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Questions Following Prevezon Money Laundering Settlement

By **Elizabeth Prewitt, Marc Weinstein and Jeffrey Goldberg**

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On May 12, 2017, on the eve of trial, the parties in United States v. Prevezon Holdings Ltd., et al., No. 13-cv-6326 (WHP) (S.D.N.Y.), settled a civil forfeiture action over Manhattan property allegedly obtained with proceeds of money laundering and other unlawful activities. This case resulted from a four-year investigation by the U.S. Department of Justice focusing on an alleged $230 million tax fraud scheme carried out in Russia by Russians and against the Russian government, but yet was settled in a U.S. court for $6 million.


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The facts as alleged, if true, shed light on a brazen fraud scheme, but the Russia-centric nature of the case raises the following questions: (1) What was the government's jurisdictional hook? (2) What was the specified unlawful activity underlying the alleged money laundering? and (3) What prompted the case to settle short of trial?

Background

The $230 million tax fraud scheme alleged by the government was uncovered by Sergei Magnitsky, a Russian lawyer who had the tables turned on him by the Russian government, as he was ultimately arrested in Russia on tax evasion charges and sentenced to prison where he later died. (Following his death, the U.S. Congress passed the Magnitsky Act, which imposes sanctions on Russians suspected of involvement in Magnitsky's death.)[1] The alleged scheme involved a Russian criminal organization stealing corporate identities of the Hermitage Fund, a foreign investment fund operating in Russia, and re-registering these companies so they could file sham lawsuits before the Russian courts. The conspirators pretended to represent the Hermitage companies and confessed to liability in court, which led to large money judgments that were then used to obtain tax refunds, through the alleged assistance of corrupt Russian tax officials. Ultimately, the conspirators fraudulently obtained $230 million from the Russian treasury in tax refunds.[2]

The DOJ first brought suit in September 2013 against Prevezon Holdings and related persons and entities, which allegedly purchased properties in New York partially funded from the Russian tax fraud proceeds. In response to various motions to dismiss, the government twice amended its complaint and

ultimately survived both the motions to dismiss and a summary judgment motion.

Basis for U.S. Jurisdiction Over Assets

The government pursued both civil forfeiture and civil money laundering claims pursuant to 18 U.S.C. §§ 981, 1956 and 1957 on the basis that the properties were purchased with proceeds of laundered money from the Russian tax scheme. Under 18 U.S.C. § 981(a)(1)(A), real property "involved in a transaction or attempted transaction in violation of" the money laundering statutes 18 U.S.C. §§ 1956 or 1957 "is subject to forfeiture to the United States." Sections 1956 and 1957 broadly penalize transactions where a person knowingly uses finances derived from unlawful activity. To prove a money laundering claim, the government must demonstrate "(1) that the defendant conducted a financial transaction; (2) that the transaction in fact involved the proceeds of a specified unlawful activity as defined in Section 1956(c)(7); and (3) that the defendant knew the property involved in the financial transaction represented the proceeds of some form of unlawful activity."[3]

The government's attempt to allege wire fraud, pursuant to 18 U.S.C. § 1343, as the specified unlawful activity ("SUA") in the case failed at the motion to dismiss stage. The court found that with the exception of a single wire transfer routed through the U.S., the fraud scheme was completely foreign, and that the wire fraud statute cannot be applied extraterritorially.[4] The court ultimately sustained the government's allegations of three additional SUAs — the interstate transportation of stolen property, fraud against a foreign bank, and the misappropriation, theft or embezzlement of public funds by or on behalf of a foreign official.[5] Interestingly, in rejecting the defendants' argument that a Russian court opinion established that the Russian officials were deceived by, rather than complicit in, the fraud and thus the government could not prove a theft on behalf of a foreign public official, the court held that, "at this stage, the court is not required to accept as credible a finding of a Russian court at odds with the alleged facts."

The government asserted jurisdiction over the assets pursuant to 28 U.S.C. § 1355. Section 1355(b)(1)(A) allows a forfeiture action to be brought in "the district court for the district in which any of the acts or omissions giving rise to the forfeiture occurred," and Section 1355(b)(1)(B) provides jurisdiction in the district where the property to be forfeited is located. Here, the government alleged that some of the tainted money passed through New York correspondent bank accounts, and that the defendants used a portion of the tainted funds to purchase the real estate holdings in New York that constitute most of the named assets in this case.[6] While the assets ultimately could not have been forfeited absent sufficient tracing back to the fraud proceeds, for jurisdictional purposes, the court found sufficient allegations of New York connections to preside over the matter, which is why the assets remained frozen from the date of the initial complaint until the settlement. This was not the case for all of the assets the government originally targeted, however. The government initially argued that Section 1355 conferred jurisdiction over certain assets located abroad. The defendants challenged that jurisdictional assertion, relying on the Second Circuit's decision in Deposit in any Accounts Maintained in Names of Meza or De Castro, 63 F.3d 148 (2d Cir. 1995), for the proposition that property located in a foreign country is outside the court's jurisdiction unless the property is in the actual or constructive control of the district court.[7] Notwithstanding more recent decisions to the contrary from other circuit courts, the government subsequently dropped its claims against the foreign property.

Background for Settlement

The settlement came on the heels of the court's May 10, 2017, denial of the defendants' motion for summary judgment. In its ruling, the court considered four forms of evidence the DOJ submitted to

demonstrate SUAs by the defendants (i.e., transporting stolen property, fraud against a foreign bank, bribery and money laundering), and that the accounts used were connected to the fraud (i.e., tracing).[8] The court's reasoning on these issues sheds light on how the government's claims survived:

- Transporting Stolen Property via Correspondent Banks: The court concluded that although 18 U.S.C. § 2314, a statute criminalizing the interstate transportation of property stolen or taken by fraud, did not apply expressly to extraterritorial conduct, it could reach the conduct in this case through the defendants' use of U.S. correspondent bank accounts. On four occasions, foreign companies transferred U.S. dollars between and among foreign bank accounts. The transfer of U.S. dollars necessarily requires that the transfers flow through a U.S. correspondent bank account, even though both the transferor and the transferee might have assumed that the transfer was entirely a foreign affair. The court found that the use of U.S. correspondent accounts to process the payments was "nontrivial" since "aside from carrying the currency across the U.S. border, the transfers could not have been completed without the services of the U.S. correspondent banks" in New York, and each transfer requires two separate transactions that cross the U.S. border — upon entering and exiting a U.S. account.[9] The court also noted that it did not matter that the wrongdoers had not purposefully used the U.S. banks since "it is hard to imagine what types of domestic conduct other than the use of correspondent banks could be alleged to displace the presumption against extraterritoriality in a statute addressing the transportation of stolen property."[10]

- Fraud Against a Foreign Bank, Bribery and Money Laundering. The court also concluded the government had offered sufficient evidence on three other forms of unlawful activity to proceed to trial. The court held that there was sufficient evidence of fraud against a foreign bank since members of the Russian criminal organization made false representations to HSBC concerning a number of matters, thereby defeating defendants' arguments that the alleged fraud was only perpetrated against the Russian Treasury. Next, although there was a factual dispute about the origins of supposed payments to the ex-husband of a Russian tax official and whether the fraud was on behalf of a public official, the court observed that was an issue for the jury to resolve. Finally, the court found that the government can identify successive money laundering claims based on other sufficiently alleged non-money laundering SUAs as additional SUAs.[11]

- Tracing Proceeds From the Russian Tax Fraud Scheme to the U.S. Accounts. The defendants also challenged the government's inability to trace the tainted funds clearly from the initial fraud through to the ultimate alleged end use. But the court held that circumstantial evidence can establish that the accounts used and transactions undertaken had certain indicia of concealment and thus the structure and characteristics of the transactions were sufficient for a jury to find that they were money laundering transactions traceable to the fraud, including: (1) the suspicious timing of transactions where accounts were opened at the same bank on the same day only months before the transfers at issue; (2) that two intermediary accounts had strikingly similar patterns of activity including receiving money from certain senders on the same date, dividing amounts, and wiring money to three other companies at the same bank; and (3) the use of coded language such as describing a payment for "electronics equipment" although the receiving company was registered to a residential apartment block in London.[12]

Although the government's victory at summary judgment was likely one factor that led to settlement, the court's May 9, 2017, order[13] ruling certain documents critical to the government's case admissible at trial could also have played a role. The documents at issue were from a Russian criminal case file consisting of evidence collected by Russian judicial and law enforcement authorities. The government initially requested the documents from the Russian government, but the request was denied. The government then collected records pertaining to the alleged money laundering from various foreign sources, most of which came from Nikolai Gorokhov, a Russian lawyer representing the Magnitsky family, who copied the documents in the course of his work in an unrelated action.[14] Gorokhov provided his dossier of documents to the U.S. embassy in London, but he personally became unavailable to the government when, on March 21, 2017, he allegedly fell from a window in his home and is in critical condition. Despite the unofficial manner in which the records were obtained and the unavailability of the witness who obtained them, the court ruled that the bank records were admissible at trial pursuant to the oft-disfavored residual hearsay exception. The court applied the exception due to the "highly unusual and atypical circumstances" of the case.[15]

Also highly unusual and atypical was the method the DOJ used to obtain the Russian criminal file. The DOJ's Criminal Resource Manual warns that foreign nations "may regard an effort by an American investigator or prosecutor to investigate a crime or gather evidence within its borders as a violation of sovereignty" and recommends that government attorneys "invoke the aid of the foreign sovereign in obtaining the evidence."[16] As an alternative to formal methods of gathering evidence abroad, the Criminal Resource Manual also includes guidelines for informal methods of obtaining information, including persuading authorities to open an investigation, making requests through diplomatic channels for public records, taking depositions of voluntary witnesses, making treaty-type requests, or making requests through Interpol for evidence.[17] None of the enumerated informal methods include obtaining evidence from a foreign national after the foreign national's government refused to provide the information requested, as happened here. The government's gamble, which ultimately paid off, appears to have saved its case, as the government acknowledged in open court that without the Gorokhov files, it would have been difficult if not impossible to show how the defendants benefited from the scheme.

While the evidentiary and other legal rulings might have hampered some of the trial defenses, there may have been additional reasons why the defendants settled short of trial. For instance, even though only a portion of the funds used to purchase the properties may have been traceable to crimes, an entire property can be subject to forfeiture where the commingling of funds was used to disguise an illegal scheme. In this case, although the government alleged that approximately $1.9 million in tainted funds was used to purchase the real estate properties, the purchase value of those properties the government sought to forfeit was in excess of $20 million. Furthermore, based on the settlement stipulation, it also appears that the government had caused the freezing of an overseas fund in the Netherlands, which it agreed to relinquish as part of the settlement, and agreed to inform a number of other countries, including Switzerland, Latvia, Lithuania, Estonia, Ukraine and Russia, that the matter had been resolved.[18]

Conclusion

The Prevezon matter stands out as an example of the extraordinary lengths the U.S. government can and will go to assert jurisdiction over matters involving foreign entities and persons who commit crimes abroad to the detriment of foreign countries and citizens. However, it is important to remember that the matter settled and therefore the government's case was neither tested at trial nor in the appellate

courts. While it is possible that the equally extraordinary facts of this case, which led to the enactment of the Magnitsky Act, make the case an outlier, it is consistent with the government's aggressive reach across the globe in other criminal, forfeiture and civil money laundering cases. It remains to be seen whether the current administration will support similarly aggressive prosecutions. At least for now, the DOJ has trumpeted its commitment to not "allow the U.S. financial system to be used to launder the proceeds of crimes committed anywhere — here in the U.S., in Russia, or anywhere else."[19]

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[1] Russia and Moldova Jackson-Vanik Repeal and Sergei Magnitsky Rule of Law Accountability Act of 2012, Pub. L. No. 112-208, 126 Stat. 1496 (2012).

[2] See Second Amended Complaint, Oct. 23, 2015, ECF No. 381.

[3] Tymoshenko v. Firtash, 57 F. Supp. 3d 311, 322 (S.D.N.Y. 2014).

[4] See United States. v. Prevezon Holdings Ltd. et al., 122 F.Supp.3d 57 (S.D.N.Y. 2015).

[5] See Second Amended Complaint, Oct. 23, 2015, ECF No. 381.

[6] See Id.

[7] See Memorandum of Law in Support of Defendant Kolevins' and Ferencoi's Motion to Dismiss, Dec. 20, 2013, ECF No. 45.

[8] United States v. Prevezon Holdings, Ltd., et al., No. 13-cv-6326 (WHP), slip op. (S.D.N.Y. May 10, 2017).

[9] Id. at 11.

[10] Id. at 12.

[11] Id. at 4-9, 12-14.

[12] Id. at 14-17.

[13] United States v. Prevezon Holdings, Ltd., et al., No. 13-cv-6326 (WHP), slip op. (S.D.N.Y. May 9, 2017).

[14] Id.

[15] Id. at 14.

[16] U.S. Dep't of Justice, Crim. Resource Manual § 267, https://www.justice.gov/usam/criminal-resource-manual-267-obtaining-evidence-abroad-general-considerations.

[17] See id. § 278, https://www.justice.gov/usam/criminal-resource-manual-278-informal-means.

[18] See Stipulation and Order, May 5, 2017, ECF No. 716.

[19] See Press Release, U.S. Dept' of Justice, Acting Manhattan U.S. Attorney Announces $5.9 Million Settlement of Civil Money Laundering and Forfeiture Claims Against Real Estate Corporations Alleged to have Laundered Proceeds of Russian Tax Fraud (May 12, 2017), https://www.justice.gov/usao-sdny/pr/acting-manhattan-us-attorney-announces-59-million-settlement-civil-money-laundering-and.
