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'Litvak' Dicta Provides Counsel Fodder for Challenging Proof of Intent

"Everyone else is doing it" could be probative evidence of good faith.

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BIGSTOCK

On Dec. 8, 2015, in a highly anticipated ruling, the U.S. Court of Appeals for the Second Circuit reversed the criminal conviction of Jesse Litvak, a bond trader, on charges of securities fraud, false statements, and defrauding the U.S. government. *United States v. Litvak*, 14 Cr. 2902 (2d Cir. 2015). The charges focused on Litvak's alleged misstatements regarding prices he charged his customers for residential mortgage backed security (RMBS) bonds. Although the government acknowledged that Litvak accurately disclosed these bond prices to his customers, it alleged that Litvak's statements regarding the circumstances of the prices—such as the spread between the purchase and sale prices—were false and materially misleading. Two key trial defenses were that: (1) Litvak's statements were immaterial as a matter of law since his trading counterparties agreed to the transaction prices and should not have been influenced by Litvak's profit margin, and (2) Litvak acted in good faith and therefore lacked the intent to commit securities fraud. Neither defense bore fruit at trial, as Litvak was convicted after two days of deliberations.

In reversing Litvak's conviction, the Second Circuit declined to endorse defense counsel's argument that the statements at issue were immaterial as a matter of law. However, the Circuit held that the evidence was insufficient to sustain Litvak's convictions on the false statement-related charges, and that the trial court abused its discretion in refusing to admit expert testimony relating to the securities fraud charges.

The Circuit also considered various other evidentiary rulings that the defense raised on appeal, in order to "assist the District Court and parties on remand." *Litvak* at 83. Though arguably dicta, one of the Circuit's evidentiary rulings could provide ample fodder for trial counsel seeking to challenge the government's proof of intent. Specifically, the Circuit held that the trial court erred in excluding evidence that Litvak's supervisors approved instances in which his colleagues engaged in the same type of conduct for which he was convicted. The Circuit rejected the trial court's characterization that this evidence was just offered to show that "everyone else is doing it," and instead found that this evidence was probative of Litvak's good faith.

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This evidentiary ruling, and its implication for future defendants' good faith arguments, is the focus of this article.

Background and Alleged Misconduct

In January 2013, a grand jury sitting in the District of Connecticut returned an indictment against Litvak, charging him with 16 counts of securities fraud, false statements, and defrauding the U.S. government. Litvak, a former senior trader/managing director at a global securities broker-dealer and investment banking firm (the Firm), was indicted for statements he made to trading counterparties during bond purchase and sale negotiations. The government's case principally alleged that Litvak committed fraud by misrepresenting to trading counterparties: (1) the costs at which Litvak's firm acquired the bonds it was selling; (2) the costs at which his firm would resell the bonds it was purchasing; and (3) that his firm was acting as an intermediary in the transactions, when it really was selling the bonds from inventory.

The falsity of these statements—and the allegation that Litvak made them—was not seriously disputed at trial. Instead, the defense primarily focused on the issue of whether those statements were material. Defense counsel analogized such statements to "water off a duck's back," much like statements that a car salesman makes to buyers on a car lot. The government countered this argument by calling certain of Litvak's "victims" at trial, who testified that Litvak's misrepresentations—regarding his commission, underlying purchase prices, or contemplated re-sale prices—were "important" to them in negotiating the overall purchase price for the bonds at issue. Litvak attempted to introduce expert testimony regarding the sophisticated bond-trading market, where purchases largely are driven by complex pricing models, rather than negotiations among bond salesmen. But, as noted above, this evidence was excluded by the court on relevance grounds.

A second key defense at trial was that Litvak acted in good faith, and had no intent to defraud his trading counterparties or the United States. In support of this defense, counsel attempted to introduce evidence that: (1) given the structure of the sophisticated bond-trading market, Litvak had no reason to believe his statements had any bearing on his counterparties' trading strategy; and (2) Litvak's supervisors (and other supervisors at his firm) knew of, and encouraged, these sales practices, which "tended to prove the absence of intent … given the nature" of the firm's culture. Joint Appendix on Appeal, *United States v. Litvak*, (J.A.) at 644-45.

After a three-week trial, the jury convicted Litvak of all counts. On July 23, 2014, Litvak was sentenced to two years in prison. The Second Circuit later granted Litvak bail pending appeal.

The Second Circuit Decision

The Second Circuit reversed Litvak's conviction on all counts. The Circuit grounded a significant part of its reversal on the district court's exclusion of the defense's proffered expert testimony relating to materiality, finding that it put Litvak in the "untenable position whereby he could not introduce testimony that either (1) the specific statements at issue in the case would not be important to a reasonable investor … or (2) the types of statements at issue are generally not important to a reasonable investor." See *Litvak* at 61.

The Second Circuit has recognized **the need for the defense to challenge the government's proof of intent**, and the 'Litvak' opinion provides various means for counsel to do just that.

In a similar vein, the Circuit took issue with a number of other evidentiary rulings handed down by the trial court. One of these rulings related to the trial court's exclusion of evidence consisting of communications between the Firm's supervisors and other traders, to which Litvak himself was not privy. Specifically, although the district court allowed evidence of Litvak's supervisors' knowledge and approval of *his own* misrepresentations, it excluded evidence of the Firm's managers'—including Litvak's supervisors'—knowledge and approval of *other employees'* very similar conduct.

On appeal, Litvak argued that excluding the latter category of evidence was error because it could have supported the inference that when Litvak engaged in similar behavior, his supervisors likewise approved his own conduct, which in turn would bear on his good faith. Litvak's counsel made a consistent argument before the trial court: "I think that evidence that supervisors approve this conduct and participate in the conduct on a repeated basis is a fair basis upon which to infer that when Mr. Litvak did the very same thing, that the supervisors saw and approved of as standard operating procedure, that Mr. Litvak lacked intent to defraud … . It is circumstantial basis to infer that Mr. Litvak had a belief, as we have contended, that he was not committing fraud … ." J.A. at 644.

The trial court characterized the defense argument as "everybody [else] did it and therefore it isn't illegal," which is no defense to criminal charges—a principle that countless trial courts have adopted. The trial court emphasized that because Litvak was not even privy to Firm supervisors' endorsements of his colleagues' conduct, those endorsements were irrelevant to Litvak's state of mind ("I find that irrelevant when it does not involve … Mr. Litvak. Because at the end of the day, as I have said, all of this can only go to state of mind proof. And if it is something [Litvak] didn't know, then it can't go to a state of mind." J.A. at 645.)

The Second Circuit rejected this reasoning. It ruled that the proffered evidence—even without any indication that Litvak had knowledge of such approvals—"would support Litvak's attempt to introduce a reasonable doubt as to his intent to defraud, i.e., that he held an honest belief that his conduct was not improper or unlawful." *Litvak* at 82. The Circuit concluded that had this evidence been introduced, "the jury may have found [Litvak's good faith defense] more plausible in light of his supervisors' approval of his colleagues' substantially similar behavior." Id. In other words, the Circuit characterized the contested evidence as showing that Litvak's supervisors approved of his colleagues' tactics, which in turn tended to show that those same supervisors approved of Litvak's *own* tactics, which in further turn tended to show Litvak's good faith. Echoing its concerns about defendants' ability to challenge the government's proof on materiality, the Circuit cited helpful language

from *United States v. Brandt* regarding the need to permit introduction of "good faith" evidence in criminal cases: "Since [good faith] may be only inferentially proven, no events or actions which bear even remotely on its probability should be withdrawn from the jury unless the tangential and confusing elements interjected by such evidence clearly outweigh" its relevance. *Litvak* at 82-83 (quoting *Brandt*).

The Circuit carefully limited the scope of this ruling. It emphasized, for example, that because the trial court excluded this evidence purely on relevance grounds, the Second Circuit's holding was limited to reviewing that narrow issue. The Circuit thus left open the possibility for the trial court to exclude this evidence on Rule 403 grounds, i.e. if its probative value is "substantially outweighed by a danger of … unfair prejudice, confusing the issues, misleading the jury, undue delay, wasting time, or needlessly presenting cumulative evidence." In addition, because the Circuit determined that reversal was warranted on other grounds, it did not consider whether the trial court's ruling was harmless error.

Third-Party Conduct to Prove Good Faith

While the Circuit's holding was limited, it nevertheless could have broad and helpful implications for future trial defenses as it provides a roadmap to introduce evidence that routinely is challenged and excluded. Like the trial court in *Litvak*, prosecutors and courts frequently view attempts to introduce evidence of such third-party conduct as a way of showing that everyone else engaged in the charged conduct, but only the defendant got charged. This is especially the case where—as here—the defendant may have been unaware of this evidence. Courts and prosecutors reason that such evidence is a subtle argument for jury nullification, which is not permitted. Thus, to take advantage of the *Litvak* ruling, defense counsel will have to convince the court that the proffered evidence in fact is probative of good faith, and is not being impermissibly used for jury nullification.

The *Litvak* court did not provide concrete guidance to trial courts in making this determination. However, the court did provide helpful language that defense counsel should bear in mind when seeking to admit evidence pursuant to this *Litvak* ruling. Below are some general principles for defense counsel to consider in seeking to admit this evidence:

First, there is a higher likelihood that such evidence will be admitted if the central defense at trial is lack of intent. In the *Litvak* case, the Second Circuit cited the difficulty of proving good faith, which often relies on circumstantial proof and inference. The Circuit conveyed that without this proffered evidence, Litvak would be stifled in raising his key defense of good faith. See *Litvak* at 82-83. In citing *Brandt*, the Circuit concluded that any evidence that "even remotely" bears on the probability of good faith should be submitted to a jury, unless the confusing or prejudicial impacts of the evidence "clearly outweigh" the relevance. Id. This is powerful language for defense counsel to cite, especially where the sole defense at trial is a lack of intent.

Second, defense counsel will continue to face an uphill battle admitting such third-party conduct evidence, absent proof that the defendant was at least generally aware of his/her supervisors' countenance of such conduct. The trial court drew a line in the sand regarding this evidence—distinguishing between third-party conduct of which the defendant was aware, and that of which he was not aware. The Circuit rejected this distinction for purposes of the relevance analysis, but that still leaves district courts with plenty of discretion to exclude this evidence on Rule 403 grounds. Indeed, even the Circuit recognized that the latter type of evidence (of which the defendant was unaware) was "less probative of Litvak's intent." *Litvak* at 82. And, we suspect prosecutors will continue to vigorously challenge admission of such evidence on Rule 401 or 403 grounds, citing its limited probative value and the risk that defense counsel really is trying to establish that "everyone else" engaged in such conduct but was never charged.

Third, the admission of such evidence is more likely if the defense can both closely line up the charged conduct with that of the third-party conduct it is seeking to introduce, and also prove that this third-party conduct was well-established within an organization. While the Second Circuit did not lay out bright-line rules for courts considering this issue, it characterized the defense proffer as one where Litvak's supervisors "regularly approved of conduct identical to that with which Litvak was charged," and concluded that such evidence permitted the inference that when "Litvak did the very same thing," "the supervisors saw and approved of [it] as standard operating procedure." *Litvak* at 81. This reasoning provides trial courts with wide latitude in distinguishing the facts of defense proffers from those in *Litvak*. Prosecutors will also no doubt treat the Circuit's references to "regular" approvals, "identical" conduct, and "standard operating procedure," as minimum thresholds for admissibility. Although defense counsel can take comfort in the general principles of good faith evidence laid out by the *Litvak* court, it is clear that counsel will have the greatest success when it can establish that a particular practice was pervasive within an organization, and that a defendant's charged conduct was similar—if not identical—to such practices; the more isolated or infrequent the practice, the greater challenges counsel will face.

Fourth, given the uncertainty over courts' interpretations of this aspect of the *Litvak* decision, it will behoove defense counsel to consider filing motions in limine on these issues early and often. Establishing all of the facts necessary to support the above arguments will take time, and many judges' individual practices permit motions in limine to be filed any time before trial. Given the potential benefits such evidence can yield, an early motion in limine can give the trial court time to consider these issues in detail, and even have a preliminary hearing regarding admissibility.

Regardless of the future contours of this evidentiary ruling, it and other aspects of the *Litvak* decision are good news for defense trial counsel. The Circuit has recognized the need for the defense to challenge the government's proof of intent, and the *Litvak* opinion provides various means for counsel to do just that.