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# United States v. Santos: The U.S. Supreme Court Rewrites the Money Laundering Statute

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# *UNITED STATES V. SANTOS:* THE U.S. SUPREME COURT REWRITES THE MONEY LAUNDERING STATUTE

By Stefan D. Cassella[1]

*The United States Supreme Court has upset decades of money laundering case law, by construing the term "proceeds" to mean "net profits" instead of "gross receipts" in at least some money laundering cases. In the resulting confusion, lower courts have struggled to determine when the Court's ruling applies, and how the Government may satisfy the "profits" requirement when it must do so. This article discusses the Court's decision in* United States v. Santos *and the problems that it has created, and attempts to make sense of the post-*Santos *case law.*

## INTRODUCTION

In most money laundering cases, the Government must prove that at least some of the property involved in the money laundering transaction – that is, the property the defendant is accused of laundering – was the "proceeds" of a crime.[2] The term "proceeds" is nowhere defined in the money laundering statute, but for more than two decades,[3] almost no one considered this to be an issue. To the contrary, the vast majority of courts routinely assumed – and some courts expressly held – that the "proceeds" of an offense are its "gross receipts" – *i.e.*,

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[2] The "proceeds" element is one of the four essential elements of the offense of domestic money laundering under federal law, 18 U.S.C. § 1956(a)(1). Taken together, the four elements are that the defendant 1) conducted a *financial transaction*, 2) involving the *proceeds* of a specified unlawful activity, 3) *knowing* that the property was the proceeds of some form of unlawful activity, and 4) *intending* to promote another specified unlawful activity, or *knowing* that the transaction was designed to conceal or disguise the source, nature, location, ownership or control of the proceeds of the activity from which the property was derived. *Id.* A separate international money laundering statute, 18 U.S.C. § 1956(a)(2)(A) does not contain a "proceeds" element. As discussed later in the text, this gives prosecutors a convenient way of avoiding the problems created by the *Santos* decision in international money laundering cases.

[3] The statutes making money laundering a federal criminal offense, 18 U.S.C. §§ 1956 and 1957, were enacted in 1986 as part of the Anti-Drug Abuse Act of 1986.

the tangible and intangible things of value that one obtains or retains through the commission of a crime.[4]

On June 2, 2008, however, the U.S. Supreme Court ruled that, for purposes of the money laundering statutes, "proceeds" means "net profits" not "gross receipts." *See United States v. Santos,* 128 S. Ct. 2020 (2008). That is, in the view of the Court's plurality, to prove a money laundering offense, the Government must establish that the money being laundered was not just the money obtained as a result of the offense, but was the *profits* that remained after the expenses of the offense were deducted. This controversial decision upset decades of money laundering case law built on the assumption that "proceeds" meant "gross receipts," and has produced a wave of litigation in which the courts have struggled to apply *Santos* to the vast variety of facts that can arise in money laundering prosecutions. The results, to say the least, have been mixed.

Some courts have held that *Santos* is limited to its facts, and that therefore its "profits" requirement applies only in a narrow set of cases. For example, some cases hold that *Santos* only applies when the underlying crime that generated the proceeds was a gambling offense – the crime that served as the predicate in *Santos* itself – or where the money laundering transaction was the payment of an essential expense of the underlying crime such that the money laundering offense and the predicate act effectively merged with one another. Other courts have read *Santos* to apply more broadly, but have held that the profits test was satisfied nonetheless. Ironically, contrary to the expectations of many observers when *Santos* was first decided, no court has yet required the Government to produce books and records or similar evidence to prove that the predicate crime was profitable at the time it generated the money or other property that the defendant allegedly laundered in a subsequent transaction.

This article reviews the three divergent opinions rendered by the Supreme Court in *Santos* – decisions that produced a controversial decision with no clear majority, and then attempts to analyze the post-*Santos* case law. In so doing, I attempt to group the post-*Santos* decisions in a way that illustrates the different approaches that the lower courts have taken, beginning with the cases that discuss whether *Santos* applies at all in a given case, and then moving on to the cases that apply the profits test to particular facts and circumstances. Finally, the article concludes with the discussion of a possible jury instruction that the courts

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[4] As is discussed *infra*, this is similar to the definition of "proceeds" that appears in Art. 2(e) of the United Nations Convention Against Transnational Organized Crime.

might use to explain to a jury exactly what it must find in a money laundering case before returning a verdict of guilty.

## THE FACTS IN *SANTOS*

Efrain Santos ran an illegal gambling business. He took in money from bettors at bars and restaurants, and after taking out a cut for himself, used that money to pay winning bettors, labor costs, and other expenses of the activity that generated the money.

The Government charged those transactions as money laundering offenses committed in violation of 18 U.S.C. § 1956(a)(1)(A)(i) – what is commonly called "promotion money laundering." Each payment that Santos made, the Government said, involved the proceeds of the crime – *i.e.*, money taken in by the gambling operation – and "promoted" the scheme by paying its expenses.

## THE LEGAL BACKGROUND

There are two types of money laundering offenses under the money laundering statute: Under Section 1956(a)(1)(A)(i), it is an offense to conduct a financial transaction using criminal proceeds with the intent to *promote* a criminal activity; this is "promotion money laundering." Under Section 1956(a)(1)(B)(i), it is an offense to conduct a financial transaction using criminal proceeds knowing that the transaction was designed to *conceal or disguise* the nature, source, location, ownership or control of the proceeds; this is "concealment money laundering."

There was plenty of precedent for the Government's promotion money laundering theory in *Santos.* Charging promotion money laundering when a defendant uses the revenue from an illegal scheme to keep the scheme going has been routine practice in federal courts for decades, and there are a great many cases affirming money laundering convictions in such instances.[5] In

[5] *See United States v. Singh,* 518 F.3d 236, 247-48 (4th Cir. 2008) (prostitute who uses the money received from her first customer of the day to pay for her motel room commits promotion money laundering where the payment gives her the right to the use of the room for the rest of the day without further charge, and creates goodwill for future transactions); *United States v. Pennell*, 409 F.3d 240, 244 (5th Cir. 2005) (using proceeds from bogus invoice to repurchase other bogus invoices to keep the scheme going was a promotion money laundering offense); *United States v. Thorn*, 317 F.3d 107, 133-34 (2d Cir. 2003) (promotion includes continuing the illegal activity or taking a step essential to its completion; using

particular, courts have held that plowing gambling receipts back into an illegal gambling business promotes the continuation of the scheme and thus constitutes a money laundering violation. In fact – and this is an important part of this story – one of the leading cases on that point was the decision of the Court of Appeals for the Seventh Circuit in *United States v. Febus*, 218 F.3d 784, 789-90 (7th Cir. 2000).[6]

Moreover, no court had held that there was any "merger" problem if the money laundering transaction, as alleged in the indictment, was actually part of the offense being promoted. To the contrary, it was well-established that while the money laundering transaction had to be separate from the offense that *generated* the proceeds, the same transaction could be both a promotion money laundering offense and part of the underlying scheme. For example, in *United States v. Taylor*, 239 F.3d 994, 999 (9th Cir. 2001), the court held that using criminal proceeds to pay for a minor's airline ticket from Arizona to Nevada to engage in prostitution was both money laundering offense and violation of 18 U.S.C. § 2423 – the statute making it a crime to transport a minor in interstate commerce to engage in sex trafficking.[7] Likewise in *Febus*, the court rejected the

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proceeds to "finance the next project," where each project is a fraud involving asbestos cleanup for another victim who pays for services not performed properly, promotes the offense); *United States v. Masten*, 170 F.3d 790, 797-98 (7th Cir. 1999) (using money from new investors to pay off earlier investors—as in a classic *Ponzi* scheme—promotes the scheme because it fosters good will and nurtures false impression that investors who want their money back will be paid); *United States v. Godwin*, 272 F.3d 659, 669-70 (4th Cir. 2001) (paying interest to original investors in Ponzi scheme promotes the scheme by quieting the "squeaky wheel"); *United States v. Savage*, 67 F.3d 1435, 1440-41 (9th Cir. 1995) (money transfers provided defendant with resources to travel and continue contacting victims, thus promoting the fraud scheme); *United States v. Cole*, 988 F.2d 681, 685 (7th Cir. 1993) (payment of "interest" to defrauded investors keeps scheme going).

[6] *See also United States v. Iacaboni*, 363 F.3d 1, 5 (1st Cir. 2004) (paying winners promotes the gambling scheme because it is necessary to keep the scheme going); *United States v. Conley*, 37 F.3d 970, 978-81 (3d Cir. 1994) ("plowing" proceeds of gambling business back into business), *rev'g* 833 F. Supp. 1121 (W.D. Pa. 1993).

[7] *See also United States v. Wyly*, 193 F.3d 289, 296 (5th Cir. 1999) (paying kickback to public official promotes the mail fraud scheme of which kickback is a part); *United States v. Wilkinson*, 137 F.3d 214, 221 (4th Cir. 1998) (same transaction may constitute money laundering offense and next step in overall fraud scheme; there is no merger problem with the promotion prong of the offense; distinguishing *Heaps*, *infra*); *United States v. Piervinanzi*, 23 F.3d 670, 679-81 (2d Cir. 1994) (wiring money out of bank to an overseas account to commit bank fraud is an act intended to promote the bank fraud of which the wire transfer is a part);

argument that the money laundering offense merged with the gambling offense when the defendant used the gambling proceeds to pay off the winning bettors.

The only significant limitation that some courts placed on the promotion money laundering theory was one based on a distinction that the Fourth Circuit drew: a transaction that pays an expense necessary to keep the scheme going in the *future* is a promotion money laundering offense, the court said, but one that pays the expense of a completed scheme is not. Thus, in *United States v. Heaps*, 39 F.3d 479, 485-86 (4th Cir. 1994), the court held that using the proceeds of a drug sale to pay the person who had provided the same drugs for sale on consignment was not a money laundering offense under the promotion prong of the statute because the payment was a one-time payment on an antecedent debt and there was no evidence it was made to create goodwill or otherwise promote future transactions. But the same court held in *United States v. Singh,* 518 F.3d 236, 247-48 (4th Cir. 2008), that a prostitute's use of the proceeds of her prostitution offense to pay for the future use of a motel room did constitute promotion money laundering because it was intended to keep the prostitution scheme going into the future.[8]

## THE COURT OF APPEALS' DECISION IN *SANTOS*

The Fourth Circuit's distinction aside, when the Government drafted the indictment in *Santos,* it was on solid legal ground, and Santos was found guilty by a jury. But the Court of Appeals for the Seventh Circuit reversed the conviction in

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*United States v. Anvari-Hamedani*, 378 F. Supp. 2d 821, 832-33 (N.D. Ohio 2005) (wiring money from United States to Iran is both a section 1956(a)(2)(A) offense and an IEEPA offense; there is no merger, multiplicity, or double jeopardy problem; following *Piervinanzi*).

[8] Not all appellate courts drew the distinction the Fourth Circuit drew between transactions that keep a scheme going into the future and transactions that simply complete the act that generated the criminal proceeds in the first instance. In fact, prior to *Santos*, the majority of courts held that promotion money laundering encompassed transactions that related back to the predicate criminal activity. *See United States v. Montoya*, 945 F.2d 1068, 1076 (9th Cir. 1991) (deposit of check that represents proceeds of state bribery offense promotes bribery in that it gives defendant use of the fruits of his criminal activity); *United States v. Paramo*, 998 F.2d 1212, 1218 (3d Cir. 1993) (converting fraudulently obtained checks into cash promotes underlying fraud scheme by giving defendant access to funds; intent to plow back funds into the scheme not required); *United States v. Valuck*, 286 F.3d 221, 226 (5th Cir. 2002) (negotiating cashier's check purchased with fraud proceeds deposited into codefendant's account allowed defendant to "prosper from his wrongdoing" by completing the "antecedent wire fraud" and giving him access to the money; prosecution of a "receipt-and-deposit" transaction is legally proper however disfavored as a matter of policy).

*United States v. Santos*, 461 F.3d 886 (7th Cir. 2006).

How could the court do that in the face of all of the precedents – including its own decision in *Febus* – holding that plowing the proceeds back into the scheme constituted promotion money laundering? Evidently, the court was offended that the defendant was being convicted of money laundering when all he did was pay the essential expenses of the gambling offense, but it was precluded by *Febus* from holding that the paying of expenses did not *promote* the scheme, or that there was a merger between the money laundering offense and the gambling offense. So, if the panel wanted to reverse the conviction, it had to do so on some other ground. Its solution was to reinterpret the "proceeds" element of the money laundering statute.

Relying on its earlier decision in *United States v. Scialabba*, 282 F.3d 475, 478 (7th Cir. 2002), the court held that the term "proceeds," as used in Section 1956, means net profits, not gross receipts. How did that solve the court's problem? Because there are no profits of a business until its expenses are paid, the court reasoned, payments made to defray the necessary expenses of the business cannot themselves be said to involve the profits of the business. Thus, if a money laundering conviction requires proof that the transaction involved "proceeds," and "proceeds" means "profits," payments that defray the essential expenses of an illegal enterprise can never constitute a money laundering offense. Accordingly, the court held that Santos' payments of the expenses of his gambling operation could not have constituted violations of the money laundering statute, and his conviction was reversed.

Prosecutors throughout the United States thought this was absurd. It would have been one thing if the court had taken a narrower view of what "promotion" means, as the Fourth Circuit did in *Heaps,* and avoided the merger problem by holding that when Santos paid off his winning bettors he was merely completing the underlying gambling offense and not was committing a new crime or facilitating the continuance of his operation into the future. But here the panel was construing an entirely separate element of the money laundering offense in a way that made no sense, just to achieve a desired result.

That could not be right, the prosecutors said; "proceeds" can't mean profits in a money laundering case. Is the Government supposed to prove that a drug dealer earned a profit on his drug sales before he may be convicted of money laundering when he hides his drug money in Mexico? The purpose of the money laundering statute – particularly as applied in drug cases – is to criminalize the illegal movement, concealment and reinvestment of the money derived from an

illegal act; whether that act was "profitable" in an economic sense, should be irrelevant. Yet the Court of Appeals held in *Santos* that it was not irrelevant at all. Indeed, a year after *Santos* was decided, the same court held that a drug dealer was *not* guilty of money laundering when he hired a third party to transport the "gross proceeds" of his drug offense across the Mexican border.[9]

Other appellate courts, however, agreed with the Government on this point and rejected *Scialabba* and *Santos,* holding that "proceeds" means "gross receipts."[10] Confident that these courts had the better view, the Department of Justice asked the Supreme Court to grant *certiorari* to resolve the split in the circuits and fix the problem that the Seventh Circuit had created in that jurisdiction. To put it mildly, things did not go according to plan.

## THE PLURALITY, DISSENTING, AND CONCURRING OPINIONS OF THE SUPREME COURT

The *Santos* case divided the Supreme Court into three factions: four of the nine justice agreed with the Court of Appeals that "proceeds" means "profits" in all money laundering cases; another four said that, to the contrary, it means "gross receipts" in all cases; and a lone justice said that it might mean profits in some cases and gross receipts in others. Thus, with no majority decision, the Court spawned massive confusion in the lower courts and made a complete mess of what had been an important law enforcement tool involving a well-understood statute.

To understand what the Supreme Court has wrought, and to make sense of the conflicting post-*Santos* decisions of the lower courts, it is necessary to examine the three *Santos* decisions in some detail.

### *The plurality opinion*

The lead opinion was written by Justice Antonin Scalia on behalf of a four-justice plurality. He reasoned that the term "proceeds" as used in Section 1956

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[9] *See United States v. Malone*, 484 F.3d 916, 921 (7th Cir. 2007) (applying *Scialabba*; intermediary hired by drug dealer to find a way to transport his drug proceeds to him in Mexico is not guilty of a money laundering offense because, in the intermediary's hands, the money is "gross proceeds"; the only net profit would be the intermediary's commission).

[10] *See United States v. Grasso*, 381 F.3d 160, 167 (3d Cir. 2004); *United States v. Iacaboni*, 363 F.3d 1, 4 (1st Cir. 2004).

could mean either profits or receipts, and that Congress's failure to specify which meaning was intended rendered the statute "ambiguous." Invoking what is known as the rule of lenity, Justice Scalia said that courts are required to construe ambiguous statutes in the way that is most favorable to the defendant in a criminal case. Accordingly, Justice Scalia concluded, because it would be harder for the Government to satisfy a profits test in a criminal case, "proceeds" must mean "net profits" and not "gross receipts" in all money laundering cases.

Was the statute really so ambiguous that the Court was compelled to invoke the rule of lenity? Or was there some other reason why they felt it necessary to go so far?

What really upset the plurality was the same thing that had concerned the panel in the Seventh Circuit – that the Government was abusing the statute by charging promotion money laundering in cases, like *Santos*, where the alleged transaction was nothing more than the payment of a necessary expense of the underlying crime. Over and over the plurality said that it was wrong to use the money laundering statute to impose a 20-year sentence – the punishment for money laundering – on someone who had done nothing more than commit a gambling offense that carried a maximum penalty of 5 years. In such cases, the plurality said, the money laundering charge merged with the underlying unlawful activity, such that a conviction for money laundering would constitute an improper second conviction for the same offense.

Now, as Justice Stephen Breyer said, the Court could have dealt with that problem at the sentencing end. It could have held that when a defendant is convicted of both money laundering and another crime in a case where the two offenses merge, the sentences have to be concurrent and cannot exceed the maximum sentence for the underlying offense. Or it could have limited the scope of "promotion money laundering" to exclude cases where the transaction was really an essential step in committing a completed crime. Unlike the Seventh Circuit panel, the Supreme Court wasn't limited by the case law construing what "promotion" means. But Justice Scalia preferred to follow the Seventh Circuit's approach, and simply redefined "proceeds" to mean "net profits," thus making it impossible for the Government to convict a person of money laundering if all he is doing is paying the expenses of his criminal scheme.

"If 'proceeds' meant 'receipts,'" he said, "nearly every violation of the illegal-lottery statute would also be a violation of the money laundering statute, because paying a winning bettor is a transaction involving receipts that the defendant intends to promote the carrying on of the lottery." Slip op. at 8. On the

other hand, in the plurality's view, "[i]nterpreting "proceeds" to mean "profits" eliminates the merger problem." *Id.* at 9. "[A] criminal who enters into a transaction paying the expenses of his illegal activity cannot possibly violate the money laundering statute, because by definition profits consist of what remains after expenses are paid. Defraying an activity's costs with its receipts simply will not be covered." *Id.*

Among the many problems with this approach is that the plurality opinion did not limit its construction of the statute to promotion cases, like *Santos* and *Heaps,* where the act of promotion consisted of defraying the expenses of a completed crime and thus could be viewed as having merged with that offense. To the contrary, the plurality's reasoning apparently would apply to all money laundering offenses, including cases where the transaction facilitated the continuation of an on-going offense into the future, as in *Singh*, or constituted an entirely new offense, as in *Taylor.* And it would apply equally to *concealment* money laundering cases in which the transaction had nothing whatsoever to do with defraying expenses, but instead involved prototypical efforts to hide criminal proceeds in false names or foreign bank accounts or embedded in convoluted transactions. Why a "profits rule" would make sense in that context the plurality did not explain.

Moreover, Justice Scalia made it clear that his view applied not only to the proceeds element of the money laundering offense, but to the knowledge element as well. To obtain a conviction, he said, the Government would have to prove beyond a reasonable doubt not only that the property involved in the transaction represented the profits of an offense, but also that the defendant knew that the property represented such profits. *Id.* at 14. In many money laundering cases, the defendant is not the person who committed the underlying crime but instead is a third party who is given the criminal proceeds to launder, often for a fee. Under Justice Scalia's approach, the Government would not only have to prove that the laundered funds represented the *profits* of a crime, but also that the third party defendant knew that the crime was profitable. It is doubtful that this is what Congress intended.

***The principal dissent***

Another four justices, led by Justice Samuel Alito, filed a dissenting opinion sharply disagreeing with the plurality's view. They would have held that in all money laundering cases, "proceeds" means "the total amount brought in" – *i.e.,* the gross receipts of the underlying crime. The Scalia view, Justice Alito said,

"would frustrate Congress' intent and maim a statute that was enacted as an important defense against organized criminal enterprises." Opinion of Alito, J., dissenting, at 1.

First, Justice Alito pointed out that the "profits" definition would be inconsistent with the legislative history of the money laundering statute and with other money laundering laws. The money laundering statutes were enacted primarily to deal with the laundering of drug proceeds, and it would make no sense to limit it to cases where a drug offense was profitable. The point of the statute is to inhibit the reinvestment of the money to promote the growth of the criminal enterprise and the commission of criminal acts in the future, he said. These concerns exist whether or not the underlying crime has turned a profit at the time the alleged money laundering transaction takes place. Therefore, limiting the definition of proceeds to "net profits" is a pointless exercise.

> Even if a drug or gambling ring was temporarily operating in the red during a particular period, the laundering of money acquired during that time would present the same dangers as the laundering of money acquired during times of profit. It is therefore implausible that Congress wanted to throw up such pointless obstacles. *Id.* at 12-13.

Justice Alito also noted that the United States is a party to the U.N. Convention Against Transnational Organized Crime. The Convention obligates all States to enact money laundering statutes and defines "proceeds" to mean "any property derived from or obtained, directly or indirectly, through the commission of an offence." Convention, Art.2(e). A "profits" definition, Justice Alito concluded, would put the United States in violation of the Convention.

Justice Alito devoted most of his attack on the plurality opinion to the practical problems of proof that the "profits" rule would create. Among other things, the Government would have to show that an illicit enterprise had yielded a profit over the long term, despite the ebb and flow of its fortunes. It was no answer for the plurality to suggest, Justice Alito continued, that the Government could charge money laundering based on isolated event that had proven to be profitable: in many money laundering cases, the Government's only alternative is to establish that the money involved in a financial transaction was derived from a particular type of criminal activity generally, it being impossible to trace the laundered funds back to a particular event.

Justice Alito gave the following example of a typical money laundering case involving drug proceeds:

> [T]he prototypical case involves numerous criminal acts that occur over a period of time and the accumulation of funds from all these acts prior to laundering – for example, the organized crime syndicate or drug cartel that amasses large sums before engaging in a laundering transaction. . . . In such cases, it is unrealistic to think the individual dollars can be traced back to individual drug sales – or that Congress wanted to require such tracing. *Id.* at 13.

The same problems, he said, would apply to gambling cases, fraud cases, and a variety of other crimes that "comprehend[] numerous acts that occurred over a considerable period of time." *Id.* at 15. In fact, that is how it came to be well-established that the Government does not have to trace the funds involved in a money laundering transaction to a particular offense.[11]

Finally, Justice Alito pointed out, as I did a moment ago, that it would be difficult to prove the knowledge element in cases where the defendant was a third party and not the person who had committed the underlying crime. For example, the Government could not convict a car dealer of aiding a drug dealer in concealing or disguising his drug proceeds by purchasing cars in false names unless it could prove that the car dealer knew that the drug dealer's business was profitable.

Justice Scalia's response to these practical difficulties was terse: "We interpret ambiguous criminal statutes in favor of defendants, not prosecutors." Plurality Opinion at 12.

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[11] *United States v. Jackson*, 983 F.2d 757, 766 (7th Cir. 1993) (the Government is only required to prove money came from drug dealing; no need to trace laundered proceeds to specific predicate offense); *United States v. Mankarious*, 151 F.3d 694, 702 (7th Cir. 1998) (where SUA is mail fraud, the Government need only show that laundered funds came from a fraudulent scheme and that the use of the mails furthered that scheme; no need to trace proceeds to a particular mailing); *United States v. Habhab*, 132 F.3d 410, 414 (8th Cir. 1997) (evidence that defendant was engaged in fraudulent activity and had received fraud proceeds prior to date of financial transaction charged as money laundering was sufficient to establish money was SUA proceeds); *United States v. Bencs*, 28 F.3d 555, 562 (use of the term *involve* does not impose a tracing requirement) (6th Cir. 1994); *United States v. Carr*, 25 F.3d 1194, 1205 (3d Cir. 1994) (same).

***Justice Stevens' concurring opinion***

The opinions written by Justice Scalia and Justice Alito left the Court evenly divided between the view that proceeds means profits in all cases (the "profits rule"), and the view that it means gross receipts in all cases (the "receipts rule"). Justice John Paul Stevens provided the tie-breaking vote.

Disagreeing with both the plurality and the dissent, Justice Stevens argued that there was no reason the Court had to pick one definition of proceeds that would apply in all cases, regardless of the nature of the underlying unlawful activity. In some cases, he said, one definition might be "incongruous" or lead to "perverse results," while in other cases the same definition might not. Opinion of Stevens, J., concurring, at 2, 5.

For example, Justice Stevens agreed with Justice Alito that "Congress intended the term "proceeds" to include gross revenues from "the sale of contraband and the operation of organized crime syndicates involving such sales." *Id.* at 2-3. "Thus I cannot agree with the plurality that the rule of lenity must apply to the definition of 'proceeds" for these types of unlawful activities," he said. *Id.,* at 3 n.3. Consequently, there were five votes on the Court for applying the receipts rule to drug cases.

On the other hand, Justice Stevens said that defining proceeds to mean gross receipts in other cases would have "perverse consequences." His concern was that calling the "mere payment of the expense" of the illegal business a money laundering offense was "tantamount to double jeopardy:"

> The consequences of applying a 'gross receipts' definition of 'proceeds' to the gambling operation conducted by respondents are so perverse that I cannot believe they were contemplated by Congress . . . . *Id.* at 3.
>
> Allowing the Government to treat the mere payment of the expense of operating an illegal gambling business as a separate offense is in practical effect tantamount to double jeopardy, which is particularly unfair in this case because the penalties for money laundering are substantially more severe than those for the underlying offense of operating a gambling business. *Id.* at 4.

Accordingly, Justice Stevens concluded that "[t]he revenue generated by a gambling business that is used to pay the essential expenses of operating that business is not 'proceeds' within the meaning of the money laundering statute." *Id.* at 5.

**WHAT DOES *SANTOS* HOLD?**

So what is the holding in *Santos*? When the Court is split 4-4-1 so that there is no majority decision, or even a common thread that had the support of at least five justices, does the case have any precedential value beyond its facts? If not, does it mean that *Santos* applies only when the predicate offense in a money laundering prosecution is the operation of an illegal gambling operation? Or does the tie-breaking decision of Justice Stevens mean that the courts must engage in a case by case analysis to determine if the "profits" rule applies based on the legislative history of the money laundering statute and the nature of the underlying crime? In other words, is there one blanket rule for gambling cases, another for drug cases, a third for sex offense cases, and so forth? Or should the courts look not at the nature of the underlying crime but rather at the relationship of the money laundering transaction to that crime, limiting the profits rule to situations where the particular facts of the case would yield the "perverse results" that Justice Stevens wanted to avoid?

So far, the cases decided by the lower courts have been all over the map. A significant number have agreed with the Government that because there is no controlling decision, *Santos* is limited to its facts, and thus applies only when the underlying crime is the operation of an illegal gambling business. Others, hold that while the profits test may not be limited to gambling cases, it does not apply in drug cases. A large number of courts – a plurality? – hold that the profits test may well apply across the board, but that the court must look to the relationship of the money laundering transaction to the underlying crime, and should find that a money laundering conviction is precluded only if the transaction constituted an essential expense. Interestingly, not a single court has yet required the Government to prove, based on accounting principles and economic data, that the underlying crime was "profitable" in the sense that its revenue exceeded its costs.

The following summary illustrates how the lower courts are reacting to *Santos* and suggests the arguments that practitioners may want to make as new cases arise.

## THE POST-*SANTOS* CASE LAW

### Does *Santos* apply outside of gambling cases

The Government has taken the position in all post-*Santos* cases that the Supreme Court's decision has no precedential value beyond its facts. The only thing that a five-justice majority agreed on, the Government argues, is that the profits test applies in cases involving the proceeds of an illegal gambling operation. The view that the profits test applies in *all* money laundering cases had only four votes; the view that it applies in *no* money laundering cases had only four votes; and the view that the a court must do a case-by-case analysis to determine which test applies had only one vote – eight justices having agreed, for divergent reasons, that Justice Stevens' approach was wrong. Thus, in the Government's view, there is no majority for any proposition other than that a court must apply the profits test – whatever that means – in gambling cases.

At least four trial courts have accepted this view, but other courts have not. In *Kenemore v. United States,* 2008 WL 4965948, at *6 (E.D. Tex. Nov. 17, 2008), the court carefully analyzed *Santos* and held that it only applies in money laundering prosecutions involving "standalone illegal gambling operations," and thus does not apply where the defendant was accused of laundering the proceeds of an embezzlement offense under 18 U.S.C. § 664. Similarly, in *United States v. Prince,* 2008 WL 4861296, at *8 (W.D. Tenn. Nov. 7, 2008), the court held, for the same reason, that the profits test does not apply where the offense involves the laundering of the receipts of a health care fraud offense. *See also United States v. Orosco,* 575 F. Supp.2d 1214, 1215 (D. Col. 2008) (declining to apply *Santos* in a drug case); *Bull v. United States,* 2008 WL 5103227, at *8 (C.D. Cal. Dec. 3, 2008) (same).

One appellate court has held that even if *Santos* applies beyond its facts to cases that involve crimes other than illegal gambling, it does not, in any event, apply in drug cases. *See United States v. Fleming*, 287 Fed. App. 150, 155 (3rd Cir. 2008). The panel in that case reasoned that even though Justice Stevens did not agree with Justice Alito on all points, he did agree – and thus provided the essential fifth vote – that Congress intended to apply a gross receipts rule to the laundering of drug proceeds.

Two other courts, however, have expressly rejected the view that the term "proceeds" can mean different things in the same statute, depending on the context. Thus, they have reasoned, if "proceeds" means "profits" in *any* case, it must mean "profits" in *all* cases. Accordingly, because the Supreme Court held

that proceeds means profits in gambling cases, it must mean profits in all other cases as well. *See United States v. Hedlund,* 2008 WL 4183958 (N.D. Cal. Sept. 9, 2008) (Justice Stevens opinion that the definition of proceeds may change from case to case, and the dicta that the receipts rule applies in drug cases, cannot be controlling; because *Santos* did not overrule *Clark v. Martinez*,[12] which held that the same term cannot mean different things depending on a statute's application, the definition of proceeds must be the same in all instances); *United States v. Baker*, 2008 WL 4056998, at *3 (E.D. Mich. Aug. 27, 2008) (rejecting the view that because of the 4-4-1 split, Justice Stevens' view prevails; proceeds means profits in all cases, including drug cases).

One other court has expressly accepted the notion that the profits rule may apply in some cases but not others, but it applied a test that Justice Stevens never suggested. The profits rule applies, the court said, if the maximum sentence for the underlying crime is less than then maximum sentence for money laundering.[13] No other court has indicated any interest in that approach.

***Satisfying the "Profits" Test***

While some courts have addressed the Government's argument that *Santos* applies only in gambling cases, and some of those have held that the Supreme Court's decision is indeed limited to its facts, most courts have not lingered over this threshold issue. Instead, most have assumed that *Santos* does impose a profits test on all money laundering prosecutions, but have held nevertheless that the requirement has been satisfied.

*The nature of the underlying offense*

First, some courts have held that given the nature of the underlying crime, or the defendant's role in the underlying crime, *any* property derived from or retained as a consequence of the crime *must be* considered profits and not just gross receipts. In a tax fraud case, for example, one appellate court held that the

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[12] *Clark v. Martinez,* 543 U.S. 371, 382 (2005) (to hold that the meaning of words in a statute may change with the statute's application "would render every statute a chameleon").

[13] *United States v. Djeredjian,* No. 2:07-cr-00475-GHK (C.D. Cal. Aug. 13, 2008) (Justice Stevens' opinion controls; whether the "profits" test applies in a given case depends on whether Justice Stevens would think the "receipts" test would lead to a "perverse result;" that would include any case where the sentence for money laundering is greater than the maximum sentence for the SUA such as cigarette trafficking).

property the defendant concealed from the taxing authority was the proceeds of the fraud. Because there are no expenses associated with such an offense, the court concluded, all of the concealed property must be considered "profits" under *Santos. See United States v. Yusuf,* 576 F.3d 178, 183 (3rd Cir. 2008). Likewise, in a bankruptcy fraud case, a court held that the property concealed from the bankruptcy court was the proceeds of the scheme, and because there are no expenses incurred in committing such an offense, all of the concealed property was "profits" for the purposes of *Santos*. *United States v. Everett,* 2008 WL 3843831, at 7 & n.5 (D. Ariz. 2008).

The same is true of the money that the defendant receives as his "cut" or payment for participating in an illegal scheme. For example, in *United States v. Bohuchot*, 2008 WL 4849324, at *6 (N.D. Tex. Nov. 10, 2008), a contract officer received a bribe for his role in steering a Government contract to a particular bidder. The court held that the bribe was the proceeds of the offense, and that it constituted the defendant's "profit" under *Santos.* Similarly, in *United States v. Rezko,* 2008 WL 4890232, at *6 (N.D. Ill. Nov. 12, 2008), the court held that the "finders fee" that a defendant received for his role a fraud scheme was his "profit" from the scheme.

*The nature of the money laundering transaction*

In *Yusuf, Everett, Bohuchot* and *Rezko* it was apparent from the nature of the underlying offense, or from the defendant's role in the underlying offense, that the proceeds of the crime could only be characterized as profits. Other courts have concluded that the property involved in a money laundering offense must represent the profits of the underlying crime based not on the nature of the underlying offense, but on the nature of the money laundering transaction itself. For example, if the money laundering transaction involves spending the criminal proceeds on a luxury item or some other discretionary expense that is *not* an essential expense of the underlying crime, courts have been willing to assume – without requiring the Government to produce any books and records or other accounting data – that the defendant was spending "profits" when he conducted the transaction.

In so holding, courts have effectively limited *Santos* to the situation that animated Justice Scalia's plurality opinion. That is, these courts have held that the plurality's profits requirement is violated only when, as in *Santos*, the money laundering transaction constitutes a payment essential to the commission of the underlying crime so that the transaction and the predicate offense must

necessarily merge with one another. Thus, in *United States v. Baker*, one of the cases that rejected the Government's view that *Santos* is limited to gambling cases, the court nevertheless held that when a drug dealer uses drug receipts to by luxury items, and not to defray the essential expenses of his drug trafficking offense, at least some of the money involved in the transaction must be "profits." 2008 WL 4056998, at *4. Another court came to the same conclusion when the defendant used his drug proceeds to buy a house. *See United States v. Spencer,* 2008 WL 4104693, at *5 (D. Minn. Aug. 29, 2008) (limiting *Santos* to cases where defendant spends money to defray an expense; it is implicit in use of drug money to buy a house that defendant was spending profits).

Court have done the same in fraud cases. In *United States v. Shelburne,* 563 F. Supp.2d 602 (W.D. Va. 2008), the defendant was a dentist who was charged with laundering the proceeds of a Medicaid fraud scheme. The court held that the transactions involving payments for rent, equipment and dental supplies could not be money laundering offenses because the transactions were necessary to defray the expenses of the scheme, but the transactions in which the defendant paid himself a salary were *not* essential expenses of the scheme and therefore involved profits. The latter expenses, the court said, constituted money laundering. 563 F. Supp. 2d at 605. Likewise in *United States v. Varnado,* 2008 WL 4773057 (W.D.N.C. Oct. 24, 2008), the evidence at trial showed that the defendants agreed to share the "profits" of their health care fraud scheme among themselves, after the expenses of the scheme were paid. Thus, the distribution of the profits among the defendants could be prosecuted as a money laundering offense. 2008 WL 4773057, at *6. *See also United States v. Poulsen*, 568 F. Supp.2d 885, 912-15 (S.D. Ohio 2008) (assuming the profits definition applies, a money laundering transaction involves profits as long as it is not the payment of an expense of the underlying crime); *United States v. Happ,* 2008 WL 5101227, at *2 (S.D. Ohio Nov. 25, 2008) (same; following *Poulsen*).

*Promoting the commission of new offense*

The most difficult cases, from the Government's perspective, have been those where the money laundering transaction *was* an essential expense of the scheme, but it was expense that was essential to keeping the scheme going *in the future*, not an expense that was essential to completing the crime that generated the proceeds in the first place. The Government argues that this is a distinction that makes a great deal of difference. It may be, the Government says, that a defendant, like Santos, is not laundering "profits" when he defrays the expenses of a past act, because that act has yielded no profits until its expenses have been paid. But a person who is conducting transactions with the intent to

promote the commission of a *future* act may well be using the profits of his past act to do so. This is the distinction the Fourth Circuit drew in *Heaps* and *Singh* when it held that using the proceeds of a drug sale to pay the supplier who had provided those same drugs on consignment was not a promotion money laundering offense, but using the proceeds of a prostitution offense to pay for the prostitute's future use of a motel room did constitute such an offense.

One court has viewed *Santos* this way. In *United States v. Catapano,* 2008 WL 4107177 (E.D.N.Y. Aug. 12, 2008), the defendants defrauded the State of New York by misrepresenting that they were eligible for a contract as a "minority business." In the money laundering count, they were accused of using the fraud proceeds to commit new frauds against the same victim. The defendants argued that these were essential expenses of the fraud scheme and thus could not constitute profits under *Santos*, but the court disagreed.

*Santos*, the court said, applies to cases where the money laundering transaction relates back to the offense that generated the proceeds – *i.e.*, to cases where there is a merger problem – and not to cases where the defendant was using the proceeds of a completed crime to commit a new one, even if it is part of the same scheme. In the latter case, the court concluded, the defendant is necessarily using the profits of the first part of his scheme to facilitate or promote the commission of the next part. 2008 WL 4107177, at *4.

*Catapano* and the other cases that focus on the nature of the alleged money laundering transaction reflect the analysis that was central to Justice Stevens' concurring opinion in *Santos.* As noted earlier, it was Justice Stevens' view that "proceeds" must mean "profits" in cases where treating the money laundering transaction and the underlying crime as separate offenses would be "tantamount to double jeopardy" and would lead to "perverse results." All eight of remaining justices rejected Justice Stevens' approach, but ironically, his view that the profits test applies only when there is a merger of the money laundering transaction and the underlying crime may be emerging as the test most courts will adopt in money laundering cases.

## APPLYING *SANTOS* OUTSIDE OF "PROMOTION" CASES

Many, if not most, of the cases discussed thus far have involved promotion money laundering. But as mentioned at the outset, there is nothing in the *Santos* decisions that would necessarily limit the application of the profits test to such

cases. Indeed, at least one court has expressly held that *Santos* does apply in a concealment money laundering case.[14]

Applying *Santos* in traditional concealment cases would make little sense. Suppose, for example, that a child pornographer invested $20,000 in acquiring computers, photographs, an internet website and other accouterments of the sex trade and began selling illegal images over the internet. And suppose that after receiving $15,000 in receipts he hid the money in an overseas bank account in the name of a third party. Most people would agree that this would constitute a classic example of money laundering that ought to fall within the ambit of the statute, but applying a strict profits test would yield, to use Justice Stevens' phrase, a "perverse result:" there would be no money laundering offense because at the time the transaction took place, the scheme had yet to yield a profit.

It would also be odd to apply the profits test to a money laundering case that involved an undercover "sting." Under 18 U.S.C. § 1956(a)(3), a defendant is guilty of money laundering if he conducts a financial transaction involving property that has been represented to him to be the proceeds of a criminal offense. Would applying a profits test to this scenario mean that the undercover agent making the representation to the targeted money launderer would have to make clear that the money was *the profits* of an illegal enterprise? That would seem to be absurd.

Also, a profits test would presumably apply to the definition of proceeds in another money laundering statute, 18 U.S.C. § 1957. That statute makes it an offense simply to spend or invest more than $10,000 in criminal proceeds, the idea being that criminalizing such conduct will help to keep criminally-derived funds out of the stream of commerce.[15] But ironically, applying a profits test to Section 1957 cases would only freeze the proceeds of *profitable* criminal enterprises out of the banking system and other commercial transactions. Criminals who have yet to earn a profit, or who are using the instruments of the commercial world to defray their expenses, would remain at liberty to do so. That cannot be what Congress had in mind when Section 1957 was enacted.

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[14] *See United States v. Thompson,* 2008 WL 2514090 (E.D. Tenn. Jun. 19, 2008) (where indictment alleges that defendant conducted a transaction with intent to conceal proceeds of overbilling on Government contract, Government will have to prove that the check from the Government represented "profits" after deducting cost of work actually performed).

[15] *See United States v. Rutgard*, 116 F.3d 1270, 1291 (9th Cir. 1997) (section 1957 is designed to freeze criminal proceeds out of the banking system).

One final irony is this: the *domestic* money laundering statute requires proof that the property involved in a promotion money laundering offense be the proceeds of another crime. *See* 18 U.S.C. § 1956(a)(1)(A)(i). The *international* money laundering statute, 18 U.S.C. § 1956(a)(2)(A), contains no such requirement; to commit an international offense, the defendant need only have sent money into or out of the United States with the intent to commit another crime. Thus, in international promotion money laundering cases, a merger between the money laundering transaction and the offense being promoted is quite likely to occur.[16] The irony is that while the plurality opinion in *Santos* goes to great lengths to reinterpret the proceeds requirement to avoid mergers between the money laundering offense and the offense being promoted, it has no effect at all on cases involving a complete merger of the money laundering transaction with the offense being promoted in cases where the money crossed an international border.

## APPLYING *SANTOS* PRIOR TO TRIAL

Virtually all of the judicial decisions discussed so far involved cases in which the defendant was convicted of money laundering before the Supreme Court rendered its opinion in *Santos*, and the court then had to decide what effect *Santos* had on the previously-entered verdict, conviction, or sentence. There were, of course, many other money laundering cases that were indicted but not yet tried when *Santos* was decided. In those cases, one can almost sense the glee with which defense attorneys moved to dismiss the money laundering charges on the ground that *Santos* rendered a money laundering conviction impossible. But the courts have uniformly rejected those challenges as premature.

It is well-settled that an indictment that tracks the language of a criminal statute is valid on its face, and a court will not dismiss a facially valid indictment

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[16] *See United States v. Piervinanzi*, 23 F.3d 670, 679-83 (2d Cir. 1994) (because section 1956(a)(2)(A) contains no proceeds requirement, there is no merger problem when the defendant wires money out of the United States to promote fraud against bank and the wire transfer constitutes both the money laundering offense and the bank fraud); *United States v. O'Connor*, 158 F. Supp. 2d 697, 726 n.52 (E.D. Va. 2001) (following *Piervinanzi*; no merger problem when defendant sends money to Bahamas and brings it back to make it appear to be new funds in furtherance of fraud scheme); *United States v. Caplinger*, 339 F.3d 226, 231 (4th Cir. 2003) (no discussion, but convictions for both wire fraud and international money laundering based on same transfer affirmed).

pre-trial on the ground that the Government may not be able to meet its burden of proof. If the indictment alleges that the defendant in a money laundering case conducted a transaction involving the "proceeds" of another crime, the indictment is valid on its face. Whether the Government will be able to establish the proceeds element beyond a reasonable doubt is an issue to be resolved by the jury based on the evidence presented at trial, and what definition the jury must apply to the term "proceeds" is a matter to be considered when the court gives the jury its instructions at the close of the evidence. Depending on what the evidence turns out to be, and what instruction the court gives, the defendant may or may not be convicted, but in no event would there be any basis for granting a pre-trial motion to dismiss the facially valid indictment. *See United States v. Catapano,* 2008 WL 4107177, at *2 (E.D.N.Y. 2008) (*Santos* cannot be the basis for a motion to dismiss an indictment that is valid on its face; the Government may be able to prove profits at trial); *United States v. Thompson,* 2008 WL 2514090, at *2 (E.D. Tenn. 2008) (same).

**JURY INSTRUCTIONS IN FUTURE CASES**

So what instruction should the court give the jury in a money laundering case in light of *Santos*? As of yet there are no reported decisions setting forth the court's instructions in a post-*Santos* money laundering case, but for cases where the court determines that *Santos* applies, the following instructions may be gleaned from the holdings in the foregoing cases.

1. To prove a money laundering offense, the Government must prove that the property involved in the financial transaction was the *proceeds* of a specified unlawful activity. That means that the property represents the *profits* of the underlying crime, not just its gross revenue. To determine whether the property represents profits, you may use the following rules of thumb.

2. If it did not cost anyone anything to commit the underlying crime, then you may assume that everything obtained or retained as a result of committing that crime was profit. In other words, if there were no costs, then everything gained or retained is profit.

3. Even if there were costs associated with the underlying crime, if the financial transaction was one that was not essential to committing that crime, you may assume that the transaction involved the profits of that crime. For example, if someone uses money derived from a crime to buy

luxury items, you may assume that he or she used the profits of the crime to do so.

4. Likewise, if someone uses money derived from one crime to commit or to promote the commission of a new or different crime, you may assume that he or she was using the profits of the old crime to do so.

5. But if a person uses the money derived from a crime to defray the expenses of that same crime, you cannot assume that he or she was using profits to do so. Until a person pays the expenses of his crime, there are no profits.

**CONCLUSION**

The *Santos* decision has created great uncertainty regarding the application and enforcement of the federal money laundering statutes in the United States. That uncertainty is likely to last for some time. Congress could resolve the issue quickly by enacting clarifying legislation that defines "proceeds" to mean any property obtained or retained as a result of the offense, but absent such congressional action, courts will inevitably struggle to determine if *Santos* applies at all, and if so, how the profits test may be satisfied.

It appears from the early cases that courts are unhappy with the *Santos* decision and are likely to continue to limit it to cases where the money laundering transaction represents an essential expense of the underlying crime, such that the two crimes may be said to merge. That, after all, is what animated the plurality decision in *Santos*. But it remains quite possible that *Santos* will be construed to limit the use of the money laundering statute as a law enforcement tool in situations far removed from the facts in *Santos* that were entirely unforeseen by a Supreme Court that was largely unfamiliar with this area of the substantive criminal law.