

# Corporate Fraud Defense Report

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## Employee Indicted on Federal Obstruction Charge For False Statements in Corporate Internal Investigation

A federal grand jury in the Southern District of Texas recently issued an indictment that includes an obstruction of justice count pertaining to the defendant's allegedly false statements made to corporate internal investigators.

In its ten-count indictment, the grand jury charged Greg Singleton with conspiracy, false reporting, wire fraud, and obstruction of justice arising out of Singleton's conduct while working as a natural gas trader for the El Paso Corporation. According to the indictment, Singleton reported false information to two trade newsletters that published index prices, including the reporting of fictitious trades and the concealment of real trades. This allegedly false information in turn affected the price of natural gas.

The obstruction charge focused on allegedly false statements that Singleton made to El Paso Corporation's outside counsel who were conducting, in response to a FERC data request, an internal investigation into the accuracy of information reported to trade publications. According to the indictment, during an interview with these attorneys, Singleton falsely denied and otherwise concealed that he had provided false information to trade publications. El Paso Corporation then provided information about Singleton's interview to the FERC and CFTC, who were conducting their own price reporting investigations of El Paso. The indictment alleges that Singleton intentionally obstructed the government's investigations in violation of 18 U.S.C. §1512(c)(2). *U.S. v. Singleton*, 4:06-cr-00080 (S.D. Tex., 3/8/06).

## PineBank Again Faces Money Laundering Scrutiny

PineBank has been ordered by the U.S. Comptroller of the Currency to reform and improve its Bank Secrecy Act ("BSA") and anti-money laundering safeguards. The Brazilian-owned bank, which is based in Miami, was given 5 days to establish a compliance committee, and 60 days to become fully compliant with the BSA's money laundering regulations. Its compliance program was ordered to include an annual written assessment of its BSA and money laundering risks, due diligence procedures in account opening, monitoring of high risk accounts, controls and procedures to perform transaction testing to detect suspicious activity, testing for foreign correspondent bank accounts, and a strict adherence to the Patriot Act. The bank was also ordered to engage an outside auditor to review foreign transaction activity between 2003 and 2005 to determine whether suspicious activity was reported. The bank previously came under scrutiny by the Senate for having opened accounts for former Chilean leader Augusto Pinochet, and in 2004 it agreed to pay \$4.2 million to the Chilean government amidst allegations that it was a conduit for millions of dollars taken from Chile illegally. *In the Matter of PineBank, National Association*, Treasury Dept., Office of the Comptroller Consent Order No. 2006-1.

Continued from page 1

## New FinCEN Guidance for Futures Commission Merchants on Financial Intermediaries

Pursuant to new guidance issued by the U.S. Financial Crime Enforcement Network (FinCEN), futures commission merchants engaging in transactions through omnibus accounts and sub-accounts established by financial intermediaries should treat the financial intermediary - rather than the beneficial owner - as the "customer" for purposes of customer identification. According to the preamble of the rule defining the customer as "the account's holder" (68 FR 25149, 5/9/03), "[i]f the intermediary is the account holder ... an FCM is not required to look through the intermediary to the underlying beneficiaries." 31 CFR 103.123.

The guidance applies to the following circumstances: (1) The omnibus account or relationship is established by, or on behalf of, a financial intermediary to execute transactions that will clear or settle at another financial institution; (2) The omnibus account-holder provides limited information to the merchant solely to deliver assets to the custody account of the beneficial owner at another financial institution; (3) The limited information given to the merchant about the beneficial owner is used primarily to assist the financial intermediary with recordkeeping, or to establish sub-accounts that hold positions for a limited duration to facilitate the transfer of assets to another financial institution; (4) All of the transactions in the omnibus account or sub-accounts are initiated by the financial intermediary; and (5) The beneficial owner has no direct control over the omnibus account or sub-accounts. FinCEN Guidance FIN-2006-G004, 2/14/06.

## SEC Advisory Committee to Vote on Smaller Public Companies Report

On April 12, 2006, the SEC's Advisory Committee on Smaller Public Companies held a public teleconference concerning its final recommendations to improve the current securities regulatory system for "smaller companies." The Committee's draft report defined smaller companies as two tiers of corporations in the lowest 6% of total U.S. equity market capitalization. The top 94% of the total public U.S. equity capital markets would still be subject to the full panoply of securities regulations. The Committee's draft recommendations, if adopted by the SEC, would scale back Sarbanes-Oxley Act requirements for external auditors, decrease financial statement requirements, and urge development of a safe-harbor protocol for accounting for transactions in 78% of U.S. public companies. The Committee published 32 recommendations in an exposure draft report on February 28, 2006. The SEC accepted public comments on the report until April 5, 2006. Information concerning the Committee's public teleconference is available at <http://www.sec.gov/info/smallbus/acspc.shtml>. Publication of Exposure Draft of SEC Advisory Cmte. Report on Smaller Public Companies, 71 Fed. Reg. 11,090 (3/3/06); Meeting Notice, 71 Fed. Reg. 14,966 (3/24/06).

## Brokerage Firm Fined - Suspended for Variable Annuities and Life Insurance Abuses

The NASD has fined New York brokerage firm David Lerner Associates, Inc. \$400,000 and suspended the firm from engaging in any new variable life insurance or variable annuity business for 30 days for engaging

in replacement sales of variable life insurance and variable annuities that violated NASD and New York state rules. The NASD also held two Lerner principles jointly and severally liable for \$25,000 of the firms' fine and suspended each of them for 20 days.

The NASD found that Lerner routinely circumvented New York's Regulation 60, which requires brokers to inform customers that a variable life insurance policy or annuity contract replacement is being considered, obtain their written consent to collect information about the existing policy or contract, and provide them with a comparison of the old and new policies or contracts before the customer signs the application for a new insurance policy or annuity. According to the NASD, Lerner employees would instruct clients to pre-sign Regulation 60 forms and forward them to the firm's main office where they would be completed by an employee who had no knowledge of the reason for the proposed replacement, thus, allowing Lerner to effect the replacements before the client ever received or reviewed the Regulation 60 required information. *NASD v. David Lerner Associates, Inc.*, NASD CRD No. 5397; NASD NTM Disciplinary Actions, March 2006 at pp.22-23.

## SEC Subpoenas to Reporters Prompt Strong Rebuke From Chairman; New Guidance to be Issued

SEC Chairman Christopher Cox issued a statement on February 27th rebuking the San Francisco office for not consulting him or the other commissioners before issuing "highly unusual" subpoenas to three reporters. Herb Greenberg, a columnist for Marketwatch.com, Carol S. Redmond, a columnist for Dow Jones Newswires, and James Cramer, founder and majority shareholder of TheStreet.com, received subpoenas seeking

telephone records, e-mails, and other documents relating to accusations of a conspiracy by a research company and several hedge funds and traders to manipulate stock prices. One of the companies whose stock is at issue is Overstock.com Inc. (“Overstock”), an Internet-based discount retailer. In a lawsuit filed last year, Overstock alleged that Gradient Analytics Inc. (“Gradient”), a stock-research firm, conspired with short sellers to drive down the price of Overstock’s shares. The Commission has decided not to enforce the subpoenas to the reporters, all of whom wrote columns that were critical of Overstock, at the present time. Chairman Cox said, “sensitive issues” raised by the subpoenas “should, and will be, considered and decided by the commission before this matter proceeds further.”

On March 2nd, Chairman Cox said that the SEC will develop a new policy on subpoenaing journalists as a result of the controversy. The new policy, which is expected to be available by the end of March, will lay out the circumstances under which it is appropriate for journalists to be subpoenaed in SEC investigations. SEC Press Rel. No. 2006-24, 2/27/06.

### SEC Sues to Stop Hedge Fund Fraud

On February 28, the SEC announced that it had filed a complaint and a request for a TRO against Kirk S. Wright, International Management Associates, LLC (IMA) International Management Associates Advisory Group, LLC (IMA Advisory) and seven hedge funds. In the complaint filed in the Northern District of Georgia, the SEC alleged that the investment advisors, through Wright, had been providing investors with fraudulent financial statements that misrepresented the amount of assets in the funds and the rates of return. In reality, by 2005, the assets of the funds had largely disappeared.

The court “entered an order temporarily restraining and enjoining the defendants from future violations” of Section 17(a) of the 1933 Act and Section 10(b) of the 1934 Act along with Rule 10b-5. Further, he enjoined three of the defendants from future violations of Sections 206(1) and 206(2) of the Investment Advisers Act of 1940. He “also appointed a receiver for all of the defendants except Wright” and ordered expedited

*“The Commission has decided not to enforce the subpoenas to the reporters, all of whom wrote columns that were critical of Overstock, at the present time.”*

discovery and that documents be preserved. As to further relief, the SEC seeks permanent injunctions, disgorgement, prejudgment interest and civil penalties. *SEC v. Wright*, SEC Lit. Rel. No. 19581, 2/28/06.

### SEC Announces Broker-Dealer/Investment Advisor Study

SEC Chairman Christopher Cox recently announced that the SEC will begin studying the levels of protection provided to retail clients of financial service providers under the Securities Exchange Act and the Investment Advisers Act. The SEC’s stated intent is to identify and resolve any investor protection concerns arising from material differences between the two Acts. The study was prompted by the large number of comments received by the SEC during its promulgation of

the IA/BD rule in April 2005. Under the IA/BD rule, when a broker-dealer charges a fixed fee, it is excepted from the Advisors Act provided the advice given is merely incidental to brokerage services and the broker-dealer makes certain specified disclosures. According to Chairman Cox, the study will further the SEC’s “commitment to pursuing the most effective solutions to vital issues.”

### Kumar Alleged to Erase Hard Drive to Conceal Evidence

Former CEO of Computer Associates, Inc., Sanjay Kumar, is alleged to have erased the hard drive of his laptop computer to conceal evidence from prosecutors. Kumar was indicted in 2004 on criminal securities fraud and obstruction of justice charges in connection with a \$2.2 billion accounting scandal at Computer Associates, Inc. According to a February 2, 2006 letter from the U.S. Department of Justice, Kumar installed the Linux operating system on his laptop after the initiation of a government investigation in a deliberate attempt to destroy memory and wipe out damaging evidence on his hard drive. See 2/2/06 letter from Eric Komitee, Asst. U.S. Attorney, E.D.N.Y., Criminal Docket No. 04-846 (S-2) (ILG).

### Auditor Independence Rules Set for Comment

On March 7, 2006, the SEC issued a notice to solicit comments on a proposed set of rules promulgated by the Public Company Accounting Oversight Board (“PCAOB”) regarding auditor ethics and independence. In particular, the PCAOB has proposed several measures to address concerns about auditor provision of tax services to public company audit clients: (1) a rule aimed to prevent auditors from performing services for their audit clients for a contingent fee or commission; (2) a rule restricting

auditors from providing aggressive tax avoidance services for their audit clients; and (3) a rule designed to restrict auditors from providing tax services to persons in a financial reporting oversight role at an audit client.

Additionally, the PCAOB proposed two more rules to address concerns about auditors' tax services for audit clients. The first proposed rule provides that persons associated with registered public accounting firms shall not knowingly or recklessly take an action that would directly and substantially contribute to the firm's violating relevant laws and regulations. The second proposed rule establishes procedures for public accounting firms to follow when seeking audit committee pre-approval to perform permissible tax services for audit clients. SEC Rel. No. 34-53427, SEC File No. PCAOB-2006-01, 3/7/06.

### AICPA Issues New Standards on Auditor Communications with Governance Officials

The American Institute of Certified Public Accountants (AICPA) recently announced a proposal to supersede its former standards for communications with the audit committee. See *Statement on Auditing Standards (SAS) No. 61, Communications with Auditors*. The proposal stems from the AICPA's concern regarding "well-publicized audit failures" and "emerging best practices." The new standards include many of the existing requirements of SAS No. 61, but expand them to include: (1) a description of the purposes and effective means of communications with those charged with governance; (2) a detailed structure that takes into account the diversity in governance structures to determine the appropriate person(s) to whom to communicate particular governance matters; (3) standards for communication with those charged

with governance when all charged individuals are also involved in managing the entity; (4) planned communications regarding the scope and timing of the audit and information to be requested from management; (5) forms for various types of communications, including emphasis on those which must be in writing; (6) an evaluation of the effectiveness of communications between the auditor and those charged with governance;

*"The court held that the complaint's recitation of neutral facts failed to allege that defendants knew of specific FCPA violations."*

and (7) standards for documentation of communications with governance officials. The comment period for this proposal expires on May 31, 2006. AICPA, Proposed Statement on Auditing Standards: The Auditor's Communications with those Charged with Governance (3/6/06).

### FCPA Claims Dismissed

A district court recently dismissed plaintiffs' Foreign Corrupt Practices Act ("FCPA") claims against InVision, a manufacturer of aviation baggage screening products. In March, 2004, InVision announced that General Electric Company ("GE") would acquire InVision in an all-cash transaction valued at approximately \$900 million, or \$50.00 a share. Around that same time, InVision announced its quarterly numbers and filed its quarterly report with the SEC. According to the complaint, those re-

ports, along with subsequent press releases announcing the merger with GE, contained materially false and misleading information because they failed to disclose that (1) InVision's foreign distributors were engaging in possibly illegal activities; (2) InVision's foreign distributors had violated the FCPA by making improper payments in connection with foreign sales activities; (3) InVision improperly accounted for the funds used in these payments; and (4) InVision's improper accounting regarding these payments allowed the GE merger to take place.

The court held that the complaint's recitation of neutral facts failed to allege that defendants knew of specific FCPA violations. Therefore, construing the allegations as actually pleading falsity necessitated interpreting the defendants' announcements "well beyond their plain meaning." *In re InVision Tech., Inc.*, C04-03181 (N.D. Cal., 1/23/06).

### No Private Right of Action Under ICA Provisions

In *Forsythe v. Sun Life Financial, Inc.*, a federal district court found that there was no private right of action under Sections 34(b), 36(a) and 48(a) of the Investment Company Act of 1940 (ICA). Plaintiffs' 34(b) claims alleged false and misleading statements in various public filings, including annual reports, semi-annual reports, and registration statements. Plaintiffs also alleged breaches of fiduciary duties under Section 36(a) as well as "control person" liability under 48(a) for ICA violations under Sections 34(b), 36(a) and 36(b).

In finding that there was no private right of action, the court first noted that there was no express private right of action enumerated in the statutory provisions. Next, in finding that there was no implied private right of action

in the statutory provisions, the court found that the requisite “rights-creating language” was not present. In particular, the statutes at issue focused on the regulated persons “rather than a class of persons benefited by the regulation.” Moreover, in finding that there was no private right of action, the court noted that general responsibility for enforcement of the ICA statutory scheme rested with the SEC, not private individuals. *Forsythe v. Sun Life Financial, Inc.*, 04-10584-GAO (D. Mass., 1/19/06).

### Court Infers Scierer From GAAP Violations and SOX Certifications

In rejecting a motion to dismiss, the U.S. District Court (D. Ore.) found that corporate officer defendants’ Sarbanes-Oxley certifications provided evidence of scierer in a §10(b) securities action. The court concluded that the certifications, in combination with other evidence, including defendants’ statements that directly contradicted portions of their Sarbanes-Oxley certifications, created a strong inference of actual knowledge or deliberate recklessness. The court wrote that the Sarbanes-Oxley certifications should not be disregarded as “boilerplate” statements and that legal requirements to make the certifications do not diminish potential liability for false certifications. The court went on to hold that a strong inference of scierer was created by plaintiffs’ pleading significant violations of GAAP, taken in conjunction with defendants’ knowledge of and access to corporate financial information, the contradicted Sarbanes-Oxley certifications, and other evidence of motive.

The court denied defendants’ motion to dismiss the complaint, except as to one defendant who was found lacking sufficient ability to direct company policies. Two months after the deci-

sion, defendant company, Lattice Semiconductor Corp., announced an agreement in principle with plaintiffs. The agreement contemplates that plaintiffs will receive \$3,500,000 in exchange for releases of the company and individual defendants. *In re Lattice Semiconductor Corp. Securities Litigation*, CV04-1255-AA (D. Ore., 1/03/06); <http://www.latticesemi.com> (3/16/06).

### Former Executive’s SOX Whistleblowing Claim Survives Motion to Dismiss

A federal court has allowed a former investment management firm executive to pursue his claim that he was wrongfully terminated in violation of the Sarbanes-Oxley Act after complaining in an e-mail that he was not allowed to communicate firm-wide that the New York office was liquidating its WorldCom holdings. The court found that while plaintiff’s e-mail does not expressly state that defendants were engaged in illegal conduct, the e-mail satisfies the pleading requirement for a SOX whistleblowing claim because the firm’s New York office clients benefited from the decision to sell WorldCom bonds, whereas other clients suffered losses that might have avoided had the decision to sell been communicated.

The court dismissed two other SOX whistleblower claims, however, because they merely alleged that plaintiff’s investment advice was not followed. The court also dismissed an ERISA whistleblower claim because plaintiff never gave “information in connection with an ‘inquiry,’” and an ERISA breach of fiduciary duty claim because plaintiff failed to allege that defendants were fiduciaries. Finally, plaintiff’s securities fraud claims were dismissed because he lacked standing as a purchaser or seller of securities, since he received

his securities as part of an incentive plan. *Fraser v. Fiduciary Trust Com. Int’l*, 2006 WL 399468 (S.D.N.Y., 2/15/06).

### SEC Confidentiality Agreement Protected Opinion Work Product, But Not Other Privileges

QWEST did not waive attorney opinion work product protections by sharing privileged documents with the SEC pursuant to a confidentiality agreement during an SEC investigation. QWEST did, however, waive attorney-client privilege and attorney fact work product protections. After the SEC investigation, class members claimed that QWEST had waived attorney-client and work product protections by disclosing its privileged communications to the SEC. A magistrate judge held that QWEST waived the privilege and ordered QWEST to produce the documents. The district judge agreed. QWEST asked the district court to reconsider that ruling, based in part on a later privilege ruling by the same district judge. The court concluded, without any detailed recitation of facts or law, that attorney opinion work product was protected by the confidentiality agreement, but that the agreement did not protect attorney-client communications or attorney fact work product. *In re QWEST Communications International, Inc. Securities Litigation*, 2006 WL 278279 (D. Colo., 2/2/06).

### Fifth Circuit Rejects Group Pleading Standard in Securities Fraud Case

The Fifth Circuit has rejected “group pleading” against multiple defendants in *Financial Acquisition Partners LP v. Blackwell*. The individual defendants in *Blackwell* were former officers and directors of Amresco, Inc. who were accused of fraud in

connection with Amresco's financial statements and representations made to investors. The Fifth Circuit upheld the dismissal of plaintiffs' securities fraud claims because the complaint failed to identify specific facts establishing causes of action against each specific defendant. The court held that plaintiffs "must distinguish between defendants and allege the role of each. Corporate officers are not liable for acts solely because they are officers." *Financial Acquisition Partners, LP v. Blackwell*, No. 04-11300 (5th Cir., 2/14/06).

### Insider Trading Charges Dismissed Against Fidelity National Official

A federal district court has dismissed insider trading charges filed by the SEC against J. Thomas Talbot, a former director of Fidelity National Financial Inc. The SEC alleged that, in April 2003, Talbot bought stock in LendingTree, Inc. after learning at a meeting of the Fidelity Board of Directors that LendingTree would be acquired by another company at a significant premium over its then-current trading price. At the time of the meeting, Fidelity owned 12% of LendingTree. Two days after the meeting, Talbot purchased 5,000 shares of LendingTree stock, and 5,000 more shares shortly thereafter. A few weeks later, on the day that LendingTree's acquisition was announced, Talbot sold his stock for a \$67,000 profit. The SEC alleged that Talbot's conduct breached his fiduciary duty to Fidelity and violated § 10(b) of the 1934 Securities Act. After cross-motions for summary judgment, the court ruled in Talbot's favor. It held that Talbot owed no duty to Lending Tree and dismissed the complaint. *SEC v. Talbot*, 2:04-cv-04556 MMM (PLA) (S.D. Cal., 2/14/06).

### SEC Rewards NetEase Cooperation with an Injunction

On February 27th, 2006, the SEC settled its accounting fraud charges against internet company, NetEase.com. According to the complaint, NetEase employees circumvented internal accounting controls and falsified books, overstating NetEase's revenue by \$4.3 million. Specifically, NetEase employees (1) improperly shifted revenue into earlier quarters; (2) recorded fictitious revenue from nonexistent or unperformed advertising contracts; and (3) recognized fictitious revenue from similarly nonexistent or unperformed barter arrangements. The SEC, noting NetEase's cooperation, accepted NetEase's offer to settle whereby NetEase agreed to be permanently enjoined from violating federal securities laws' internal control provisions.

In related matters, the SEC also settled with NetEase's former CFO, Helen Haiwen He, and former Chief Accountant and Acting CFO, Geoffrey Jie Wei. Haiwen He had allowed NetEase to record the fictitious revenue from the nonexistent or unperformed contracts and bartering arrangements. Wei, despite warning a NetEase officer about the illegality of the company's revenue recognition practices, nevertheless failed to stop NetEase employees from altering contracts to shift revenue into earlier quarters. *SEC v. NetEase.Com, Inc.*, Case No. 06-CV-342 (D.D.C. 2006); *In re He*, SEC Admin. Proc. No. 3-12219, 2/27/06; *In re Wei*, SEC Admin. Proc. No. 3-12218, 2/27/06.

### Negligence Claims Survive Third Circuit Scrutiny in Securities Action

The Third Circuit was recently confronted in *In re Suprema Specialties* with the issue of "whether the District Court properly applied the 'sounds in fraud' doctrine in dismissing the claims asserted under Section 11 and Section 12(a)(2) despite plaintiffs' efforts to ground their Securities Act claims in negligence and to plead them separately in the complaints from their fraud-based claims." The Third Circuit held that the Securities Act claims did not sound in fraud since ordinary negligence was expressly plead in connection with those claims. "In such a case, the fraud allegations cannot be said to 'contaminate' the Section 11 and Section 12(a)(2) claims if the allegations are pled separately." Thus, the court reversed dismissal of Securities Act claims alleging former officers were negligent in failing to recognize material misrepresentations and omissions in the company's registration statement. The court also reversed dismissal of Section 10(b) claims against Suprema's auditor that alleged it had recklessly failed to follow GASS and to heed "red flags."

However, the court affirmed dismissal of Securities Act claims, brought against outside directors and members of the auditing committee under Sections 10(b) and 18, alleging they had access to unspecified records and a duty to review them. The court also affirmed dismissal of claims brought against underwriters of Suprema's public offerings, alleging they had negligently breached a duty to investigate and that they profited from their services. *In re Suprema Specialties, Inc.*, 438 F.3d 256 (3rd Cir. 2006).

## Delaware Court Invokes Public Policy to Overturn Contractual Limitation on Liability Provision.

The Delaware Chancery Court issued an opinion rejecting a contractual limitation of liability provision in light of allegations that the seller of a company made intentional, fraudulent representations in connection with the sale of a company. In *Abry Partners V, L.P. v. F&W Acquisition LLC*, Abry Partners, a private equity firm, purchased a publishing company from another private equity firm, Providence Equity Partners. In the purchase documents, Providence represented that the financial records of the publishing company were accurate. The parties agreed that Abry's remedy for breach of this representation would be limited to damages capped at \$20 million from an indemnification fund. After acquisition, Abry discovered extensive accounting and financial problems with the publishing company and brought suit seeking rescission of the purchase agreement. The court found that if Abry could show that Providence made intentional misrepresentations regarding the publishing company's finances in connection with the purchase agreement, then the limitation on liability provision, capping recovery at \$20 million, would be void as against public policy. *Abry Partners, L.P. v. F&W Acquisition LLC*, Case No. C.A. 1756-N (Del. Ch. Ct., 12/14/06).

## Prosecutor Uses "Office Abuzz" Theory to Impeach X-Box Insider

The Ninth Circuit approved of a prosecutor's use of the "office abuzz" theory to impeach the testimony of an employee of an X-Box

contract award winner, Nvidia Corp., despite the fact that the theory was not charged in the original indictment. The conviction stemmed from allegations that Atul Bhagat, an engineer at Nvidia, made purchases of Nvidia stock with knowledge that it had obtained a lucrative X-Box contract with Microsoft. Just days after the public announcement, Bhagat sold his newly acquired stock at a significant profit.

The original indictment claimed that Bhagat learned of the X-Box contract through reading an official company announcement, upon which company officials later imposed a trading blackout. Evidence showed that Bhagat purchased the stock twenty minutes after the company announcement, but Bhagat claimed not to have seen the announcement until after making the purchase. Prosecutors used the theory that the office was "abuzz" with information about the X-Box contract to rebut his testimony that he did not know about the contract until after he made the purchase. Bhagat argued that this was improper because the "office abuzz" theory was not included in the indictment. Both the trial court and the Ninth Circuit permitted this use of the theory for impeachment purposes. *U.S. v. Bhagat*, 436 F.3d 1140 (9th Cir. 2006).

## Ninth Circuit Dismisses Individual RICO Claim

On March 3, 2006, the Ninth Circuit held that an individual securities fraud claim cannot serve as a civil RICO predicate act. Plaintiffs had sued Wells Fargo and others alleging causes of action under RICO and state law, claiming that they had defrauded plaintiffs of millions of dollars through a Ponzi scheme. The trial court held, based on 18 U.S.C. §1964(c), that it did not have jurisdiction to consider the RICO claim, and declined to exercise jurisdiction over the supplemental state law claims. The Ninth Circuit affirmed,

finding that the preclusive effect of §1964(c) applies to claims asserted individually as well as to claims presented in a class action. In doing so, the court rejected plaintiffs' argument that Congress had intended §1964(c) to apply only as a bar to class actions. The court found nothing in the legislative history to indicate that Congress intended to limit §1964(c) to class actions. The court further held that, even if it were to assume that the legislative history indicated an intention to limit §1964(c) to class actions, such history could not trump the unambiguous text of the statute, which clearly bars any RICO action alleging securities fraud, whether or not such action is a class action. *Powers v. Wells Fargo*, 2006 WL 508746 (9th Cir. 2006).

## No Requirement to Identify Confidential Witness in Discovery

Ruling on a motion by defendant Cigna Corp. in a securities fraud litigation case, the U.S. District Court for the Eastern District of Pennsylvania ruled that the plaintiff should not be compelled to disclose the specific identity of a confidential informant who assisted in plaintiff's investigation and preparation of the complaint. The court held that fairness dictates that the identity of a person with relevant information should be disclosed in discovery, but without disclosing that the person is a confidential informant. The court reasoned that at the discovery stage, "requiring specific identification of confidential sources from among the universe of individuals with relevant knowledge in a securities fraud case would chill informants from providing critical information which may end up in the public eye." *In re Cigna Corp. Securities Litigation*, slip op., 2006 WL 263631 (E.D.Pa., 1/31/06).

## The Corporate Fraud Defense Report™

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