**UNITED STATES, Appellee, -v- MARK P. KAISER, Defendant-Appellant.**

**Docket No. 07-2365-cr**

**UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT**

**609 F.3d 556; 2010 U.S. App. LEXIS 13463; Fed. Sec. L. Rep. (CCH) P95,789**

**July 6, 2009, Argued**
**July 1, 2010, Decided**

**JUDGES:** Before JACOBS, Chief Judge, CALABRESI, and POOLER, Circuit Judges.

**OPINION BY:** POOLER

**OPINION**

POOLER, Circuit Judge:

Mark P. Kaiser ("Kaiser") appeals from a judgment of conviction and sentence entered on May 18, 2007, following a jury trial in the United States District Court for the Southern District of New York (Griesa, J.). The government alleged at trial that Kaiser, a high-level executive at U.S. Food Services ("USF"), made fraudulent misrepresentations regarding the financial condition of USF, and ultimately, the financial condition of Royal Ahold N.V. ("Ahold"), which acquired USF in April 2000.

Count One of the indictment alleged that from April 2000 to February 2003, Kaiser participated in a conspiracy to commit securities fraud, to make false filings with the Securities and Exchange Commission ("SEC"), and to falsify books and records, in violation of 18 U.S.C. ß 371. Count Two charged that Kaiser committed securities fraud in violation of 15 U.S.C. ßß 78j(b) & 78ff, 17 C.F.R. ß 240.10b-5, and 18 U.S.C. ß 2. Counts Three, Four, Five, and Six charged that Kaiser made or caused to be made a false filing to the SEC on behalf of Ahold, in violation of 15 U.S.C. ßß 78m(a) & 78ff, 17 C.F.R. ß 240.13a-1, and 18 U.S.C. ß 2.

The jury returned a verdict convicting Kaiser on all five counts of the indictment. With respect to Count One, the conspiracy count, the jury found that the objectives of the conspiracy included making false filings and falsifying books and records, but not committing securities fraud. Judge Griesa sentenced Kaiser principally to a term of 84 months' imprisonment and imposed a $ 50,000 fine. Kaiser has been released on bail pending resolution of this appeal.

Kaiser argues that there were two errors in the district court's jury instructions, three erroneous evidentiary rulings, and two errors in sentencing. With regard to the jury instructions, Kaiser contends that the district court made errors on the conscious avoidance theory and the "willfulness" element of securities fraud. Kaiser argues that the district court also erred in admitting 1) evidence of his fraudulent dealings before the charged securities fraud began in April 2000, 2) certain business planners under the business records exception to the hearsay rule, and 3) a hearsay statement that USF's General Counsel wanted to report Kaiser to the SEC. Finally, Kaiser argues that the district court improperly calculated his sentence.

We conclude that the district court erred in its instructions with respect to the conscious avoidance theory and in admitting the statement of USF's General Counsel, but reject Kaiser's other claims on appeal. Because we vacate and remand the matter to the district court for a new trial, we do not reach Kaiser's claims that the district court's sentencing determination was in error.

**I. BACKGROUND**

USF is one of the largest distributors of food and related products in the United States. Its primary business is to serve as a middleman by purchasing various food products from manufacturers and selling them to restaurants. Between 1994 and 2001, Kaiser supervised employees in USF's Purchasing Department, which managed the company's dealings with

its food vendors. In the Purchasing Department, Kaiser negotiated payments from vendors known as "promotional allowances," or "PAs," a type of rebate paid to USF upon satisfaction of certain purchasing targets. These PA payments are an important source of revenue for USF and a profitable aspect of its business.

The indictment issued against Kaiser charged that he devised a scheme to fraudulently inflate USF's PA income for the years 2001 and 2002, that he engaged in further fraudulent acts to hide the inflated numbers from outside auditors, and that he made various misrepresentations to the auditors concerning the PA agreements with vendors. The government's case against Kaiser was primarily built around the testimony of three cooperators, all of whom testified pursuant to plea agreements with the government: 1) Tim Lee, a USF employee in the Purchasing Department, 2) Bill Carter, who worked for Lee at USF, and 3) Gordon Redgate, who owned two corporations that provided services to USF related to the scheme. Lee and Redgate testified that Kaiser engineered the scheme and knew it was illegal. Kaiser, on the other hand, argued that he had been set up by Lee and Redgate as a scapegoat and that he had been unaware of the fraud.

**A. Promotional Allowance ("PA") Income Scheme**

Lee testified that, beginning in the 1990s, Kaiser negotiated PA contracts that required vendors to prepay PAs, subject to the condition that USF would repay the amount if it did not meet its targets. Although the PA payments were not actually earned until USF met the conditions in the contract, Kaiser immediately recorded the prepayments as income in USF's books and records, thereby artificially inflating the amount of revenue USF had earned from PA payments to ensure that USF met its earnings and other budgetary targets. USF executives, including Kaiser, only received bonuses when USF met these targets, providing a powerful motive for Kaiser to inflate USF's PA income.

As an example, Lee testified about Kaiser's involvement with vendor Puritan Chemical. According to Lee, Kaiser negotiated a $ 26.5 million PA from Puritan Chemical in 1999 to be earned over a term of ten years. The agreement provided for an $ 18 million prepayment to USF, despite the fact that none of the conditions of the PA had been met. To disguise the payment, Kaiser sent Puritan Chemical's check to a third-party intermediary company owned by Redgate, which broke up the payment into six smaller checks and sent them to USF. Kaiser argued that it was Lee who was responsible for most of the vendor contracts containing prepayments, pointing out that "[o]f the 80 contracts in the record from 2000 and before, Kaiser signed 9 and Lee signed 45."

Lee also testified that Kaiser developed a scheme in the 1990s whereby Kaiser would take "PA deductions" out of amounts that USF owed to vendors for goods, thereby increasing the amount of PA income on the books. Many of these deductions were inaccurate and not authorized by the vendors. If a vendor complained, Kaiser would either negotiate with the vendor to pay back the deductions the following year, thereby allowing USF to meet current-year budget targets, or he would stall until the year-end audits had been completed. Both the PA prepayment scheme and the PA deduction scheme resulted in inflated PA income on USF's books.

**B. Scheme After Ahold's Acquisition of USF**

In April 2000, Ahold acquired USF. In early 2001, Kaiser was named the Chief Marketing Officer of USF, and his focus shifted away from purchasing to the retail side of the business. According to Lee, however, Kaiser continued to be involved in a constellation of PA-related schemes to boost USF's revenue. For instance, Lee testified that Kaiser coordinated approximately $ 100 million in fraudulent PA deductions in 2001. Kaiser, however, alleged that it was Lee who executed the deductions and that Kaiser believed them to be valid. Kaiser also pointed out that his departure from the Purchasing Department coincided with a dramatic increase in the number of vendor contracts, many of which had prepayment terms, and that it was Lee and Carter who were responsible for them. Kaiser signed only one contract after 1999, and that contract had no prepayment term.

Lee also testified concerning Kaiser's role in setting the "PA rate," or the amount of PA income USF expected to receive in a given fiscal year. [1] The rate was calculated based on PA income received in previous fiscal years and then adjusted for increases or decreases in sales and projected sales. However, because USF's PA income had been inflated in previous years, the PA rate for fiscal year 2001 was also inflated. In order to compensate for this shortfall, the government argued that Kaiser recorded and caused others to record non-existent PAs in "top-side journal entries" on the company books. This resulted in phantom accounts receivable for PA payments that USF was not, in fact, owed. By January 2002, the accounts receivable balance for PA payments had grown to $ 300 million. By the end of 2002, the balance had ballooned to more than $ 700 million.

1 Kaiser denies being responsible for setting the PA rate. Lee testified that he was not certain who set the rate, but that Kaiser was involved in certain conversations about it. However, the government introduced a July 11, 2001 email document in which Kaiser informed other USF employees of the "rate that you should be accruing" based on Kaiser's assessment of the accounting.

### C. Deloitte's Audit of USF

After Ahold acquired USF, the accounting firm Deloitte & Touche ("Deloitte") was hired to audit USF's year-end financial statements. Although Kaiser was no longer the head of the Purchasing Department, he was still responsible for helping Deloitte conduct its audit of USF's PA income. Most of the acts charged in the indictment concern Kaiser's involvement with the Deloitte audit.

#### 1. Fraudulent Accounting Practices

According to the government, because Kaiser knew that a high PA accounts receivable balance would raise the suspicion of Deloitte auditors, he began manipulating ordinary, non-PA payments to make them appear to auditors as if vendors were paying down their PA balance. For example, in the 2001 audit, there was a $ 10.6 million payment from Redgate's company that was treated as a PA even though it was not related to any PA transaction. Kaiser sent Redgate a backdated letter requesting that the payment be treated as a PA and asked Redgate to send auditors only the top part of the check so that they would not know the purpose of the payment. Redgate wrote in his planner on February 5, 2002, that Kaiser had called to say he "needs top copy of check dated 4/11/02 for 10 million. Top portion only!"

The government also cited a $ 1.6 million payment received from the vendor Frozen Farms, which was recorded as a PA payment from another vendor, Koch Poultry Farms. Later, Kaiser signed and sent Koch Poultry Farms a confirmation letter stating that it owed USF $ 3.18 million. By reallocating the $ 1.6 million that had been received from Frozen Farms to the PA-related account receivable for Koch Poultry, the government argues that Kaiser endeavored to mislead Deloitte auditors by creating the false impression that the approximately $ 3.18 million PA figure was legitimate and that it was being paid down by Koch Poultry. Kaiser responded to these allegations at trial by emphasizing that the allocation of PAs among vendors had innocuous explanations, including that the reallocation of funds was necessary to account for changes in USF's business.

#### 2. Fraudulent Misrepresentations

In addition to attempting to hide the inflated PA income, Kaiser allegedly lied to Deloitte auditors about two facts related to the PA agreements. First, the government alleged that in order to hide the existence of PA prepayments, Kaiser told the auditors that USF did not receive prepayments. In a document that appears to have been prepared for a November 29, 2000 Audit Committee Meeting, with "Mark Kaiser," typed on the front cover, there is a statement that appears to have been drafted by USF management to Deloitte. The statement provides that USF did not "regularly negotiate 'upfront' payments from vendors for its [PA] programs." This turned out to be false. Kaiser argued that the misrepresentation could not be directly attributed to him, and that, in any event, he was never made aware of the number of PA agreements with prepayment terms.

Second, the government alleged that in order to hide the prepayments from the auditors, Kaiser told them that USF did not have written PA agreements with the vendors. In a letter providing recommendations to USF management for the year ending December 29, 2001, Deloitte included an "[o]bservation" related to USF's "promotional allowances with vendors" that "no formal written agreement's [sic] are signed." An auditor testified that the document was discussed at a meeting attended by Kaiser. Kaiser argued that this statement was not specifically attributed to him, and pointed to testimony from auditors at trial that indicated their understanding that there were some written agreements in place.

#### 3. Fraudulent Confirmation Letters

Finally, the government alleged that Kaiser attempted to hide the inflated PA income from Deloitte auditors by drafting and sending confirmation letters to certain selected vendors requesting confirmation that USF had earned and was owed the PA amounts reflected on its books. Lee testified that one vendor, Pactiv, was shocked by a letter asking it to confirm that it owed $ 5.6 million in promotional allowances for 2001. Another vendor, Ken's Foods, refused to sign a letter unless Lee signed off on an additional letter stating that the amount in the confirmation was not actually owed.

Redgate testified that his company had signed confirmation letters after receiving assurances from Kaiser that it would not have to pay the amounts set forth in the letters. The government introduced evidence at trial, the admissibility of

which is now at issue on this appeal, that Redgate contemporaneously recorded these conversations in business planners. Kaiser argued that the government relied almost exclusively on these planner entries to show that the confirmation letters signed by Kaiser were not good faith estimates of the vendors' PA obligations. The trial court admitted the planners over Kaiser's objection under the business records exception to the hearsay rule. Fed. R. Evid. 803(6).

**D. The Scheme Unravels**

The final straw was a letter signed by Kaiser and sent to the vendor Heritage Bags stating that Heritage owed a PA balance of over $12 million. The CFO of that company was a former Deloitte auditor, who became concerned and sent a separate letter to Deloitte setting forth the accurate balance, $ 2.5 million, and also disclosing that there was a prepayment and a written agreement. On February 11, 2003, after receiving this letter and other evidence that USF had agreements with vendors that provided PA agreements, Deloitte suspended work on its 2002 year-end audit.

An investigation ensued, resulting in an indictment against Kaiser charging him with conspiracy to commit securities fraud, make false filings with the SEC, and falsify books and records; securities fraud; and making false filing with the SEC. Trial commenced on October 12, 2006 and on November 8, 2008, the jury returned a verdict of guilty on all counts. Specifically, the jury found the that objectives of the conspiracy included making false filings and falsifying books and records, but not committing securities fraud. On May 17, 2007, Judge Griesa sentenced Kaiser to 84 months' imprisonment, two years' supervised release, a $ 50,000 fine, and a $ 600 special assessment. This appeal followed.

**II. DISCUSSION**

Kaiser raises many different challenges to the trial below. We first consider Kaiser's claims with respect to the conscious avoidance and willfulness jury instructions. We then turn to Kaiser's argument that he had insufficient notice of evidence the government introduced relating to his activities before 2000. Finally, we consider Kaiser's claims with respect to the testimony of USF's general counsel and the district court's admission of Redgate's business planners.

**A. Jury Instructions**

Kaiser argues that the district court erred in instructing the jury with respect to the willfulness requirement and the knowledge requirement of securities fraud. We affirm the district court's instructions on willfulness, but agree that the district court erred in instructing the jury on the issue of conscious avoidance.

**1. Conscious Avoidance [omitted]**

**2. Willfulness**

Judge Griesa instructed the jury that the required mental state for securities fraud was that Kaiser "acted knowingly and with intent to deceive," and elaborated as follows:

> In order to convict the defendant, you must find that he knew that false statements were being made, false information was being incorporated into the earnings results and the accounts receivable results, that he knew that the promotional allowance figures were being inflated, and that he did this with intent to cause a deception, a falsification. Now this means that he cannot be convicted of mistake, he cannot be convicted if he in good faith thought that these results were correct, even though they turned out not to be correct. And the government must prove the contrary of the idea of mistake or good faith belief. The government must prove, as set forth here, that he knew of the false and fraudulent inflation of the promotional allowance figures, he knew of the false and fraudulent inflation of earnings as a result and accounts receivable as a result and that he did that with intent to create a deception.

Kaiser argues that the district court erred in failing to instruct the jury that "willfulness" required knowledge of illegality. [2] We do not agree, however, that "willfulness" requires proof that the defendant knew that his actions were illegal.

> 2 Both parties requested that Judge Griesa instruct the jury that willfulness required knowledge of illegality. Judge Griesa did not give the proposed instruction, and did not rule on the proposed instructions before giving the charge, calling the practice "a waste of time." [HN7] Because Kaiser failed to object after Judge Griesa charged the jury, we review the jury instruction for plain error. Fed. R. Crim. P. 30(d).

The Securities Exchange Act of 1934 criminalizes only "willful" violations of its provisions. 15 U.S.C. ß 78ff(a); United States v. Cassese, 428 F.3d 92, 98 (2d Cir. 2005). With respect to misstatements in public filings, the defendant must have also acted with knowledge of the falsity of the statement. See 15 U.S.C. ß 78ff(a). But the government is not re-

quired to present "[p]roof of a specific intent to violate the law . . . to uphold a conviction under ß 32(a) of the Act, provided that satisfactory proof is established that the defendant intended to commit the act prohibited." United States v. Schwartz, 464 F.2d 499, 509 (2d Cir. 1972). Instead, a defendant may raise the defense that he did not know the law to avoid imprisonment. See 15 U.S.C. ß 78ff(a) ("[N]o person shall be subject to imprisonment under this section for the violation of any rule or regulation if he proves that he had no knowledge of such rule or regulation.").

In view of this unique statutory language, we have held that, whatever "willful" might mean for purposes of other statutes, for the purposes of Section 32(a), it does not encompass the requirement that a defendant knew he was violating the law. United States v. Dixon, 536 F.2d 1388, 1395 (2d Cir. 1976) ("A person can willfully violate an SEC rule even if he does not know of its existence" (quoting United States v. Peltz, 433 F.2d 48, 54 (2d Cir. 1970)); see also United States v. Tarallo, 380 F.3d 1174, 1188 (9th Cir. 2004) ("Under our jurisprudence, . . . 'willfully' as it is used in ß 78ff(a) means intentionally undertaking an act that one knows to be wrongful; 'willfully' in this context does *not* require that the actor know specifically that the conduct was unlawful."); United States v. O'Hagan, 139 F.3d 641, 647 (8th Cir. 1998) ("Courts that have interpreted 'willfully' in ß [78ff] have reached the same conclusion that we reach in this case: 'willfully' simply requires the intentional doing of the wrongful acts -- no knowledge of the rule or regulation is required.").

In Peltz, the defendant was charged with illegal short selling, an offense that required a "willful" state of mind. 433 F.2d at 54. To satisfy the willfulness element, this Court held that it was sufficient that the defendant had made statements to his brokers about owning stock that the defendant knew were false. Id. at 55. We held that Peltz could not avail himself of Section 32(a) because he had made "no effort to bring himself within this proviso." Id. at 55 & n.7. Likewise, Kaiser never requested an instruction on this defense or attempted to meet his burden of proving ignorance of the securities laws.

In Id, the defendant faced charges of failing to disclose in certain SEC statements that his corporation had loaned him money. 536 F.2d at 1395. Dixon had recorded his debts on the corporate books under the names of other individuals, knowing that those debts were in fact his own. Id. at 1396. At trial, Dixon did "not deny his knowledge that there were SEC rules requiring the reporting of loans to officers." Id. at 1395. Rather, Dixon contended that he had been incorrectly informed that so long as he had paid back most of the loan by the end of the year, he was exempted from the disclosure rule. Id. We concluded that this was not a "case of a defendant manifesting an honest belief that he was complying with the law." Id. at 1396. Dixon acted willfully by misstating who had taken out the loans in the corporate books -- this was a "wrongful act," in the sense of that term in Peltz. Id. Judge Friendly wrote for the Court:

> Dixon may have thought his year-end thimblerig would provide escape from a rule different from the one that existed. But such acts are wrongful "under the Securities Acts" if they lead, as here, to the very violations that would have been prevented if the defendant had acted with the aim of scrupulously obeying the rules (which would have necessarily involved correctly ascertaining them) rather than of avoiding them. Such an intention to deceive is enough to meet the modest requirements of the first clause of section 32(a) when violations occur.

Id.

More recently, we seemed to endorse a higher standard for willfulness in insider trading cases, stating that willfulness requires

> "a realization on the defendant's part that he was doing a wrongful act" *under the securities laws*, United States v. Peltz, 433 F.2d 48, 55 (2d Cir.1970), in a situation where . . . "'the knowingly wrongful act involved a significant risk of effecting the violation that has occurred,'" Metromedia Co. v. Fugazy, 983 F.2d 350, 364 (2d Cir. 1992) (quoting Peltz, 433 F.2d at 55).

Cassese, 428 F.3d at 98 (emphasis added). The majority in Cassese did not reach the question of whether willfulness required only awareness of general unlawfulness or whether it required that the defendant knowingly commit the specific violation charged, finding that the government had failed to sustain its burden "even under the more relaxed definition of willfulness." Id. at 95. Judge Raggi dissented in Cassese, writing that under Peltz, the government must only prove "the defendant's awareness of the general unlawfulness of his conduct," and concluding that the government had met its burden. 428 F.3d at 109 (Raggi, J., dissenting).

Whatever the gloss put on Peltz and Dixon by Cassese in insider trading cases, as a general matter, we conclude that Peltz and Dixon do not require a showing that a defendant had awareness of the general unlawfulness of his conduct, but rather, that he had an awareness of the general wrongfulness of his conduct. Unlike securities fraud, insider trading does not necessarily involve deception, and it is easy to imagine an insider trader who receives a tip and is unaware that

his conduct was illegal and therefore wrongful. The same cannot be said of one who deliberately misleads investors about a security.

In this case, the jury was charged that they had to find that Kaiser knew the statements were "false and fraudulent" and that he made those statements "with intent to create a deception," and the government had to prove "the contrary of the idea of mistake or good faith." For the jury to have found that Kaiser possessed such an intent, it follows necessarily that it also concluded that there was "'a realization on the defendant's part that he was doing a wrongful act.'" Dixon, 536 F.2d at 1395; cf. United States v. Tucker, 345 F.3d 320, 335 (5th Cir. 2003) (affirming conviction where jury was charged that government was required to prove that the defendant acted "knowingly *or* willfully," instead of "knowingly *and* willfully," finding, among other things, that "the district court's placement of the definition of 'intent to defraud' immediately following the elements of the [securities fraud] count effaced any confusion the jury might have encountered concerning the requisite *mens rea*"). We conclude that the district court's instruction on the meaning of "knowingly and with intent to deceive" necessarily encompassed a finding of willfulness under Section 32(a).

**B. Rule 404(b) [omitted]**

**C. Hearsay Testimony [omitted]**

**D. Redgate's Planners [omitted]**

**III. CONCLUSION**

For the foregoing reasons, the matter is **VACATED** and **REMANDED** to the district court for a new trial. Because we find that the trial was flawed, we do not reach Kaiser's various challenges to his sentencing.