

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CRIMINAL MINUTES - GENERAL

Case No.	CR 05-398-GAF	Date	January 5, 2010
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Present: The Honorable	GARY ALLEN FEESS
Interpreter	None

Renee Fisher <i>Deputy Clerk</i>	None <i>Court Reporter/Recorder, Tape No.</i>	Michael R. Wilner <i>Assistant U.S. Attorney</i>
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<u>U.S.A. v. Defendant(s):</u>	<u>Present</u>	<u>Cust.</u>	<u>Bond</u>	<u>Attorneys for Defendants:</u>	<u>Present</u>	<u>App.</u>	<u>Ret.</u>
Stuart H. Wolff	√			John F. Gibbons			√

Proceedings: (In Chambers)

ORDER RE: PRE-TRIAL MOTIONS

Defendant moves for an evidentiary hearing to question current and former employees of Price Waterhouse Coopers (“PWC”) about the alleged modification, destruction and non-retention of documents. The government opposes the motion. As discussed in greater detail below, the motion is **DENIED**. Defendant Wolff has not identified any issue that requires an evidentiary hearing for resolution and may not circumvent the limitation on pre-trial deposition practice by claiming the existence of a dispute with the government where none exists. If Wolff believes that PWC witnesses have additional information that may be helpful to his defense, he may call them to testify at trial.

A. BACKGROUND

1. The Homestore Fraud

Several executives and high level Homestore.com (Homestore) managers have been prosecuted or otherwise disciplined for their role in a scheme to perpetrate a fraud on the market by falsely inflating Homestore’s revenues in the first two quarters of 2001. Among other things, the indictment setting forth the charges against the management team asserts that they covered up the scheme by providing to its outside auditor, PWC, documents that concealed that a substantial portion of Homestore’s reported revenues were nothing more than Homestore’s own funds that had moved in a circular fashion from Homestore and back again through so-called “round trip” transactions. In reality, according to the indictment, the round trip transactions were shams and generated no real revenue at all. Many members of the management team acknowledged their complicity in the scheme, negotiated

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guilty pleas with the government, and agreed to testify as government witnesses at trial.

2. The First Trial

One defendant – Homestore CEO Stuart Wolff – proceeded to trial on the charges. At the trial, the government presented evidence that included: (1) testimony from numerous Homestore executives and employees; (2) Homestore documents; (3) the testimony of a PWC audit partner; and (4) PWC audit workpapers. The evidence presented was designed to show that Homestore had in fact engaged in the round trip transactions, that it had concealed that fact from PWC to insure that PWC would approve its 2001 quarterly financial statements, and that Wolff was a knowing participant in that scheme. After several weeks of trial, Wolff was convicted on all counts. However, that conviction was reversed based on the purported financial conflict of interest of the district judge who presided over his trial. The case was returned to the district court and reassigned to the present trial judge for further proceedings.

3. Current Proceedings

During the course of these proceedings, Wolff retained different counsel. New counsel requested and obtained early return trial subpoenas which permitted Wolff to gather from PWC, documents that he did not have at the prior trial. Based on counsel’s review of the documents, Wolff now claims to have discovered that PWC modified its workpapers after the fact in ways that tend to exonerate PWC from any liability in the alleged criminal conduct. According to Wolff, PWC modified those workpapers after the internal investigation leading to the present case had commenced. Wolff also contends that PWC also destroyed or failed to preserve documents that are material to the communication between Homestore and PWC regarding the transactions under scrutiny in this case. Wolff alleges that the modifications were made to alter the evidence “about what PWC knew and when it knew it.” (Motion, at 29.) Moreover, according to Wolff, the PWC witness who testified at trial lied when he stated that the workpapers had not been modified in any material way. (Id., Introduction, at 2.) The information developed by Wolff’s new counsel was communicated to the government. The government then undertook a series of interviews of PWC personnel involved in the preparation of the quarterly reports to assess whether PWC acknowledged the changes to the documents and to obtain an explanation for why those changes were made. Based on those interviews, it is apparent that PWC personnel have conceded that some alterations were made to the documents and that there were materials that should have been retained that were not. The reports of interview were shared with defense counsel, who is of the view that the witnesses made false statements to the government in the interviews, at the prior trial, or both.

Accordingly, Wolff moves for an evidentiary hearing to interrogate PWC personnel about what workpapers were modified and why, how and why so much allegedly relevant information could have vanished, and the alleged falsity of recent statements made by PWC personnel to the government about the timing and scope of the modifications. (Id., at 1.) Wolff contends that the evidence at issue is “crucial to the defense of his case” and that “fundamental fairness and due process require that he be afforded a fair opportunity [to go back and see what PWC did.]” (Id., at 2.) Wolff theorizes that,

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despite the testimony of numerous witnesses from his own management team and an elaborate document trail that obfuscates the round trip nature of numerous transactions, PWC was provided with all pertinent information and blessed these and similar transactions “and that Wolff never schemed to mislead Homestore’s auditors.” (Id., at 13.) In short, the motion, taken as a whole, suggests that PWC has modified its workpapers and destroyed documents showing its knowledge of the round trip transactions either to conceal its complicity in the scheme and to avoid any potential consequences that might arise because of its approval of the transactions, or to obfuscate its negligence in failing to discover them and the resulting consequences. Defendant now demands that the Court conduct an evidentiary hearing at which defense counsel can examine the PWC witnesses concerning these matters.

B. DISCUSSION

The motion is best understood in context.

1. Trial Evidence

At the prior trial, the government presented evidence that, in 2001, Homestore’s share price was in jeopardy because its revenues had begun to decline. Wolff and the other managers, fearing a market blood bath, engaged in a series of round trip, or “triangle,” transactions in which they would purchase large quantities of unnecessary products or services at inflated prices from a vendor with the understanding that the vendor would in turn enter into a transaction that would move the excess revenue to a third party that would, in turn, buy advertising from Homestore. The purchase of advertising was recorded as revenue when the funds were nothing more than a circular movement of Homestore funds through intermediaries. By recording the revenue on its books, Homestore was able to meet the expectations of Wall Street analysts, and avoid a collapse in its share price. However, in audit proceedings in late 2001, PWC began to question certain of these transactions, which led to an investigation and ultimately to the disclosure of the scheme and the company’s demise. On the basis of these and related transactions, the government charged Homestore management, including Wolff, with securities fraud, submitting false reports to the SEC, accounting fraud, fraud on the outside auditor, and insider trading.

Under the government’s theory, management furthered its scheme by concealing the circular transactions from its auditors who might otherwise refuse to sign off on any public report or statement confirming Homestore’s revenue numbers. In support of its theory, the government offered the testimony of Homestore’s managers, including Gieske, Shew, and Tafeen, who testified at the first trial that they participated in the presentation of false information to PWC and that the scheme was discussed with and approved by Wolff. The government also presented documentation from PWC purporting to show that its approval of the 2001 second and third quarter reports to the SEC was based on representations by management regarding the legitimacy of the round trip transactions. Specifically, the government offered into evidence the PWC workpapers underlying the preparation of the quarterly reports. As indicated above, these documents appear to have been compromised.

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Having been presented with this evidence, the government has moved to dismiss the fraud on the accountant counts (10 through 14) and to abandon the related conspiratorial object and to pursue its case without the PWC documents of the testimony of its personnel. Defendant argues that this is not enough and complains that the government has not instituted an investigation and/or prosecution of PWC for perjury or obstruction of justice. Defendant argues that the government is improperly taking an inconsistent position within the meaning of United States v. Bakshinian, 65 F. Supp. 2d 1104 (C.D. Cal. 1999) and that the evidentiary hearing it seeks is required under United States v. Hanna, 55 F.3d 1456 (9th Cir. 1995). The government contends that its position is not at all inconsistent with its prior theory and that the evidentiary hearing, which is a thinly disguised request for pre-trial depositions, is not proper under Rule 15, Fed. R. Crim. P.

2. Evaluation

Having reviewed the materials submitted by the parties, conducted a hearing on the motion, and then reviewed the materials a second time, the Court concludes that the motion does not withstand close scrutiny.

First, Wolff asserts, with citations to United States v. Panitz, 907 F.2d 1167 (1st Cir. 1990) and United States v. Batiste, 868 F. 2d 1089 (9th Cir. 1989), that an evidentiary hearing is required to resolve differences with the government. The Court disagrees. Those cases involved motions to suppress evidence which required a court hearing to receive testimony and other evidence to determine whether the seizure of the evidence met constitutional requirements. Here the government and the defense assess the actions of PWC differently but their differing viewpoints need not be resolved to determine the admissibility of any evidence or to resolve any other disputes. Indeed, because, as noted above, the government has determined that it will not use any of the PWC documents or call any PWC witnesses at defendant's re-trial, there is nothing for the Court to consider.

In reality, as the discussion of defendant's motion indicates, the request for an evidentiary hearing has nothing to do with governmental conduct and everything to do with Wolff's desire to investigate PWC and its employees about its document handling and retention. The government correctly observes that the motion amounts to a request for pre-trial depositions conducted under the direction of the Court. But as the government also points out, Rule 15, Fed. R. Crim. P., authorizes depositions in criminal cases only for the purpose of preserving testimony and not for discovery purposes. E.g., United States v. Edwards, 69 F.3d 419, 437 (10th Cir. 1995), cert. denied, 517 U.S. 1243 (1996); United States v. Kelley, 36 F.3d 1118, 1124 (D.C. Cir. 1994); United States v. Cutler, 806 F.2d 933, 935-36 (9th Cir. 1986). Accordingly, Wolff has established no basis for an evidentiary hearing in this case. While Wolff's desire for further discovery may be understandable, the use of the Court to conduct his investigation is not authorized by statute, rule or case law.

Second, the Court completely agrees with Wolff that the government had an obligation to produce any material known to it that would have impeached its witnesses at the prior trial. United States v. Hanna, 55 F.3d 1456, 1459-60 (9th Cir. 1995) is just one of many cases to so hold.

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Furthermore, the Court agrees that the evidence of PWC misconduct could be characterized as Brady material because it provides a means of impeaching PWC witnesses and eliminates a source of corroboration for the testimony of cooperating witnesses. But Wolff has obtained the Brady material that he claims is being sought through the evidentiary hearing. Because of his investigation, he has identified grounds for impeaching the PWC witnesses and for suggesting that they were complicit in the fraud on the market. Further, as a result of the defense investigation, the prosecution has narrowed the charges against Wolff and has determined to abandon the use of PWC documents and witnesses, who at the prior trial corroborated the testimony of Homestore accomplice witnesses. In that way the case has been weakened.¹ And although Wolff complains that the government has not investigated or charged any PWC employees or witnesses with perjury or obstruction of justice, that is a decision that rests with the executive branch and has little bearing on this Court's view of the present motion.

Third, Wolff suggests that by eliminating the "lying to accountants" charges, the government is taking an inconsistent position in the second trial in violation of the principle articulated in United States v. Bakshinian, 65 F. Supp. 2d 1104 (C.D. Cal. 1999). Bakshinian does not support the argument. Bakshinian stands for the proposition that the government may not, in separate trials of co-conspirators, take inconsistent positions in the two trials as to the roles played by the co-conspirators. In other words, the government cannot claim in Conspirator One's trial that he was the mastermind and then make the same claim as to Conspirator Two in his trial. In this case, although it intends to pursue fewer counts and present less evidence, the government's theory has not changed at all. The government contends that Homestore management, including Wolff, lied to PWC as part of an overall scheme to perpetrate a fraud on the market. Thus, the Bakshinian case has no application in present circumstances.

Finally, there is nothing in the record to suggest that the government has engaged in any improper conduct in connection with the investigation and prosecution of this case. In that regard, this motion has required the Court to study some of the evidence presented at the prior trial which suggests that Wolff's asserted belief that the round trip transactions were proper because they were blessed by PWC is contrary to the detailed and undisputed evidence regarding these transactions. No one, except perhaps Wolff, is now claiming that the "triangle" transactions were anything but a sham to inflate Homestore's revenues during the relevant time period. Moreover, the suggestion that PWC was covering its own tracks ignores the fact that PWC discovered the fraud and that PWC blew the whistle when it could not confirm the legitimacy of questionable transactions reported by Homestore. That discovery occurred by mid-November 2001 at the latest and triggered the internal investigation that

¹As the Court noted at the hearing, the denial of a pre-trial evidentiary hearing does not foreclose defendant's opportunity to interrogate the witnesses. The defendant may, if he chooses, call PWC witnesses at trial and question them regarding the topics of interest to him: what workpapers were modified and why; how and why so much allegedly relevant information could have vanished; whether the recent statements made by PWC personnel to the government about the timing and scope of the modifications were false or misleading. If, as Wolff asserts, this information is crucial to his defense, he can elicit the information at trial.

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uncovered the scheme to inflate revenue well before the government was even involved in the case. By the end of 2001, the Homestore Audit Committee’s investigators had identified documents from Homestore’s own files that identified a number of the fraudulent transactions, the participants in the transactions, and the motivation for the transactions. (E.g., Mot., Ex. 13.) Among other things, the investigators discovered email correspondence between a Homestore official and a customer in September 2001 discussing a means of structuring a deal “that won’t raise ‘a red flag to your [HOMS] auditors,’” and had identified the May 18, 2001, spreadsheet of Sophia Losh “that clearly indicates the ‘triangle’ nature of various AOL deals.” (Id., at 3.) In short, this case is largely based on documentation from Homestore and information from and about its employees that exposed the fraudulent round trip transactions. That information is not impacted at all by Wolff’s allegations against PWC.

C. CONCLUSION

For the foregoing reasons, the motion for an evidentiary hearing is **DENIED**. The government’s motion to dismiss counts 10 through 14 is **GRANTED**.

IT IS SO ORDERED.

_____ : _____
Initials of Deputy
Clerk _____