Discord Stock Case Toss Means Little For Fraud Defendants

By **William Johnston** (April 12, 2024)

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On March 20, the U.S. District Court for the Southern District of Texas dismissed an indictment that charged eight individuals with perpetrating a $114 million "pump and dump" scheme through social media platforms including X, formerly known as Twitter, and Discord.[1]

The indictment in U.S. v. Constantinescu alleged all the hallmarks of a traditional pump-and-dump scheme: false information about certain stocks blasted out to investors; inflated prices for those stocks as investors reacted to the false information; and then secret sales of those stocks by the defendants to the unsuspecting investors.[2] Such securities fraud schemes have been targeted for criminal prosecution for decades.

U.S. District Judge Andrew S. Hanen, in granting the defendants' motion to dismiss, ruled that the indictment alleged a scheme to defraud investors of the right to control their property — a right no longer cognizable by the fraud statutes following the U.S. Supreme Court's decision last year in Ciminelli v. U.S.[3]

Judge Hanen accepted the view that the false information allegedly spread by the defendants at most deprived investors of information needed to buy and sell stock; the investors were not defrauded of their property.[4]

Does the Constantinescu decision offer any lessons on how defendants can use Ciminelli to their advantage?

At first blush, Judge Hanen's reliance on Ciminelli may seem odd. The facts of Ciminelli had nothing to do with stock market schemes. There, Louis Ciminelli, a construction executive, was charged with wire fraud for making payments to rig New York state-funded construction contracts that were part of then-Gov. Andrew Cuomo's "Buffalo Billion" initiative.

At trial, the government's theory of prosecution was that the defendant had deprived Fort Schuyler Management Corp., the company administering the contracts, of "potentially valuable economic information that it would consider valuable in deciding how to use its assets."[5]

In other words, the victim company would have wanted to know that the defendant had paid bribes to a member of its board of directors before awarding the construction contracts to the defendant.

The Supreme Court held that the right to such information for controlling one's assets was not a "traditional property interest" protected by the wire fraud statute.[6]

This broad holding has made the Ciminelli decision an intriguing new arrow in the quivers of defendants around the country seeking to attack a variety of fraud theories.[7] Could Ciminelli apply beyond bid-rigging to securities fraud? Are pump-and-dumps still prosecutable under the federal fraud statutes?

The answers to these questions will be mostly disappointing to defendants.

In theory, Ciminelli would apply to securities fraud cases. Nothing in Ciminelli limits its holding to the context of bid-rigging. Prior to Ciminelli, federal prosecutors — particularly within the U.S. Court of Appeals for Second Circuit — had relied on the right-to-control theory in a variety of fraud prosecutions.[8]

A common theme in right-to-control prosecutions was that victims may not have suffered any financial loss, but, according to the government, were nevertheless harmed because they were deprived of the information they needed to make decisions about what to do with their property.

A securities fraud indictment that did not allege the intent to actually deprive the victim of their property or money might be susceptible to a Ciminelli challenge.

Yet securities fraud indictments, including for pump-and-dump schemes, typically do contain such allegations. Indeed, it's hard to imagine a pump-and-dump case where the object of the fraud is not to obtain investors' money. That is the whole point: to cause investors to buy securities at artificially high prices, while simultaneously and secretly selling one's own shares before the inevitable collapse of the stock price.

And the government typically intends to offer evidence at trial that the object of the scheme was to induce investors to part with their money through the purchase of securities based on materially false information.

The defendants in Constantinescu reinterpreted these standard allegations as embodying a right-to-control theory. They contended that investors have only been deprived of information necessary to make discretionary economic decisions, and that investors otherwise received the benefit of their bargain — the purchase of securities.[9]

One could attempt this reframing in nearly any fraud case. For example, one could say that a bank, induced by a borrower's lies to lend money, was not in fact defrauded of a property interest; it was merely deprived of information it needed to make decisions about how to control its assets. Yet few courts would rule that such a quintessential fraud case was now outside the bounds of the federal fraud statutes.[10]

The U.S. District Court for the Southern District of New York rejected just such an argument last year in U.S. v. Tournant, the ongoing prosecution of a former Allianz Global Investors U.S. LLC portfolio manager for an alleged $6 billion securities fraud scheme.

The defendant there had moved to dismiss several counts of the indictment, including the main conspiracy count, on the grounds that the indictment alleged that "(1) investors and potential investors were deprived of information, and (2) the investors and potential investors would have done something different if they had this information."[11]

Chief U.S. District Judge Laura Taylor Swain held that "[u]nlike cases ... in which the alleged harm to victims was solely the deprivation of information that was valuable in making economic decisions, the Indictment here does not cast risk-related information as the property of which victims were defrauded."[12]

The misrepresentations highlighted by the defense as supposedly embodying the right-to-control theory were in fact merely part of the scheme "designed to attract and retain actual investments of assets."[13] In other words, the defendant had confused the manner and

means of the scheme for its object.

Other courts across the country have come to the same conclusion when presented with similar reframing arguments in the wake of Ciminelli.[14]

In this way, the Constantinescu decision is an outlier, and offers little assistance beyond the motion to dismiss stage. For Judge Hanen, the absence of specific allegations of an intent to deprive investors of their money was the Achilles heel of the Constantinescu indictment.

He wrote: "[T]he language of the Indictment indicates that losses to victims happened incidentally (i.e., 'at the expense of') rather than as the 'object of' the alleged scheme."[15]

The government filed a notice of appeal earlier this month. The government will likely challenge that distinction as being one without a difference.

Whether or not the U.S. Court of Appeals for the Fifth Circuit reverses Judge Hanen on appeal, the government has options — in this case and others. It could obtain a new indictment and add the specific allegations that Judge Hanen found missing. Or the government could bring charges under Title 15 securities fraud, where intent to harm is not a requirement of scienter, just an intent to deceive or manipulate.[16]

These various outcomes illustrate how the disappearance of the right-to-control theory is more of a semantic victory than a substantive one.

To be sure, post-Ciminelli, the government now has to ensure that its indictments charging wire fraud or securities fraud under Title 18 specifically allege that the object of the fraud is money or property, not information. But, in a securities or investment fraud case, which almost always involves money, that is not a difficult rule to follow.

The handful of cases that used to be charged under a right-to-control theory can be reframed as traditional money-property fraud. Indeed, in Ciminelli, the solicitor general tried to reframe the bid-rigging at the heart of that case as a fraud directed at obtaining contracts — which are traditional property interests — and not the information about those contracts.[17]

But because that theory was not presented to the jury, the court declined to affirm the convictions.[18] In the future, the government will present only money-property theories to the jury.[19]

Nevertheless, there may be opportunities at trial for savvy defense attorneys in borderline securities fraud cases, where the evidence is shaky on what the true object of the scheme was. In such cases, defense attorneys should seek a Ciminelli instruction — that information is not property, and the defendant must have intended to deprive investors of their money or property. Similar arguments should be raised after trial.

For example, in U.S. v. Nordlich, the Platinum Partners LP case in the U.S. District Court for the Eastern District of New York, the defense persuaded U.S. District Judge Brian M. Cogan to rely on Ciminelli to grant a judgment of acquittal on the wire fraud convictions because there was insufficient evidence that the victim bondholders were entitled to the proceeds the defendants had supposedly misappropriated, or that the defendants had "misled bondholders with the intent to deprive them of ... [sale] proceeds."[20]

In conclusion, Ciminelli and the Constantinescu decision pose little barrier to the type of

routine securities fraud prosecutions the government has long pursued. But defense attorneys would be wise to keep Ciminelli at hand, ready to be deployed in the right case.

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[1] United States v. Constantinescu et al., 4:22-cr-612, 2024 WL 1221579 (S.D. Tex. Mar. 20, 2024).

[2] Dkt. 1 at 2, Constantinescu, 4:22-cr-612 (Dec. 7, 2022).

[3] Constantinescu, 2024 WL 1221579 at *10-*11 (citing United States v. Ciminelli, 598 U.S. 306, 308 (2023)).

[4] Constantinescu, 2024 WL 1221579 at *10-*12.

[5] Ciminelli, 598 U.S. at 311.

[6] Ciminelli, 598 U.S. at 316.

[7] United States v. Ryan, Cr. No. 20-65, 2023 WL 4561627, at *4-*5 (E.D. La. July 17, 2023) (bank fraud); United States v. Jesenik, No. 3:20-cr-228-SI, 2023 WL 3455638, at *1-*2 (D. Or. May 15, 2023) (investment fraud); United States v. Venkata, Cr. No. 20-66, 2024 WL 86287, at *9-*11 (D.D.C. Jan. 3, 2024) (theft of government property).

[8] United States v. Johnson, 945 F.3d 606, 612 (2d Cir. 2019) (fraud in foreign exchange transaction); United States v. Binday, 804 F.3d 558, 567 (2d Cir. 2015) (insurance fraud); United States v. Carlo, 507 F.3d 799, 801-02 (2d Cir. 2007) (fraud in real estate financing).

[9] Constantinescu, 2024 WL 1221579 at *10-*12.

[10] See Shaw v. United States, 580 U.S. 63, 67 (2016) ("Many years ago Judge Learned Hand pointed out that '[a] man is none the less cheated out of his property, when he is induced to part with it by fraud,' even if 'he gets a quid pro quo of equal value.'") (quoting United States v. Rowe, 56 F.2d 747, 749 (2d Cir. 1932)).

[11] Dkt. 99 at 20-21, United States v. Tournant, 1:22-CR-00276 (S.D.N.Y. Sept. 19, 2023).

[12] United States v. Tournant, 1:22-CR-00276, 2023 WL 8649893, at *9 (S.D.N.Y. Dec. 13, 2023).

[13] Tourant, 2023 WL 8649893, at *9.

[14] See, e.g., United States v. Barbera, 21-CR-154 (JGK), 2023 WL 6066249, at *1-*2 (S.D.N.Y. Sept. 18, 2023); Jesenik, 2023 WL 3455638, at *2.

[15] Constantinescu, 2024 WL 1221579, at *10.

[16] United States v. Litvak, 808 F.3d 160, 178 (2d Cir. 2015); see also United States v. Nordlicht et al., 16-cr-00640, 2023 WL 4490615, at *2 (E.D.N.Y. July 12, 2023).

[17] Ciminelli, 598 U.S. at 315.

[18] Ciminelli, 598 U.S. at 316-17.

[19] See, e.g., United States v. Kousisis, 82 F.4th 230, 242 (3d Cir. 2023) (holding post-Ciminelli that the "privilege of contracting is a property right" cognizable by the fraud statutes) (quoting Adinolfi v. Hazlett, 242 Pa. 25, 27 (1913)); United States v. Tuchinsky, 2:19-cr-00394-RJS-DBP, 2023 WL 8188423, at *4 (D. Utah Nov. 27, 2023) (holding post-Ciminelli that "contracts and money" were both "traditional property interests falling within the ambit of § 1343").

[20] Nordlicht, 2023 WL 4490615, at *5.