

## Reflections On The Goldman IP Theft Saga

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Sergey Aleynikov was employed as a computer programmer from May 2007 to June 2009 at Goldman Sachs Group Inc. developing source code for Goldman's high-frequency trading system. An HFT system uses computers with complex algorithms to transact many orders at high rates of speed. Goldman's HFT system was a closely guarded trade secret, and Aleynikov was employed under strict confidentiality obligations.

Aleynikov was earning \$400,000, the highest paid of the 25 programmers in the HFT group. In late April or early May, 2009, Aleynikov resigned from Goldman to accept a position as a computer programmer at another HFT firm, Teza Technologies LLC, in Chicago, at an annual salary of \$1.2 million.

On June 1, 2009, and June 5, 2009, Sergey Aleynikov uploaded, without authorization, 32 megabytes of Goldman Sachs' confidential high frequency trading system to a server in Germany in violation of his confidentiality obligations to Goldman. He then downloaded the purloined source code to his home computer in New Jersey — another violation of his confidentiality obligations. These facts establish clear-cut violations of civil trade secrets law.

Aleynikov was arrested on July 3, 2009. Aleynikov was prosecuted and convicted for violations of the National Stolen Property Act (NSPA) and the Economic Espionage Act (EEA). He served one year of his 97-month prison term until the NSPA and EEA convictions were overturned in April 2012 by the U.S. Court of Appeals for the Second Circuit.

On July 31, 2012, shortly after being released from prison, Aleynikov was charged with separate violations of state laws for unlawful use of secret scientific material and unlawful duplication of computer-related material. After two and a half years of motion practice on issues relating to the legal sufficiency of the grand jury indictment, double jeopardy and collateral estoppel, the three state court counts went to the jury and a verdict of guilty was returned on one of the three counts on May 1, 2015.

On July 6, 2015, Manhattan Supreme Court Justice Daniel Conviser overturned the New York state court conviction and dismissed the indictment noting in the last paragraph of his decision: "The demands of the digital age will doubtless require further refinement of our criminal laws. But it is the job of the courts to apply the laws that exist."

The Aleynikov saga starts with the original indictment under the NSPA and underscores the need to update existing criminal statutes to eliminate the antiquated distinction between tangible and intangible



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property. This is especially true when one recognizes that 80 percent of the assets of today's new economy companies are intangible assets and most are trade secret assets.

The conviction under the NSPA was doomed from the get-go. The 1937 NSPA imposes criminal penalties for transporting "goods, wares or merchandise" across state lines knowing these physical things were "stolen, converted or taken by fraud." 18 U.S.C. Section 2014. The NSPA was an extension of the 1919 National Motor Vehicle Theft Act. The NSPA extended federal jurisdiction to other types of property transported across state lines — not just automobiles.

The NSPA applies only to physical things. If you transfer a stolen source code electronically from one computer to another computer across state lines there can be no NSPA violation. However, if you print the thousands of lines of source code on paper, and transport this ream of paper across state lines, then the NSPA applies if the physical property has a value of \$ 5,000 or more.

This may seem incongruous but not when you consider that the NSPA was enacted in 1937. The government's attempt to extend the reach of the NSPA to intangible property was rejected by the U.S. Supreme Court in *Dowling v. United States* in 1985. Dowling was a bootlegger. He admitted shipping phonorecords from Los Angeles to Baltimore and Miami. However, the phonorecords were not stolen property — he owned the records. Instead, the government based its theft claim on the underlying copyright violations. In a split-decision, the Supreme Court ruled that the NSPA applies only to physical goods not the underlying intellectual property rights. The NSPA convictions were reversed.

This gaping hole in federal jurisdiction was the battle cry for the EEA in 1996. FBI Director Louis Freeh testified before Congress that the U.S. Supreme Court ruling in *Dowling* eviscerated federal prosecution efforts and the EEA was necessary so the government could prosecute foreign economic espionage and interstate computer trade secret thefts.

It surprises that the government brought an NSPA indictment against Aleynikov because there was no evidence of physical things being transported or transferred across state lines. By uploading Goldman's proprietary source code to a computer server in Germany, Aleynikov stole "purely intangible property embodied in a purely intangible format" and the Second Circuit seized upon these undisputed facts to reverse the NSPA conviction.

The reversal of the NSPA conviction, however, had the "domino effect" of focusing the Second Circuit and the Manhattan Supreme Court on the tangible/intangible aspects of trade secrets law. This microscopic focus then resulted in (1) the reversal of the EEA conviction and (2) the reversal of the subsequent state court conviction.

The reversal of the EEA conviction was stunning. The Second Circuit Court of Appeals focused on the "limitation" in Section 1832(a) that the trade secret must be related to a product that is "produced for" or "placed in " interstate or foreign commerce. Since Goldman had no intention of selling or licensing its top-secret HFT system, the HFT system was not "produced for" or "placed in" interstate commerce. Aleynikov's conviction was reversed from the bench and Aleynikov was freed after serving a year in prison.

The outcry from the trade secrets and intellectual property bar was loud and clear. The Section 1832 "interstate commerce" provision is not a "limitation" or an "element" of the offense. The Commerce Clause (Article 1, Section 8, Clause 3) of the U.S. Constitution gives Congress the power to make the theft of trade secrets a federal criminal offense. Section 1831 contains no similar provision because it is unnecessary when the offense, by definition, involves a "foreign government, foreign instrumentality, or foreign agent."

The Second Circuit's interpretation of Section 1832 reverted, once again, to the realm of physicality by

requiring there be a product that a company sells or licenses in interstate commerce. This interpretation recreated the gaping hole that the EEA was enacted to fix. The EEA was passed to encompass all forms and types of trade secrets in the new information-based economy and the statutory definition expressly includes confidential information “whether tangible or intangible.”

Fortunately, this time, the Congress moved quickly to “clarify” the interstate commerce provision of Section 1832. On Dec. 28, 2012, President Obama signed the Theft of Trade Secrets Clarification Act into law amending the interstate commerce provision in Section 1832 to apply to “a product or service used in or intended for use” in interstate or foreign commerce. There will now never be another Aleynikov fiasco.

However, the tangible/intangible property distinction also doomed the state court prosecution of Sergey Aleynikov under a separate New York penal statute enacted in 1967 and entitled the Unlawful Use of Secret Scientific Material Act Penal Law Section 165.07 was passed to address deficiencies that came to light over 50 years ago involving the theft of confidential records and micro-organisms from the Lederle Laboratories Division of American Cyanamid Company. Prosecutors could not obtain felony larceny convictions under existing penal statutes because a monetary value could not be readily assigned to the stolen research records and other scientific material. The record also shows that the defendants refused to turn over any of the stolen records or scientific material in civil proceedings.

Penal Law Section 165.07 was thereafter enacted in 1967 to specifically address the Cyanamid concerns by making it a criminal offense to be engaged in the unlawful appropriation of “secret scientific material.” However, once again, there was a physicality element in the offense. To prove the offense, the government must show that the defendant made “a tangible reproduction or representation” of such secret scientific material that was stolen. This element was missing. There was no admissible evidence that Aleynikov created physical, tangible copies of the Goldman source code; there were no physical things stolen like drawings, documents or other articles. Based on this record, Judge Conviser reversed the conviction and dismissed the indictment.

The Aleynikov failed prosecutions in both federal court and state court should be a wake-up call to the Congress and to state legislatures that statutes passed years ago when trade secrets were kept in a locked file drawer are no longer well suited for the cyberworld of the 21st century. Today, most trade secrets reside in computer environments. With the push of a keyboard button, trade secrets can now be transferred instantly to any part of the world. It is imperative that we modernize our criminal statutes to encompass all forms of property—tangible and intangible.

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