

# UNDER WHAT JURISDICTION DID DHS SEND OUT AN ARMY OF AGENTS AGAINST RENTBOY?

The NYT had a great editorial that echoes my amazement that the Department of Homeland Security sent an army of agents to take down RentBoy.com this week.

It's somewhat baffling, though, that taking down a website that operated in plain sight for nearly two decades suddenly became an investigative priority for the Department of Homeland Security and federal prosecutors in Brooklyn. This week, the website's founder and six employees were charged with violating federal law by facilitating paid sexual encounters.

Kelly Currie, the acting United States attorney for the Eastern District of New York, trumpeted the case against Rentboy.com, calling it an "Internet brothel" that "made millions of dollars from the promotion of illegal prostitution." The website pulled in \$10 million over the past five years, charging escorts for publishing their profiles, according to prosecutors. That's less revenue than an average McDonald's franchise generates.

[snip]

Prosecutors can credibly argue that the site's operators were breaking the law. But they have provided no reasonable justification for devoting significant resources, particularly from an agency charged with protecting America from terrorists, to shut down a company that

provided sex workers with a safer alternative to street walking or relying on pimps. The defendants have not been accused of exploiting sex workers, featuring minors on the website, financial crimes or other serious offenses that would warrant a federal prosecution.

DHS doesn't seem to know why DHS was involved either. In a statement to the NYT, ICE's spokesperson, Khaalid Walls, suggests ICE's jurisdiction arises because this involves the illegitimate movement of people, goods and currency in domestic and foreign transactions, which suggesting the things moved were prostitutes.

Mr. Walls said: "As the investigative arm of the Department of Homeland Security, ICE is responsible for the enforcement of laws that promote the legitimate movement of people, goods and currency in domestic and foreign transactions. Our allegation with this case is that the business and its principals purported itself to be an escort service while promoting criminal acts, namely illegal prostitution."

I'm rather curious that DHS claims jurisdiction over the movement of goods domestically. But I'm also not sure how a website constitutes moving anything.

But the claim this is about prostitution seems to conflict with ICE's description of the bust on its website, which claims it's a financial crime.

08/25/2015 NEW YORK, NY

FINANCIAL CRIMES



[ICE takes down alleged online prostitution ring, CEO arrested](#)

Jeffrey Hurant, CEO of Rentboy.com, and six others were charged by criminal complaint, unsealed Tuesday in Brooklyn federal court, with conspiring to violate the Travel Act by promoting prostitution.

As I've suggested, I wouldn't be surprised if ICE used all those hard drives they seized this week to put together the money laundering case

they leaked to some outlets. But they haven't charged it yet. Which would mean they used the prostitution claim to take down an advertising site to be able to get the evidence to charge something that might be more squarely in ICE's jurisdiction.

Add in the fact that NY DA Cy Vance – the entity that would have direct jurisdiction over prostitution headquartered in NYC – took his office off this release, and I'm genuinely confused about what DHS is doing.

None of that will mean the RentBoy defendants will be able to challenge this on jurisdictional grounds. But it does raise questions about what DHS is really doing.

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## CHUCK SCHUMER GOT RESULTS!

Motherboard has an interesting new detail on the Silk Road investigation from a mostly refused FOIA.

The few pages released show the following timeline:

June 1, 2011: Gawker publishes this story describing Silk Road.

June 5, 2011: Chuck Schumer gives a press conference repeating details from the story and claiming,

*The DEA has confirmed they are aware of the site, and while they won't confirm or deny that an investigation is underway, from my years of experience, I'd bet my bottom*

*dollar in this instance there  
is one underway,*

June 6, 2011: NY Organized Crime Drug  
Enforcement Strike Force gets tasked with  
investigating Silk Road.

70. REMARKS On June 6, 2011 members of the New York Organized Crime Drug Enforcement Strike Force, Group Z-52 were tasked with investigating a internet site called, SILK ROAD, which is purported to sell any and all illegal drugs and scheduled drugs via the internet.
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June 15, 2011: DEA opened a Personal History  
Report for its investigation into Silk Road

U.S. DEPARTMENT OF JUSTICE DRUG ENFORCEMENT ADMINISTRATION		PERSONAL HISTORY REPORT	
1. File Title Silk Road	2. File Number 82-11-0080	3. Program Code	
4. Group No. Z-52	5. G-DEP ID (b)(7)(E)	6. Date Prepared 06-15-2011	

I find the Gawker to Schumer to New York law  
enforcement to feds very interesting given  
yesterday's events.

## WHY DID THE FEDS TAKE DOWN RENTBOY?

Yesterday, federal officers (overwhelmingly  
Department of Homeland Security, not FBI) busted  
the 7 people who run RentBoy.com, the largest  
online portal for male escorts. In doing so,  
they put 10,000 sex workers out of business – or  
pushed them into more dangerous means of meeting  
customers.

This is the second time the Feds have taken down  
a sex worker portal. In June 2014, Feds took  
down RedBook, which included links to ads but  
also had a lot of chat rooms. At one level,  
then, that bust was even more of an assault on  
First Amendment rights, but the operators were  
also indicted on money laundering charges (and  
FBI found profiles of people under 18 posting

advertisements, which it used to ratchet up the pressure). Thus far, at least, there's no indication of additional charges against RentBoy's operators, even though two outlets yesterday claimed there were money laundering charges involved. Though as I'll explain, I wouldn't be surprised to see immigration charges, I bet the government will charge the money laundering they've already leaked to the press, and I fully expect once the government wades through the servers they seized yesterday, they'll come up with a list of advertisers who were also underage.

The bust leaves me with several questions. As Conor Friedersdorf asks, why is this a priority of law enforcement? Aren't there more pressing crimes – like bank money laundering – to pursue, or more dangerous forms of sex trafficking?

Some potential answers may lie in some observations from the complaint.

## **Where did this come from?**

RentBoy has been operating happily since 1997. So why did the Feds choose to take it down yesterday?

One hint about where this inquiry may have come from is on page 19-20 of the complaint, after all the salacious descriptions of slang for kinds of sex and discussions of a few escorts' profiles that have been highlighted in other reporting on this. RentBoy twice applied for an H1B for its accountant, Marco Soto Decker.

In September 2010 and March 2013, EASY RENT SYSTEMS, INC. applied to the United States Department of Homeland Security, Citizenship and Immigration Services for an H1-B non-immigrant work visa on behalf of SOTO DECKER. The application identified that EASY RENT SYSTEMS, INC. runs RENTBOY.COM which "revolutionized the escorting industry by moving it online and away from agencies and disreputable bars." The application also

said that SOTO DECKER had been operating as the accountant from July 2012, a position that reported directly to JEFFREY HURANT and which required him to prepare all financial statements and to strategically analyze, manipulate, and interpret financial data "in order to develop strategies and make recommendations critical for the CEO to utilize in his work to successfully manage and grow the company."

In connection with the application, EASY RENT SYSTEMS, INC. also submitted a job offer letter addressed to SOTO DECKER dated July 20, 2012, which identified the duties and responsibilities of the position. Among those duties was meeting with market, IT, sales, and customer service staff to review monthly expenses and see revenue and expenses optimization; supervising the company's daily e-commerce transactions; managing the entire accounting, budgeting and reconciliation process for the company's events, including the HOOKIES [an awards ceremony RentBoy puts on].

The application also included some of EASY RENT SYSTEM, INC.'s books and records. Among the expenses identified was a listing for "Viagra – Sean." In addition, the application included numerous articles about RENTBOY.COM. Many of those articles identified unambiguously that the escorts advertising on RENTBOY.COM were having sex with their customers in exchange for money.

In other words, RentBoy's parent company twice applied to DHS for an H1B visa for its accountant, the more recent application of which DOJ alleges included clear evidence the company was buying Viagra for an employee and reporting on the company made it clear that RentBoy sold sex.

Note, the complaint didn't tell us what happened with those applications. That there were two of them suggests Soto Decker may have either gotten it renewed (I need to double check but I believe it is still the case you can get two H1Bs for a total of 6 years, then you have to go home to your home country for a period) or been denied in the first application. Assuming he got the H1B would also suggest that immigration authorities not only agreed with Easy Rent that Soto Decker was a skilled employee (there's no reason to doubt that) but also that the company could find no Americans to do an accounting job. Immigration authorities are very lenient with those H1B determinations, but they almost certainly could have refused that visa back in 2013.

Still, that application to DHS in March 2013 was almost 30 months ago, and there's just one sign I saw of active investigation since *in the complaint*. That detail appears on page 14.

HURANT was present at the 2015 HOOKIES, where he provided an undercover agent a card with the RENTBOY.COM name on one side. On the opposite side the card says "Jeffrey Davids, Principal." It also lists his email address as "cyberpimp@rentboy.com." HURANT was asked by the undercover agent how the Hookies awards started. HURANT responded "Have you ever had sex with anyone and it was so good you had to tell someone? That's what it's all about!"

In other words, in March 2013, Easy Rent submitted an H1B application that may have given DHS an opening to start this investigation. Two years later, they had an undercover officer attend the Hookies and get RentBoy's CEO to say some damning things.

That timeline – if it indeed shows the span of the investigation – is interesting for several reasons.

First, it would suggest the investigation was started while Loretta Lynch was still US Attorney in Eastern District of NY (more on that in a sec). If this investigation started in 2013, it means Lynch, now the Attorney General, may well have been the one ultimately overseeing the investigation.

Second, the investigation – with an undercover officer attending awards ceremonies and who knows what else – was active after the time the head of RedBook pled guilty in December 2014. DOJ had a proof of concept in that earlier bust.

Finally, as a reader noted, the investigation had already started before the time, in July, when a RentBoy escort exposed his discussions with Tim Geithner's brother, David, at Gawker. That is, this investigation is not retaliation for a RentBoy escort embarrassing the family member of a very powerful New Yorker. But the bust did happen after that. (And if I were that escort, I'd be very worried about what evidence that DHS seized yesterday might be used in a blackmail case against me.)

One more note on timing: One of the employees busted yesterday, Diana Milagros Mattos, left Easy Rent in June, in spite of being its highest commissioned sales agent. There's no explanation of why she left. I find that worth noting.

## **Why was this charged in EDNY?**

I always ask this question, but you have to ask it. Why was this charged in the Eastern District of NY, when RentBoy is headquartered in Manhattan, in the Southern District, and only one of the employees appears to live in EDNY (though the complaint reviews three profiles whose owners live in Brooklyn)? When asked yesterday, one of the Feds apparently simply said, "the Internet is everywhere." But that response raises more questions than it answers.

I raise this not just for the Loretta Lynch connection, but also because by virtue of JFK



airport's location in EDNY, where many defendants get flown into, the district has developed a slew of precedents having to do with asserting a fairly aggressive jurisdiction overseas. Again, it's possible this whole thing started from an immigration inquiry. But I wonder whether there's some more to it, especially since RentBoy has facilities in England.

In other words, is this just the first step in a larger, more international crackdown?

## **What other investigative means did they use?**

As noted, someone leaked to several outlets yesterday this case involved money laundering, but there's no hint of that in this complaint *or even that they used investigative methods to prove it*. While RentBoy's ISP, Cogent Communications, is mentioned in an aside – in the context of how communications with the ISP described Soto Decker's responsibilities – there's no mention of any orders for traffic logs or other electronic service provider records. Still, it's fairly clear the Feds do have some records from Cogent they aren't yet telling us about.

Then there's the means by which the agent who wrote this, Susan Ruiz, identified aliases of some of the employees. In footnote after footnote, she says she compared the defendant's driver's license picture with an online picture and decided they were the same person. Neither those aliases nor the means by which she identified them are critical at this point. But I would suggest she almost certainly used more reliable means to connect the identities of these people. That could just be an insider's testimony, but it could also include traffic logs connecting certain computers with the online profiles using those aliases.

In other words, I suspect they've got electronic records they don't want to tell us about, even

as simply as records obtained from Cogent using a subpoena.

## **Why didn't they bust DaddysReviews.com?**

As the complaint makes clear, RentBoy has clear warnings against advertising sex and prices (which will be one of the defenses the accused will use). It bills itself as an escort site that will not permit the selling of sex.

To prove that the profiles the complaint describes in depth involve prostitution, it relies heavily on DaddysReviews.com, which is a review site that not only describes completed acts of sex, but the price paid for that sex.

I'm going to ask people who know the industry better than I about this. But I do wonder why DHS and DOJ chose to bust the site that doesn't explicitly tie sex to payment, but didn't bust the one that does.

Update: One suggestion on this question is that DaddysReviews wouldn't be prosecuted because they don't take money.

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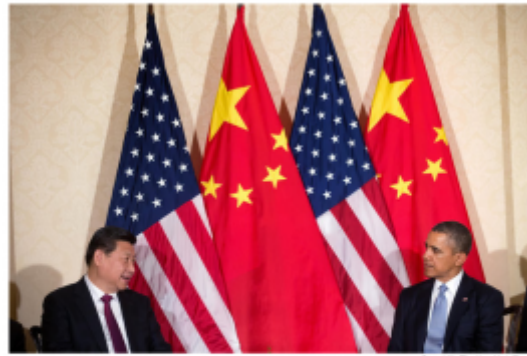
## **IS THE US THWARTING CHINA'S ANTI-CORRUPTION (AND POLITICAL CRIME) CAMPAIGN TO RETALIATE FOR THE OPM HACK?**

Two weeks after floating a story to the NYT the Obama asked for some creative ways to retaliate against China for the OPM hack, the

NYT reported (in both English and a prominently linked Chinese translation) that “in recent weeks” the US told agents trying to chase down Chinese nationals accused of corruption to get out.

## 中共秘密追捕在美贪官令美国不悦

MARK MAZZETTI, DAN LEVIN 2016年8月17日



中国主席习近平去年会见美国总统奥巴马。习近平将在下个月对华进行国事访问。

Doug Milt/The New York Times



打印 分享 微信编辑 字号

美国官员表示，中国特工暗中在美国开展行动，向旅居美国的知名华人施压——其中一些人在中国因贪污指控受到通缉——让他们立即回国。对此，奥巴马政府已向北京发出警告。

美国官员说，北京在全球开展行动，追捕潜逃到国外的中国贪官。有时还会收到他们附带的正义之财，中国执法人员在美国的秘密活动就属于这种性质。中国政府已经正式将这个全球性行动命名为“猎狐行动”。

The Obama administration has delivered a warning to Beijing about the presence of Chinese government agents operating secretly in the United States to pressure prominent expatriates – some wanted in China on charges of corruption – to return home immediately, according to American officials.

The American officials said that Chinese law enforcement agents covertly in this country are part of Beijing’s global campaign to hunt down and repatriate Chinese fugitives and, in some cases, recover allegedly ill-gotten gains.

The Chinese government has officially named the effort Operation Fox Hunt.

The American warning, which was delivered to Chinese officials in recent weeks and demanded a halt to the activities, reflects escalating anger in Washington about intimidation tactics used by the agents. And it comes at a time of growing tension between Washington and Beijing on a number of

issues: from the computer theft of millions of government personnel files that American officials suspect was directed by China, to China's crackdown on civil liberties, to the devaluation of its currency.

Operation Fox Hunt is not new – or secret. It has been covered before by the US press, including updates on how many people official Chinese sources claim they have gotten to return for prosecution. The NYT follow-up admits – though the original didn't provide the same level of detail – that DHS agreed in April to prosecute Chinese economic fugitives (which would extend the US habit of asserting jurisdiction where none exists) if provided real evidence of corruption.

But in April, the Department of Homeland Security worked out a new arrangement with China's Ministry of Public Security, which oversees Operation Fox Hunt, to assist Beijing's efforts to prosecute economic fugitives according to United States law. American officials, however, say China has so far failed to provide the necessary evidence.

Both NYT articles mention what the WSJ reports in more depth, including details of how these operatives are working: Among the economic fugitives in the US China is aggressively pursuing is Ling Wangcheng, the brother of a former top Hu Jintao aide

Mr. Ling's brother was a top aide to China's previous president, Hu Jintao, but was placed under investigation by the Communist Party in December and formally accused in July of bribe-taking, adultery and illegally obtaining state secrets.

For much of 2014, Mr. Ling was living

under an alias in a mansion in a gated community in Loomis, Calif., near Sacramento, with Mr. Yuan's ex-wife, neighbors said. The couple hasn't been seen there since around October.

Mr. Ling is now the focus of political intrigue that could overshadow a visit to the U.S. in September by China's leader, Xi Jinping.

Diplomats and analysts said Mr. Ling might have had access through this brother to sensitive information about Chinese leaders. If he sought political asylum, Mr. Ling would be the most significant Chinese defector in decades.

It isn't clear why Mr. Ling, 55 years old, moved to the U.S. in 2013 or 2014. He lost touch with many friends in China around last fall, a family acquaintance said, but later reassured friends he was safe in the U.S.

The implication from this – and other recent reporting on Ling – is that he *did* get asylum in October, and has been cooperating with US authorities.

All that is probably only tangentially related to the US leak of its earlier decision – taken precisely as the US tries to find a way to retaliate for the OPM hack – to start cracking down on this Chinese effort.

There are two things I haven't seen mentioned in coverage of this. First, remember that the US has engaged in a similar effort, using an offer of amnesty for rich tax cheats who had stashed their money in Swiss banks (though there have been what I believe to be similar efforts on the part of the US to expose tax cheats that have mostly focused on non-US citizens).

And don't forget the lengths to which the US went to get someone who had top secrets to come back to the US, including when it had Austria

ground Evo Morales' plane so it could search for Edward Snowden.

In any case, I suspect the US used Operation Fox Hunt as an opportunity to let China know it knew of these admitted agents. Sort of a way for the US to tell China we know where its operatives in the US are, just as it knows where our operatives are in China, thanks to the OPM hack.

For its part, China's Xinhua paper has scolded the US for harboring crooks (and provided slightly different details of the agreement pertaining to Fox Hunt).

Corruption is not only a serious problem in China, but also in the rest of the world. And in a world which is more and more connected, countries should take coordinated efforts in fighting corruption.

Although there is no extradition agreement between the United States and China, the two countries actually have already agreed on anti-corruption cooperation.

In April 2015, U.S. Homeland Security Secretary Jeh Johnson met Chinese Public Security Minister Guo Shengkun in Beijing, and they agreed to strengthen cooperation in law enforcement.

They agreed not to provide shelter for the other side's fugitives and would try to repatriate them in accordance with law. Specifically, Johnson also promised to actively support China's "Sky Net" and "Fox Hunt" operations, which aim to bring back corrupt officials.

So the U.S. government's decision to force China's law enforcement stuff to leave the country obviously reveals that Washington lacks sincerity and has failed to translate its words into action.

Some analysts even say that the United States is reluctant to repatriate those corrupt officials for the sake of their money of course.

Therefore, the United States, as a country that often stresses the rule of law, should clarify the issue and by no means become a safe haven for Chinese criminal suspects.

The US may have decided this would be an easy way to push back on China, but that won't prevent China from scoring points from it.

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## **GANG OF TRANSNATIONAL CRIME ORGANIZATIONS ROLL OUT OWN ENCRYPTED COMMUNICATION SYSTEM**

When Michael Chertoff made the case against back doors, he noted that if the government moved to require back doors, it would leave just the bad guys with encrypted communications.

The second thing is that the really bad people are going to find apps and tools that are going to allow them to encrypt everything without a back door. These apps are multiplying all the time. The idea that you're going to be able to stop this, particularly given the global environment, I think is a pipe dream. So what would wind up happening is people who are legitimate actors will be taking somewhat less secure communications and

the bad guys will still not be able to be decrypted.

I doubt he had the Transnational Crime Organizations on Wall Street in mind when he talked about the bad guys “still not be able to be decrypted.”

But HSBC, JP Morgan Chase, Citi, Deutsche Bank, Goldman Sachs and the other big banks supporting Symphony Communications – a secure cloud based communications system about to roll out – are surely among the world’s most hard-core recidivists, and their crime does untold amount of damage to ordinary people around the globe.

Which is why I’m so amused that Elizabeth Warren has made a stink about the imminent rollout of Symphony and whether it will affect banks’ ability to evade what scant law enforcement might be thrown their way.

I have [] concerns about how the biggest banks use of this new communications tool will impact compliance and enforcement by the Department of Justice [Warren sent versions of the letter to 6 regulators] at the federal level.

My concerns are exacerbated by Symphony’s publicly available descriptions of the new communications system, which appear to put companies on notice – with a wink and a nod – that they can use Symphony to reduce compliance and enforcement concerns. Symphony claims that “[i]n the past, communication tools designed for the financial services sector were limited in reach and effectiveness by strict regulatory compliance ... We’re changing the communications paradigm” The company’s website boasts that it has special tools to “prevent government spying,” and “there are no backdoors,” and that “Symphony has designed a specific set of procedures to guarantee



that data deletion is permanent.”

Warren is right to be concerned. These are serial conspiracists on a global scale, and (as Warren notes elsewhere) they’ve only been caught – to the extent that hand slaps count as being caught – when DOJ found the chat rooms in which they’ve colluded.

That said, the banks, too, have real reason to be concerned. The stated reason they give for pushing this project is Bloomberg’s spying on them – when they were using Bloomberg chat – for reporting reasons, which was revealed two years ago. The reference to government spying goes beyond US adversaries, though I’m sure both real adversaries, like China, and competitors, like the EU, are keeping watch on the banks to the extent they can. But the US has spied on the banks, too. As the spy agency did with Google, the NSA spied on SWIFT even though it also had a legal means to get that data. I wouldn’t be surprised if the rise in bank sanctions violations in recent years stemmed from completely necessary spying if you’re going to impose sanctions, but spying that would compromise the banks, too. Remember, too, that the Treasury Department has, at least as of recently, *never* complied with EO 12333’s requirement for minimization procedures to protect US persons, which would include banks.

And there have even been cases of hacker-insider trader schemes of late.

So banks are right to want secure communications. And while these banks are proven crooks – and should be every bit the worry to Jim Comey as ISIS’s crappier encryption program, if Comey believes in hunting crime – the banks should be reined in via other means, not by making them insecure.

If we’re going to pretend – and it is no more than make-believe – that the banks operate with integrity, then they need to have secure communications. But without that make-believe, a

lot of the important fictions America tells itself about capitalism start to fall apart.

Which is my way of saying that the 6 regulators need to think through how they can continue to regulate recidivist crooks who have their own secure messaging system, but that the recidivist crooks probably need a secure messaging system (though having their own might be a stretch).

If Jim Comey is going to bitch and moan about criminals potentially exploiting access to encrypted communications, then he should start his conversation with the banks, not Apple. If he remains silent about this gang and their secure communications, then he needs to concede, once and for all, that actual humans need to have access to the same privilege of secure communications.

On this topic, see also District Sentinel's piece on this.

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## **NEOLIBERALISM HELPED SYRIAN BANKS EVADE SANCTIONS**

I've written a lot about how neoliberalism has been counterproductive for any soft war we're waging against ISIS, Russia, or China. We keep forcing allies and client states – including post Arab Spring Egypt and, especially, Ukraine – to adopt neoliberal policies. That creates more instability at precisely the time the new regime (like it or not) is trying to consolidate.

Neoliberalism doesn't offer much benefit for many of the hearts and minds we'd like to win over.

But it has helped someone.

According to this fascinating WaPo analysis (and underlying study), the reason Syrian elites and their banks have been able to withstand sanctions is because Bashar al-Assad adopted (mixed) neoliberal policies when he assumed control. It created an interconnected elite whose ties with Assad more inextricably linked than they had previously been, such that people doing business with sanction targets have too much invested in the regime itself to stop doing business with the sanctioned entities.

Bashar aimed to revamp the three decades of populist structure in an 'authoritarian upgrading' to pursue neoliberal economic policies, eventually shifting public assets to a network of crony capitalists close to the regime. The abandonment of socialist policies in a post-populist era culminated with the establishment of the Damascus Securities Exchange (DSE) in 2009. The number of firms listed on the exchange has since grown, even after 2011, and currently comprises 23 companies spanning sectors such as transport, media, industry, agriculture, banking and insurance.

[snip]

The newly established Syrian private banking system redistributed the monopolistic market share of public banks with private lenders, while maintaining a degree of protectionism so the state-owned banks preserved their banking services monopoly. This arrangement was part of what Raymond Hinnebusch termed a 'middle way' of allowing the expansion of the private sector while ostensibly reforming state owned enterprises.

The booming private banks attracted politically connected businessmen,

including many former politicians and senior security officials, natural partners for foreign institutional investors for whom a 49 percent Syrian ownership was required for an operating license until 2010.

[snip]

Thorough review of disclosures made by publicly listed private banks on the DSE indicate a similar trend, in which prominent Syrian businessmen— some of whom have been sanctioned for their support to the regime— own a substantial number of shares and even sit on the board of directors in multiple banks. As my research shows, there are at least 23 individual investors whose shareholdings exceed 1 million shares. With more than 36 million shares in aggregate, these individuals make up at least 4.5 percent of overall shares of private banks and 11 percent of total retail investors' stock ownership.

This is symptomatic of the emergence of a new generation of 'regime businessmen,' whose relationship with the state transformed from a de facto alliance since Bashar al-Assad came to power to the central backbone of the regime now. Through joint business ventures and inter-family marriages, this alliance translated into the regime businessmen's dominance of profitable sectors, including energy, banking and finance, construction, and tourism, and has in turn ensured the regime's economic survival.

[snip]

Most of these businessmen have substantial investments in the country that outweighed their overseas assets and commercial interests. Their inextricable connections with the ruling

political elite have made them highly invested in the survival of the regime.

I suspect the same is true of Russia.

That's not all that surprising. With the exception of the largest banks, our business elite is pretty committed to the US regime, largely as a result of the cronyist benefits that those ties afford.

Indeed, the analysis raises more general questions about whether neoliberalism makes dangerous regimes more resilient.

But I also note the irony.

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## HUD DIGS AN ESCAPE TUNNEL FOR JAMIE DIMON

The other day I dismissed US disdain for Mexico at its inability to keep Chapo Guzmán jailed. After all, I pointed out, we don't even try to imprison our Transnational Crime Organization bosses.

At the Intercept yesterday, DDay pointed out another example. After JP Morgan Chase and Citigroup pled guilty to forex fraud, the Department of Housing and Urban Development "changed their form" for FHA insurance, so as to permit those TCOs to continue to have taxpayers insure their customers' loans.

On May 20 of this year, JPMorgan Chase and Citigroup both entered a guilty plea on one felony count of conspiring to rig foreign currency exchange trades, the largest market on the globe.

Five days earlier, on May 15, HUD

slipped a notice into the Federal Register, seeking to alter its standard loan-level certification form, known as HUD-92900-A. This form must be filled out for lenders to receive FHA insurance, which reimburses them if the homeowner falls into foreclosure.

On the current HUD-92900-A form, lenders must certify that their firm and its principals “have not, within a three-year period ... been convicted of or had a civil judgment rendered against them” for a variety of crimes, including “commission of fraud ... violation of Federal or State antitrust statutes or commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements or receiving stolen property.”

JPMorgan and Citi’s guilty plea would fall under the antitrust statute, and according to Brown, Warren and Waters’ reading of the certification, that would make them ineligible to obtain FHA insurance on their loans.

On the updated form, this language has been excised.

As Senators Sherrod Brown and Elizabeth Warren and Congresswoman Maxine Waters read it, this will eliminate what should have been one of the biggest impacts of the TCOs’ guilty plea.

Again, Jamie Dimon’s tunnel may not be so spectacular as Guzmán’s. But that’s partly because even more parts of government are helping him to escape any punishment for his TCO’s crimes.

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# LESSONS FROM THE FCIC FINAL REPORT IN FHFA V. NOMURA

The ruling of Judge Denise Cotes in *Federal Housing Finance Administration v. Nomura Holding America, Inc.*, is a 361 page description of the fraud and corruption that went into just one group of real estate mortgage-backed securities. FHFA was formed after the Great Crash to oversee Fannie Mae and Freddie Mac. These two entities were the actual buyers of the RMBSs offered by Nomura Securities International, Inc., and RBS Securities, Inc., then known as Greenwich Capital Markets, Inc. The Court finds that a number of statements in the offering materials were false at the time of the offering, in violation of Section 12 of the Securities Act of 1933. It awarded a judgment in the amount of \$806 million, and required FHFA to tender return of the securities.

This Reuters story is typical of the coverage of the decision, in the “we knew that” mold. Peter Eavis of the New York Times wrote a clearer explanation, pointing out that this decision undercuts any argument that Wall Street banks did not break the law in the sale of RMBSs. This is the first paragraph of the decision:

This case is complex from almost any angle, but at its core there is a single, simple question. Did defendants accurately describe the home mortgages in the Offering Documents for the securities they sold that were backed by those mortgages? Following trial, the answer to that question is clear. The Offering Documents did not correctly describe the mortgage loans. The magnitude of falsity, conservatively measured, is enormous.

In this post, I’ll look at several aspects of

the case: 1) the legal framework; 2) the discussion of the due diligence tracks the findings of the Financial Crisis Inquiry Commission in its Final Report; 3) the individual liability holdings; 4) the role of the Credit Rating Agencies; and 5) loss causation.

#### !. The Legal Framework.

The main theory of liability in this case is the Securities Act of 1933, 15 USC § 77a et seq., specifically Section 12. The operative language says that a person who

offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission

is liable to the purchaser for any loss arising from the misrepresentations. The plaintiff has to prove that the offering materials contained an untrue statement of a material fact, and that the purchaser did not know about the falsehood. Sellers can defend by proving that they did not know and “in the exercise of reasonable care could not have known” of the falsehood. Sellers can also reduce their damages to the extent they bear the burden of proving that the losses of the buyer were not caused by the falsehood. The



defendants did not claim that Fannie Mae and Freddie Mac knew that the offering materials were full of falsehoods. Thus, the main focus of the decision is the falsehoods in the offering materials.

## 2. The Due Diligence Defense and The Final Report of the FCIC

If the Defendants exercise reasonable care in preparing the offering materials, they are protected from liability. In fact, the risks of failing to exercise due care are so great that investors believe that financially strong sellers of securities wouldn't take the risk of selling unless they had done good due diligence. Of course, our dominant ideology, neoliberalism, preaches that markets, whatever they might be, police themselves, and securities laws are unnecessary. Here's a lovely example from John Spindler, now a business law professor at the University of Texas (it's not on his CV). The Final Report also calls out this bizarre idea, beginning at P. 171 (.pdf page 198).

The Final Report looks at the due diligence across the universe of securitizers in Chapter 9, page 156 (.pdf page 184). It says that the securitizers did little or no due diligence themselves. Instead, they farmed it out to third parties. These vendors examined a sample of loans from a pool, and reported whether the loans met the guidelines that the originators claimed to follow, whether they complied with federal and state laws, and whether the valuations of collateral were reasonably accurate. They also looked for compensating features that might outweigh the defects. The sample loans were graded, and the securitizers could use these grades to kick out loans, or they could waive the defects, and in either case, they could use the information to negotiate the purchase price for the pool.

The Final Report says that vendors reported very high defect rates, and that securitizers waived in a high percentage of the defective loans. The originators then put the kicked-out loans into

other pools proposed for sale. Disqualifying defects were discovered in 28% of the loans examined by one vendor, Clayton Holdings, for the 18 months ending June 30, 2007. Of those, 39% were waived in, so that 11% of defective loans were included in purchased pools. The samples were small, as low as 2 or 3%. There seems to be little effort to find the defective loans in the non-sampled portion, so it's reasonable to assume that a similar or higher percentage of loans in the entire pool are defective.

Judge Cote follows a similar pattern. Nomura had no written procedures for evaluating loans. P. 48. After it won a bid for a pool, it conducted a review of the loans, relying on the information contained on the loan tape provided by the originator of the loans in the pool. The loan tape is actually a spread sheet containing information about the loans, including FICO scores, debt to income ratios, loan to value ratios, owner-occupancy status and other important data. P. 31. Nomura sent the loan tape to its vendors to conduct reviews for credit, compliance with originator's stated underwriting guidelines, and valuation. The due diligence was done on a sample, in the range of 25-30%, but it was not a random sample, so the results could not be extended to the entire loan pool.

Of the loans submitted beginning in 2006 and the first quarter of 2007, one vendor graded 38% as failing to meet the originator guidelines. Nomura waived in 58% of those. It also had very high kickout rates for the pools it purchased. That means that of the examined loans, about 22% had major defects, again not counting the unexamined loans. With high kick-out rates, the number of defective loans remaining would be much higher.

The offering materials for these RMBSs all claimed that the loans met the originator guidelines with some exceptions. Judge Cote says this was a false statement, and that there was no showing that the defendants had done the kind

of investigation required to avoid liability.

### 3. Individual Liability.

The Judge looks at the liability of the five individual defendants in part IV.b.3. P. 234. These are the officers, directors and signatories of the entities responsible for the filing of the offering materials. The ruling is harsh:

All five Individual Defendants testified at trial. The general picture was one of limited, if any, sense of accountability and responsibility. They claimed to rely on what they assumed were robust diligence processes to ensure the accuracy of the statements Nomura made, even if they did not understand, or, worse, misunderstood, the nature of those processes. Not one of them actually understood the limited role that due diligence played in Nomura's securitization process, and some of them actually had strong reason to know of the problems with the diligence process and of the red flags that even that problematic process raised.

Each Individual Defendant made a point of highlighting the aspects of Nomura's RMBS business for which he claimed to have no responsibility. None of them identified who was responsible for ensuring the accuracy of the contents of the Prospectus Supplements relevant to this lawsuit, and, as this group of Individual Defendants furnished the most likely candidates, the only logical conclusion is that no one held that responsibility.

A detailed explanation of this summary follows. Apparently securitizers have terrible memories.

### 4. Misleading The Credit Rating Agencies

FHFA did not claim the ratings were false, but

that the ratings were not based on accurate information about the actual collateral for the RMBSs. The Court found that the defendants gamed the credit rating agencies models by submitting only the loan tapes prepared by the originators, even when they knew that the loan tapes were full of errors that would affect the final rating. Page 202. The Court found that the ratings depended on factors like the loan to value ratio and the debt to income ratio. The Court found that the LTV ratios were lower than represented by Nomura in 18-36% of the loans, and that many LTV ratios were above 100%, which skewed the models of the credit rating agencies and bought Nomura undeserved AAA ratings. This is a nice piece of lawyering by the legal team at Quinn Emanuel.

The FCIC is not so forgiving towards the Credit Rating Agencies:

The Commission concludes that the credit rating agencies abysmally failed in their central mission to provide quality ratings on securities for the benefit of investors. They did not heed many warning signs indicating significant problems in the housing and mortgage sector. Conclusion to Ch. 10 at .pdf 240

But there's no point in shooting at the credit rating agencies. They have a get out of jail free card from the judiciary, which says that they are just giving opinions and are protected by the First Amendment.

##### 5. Loss Causation.

The defendants argued that they didn't cause the loss. They claimed that it was the housing market crash. Judge Cote cites a recent decision from the Second Circuit, *Fin. Guar. Ins. Co. v. Putnam Advisory Co., LLC*, – F.3d –, 2015 WL 1654120 at 8 n.2

... there may be circumstances under which a marketwide economic collapse is itself caused by the conduct alleged to have

caused a plaintiff's loss, although the link between any particular defendant's alleged misconduct and the downturn may be difficult to establish.

Judge Cote tells us that the Second Circuit cited the Final Report of the FCIC for the proposition that the housing crash was linked to the "shoddy origination practices concealed by the misrepresentations" in the Nomura offering materials. Those shoddy practices contributed to the housing bubble, and were factors in the Great Crash. Crucially, she writes at 332:

Defendants do not dispute this. They do not deny that there is a link between the securitization frenzy associated with those shoddy practices and the very macroeconomic factors that they say caused the losses to the Certificates. This lack of contest, standing alone, dooms defendants' loss causation defense, which, again, requires them to affirmatively prove that something other than the alleged defects caused the losses.

## 6. Conclusions

The legal team at Quinn Emanuel did a nice job of preparation. The people who prepared the testimony of the expert Dr. William Schwert deserve a special mention: that was really smart. See page 204 and previous material.

It looks like the Quinn Emanuel team and the Judge were deeply informed by the Final Report, and used it as a road map to digging up and presenting evidence of the fraud and corruption in the securitization process. It's a terrible shame the spineless prosecutors at the Department of Justice couldn't grasp the point of the Final Report. That is, unless the prosecutors did understand, and the decision was made by the neoliberals at the top, Lanny Breuer and Eric Holder, and the banker's best friend,

## DEA LIKELY HAS MORE THAN ONE DRAGNET

As yesterday's USAT story on the DEA dragnet reported, DOJ's Inspector General is investigating DEA's dragnet. I first reported that in April 2014.

As I also reported in February, FBI is obstructing that investigation – so much so, that DOJ's Inspector General Michael Horowitz encouraged Congress to start using appropriations to force it to stop.

The unfulfilled information request that causes the OIG to make this report was sent to the FBI on November 20, 2014. Since that time, the FBI has made a partial production in this matter, and there have been multiple discussions between the OIG and the FBI about this request, resulting in the OIG setting a final deadline for production of all material of February 13, 2015.

On February 12, 2015, the FBI informed the OIG that it would not be able to produce the remaining records by the deadline. The FBI gave an estimate of 1-2 weeks to complete the production but did not commit to do so by a date certain. The reason for the FBI's inability to meet the prior deadline set by the OIG for production is the FBI's desire to continue its review of emails requested by the OIG to determine whether they contain any information which the FBI maintains the OIG is not legally entitled to access, such as grand jury, Title III electronic

surveillance, and Fair Credit Reporting Act information.

DOJ IG's comments about this investigation are worth reconsideration for two reasons.

First, FBI's obstruction of the investigation emphasize what we already knew from the Shantia Hassanshahi case (via which we first learned about this database). The FBI is (was) also using this database, and for purposes that far exceed counter-narcotics (Hassanshahi was busted for sanctions violations). And, as the Homeland Security investigator's dramatically changing stories about how he first identified Hassanshahi suggest, for each of those usages, there's likely some kind of parallel construction going on.

How many cases have been based off this giant dragnet?

But also look at how DOJ's IG has described this investigation.

## ***Administrative Subpoenas***

The OIG is examining the DEA's use of administrative subpoenas to obtain broad collections of data or information. The review will address the legal authority for the acquisition or use of these data collections; the existence and effectiveness of any policies and procedural safeguards established with respect to the collection, use, and retention of the data; the creation, dissemination, and usefulness of any products generated from the data; and the use of "parallel construction" or other techniques to protect the confidentiality of these programs.

DOJ IG is investigating DEA's use of subpoenas to obtain *broad collections of data or*

*information*. Its review will address the legal authority underlying *these data collections*.

Collections, plural.

Admittedly, we already know of two DEA dragnets: the international dragnet described by the USAT, and the domestic one – Hemisphere – though that resides at least partially with the White House Drug Czar.

But the authority used in the USAT dragnet, 21 USC 876, is the drug equivalent of Section 215, permitting the agency to obtain “tangible things” relevant to (that phrase again) an investigation. We know FBI used equivalent language under Section 215 to collect financial and Internet records as well.

Hell, the DEA couldn’t very well track drug cartels without following the money, via whatever means. Plus, we know cartels have used things like travelers checks and gift cards to move money in recent years.

So I would be willing to bet more than a few quarters that DOJ IG’s use of the term “collections” suggests there’s more than just these telecom dragnets hiding somewhere.

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**CHELSEA MANNING  
WARNED OF NURI AL-  
MALIKI’S CORRUPTION  
IN 2010. DAVID  
PETRAEUS’  
SUBORDINATES**



# SILENCED HER.

In early 2010, Chelsea Manning discovered that a group of people Iraq's Federal Police were treating as insurgents were instead trying to call attention to Nuri al-Maliki's corruption. When she alerted her supervisors to that fact, they told her to "drop it," and instead find more people who were publishing "anti-Iraqi literature" calling out Maliki's corruption.

On 27 February 2010, a report was received from a subordinate battalion. The report described an event in which the FP detained fifteen (15) individuals for printing "anti-Iraqi literature." By 2 March 2010, I received instructions from an S3 section officer in the 2-10BCT Tactical Operations Center to investigate the matter, and figure out who these "bad guys" were, and how significant this event was for the FP.

Over the course of my research, I found that none of the individuals had previous ties with anti-Iraqi actions or suspected terrorist or militia groups. A few hours later, I received several photos from the scene from the subordinate battalion.

[snip]

I printed a blown up copy of the high-resolution photo, and laminated it for ease of storage and transfer. I then walked to the TOC and delivered the laminated copy to our category 2 interpreter. She reviewed the information and about a half-hour later delivered a rough written transcript in English to the S2 section.

I read the transcript, and followed up with her, asking for her take on its contents. She said it was easy for her to transcribe verbatim since I blew up the photograph and laminated it. She

said the general nature of the document was benign. The documentation, as I assessed as well, was merely a scholarly critique of the then-current Iraqi Prime Minister, Nouri al-Maliki. It detailed corruption within the cabinet of al-Maliki's government, and the financial impact of this corruption on the Iraqi people.

After discovering this discrepancy between FP's report, and the interpreter's transcript, I forwarded this discovery, in person to the TO OIC and Battle NCOIC.

The TOC OIC and, the overhearing Battlecaptain, informed me they didn't need or want to know this information any more. They told me to "drop it" and to just assist them and the FP in finding out where more of these print shops creating "anti-Iraqi literature" might be. I couldn't believe what I heard, (24-25)

At the time, David Petraeus was the head of CENTCOM, the very top of the chain of command that had ordered Manning to "drop" concerns about Iraqis being detained for legitimate opposition to Maliki's corruption.

Manning would go on to leak more documents showing US complicity in Iraqi abuses, going back to 2004. None of those documents were classified more than Secret. Her efforts (in part) to alert Americans to the abuse the military chain of command in Iraq was ignoring won her a 35-year sentence in Leavenworth.

Compare that to David Petraeus who pretends, to this day, Maliki's corruption was not known and not knowable before the US withdrew troops in 2011, who pretends the US troops under his command did not ignore, even facilitate, Maliki's corruption.

### What went wrong?

The proximate cause of Iraq's unraveling was the increasing authoritarian, sectarian and corrupt conduct of the Iraqi government and its leader after the departure of the last U.S. combat forces in 2011. The actions of the Iraqi prime minister undid the major accomplishment of the Surge. (They) alienated the Iraqi Sunnis and once again created in the Sunni areas fertile fields for the planting of the seeds of extremism, essentially opening the door to the takeover of the Islamic State. Some may contend that all of this was inevitable. Iraq was bound to fail, they will argue, because of the inherently sectarian character of the Iraqi people. I don't agree with that assessment.

The tragedy is that political leaders failed so badly at delivering what Iraqis clearly wanted – and for that, a great deal of responsibility lies with Prime Minister Maliki.

Unlike Manning, Petraeus adheres to a myth, the myth that this war was not lost 12 years ago, when George Bush ordered us to invade based on a pack of lies, when Petraeus and his fellow commanders failed to bring security after the invasion (largely through the priorities of their superiors), when Paul Bremer decided to criminalize the bureaucracy that might have restored stability – and a secular character – to Iraq.

Of course, Petraeus' service to that myth is no doubt a big part of the reason he can continue to influence public opinion from the comfort of his own home as he prepares to serve his 2 years of probation for leaking code word documents, documents far more sensitive than those Manning leaked, as opposed to the 35 years in Leavenworth Manning received.

Which is, of course, a pretty potent symbol of our own corruption.