Legal Backgrounder

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U.S. ANTI-MONEY LAUNDERING LAWS IN THE WAKE OF *U.S. v. SANTOS*

by

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Money laundering is "the process by which one conceals the existence, illegal source, or illegal application of income, and disguises that income to make it appear legitimate."[1] Organized crime activities, such as drug trafficking, smuggling, prostitution rings, and illegal arms sales, can generate huge amounts of cash income. Financial Action Task Force (FATF), *Money Laundering FAQs: What is Money Laundering?*, http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html (last visited Oct. 28, 2009). Seemingly legitimate business enterprises can also produce huge illicit profits though embezzlement, insider trading, bribery, and computer fraud schemes. *Id.* Money laundering is an integral part of all proceeds-yielding crimes since the participants must create the illusion that their "dirty money" is actually clean.

In an attempt to combat this problem, Congress made money laundering a federal crime by enacting the Money Laundering Control Act of 1986. 18 U.S.C. §§ 1956, 1957. This LEGAL BACKGROUNDER will discuss the Supreme Court's decision in *United States v. Santos*, 128 S. Ct. 2020 (2008) (plurality opinion), which attempted to clarify the scope of the federal money laundering statute. The *Santos* plurality generated confusion among the lower courts and has faced criticism for making money laundering crimes more difficult to prosecute. To close the loophole that *Santos* allegedly created for defendants, Congress amended the money laundering statute in May 2009. 18 U.S.C. § 1956(c)(9).

Defining Key Terms: "Proceeds" Defined As "Profits," Not Mere "Receipts". In 2008, the Supreme Court addressed the question of how to define "proceeds" under the federal money laundering statute, 18 U.S.C. § 1956(a)(1). *Santos*, 128 S. Ct. at 2023. In *Santos*, the defendant, Efrain Santos, operated an illicit lottery in Indiana for over two decades. *Id*. Gamblers would place their bets with "runners," primarily at local bars and restaurants. *Id*. The runners took a commission from the wagers, then handed the remaining bet money over to "collectors," who, in turn, delivered the money to Santos. *Id*. at 2022-23. Santos used the bet money to pay the salaries of his collectors and to pay off the lottery winners. *Id*. These payments to runners, collectors, and winners landed Santos in federal prison on money laundering charges. *Id*. at 2023. He received 60 months of imprisonment on the gambling counts and 210 months on three money laundering counts. *Id*. Santos' money laundering convictions consisted of one count of conspiracy to launder money (§ 1956(a)(1)(A)(i) and § 1956(h)), and two counts of money laundering (§ 1956(a)(1)(A)(i)). *Id*.

The Court in *Santos* faced the question of whether the payments made to employees and winning gamblers constituted the "proceeds" of criminal conduct within the meaning of Section 1956(a)(1). *Id*. Section 1956(a)(1) uses the term "proceeds" to describe two of the elements that the government must prove: (1) that the transaction involved the *proceeds* of specified unlawful activity, and (2) that the defendant knew that the property involved in the transaction constituted *proceeds* of an unlawful activity. *Id*. Santos' money laundering conviction was premised upon the word "proceeds" meaning "receipts," as opposed to "profits." *Id.*; *see also*,

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Santos v. U.S., 461 F.3d 886, 887 (7th Cir. 2006). On appeal, Santos challenged his conviction, arguing that because the word "proceeds" was undefined, he should receive the benefit of that ambiguity. *Id.*, *see also*, Brief for Respondent Efrain Santos, *U.S. v. Santos*, 128 S. Ct. 2020 (2008) (No. 06-1005), 2007 WL 2406796.

Justice Scalia, writing for the plurality, agreed with Santos' argument.[2] The word "proceeds" was in fact inherently ambiguous and could mean either "receipts" or "profits." *Id.* at 2024-25. Looking at the face of the statue, Scalia opined that "there is no more reason to think that 'proceeds' means 'receipts' than there is to think that 'proceeds' means 'profits.'" *Id.* at 2025. Under the rule of lenity, the tie must go to the defendant. "Because the 'profits' definition of 'proceeds' is always more defendant-friendly than the 'receipts' definition, the rule of lenity dictates that it should be adopted." *Id.* Payments to employees and winners could not be fairly characterized as involving the gambling operation's "profits." *Id.* at 2031. Accordingly, Santos' money laundering convictions were vacated. *Id.*

Blessing for Defense, Scourge for Prosecutors. Justice Scalia's opinion evidences his concern that the money laundering statute could be abused by prosecutors.[3] Scalia "recognized that the 'receipts' theory of money laundering would turn every violation of a gambling statute into a money laundering case because paying a winning bettor is a transaction involving 'receipts' from the criminal operation."[4] Illegal lottery operators, who would ordinarily serve up to five years of imprisonment for gambling charges, would face an additional twenty years for money laundering.[5] Prosecutors could use the more serious money laundering charge as a tool of intimidation to induce a plea bargain to a lesser charge.[6]

Scalia's holding "bolsters the [defense] argument that financial transactions that are part and parcel of the underlying criminal activity cannot likely serve as the basis for a separate money laundering conviction." Boss, *supra* note 3 at 12. Defense attorneys and their clients heralded *Santos* as signaling the resuscitation of the lenity doctrine. Note, *Rule of Lenity*, 122 HARV. L. REV. 475, 475 (2008). According to some scholars, the rule of lenity had been shrinking over the past forty years, and was seen as dead or dying. *Id.* at 480. Pro-defense advocates believe that lenity plays an important role in the United States criminal justice system by providing fair notice about what conduct is deemed illegal. *Id.* They also praised *Santos* for "leveling the playing field for defendants faced with incredibly powerful enterprise statutes." *Id.* at 483.

On the other hand, *Santos* was criticized for undermining the effectiveness of the money laundering statute and imposing an unreasonable burden on prosecutors to prove violations.[7] *Santos* saddled prosecutors with the onerous task of proving net criminal profits, rather than just gross receipts. Gurulé, *supra* note 7 at 341-42. This narrowing of the money laundering statute allowed "[d]rug traffickers, white collar criminals, and terrorist financers [to] breath[e] a huge sigh of relief." *Id*. at 339.

According to Scalia, transactions that "normally occur" during the course of committing a particular crime are likely "not identifiable uses of profits and thus do not violate the money-laundering statute." *Santos*, 128 S. Ct. at 2027. To show net profits under *Santos*, prosecutors must subtract the defendants' overhead expenses from the total amount of money being raked in. For example, the costs for purchasing, transporting, storing, and distributing illegal drugs must be deducted from the criminal enterprise's gross receipts. Gurulé, *supra* note 7 at 340. In an insider trading case, "a defendant could argue that only the profits of the securities fraud (excluding the funds used to purchase the securities) [c]ould be the subject of a money laundering charge." *Id*.

Some observers lamented that "[t]he uncertainty in the law and complications inherent in proving profits as opposed to gross receipts, especially in the context of street operations of narcotics sales and illegal gambling, may deter prosecutors from tacking on the money-laundering charge."[8] Because illegal businesses tend not to keep records, the difficulties involved in proving "profits" may not be worth the time and resources required. Schnieders & Stodola, *supra* note 8.

***Confusion in Applying* Santos**. The splintered *Santos* Court expressed three divergent views on the meaning of the term "proceeds." Four justices opted for a more "defendant-friendly" definition, holding that the term "proceeds" means "profits" in all money laundering cases. *Santos*, 128 S. Ct. at 2025 (Scalia, J., joined by Souter, Thomas and Ginsburg, JJ.). Another four justices reached the opposite conclusion, deciding that "proceeds" means "the total amount brought in" – the "gross receipts" of a crime. *Id.* at 2035-36, 2044 (Alito, J., dissenting, joined by Roberts, C.J., Kennedy and Breyer, JJ.). Justice Stevens alone interpreted "proceeds" to mean "profits" for some predicate crimes, and "receipts" for others. *Id.* at 2031-32 (Stevens, J. concurring in

judgment).

The Court's murky message has been read broadly by some courts and narrowly by others. If viewed narrowly, *Santos* applies *only* to illegal lottery operations. For example, in *Prince*, a defendant who operated physical therapy companies was convicted of money laundering for having conducted transactions that involved health care fraud "proceeds." *U.S. v. Prince*, 627 F. Supp. 2d 863, 864-65 (W.D. Tenn. 2008). The defendant argued that in light of *Santos*, he should be acquitted of some of the money laundering charges because his payments to billing companies and quality control people "constituted part of the costs of operations of the clinics." *Id*. at 868-69. The court disagreed and held that *Santos* was limited to illegal gambling cases, and therefore, did not affect the definition of proceeds in Prince's health care fraud case. *Id*. at 870. Similarly, courts have held that *Santos* does not apply where the underlying crimes involved bank fraud, embezzlement, and the sale of a boat in exchange for drug money.[9]

In contrast, other courts, taking a broader view, have held that *Santos*' definition of "proceeds" applies to unlawful activities other than illegal gambling. In *Hedlund*, a marijuana cultivator's money laundering conviction was based on the fact that he used a portion of the proceeds from his marijuana crop to pay the mortgage on the building used to grow marijuana. *U.S. v. Hedlund*, CR-06-346-DLJ, 2008 WL 4183958, at *5 (N.D. Cal. Sept. 9, 2008). The *Hedlund* court set aside the defendant's money laundering conviction because it considered the mortgage payment to be a business expense, as opposed to profits. *Id*. According to the court, "Justice Scalia made it very clear that [*Santos*] was not to be read as permitting the word 'proceeds' to be given different meanings for different applications of the statute." *Id*. at *6. Likewise, in *Lee*, the rent, utilities, and wages paid by a prostitution enterprise were insufficient to support a separate money laundering conviction. *U.S. v. Lee*, 558 F.3d 638, 643 (7th Cir. 2009). "Because these costs are regular expenses that are essential to the spas' operation, they are not 'proceeds' within the meaning of § 1956(a)(1)." *Id*.

There is also confusion over whether *Santos* applies to the federal forfeiture laws. Gurulé, *supra* note 7 at 363. For instance, the Racketeer Influenced and Corrupt Organizations (RICO) Act authorizes the forfeiture of "proceeds" derived from a pattern of racketeering activity. 18 U.S.C. § 1963(a)(3); *see also id.* at 366. If "proceeds" is restrictively construed to mean "net profits," less money will be available for the victims of fraud. Frederick E. Curry III & Brian Midkiff, *Recovering Losses from Fraud: Options and Realities*, 254-OCT N.J. LAW. 63, 66 (2008).

Increasing Clarity and Uniformity. The Fraud Enforcement and Recovery Act of 2009 (FERA), signed by President Obama on May 20, 2009, demonstrates a congressional response to *Santos*. Pub. L. No. 111-21, 123 Stat. 1617 (2009). FERA legislatively overrules *Santos* by adding a new paragraph to the federal money laundering statute that defines "proceeds" to include the *gross receipts* of an unlawful activity. 18 U.S.C. § 1956(c)(9). The enactment of FERA mooted the "Money Laundering Correction Act of 2009," another bill that similarly proposed to amend 18 U.S.C. § 1956(c) to include "gross receipts."[10] FERA provides the federal government with increased powers to investigate and prosecute mortgage and other types of financial fraud.[11] If *Santos* were allowed to stand, "a mortgage broker who intentionally overvalues the fair market value of a home for the purposes of a mortgage would be charged for money laundering related only to any fees or potential profit made in the fraudulent transaction, rather than the full value of the house." *Supra* note 11 at *5.

Some advocates believe that legislative action is also needed to clarify the meaning of "proceeds" in the federal forfeiture laws. Gurulé, *supra* note 7 at 388-89. Establishing a broad definition of "proceeds" in the forfeiture context will further "strong policy interests, such as deterring criminal activity and disgorging any property used to facilitate such activity." *Id.* at 388.

Conclusion. The Supreme Court in *Santos* set out to clarify the scope of the federal money laundering statute, but the plurality opinion failed to provide clear guidance to the lower courts. Some courts limited the *Santos* holding to only apply to gambling operations or strictly to Section 1956(a)(1)(A)(i).[10] Others viewed that the *Santos* definition of "proceeds" applied in any criminal context where "proceeds" was deemed ambiguous.

The *Santos* decision permitted individuals to defend themselves by claiming that their illegal activities did not yield any profit. According to critics, it makes no sense to exempt money launderers from prosecution merely because the property involved in the transaction involved "receipts" rather than "net profits" of their illegal conduct. Gurulé, *supra* note 7 at 357. Regardless of whether the dirty money is categorized as receipts or profit, "the money launderer acted with a guilty mind, intending to disguise the nature, source, ownership, or

control of funds derived from criminal activity." *Id*. To the dismay of money laundering defendants, the recent statutory amendment to Section 1957 has limited their possible defenses.

ENDNOTES

[1] Mark A. Provost, *Money Laundering*, 46 AM. CRIM. L. REV. 837, 837 (2009), citing *President's Commission on Organized Crime, Interim Report to the President and Attorney General, The Cash Connection: Organized Crime, Financial Institutions, and Money Laundering* 7 (1984).

[2] *Santos*, 128 S. Ct. at 2025-26. Scalia was joined by Justices Souter, Ginsburg, and Thomas, with Justice Stevens concurring in the judgment.

[3] Barry Boss et al., *Money Laundering Defense After Santos and Regalado Cuellar*, 32-SEP Champion 12, 12 (2008).

[4] *Id.* at 13, citing *Santos*, 128 S. Ct at 2026.

[5] *See, e.g.*, *Santos*, 128 S. Ct. at 2023 (Santos received a 60-month sentence for the gambling charges under 18 U.S.C. §§ 371 and 1955, but 210-months for the money laundering charges.).

[6] *Id.* at 2026.

[7] *See, e.g.*, Jimmy Gurulé, *Does "Proceeds" Really Mean "Net Profits"? The Supreme Court's Efforts to Diminish the Utility of the Federal Money Laundering Statute*, 7 AVE MARIA L. REV. 339, 342 (2009).

[8] Allison G. Schnieders & Damion K.L. Stodola, *The Supreme Court Trims Money-Laundering Laws*, 14 NYLITIGATOR 19, 20, available at http://www.nysba.org/AM/Template.cfm?Section=Home&CONTENTID=27200&TEMPLATE=/CM/ContentDisplay.cfm (last visited Oct. 28, 2009).

[9] *See, e.g, U.S. v. Kratt*, 579 F.3d 558, 563-64 (6th Cir. 2009) (bank fraud and false statement on loan application); *Kenemore v. U.S.*, 5:08cv104, 2008 WL 4965948, at *6 (E.D. Tex. Nov. 17, 2008) (embezzlement); *U.S. v. Demarest*, 570 F.3d 1232, 1242 (11th Cir. 2009) (boat sold to undercover officers posing as narcotics traffickers).

[10] Money Laundering Correction Act of 2009, H.R. 1793, 111th Cong. § 3(2) (2009); *see also H.R. 1793, The Money Laundering Correction Act of 2009*, http://www.washingtonwatch.com/bills/show/111_HR_1793.html#usercomments (last visited Oct. 28, 2009).

[11] Christopher A. Riley & Joann E. Johnston, *Fraud Enforcement and Recovery Act of 2009: Expanding Fraud and False Claims Act Liability and Increasing Enforcement in the Wake of the Economic Crisis*, 28 No. 7 BANKING & FIN. SERVICES POL'Y REP. 1, at *1 (2009).

[10] *See, e.g., U.S. v. Caparotta*, 571 F. Supp. 2d 195, 198 (D. Me. 2008) (*Santos*' restrictive definition of "proceeds" does not extend to the forfeiture provisions of 21 U.S.C. § 853); *see also U.S. v. Fernandez*, 559 F.3d 303, 316-17 (5th Cir. 2009) (in contrast to *Santos*, defendant's convictions rested on § 1956(a)(1)(b)(i) and (ii), which prohibit transactions designed to "conceal or disguise" the origins or location of proceeds, or to avoid legal reporting requirements.)