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Wiretapping Assists Government in Developing Evidence of Insider Trading

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On October 26, 2011, the United States Attorney for the Southern District of New York indicted Rajat K. Gupta, a member of the Boards of Directors of The Goldman Sachs Group, Inc. (“Goldman Sachs”) and the Procter & Gamble Company (“P&G”), with five counts of securities fraud and one count of conspiracy to commit securities fraud. Gupta, like several recent defendants in insider trading cases, was caught on tape sharing alleged confidential business and financial information.

The charges against Gupta stem from his interactions with Raj Rajaratnam, a hedge fund manager sentenced last month to 11 years in prison for trading on illegal stock tips. According to the six-count indictment, from 2008 through January 2009, Gupta disclosed to Rajaratnam inside information that Gupta had learned in his capacity as a member of the Boards of Directors of Goldman Sachs and P&G with the understanding that Rajaratnam would use the inside information to purchase and sell securities. The indictment includes information on three phone calls Gupta made to Rajaratnam in which Gupta shared nonpublic information. Each of these phone calls was recorded by the FBI.

WHEN AND HOW THE GOVERNMENT CAN RECORD PHONE CALLS

Title III of the Omnibus Crime Control and Safe Streets Act of 1968 (the “Wiretap Act”) establishes procedures for obtaining judicial orders to authorize wiretapping by government officials. 18 U.S.C. § 2518. A federal district court judge may issue an order authorizing interception of communications for up to 30 days upon a showing of probable cause that the interception will reveal evidence that “an individual is committing, had committed, or is about to commit a particular offense.” 18 U.S.C. § 2518.

Until recently, the use of wiretap evidence was limited primarily to drug cartel, alien smuggling and organized crime cases. The Wiretap Act specifically enumerates crimes for which wiretap evidence may be used. 18 U.S.C. § 2516. While the statute enumerates several fraud related crimes under Title 18 (the general crimes Title), it does not include commodities or securities fraud, or insider trading under Title 15. Recent rulings suggest, however, that reliance on wiretap evidence may be allowed in any case in which the wiretap was authorized in the investigation of an enumerated crime, even if that crime is not itself prosecuted. This broader interpretation of the Wiretap Act has changed the face of insider trading cases by permitting the government to obtain stronger evidence. Without the use of wiretap evidence, the government most often relies on circumstantial evidence, usually pointing to telephone calls, emails or meetings that occurred around the time of a significant corporate development and subsequent suspicious trading activity. Circumstantial evidence of this type allows a defendant to create reasonable doubt about the content of the allegedly illegal communications because the actual substance of the communications is rarely available. As the trials of Rajaratnam and former Galleon Group trader Zvi Goffer demonstrated, real-time recordings of phone calls are irrefutable evidence to juries and are nearly impossible for a defendant to overcome.

The face of financial crimes prosecutions has been dramatically altered by the introduction of wiretap evidence into such cases. In the view of the U.S. Attorney for the Southern District of New York, "Today, tomorrow, next week, the week after, privileged Wall Street insiders who are considering breaking the law will have to ask themselves one important question: Is law enforcement listening?" Individuals in all highly regulated industries should take note. The government has demonstrated its appetite to tape wires for non-conventional crimes, and may well extend the application of the Title III statute even further. In this new environment, it is more important than ever to train employees on rules governing nonpublic information and permissible competition tactics.

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