

White-Collar Law

Limiting Evidence of Prior Bad Acts Under Rule 404(b)

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Everyone knows that bad people do bad things. For this reason, evidence of prior wrongdoing by a criminal defendant is extremely powerful and goes a long way toward conviction. Such evidence is especially damaging in white-collar cases, where the charged crime is typically not violent and the defendant is educated, successful and looks good in a suit. Federal Rule of Evidence 404(b) governs the admission of evidence of "other crimes, wrongs, or acts." The rule is sufficiently flexible to allow aggressive litigants to offer—and for courts to admit—highly prejudicial evidence. This article discusses Rule 404(b), highlights a recent U.S. Court of Appeals for the Third Circuit decision that meaningfully limits the use of prior-acts evidence and discusses a few recent examples where aggressive prosecutors in white-collar cases attempted to push the limits of Rule 404(b).

Rule 404(b) prohibits evidence of "other crimes, wrongs, or acts ... to prove the character of a person in order to show action in conformity therewith." However, this evidence "may be admissible for other purposes, such as proof of motive, opportunity, intent, preparation, plan, knowledge, identity, or absence of mistake or accident." In determining the admissibility of evidence of prior bad acts, a district court must analyze whether the evidence: (1) has a proper evidentiary purpose; (2) is relevant; (3) is of such probative value as to outweigh the prejudice to the defendant; and (4) is accompanied by a proper limiting instruction. The Third Circuit, in *United States v. Smith*, No. 12-1516 (decided Aug. 6, 2013), added an important qualification on how district courts assess the proposed "proper purpose" for the evidence. Noting that a skilled lawyer can always "conjure up" a proper purpose for the evidence, the Third Circuit required that the proponent "must also establish a chain of inferences no link of which is based on a propensity inference," in other words, the purpose of the evidence must "be established without an inference that the party against whom it is admitted acted in conformity with whatever the evidence of the prior act says about his or her character." The facts in *Smith* illustrate how this important holding limits admittance of prior bad-act evidence.

Durrell Smith was charged with threatening federal officers with a gun. The agents were in an unmarked car, surveilling a corner as part of a drug investigation. When the agents' car arrived at the corner, most people scattered, but Smith stood his ground, stared at the

vehicle, disappeared momentarily, then reappeared walking toward the agents' car while carrying a handgun. Smith contended that he was concerned for his safety and retrieved the gun for self-defense. At trial, the government sought to offer testimony that two years earlier Smith had been observed dealing drugs on the same corner. Smith objected, arguing that prior drug-dealing could only be relevant to the charges if the jury inferred that because Smith was a drug dealer in the past he must have been dealing drugs on the day in question. The district court overruled the objection and Smith was convicted and sentenced to 30 years in prison.

On appeal, the Third Circuit reversed the conviction, holding that the evidence of the 2008 drug sale only spoke to Smith's motives in 2010 if the jury "(a) assume[d] something about Smith's character based on the 2008 evidence (that he was then a drug dealer), and (b) infer [red] that Smith acted in conformity with that character in 2010 by dealing drugs and therefore had a motive to defend his turf." The government claimed that the evidence was relevant to Smith's motive and to rebut his contention that he possessed the gun in self-defense. The Third Circuit agreed that evidence that Smith was acting to protect his "turf" would be relevant to his motive. However, in order for the prior drug sales to be relevant to establishing that motive, the jury would have to make the inappropriate inference that Smith was dealing drugs at the time of his arrest, in accordance with his prior drug dealing. Thus, since one link of the "chain of logical inferences" necessary to render the evidence relevant included an inference that Smith was dealing drugs at the time of arrest, the evidence could not be admitted under Rule 404(b).

Two recent white-collar prosecutions featured attempts by prosecutors to stretch 404(b) to admit highly prejudicial evidence of prior bad acts. Mathew Martoma has the dubious distinction of being convicted in the largest insider-trading case in history. His employer made profit and avoided losses of more than \$276 million by trading in two pharmaceutical companies after Martoma received inside information—including a confidential report that was allegedly sent to him by email—about an unsuccessful trial of an Alzheimer's drug. Martoma denied wrongdoing and, after a nearly month-long trial, was convicted of conspiracy and two counts of securities fraud. He was sentenced to nine years in prison.

Prior to trial, the government launched a bombshell: It sought to introduce evidence that Martoma had been expelled from Harvard Law School after he had created a false transcript in which he changed several grades (including his grade in criminal law) from a B to an A, and submitted the false transcript to numerous federal judges as part of the application process for clerkship positions. The government also sought to introduce evidence that, as part of the subsequent Harvard disciplinary process, Martoma falsified emails and created a counterfeit report from a computer forensics firm in an attempt to cover his prior wrongdoing and that, after being expelled from Harvard, Martoma (who had been known as Ajai Mathew Thomas) changed his name, which facilitated his subsequent admission to the Stanford Graduate School of Business (he omitted the expulsion from his application).

For the prosecutor, this was killer evidence. The problem was that it had nothing to do with the charged crime and everything to do with showing the jury that Martoma is a bad guy who would not hesitate to trade on inside information. Undeterred, the government "conjured up" a permissible 404(b) use, to demonstrate that Martoma had the technical competence to alter computer files and to rebut Martoma's expected argument that he never received the emailed report. Martoma's lawyers strenuously fought this proposed use of Rule 404(b) and the district court ultimately disallowed use of the evidence for that purpose, leaving the

ultimate issue open to see whether Martoma "opened the door" at trial for admission of the evidence.

In another high-visibility case, Rengan Rajaratnam—the brother of Raj Rajaratnam, who had already been convicted of insider trading—was charged with illegally trading in two companies. The government sought to offer into evidence testimony concerning Rengan Rajaratnam's trading in a third company, arguing that these "other acts" were admissible to prove motive, opportunity or intent to trade on inside information. The district court did not allow the evidence, however, because it held that the government could not point to any evidence that Rengan Rajaratnam (as opposed to his brother Raj Rajaratnam) had any inside information at the time he traded in the third company's shares. Evidence of prior, well-timed trades would only be relevant if the jury inferred that those prior trades resulted from inside information and that Rengan Rajaratnam acted consistently in the instant case by trading on inside information. Such inferences, however, are inappropriate under Rule 404(b).

White-collar practitioners should keep a copy of the *Smith* opinion handy; it will help them undercut permissible Rule 404(b) purposes that wily prosecutors "conjure up" and to keep the jury from hearing extremely damaging evidence.

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