

White Collar Defense and Investigations

Second Circuit Overturns Fraud Conviction of Former Jefferies Bond Trader Jesse Litvak

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On December 8, the U.S. Court of Appeals for the Second Circuit issued an opinion reversing the conviction of former Jefferies & Co. managing director Jesse Litvak for fraud against the U.S. Treasury Department's Troubled Asset Relief Program ("TARP") and making false statements, as well as vacating Litvak's conviction on ten counts of securities fraud and remanding the case for a new trial.¹ Significantly, the Second Circuit's decision in *Litvak* preserves the ability of defendants to present key evidence to juries regarding the materiality of statements to sophisticated investors, which in light of the Department of Justice's increased emphasis on the prosecution of individuals, could prove critical.

The Case Below

Litvak, a former bond trader at Jefferies, was prosecuted by the U.S. Attorney's Office for the District of Connecticut in connection with an alleged scheme to covertly reap excess profit for Jefferies in the course of trading residential mortgage-backed securities ("RMBS"). Specifically, the government alleged that Litvak made three categories of misrepresentations to parties with whom he was transacting: (1) misrepresentations to purchasing counterparties as to the costs to Jefferies of acquiring certain RMBS; (2) misrepresentations to selling counterparties as to the price at which Jefferies had negotiated to resell certain RMBS; and (3) misrepresentations to purchasing counterparties that Jefferies was functioning as an intermediary between the purchasing counterparty and a third-party seller, where Jefferies actually owned the RMBS and no third-party seller existed. Significantly, some of the counterparties to whom Litvak made the alleged misrepresentations were Public-Private Investment Funds ("PPIFs")—partnerships between the U.S. Department of the Treasury ("Treasury Department") and private investors established through TARP to purchase "troubled assets" such as RMBS.

Litvak was convicted in March 2014 after a jury trial in federal court of ten counts of securities fraud, one count of TARP fraud, and four counts of making false statements to the federal government. He was sentenced to two years in prison and a \$1.75 million fine, but was released pending appeal.

The Second Circuit Decision

In an 84-page opinion written by Senior Circuit Judge Chester J. Straub,² the Second Circuit reversed Litvak's convictions for fraud against TARP and making false statements, and vacated Litvak's convictions for securities fraud.

TARP Fraud and False Statements

With respect to the TARP fraud and false statements convictions, on appeal Litvak argued that the evidence at trial was insufficient for a rational jury to conclude that his statements were material to the relevant decisionmaker, the Treasury Department.

“[A] statement is material if it has a natural tendency to influence, or be capable of influencing, *the decision of the decisionmaking body to which it was addressed.*”³ Applying this standard, the Second Circuit Court concluded that while Litvak’s misstatements may have been *relevant* to the Treasury Department and may even have negatively impacted PPIF returns, the government had not presented sufficient evidence for a rational jury to conclude that Litvak’s misstatements were reasonably capable of influencing a decision of the Treasury Department. To the contrary, the Second Circuit held, the evidence at trial showed: (1) the Treasury Department’s discretion to make investment decisions was constrained by its status as a limited partner in the PPIFs; (2) the PPIF fund managers were given complete discretion over the purchase and sale of assets for the PPIFs; and (3) the Treasury Department retained no authority to tell the PPIF fund managers which RMBS to purchase or at what price to transact. Given that the Treasury Department had no ability to make a decision with respect to the transactions at issue, the Second Circuit held that the government had not identified a Treasury Department decision capable of being influenced by Litvak’s alleged misrepresentations, mandating reversal of Litvak’s conviction on the TARP fraud and false statements charges.

Securities Fraud

With respect to the securities fraud convictions, Litvak argued on appeal that (1) the evidence at trial was insufficient for a rational jury to conclude that his statements were material; (2) there was insufficient evidence of his fraudulent intent, as the government had not shown “intent to harm,” and the district court failed to properly instruct the jury with respect to “intent to harm”; and (3) the district court had improperly excluded the majority of the expert testimony Litvak intended to present at trial.

The Second Circuit rejected Litvak’s argument that his alleged misrepresentations were immaterial as a matter of law, and found that there was sufficient evidence at trial for a rational jury to find Litvak’s alleged misrepresentations material. The Second Circuit similarly rejected Litvak’s contention that the government was required to adduce evidence of “intent to harm,” as opposed to intent to deceive, manipulate, or defraud; accordingly, the Second Circuit found no error in the district court’s refusal to provide a jury instruction on “intent to harm.”

The Second Circuit, however, agreed with Litvak’s contention that the district court had erroneously excluded on relevance grounds the testimony of two proffered experts concerning industry practice and whether Litvak’s statements would have been material to a reasonable investor in the RMBS market. The Court found that the proffered expert testimony would have been probative of materiality, the central and hotly-contested issue in the case, and could have educated the jury about the complex and highly-specialized field of RMBS trading. The panel noted that with testimony about the valuation procedures used by RMBS traders before it, a jury could reasonably have found that misrepresentations by a dealer like Litvak as to the price paid for certain RMBS would have been immaterial to a party that relies on its own sophisticated valuation methods and computer models rather than on a market price or the price of prior trades.

Because the Court found that the exclusion of the proffered testimony was not harmless error, the Second Circuit vacated Litvak’s conviction on the securities fraud charges and remanded to the district court for a new trial on those charges only.

Preserving Future Defendants’ Ability to Present Critical Evidence

The Second Circuit’s decision in *Litvak* will have an immediate impact for prosecutors in the District of Connecticut, as it will affect other cases that the U.S. Attorney’s Office has pursued against traders on theories of liability similar to the theory of liability in *Litvak*.⁴

More broadly, the Second Circuit’s decision in *Litvak* may be a boon for defendants charged with securities fraud. The question of materiality at the heart of such cases is an objective question, which looks at the significance of an omission or misrepresentation to a *reasonable investor*. Without the testimony of his proffered experts, Litvak had little opportunity at trial to present a defense of non-materiality; such testimony would have been critical to the jury’s understanding of how a sophisticated, reasonable investor would value RMBS and to the jury’s determination as to whether a reasonable investor in the RMBS market would have found Litvak’s statements material.

In light of the Department of Justice's move to increasingly target individuals involved in corporate crimes, a policy announced in the September memorandum authored by Deputy Attorney General Sally Quillian Yates,⁵ the question of the materiality of a trader's statements in increasingly complex markets will become an even more common and crucial question for juries to decide. In finding such evidence to be relevant and the exclusion of it to be non-harmless error, the Court in *Litvak* has preserved the ability of future defendants to present critical evidence to juries regarding the valuation processes in their complex markets and the materiality of traders' statements to sophisticated investors.

1 *United States v. Jesse C. Litvak*, No. 14-2902-cr, slip op. (2d Cir. Dec. 8, 2015).

2 The panel consisted of Judge Straub and Judges Susan L. Carney and Barrington D. Parker, Jr.

3 *Id.* at 21 (quoting *United States v. Coplan*, 703 F.3d 46, 78 (2d Cir. 2012), *cert. denied*, 134 S. Ct. 71 (2013)) (emphasis in original).

4 For example, the U.S. Attorney's Office in Connecticut charged three former traders from Nomura Securities International, Inc. with securities fraud on a theory of liability similar to that alleged in *Litvak*. See *United States v. Ross Shapiro, et al.*, 3:15-cr-00155 (RNC) (D. Conn.).

5 See U.S. Department of Justice Memorandum from Sally Quillian Yates (Deputy Attorney General), *Individual Accountability for Corporate Wrongdoing* (Sept. 9, 2015), <http://www.justice.gov/dag/file/769036/download>.

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