bottom, a famous hedge fund guy named Henry Paulson who ended up walking away with a billion dollars on this deal after the market collapsed.

And the buyer in Europe was not told that Paulson was given an opportunity during the structure of the deal to kind of handpick some loser mortgage products to put into a basket on which the European bank was going along. And the SEC won at trial, but you know, DOJ never touched this case, notwithstanding a great deal of-- and by the way, I've read the SEC trial transcript. It was not an easy win for the SEC by any stretch.

DOJ did not take this case on criminally in spite of the immense pressure on the government to bring some criminal cases involving MBS trading. And in spite of the fact that this case, unlike most of the other MBS deals that have come under legal scrutiny that I've seen materials on, involved some fairly questionable conduct with regard to sort of hiding Paulson's involvement in picking the mortgages.

But there still were some serious issues here about whether the buyer, the European bank, cared, would have cared whether Paulson was involved, would have been at all surprised that there were-- obviously, they knew there was somebody on the short side of the deal. And whether the bank was never actually lied to and they simply-- it was simply a nondisclosure in a kind of arm's length transaction in which they would have had every opportunity had they chosen to.

Nobody did, because they didn't have time. They didn't want to take the time because they were making so much money going along at that time to actually inspect the documents and decide whether they liked the mortgages in the transaction or not. Most of the MBS deals I've seen didn't have these kind of facts.

What about the Libor scandal? This is Tom Hayes, Mr. Lord Libor who worked for UBS and then Citibank who was prosecuted in London and convicted. And the Libor scandal has some of the most incriminating emails and IMs I've ever seen in a white collar case. There's actually one in a case involving some guys at a Dutch bank called Rabobank in which there's an IM of one saying to the other, we're not the biggest crooks in the market, the sort of evidence that's a prosecutor's dream that you never get in these white collar cases.

Even in the Libor manipulation, there are some complicated questions about the nature of the fraud. Basically, you have these interest rate derivative traders at various huge financial institutions trading with each other, using Libor as a benchmark on their deals.

And behind the scenes, they're getting the back office people at their banks to kind of tweak the numbers that their banks are submitting to the British Banking Authority, which are used to calculate Libor every day. And they're tweaking the numbers in a way that may be helpful to their own positions in these interest rate derivative deals.

There's some issue here as to whether-- and there were some convictions. There have also been some acquittals in the Libor case, despite the seemingly overwhelming evidence of manipulation and fraud.

I think because there's been some issues about whether anybody actually believed that Libor wasn't being manipulated. It turns out that this benchmark was supposed to be calculated off the price that banks were paying each other for short-term lending over the counter on a kind of 24-hour, day-to-day basis. And at the point at which the Libor manipulation was really out of control, apparently those transactions weren't even occurring.

And everyone in the bank-- a banking sector, particularly London knew that, and knew that the banks were basically having to estimate numbers. And of course, they were going to estimate the numbers in a way that might favor them. So I'm not saying that Libor wasn't fraud. I'm just pointing out that even the most seemingly flagrant cases can have these contextual issues.

And speaking of flagrant cases, I mean, if anybody has read Bad Blood or any of the other very good journalistic work that's been done on the Elizabeth Holmes Theranos case, you might think of that case as kind of the Silicon Valley Bernard Madoff. You know, that this is sort of-- the level at which they were lying about this blood testing product that they had and attempting to

deceive basically investors, you know, pre-IPO investors about what they had and what the promise of this business was going to be. If you read John Carreyrou's book Bad Blood, it's off the hook.

Nonetheless, Elizabeth Holmes is going to trial. The case has been continued until the spring, I think the idea being that hopefully it could be had post-COVID at some point. And she's going to have a trial argument. I don't think she's going to win, but I wouldn't even-- though I study this stuff, I wouldn't pretend to try to predict what may actually happen at this trial.

And as I understand it, the defense is essentially going to be a contextual defense, that in Silicon Valley when you're raising early round financing, you fake it till you make it. Everybody knows that. The investors know that a lot of this is spin and kind of pumping the promise of the investment, and that's why they're investing. They're not investing because they think you already have the product.

So what do you really need to know to identify a fraud? In my view, obviously you look at the conduct, the actus reas as you say in criminal terms. You need some kind of story about a deception.

But it's really markets and expectations that determine whether we have a deceit that is significant enough to matter for criminal law fraud purposes. And then, of course, we also in criminal law look at mental state and mens rea.

But here, it's interesting how often this concept of specific intent to defraud just sort of begs the question. You know, how can we say that someone intends to commit a fraud when we're arguing about the very question of whether the conduct itself is fraud? Of course, everyone in all of these cases intends to be doing what they're doing. The question is whether what they intend to be doing is the kind of deception that counts as a fraud.

And often, what I think juries and prosecutors and defense attorneys defending these cases and appellate courts reviewing them look to is this idea of, was there some kind of consciousness of wrongdoing within this particular context? So often in these cases it turns out that the cover-up is the crime in some fundamental sense.

And this is an old idea. I mean, for those of you-- anybody who practices credit or debtor law knows the idea of badges of fraud that goes back to the ancient common law. And therefore, I think the argument about what counts as a fraud, just as the markets and the conduct and the transactions and the businesses and industries that we've scanned over here are going to continue to present new scenarios that we've never seen before, guaranteeing that the argument about whether something is a fraud or not will never actually be settled.

And I'll just finish with this quote, the famous English common law writer, Edward Coke and lawyer from a 1601 case, in a twins case, an Elizabethan case. He's reporting as the queen's attorney general in this case, and he writes in Latin, translated, "If you ask why there are so many frauds, the answer is that fraud-- why there's so many laws, the answer is that fraud ever

increases on this earth." So with that, I'm going to attempt to stop the screen share and take questions.

CONNER COOK: Perfect. Thank you so much, Professor Buell. We do have some time reserved for Q&A. Before we get to that point, we're going to launch a quick poll that you'll see pop up on your screen. This is to help us meet the requirements for CLE credits. So if you can just please click, yes, that you are participating, and then click the button to submit your answer, and then we will move on to the Q&A.

SAMUEL BUELL: And if you say yes and you weren't listening, I won't take any position on whether the CLE authorities will treat that as a fraud. We have at least one confession. Somebody seems to have said, no, I'm not listening. [LAUGHS]

CONNER COOK: Perfect. And we're going to go ahead and end the poll. So if anybody else has not answered-- perfect. Thank you. If it's still displaying on your screen, just click the red X button at the top, and it will go away. So going on to our Q&A portion of the program, we're going to use a Raised Hands feature of Zoom.

If you're not familiar with that, if you hover over the bottom of your screen, you will see a toolbar appear, and there is an option that says Participants. If you click on the Participants button at the bottom right-hand side of your screen, you should see an option that says Raise Hand. If you're having any difficulties with that, you can put your questions in the chat as well. We'll give everybody a minute to raise their hands for questions.

SAMUEL BUELL: Yeah. While we're doing that, I see there's a question in the chat that I can answer. So this is from Pete Murray who works in the California DOJ, prosecuting health care fraud civilly and criminally, and admits that even within that specialized sphere, they're struggling constantly with the question of, what's the difference between a civil and a criminal case?

Yeah. I mean, look. A lot of-- most of my former colleagues at DOJ have gone on to become partners at big law firms that do corporate criminal defense and white collar government investigations. And this is what they get paid the big bucks for is to walk into the conference room at DOJ and try to persuade the prosecutors or any US attorney's office that this is really just a civil case, right? You don't want to go criminally.

Now there are some doctrinal ways to think about that, and as Pete points out and as I mentioned in the talk, there's some elements that the prosecutor doesn't have to prove that would be necessary in a civil case in terms of damages, and so on.

But I think most people intuitively would think, gee, it wouldn't make any sense at all to have it be harder to prove civil fraud than criminal fraud. Criminal fraud should be some kind of higher level, right?

But it's difficult other than to point to mens rea and specific intent to defraud, it's difficult to give a doctrinal answer to that question. You know, someone could say in a very breezy way, oh,

unless you have the specific intent to defraud, you don't have a criminal case. OK, but tell me what that is, right?

Because obviously, anybody in a business context that we're dealing with in these cases intends to be doing what they're doing. And often, there's a great deal of planning and purpose involved in the execution of the particular transaction. But how do we know that that purpose includes a purpose to commit fraud, right? And that's where I kind of get into this idea about consciousness of wrongdoing.

But I also think that if you're a lawyer or a practice and you're trying to predict how the government's going to handle a particular case, obviously there are other factors that are going to go into the discretionary question of whether to treat it criminally. Who is harmed? How badly were they harmed? Who is committing the fraud?

What kind of position of importance or trust or privilege might that person have occupied? How significant of a departure was this from the kinds of things that maybe other people have done in the industry that previously didn't trouble anyone? And so on, right?

And there, I think, it's not a completely unprincipled discussion in the sense that I do think what's going on is a conversation that is very much rooted in the fundamental ideas in criminal law about deterrence and retribution. In a criminal case, it's not about compensating the victims so much or making people pay as it is about identifying those individuals who've engaged in something when it counts as serious moral wrongdoing and identifying those individuals for whom a civil sanction might not be sufficient to create the kind of deterrence that seems to be warranted in a particular sector. But I think Pete's question is great and very revealing.

CONNER COOK: Thank you. And we have time for just a couple more questions if anyone would like to use the Raised Hands feature or if you need to put them in the chat as well. Either way works, but we've just got a couple more minutes left.

SAMUEL BUELL: I'd love to have some questions. I've been talking for a long time. I don't even know who I'm speaking to. I have heard no voices. I can't see most faces.

CONNER COOK: All right. Well, we can take that as a sign that everyone got all their questions answered during the presentation.

SAMUEL BUELL: Or I successfully put the entire group to sleep.

CONNER COOK: No, because they were answering the poll. I think they're there.

[LAUGHS]

Thank you, everyone, for joining us. This was a wonderful program. And Professor Buell, thank you so much for spending part of your day with us to help celebrate Reunion.

We do have several more programs scheduled for throughout this week, so if you have already registered for some sessions and you'd like to add some more sessions to your schedule, you can do that just by updating your registration page that you got. We'll also put the link for registering for events in the chat. We look forward to seeing more of you-- seeing you all during more of our programs later this week. But thank you for joining us for today's program.