The Legal Intelligencer

THE OLDEST LAW JOURNAL IN THE UNITED STATES

1843 – 2000 PHILADELPHIA, TUESDAY, MAY 9, 2000 VOL 222• NO. 89

Charges Against Fraud Defendant Dropped

Hand-Me-Down Issue from Brother's Case Reverses Conviction

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Because the U.S. Attorney's Office in Philadelphia has such a high conviction rate, defense lawyers count their victories mostly in achieving reduced sentences or beating stiff mandatory minimum terms.

And that's why *United States v. McLaughlin et al.* is so remarkable. In a three-defendant tax indictment, the prosecutors have lost in just about every way they can.

Two brothers and a sister were indicted in March 1995. A jury acquitted all three siblings on a conspiracy charge but convicted the brothers on tax-evasion charges in February 1996. On appeal, one brother won a re-sentencing, and the second brother won a new trial.

The second brother, Russell McLaughlin, was then acquitted of tax-evasion charges in November 1998, and the government dropped the remaining charge of filing a false tax return, on which the jury had hung.

The first brother, Mark McLaughlin, then argued that he, too, should get a new trial due to revelations during the second brother's retrial that showed the prosecution's star witness had committed perjury on a crucial point in the first trial.

In March of this year, Chief U.S. District Judge James T. Giles agreed, finding that the witness — an accountant — had perjured himself and that prosecutors committed a *Brady* violation by withholding evidence that could have been used by the defense to ferret out the perjury.

But Giles — who inherited the case when U.S. District Judge Robert Gawthrop III died — stopped short of finding that Assistant U.S. Attorney Maureen Barden had knowingly used perjured testimony, saying he didn't need to reach the issue since he already had two reasons for granting a new trial.

Last week, the U.S. Attorney's Office announced that it was dropping all remaining charges.

GILES

WELSH

For defense attorneys Robert Welsh and Catherine Recker of Welsh & Recker, the government's decision represents the final piece in a total victory.

"This case is a startling finding of what might be labeled prosecutorial misconduct in regard to building a case upon a perjurious witness's story and then hiding exculpatory evidence which was inconsistent with and would have contradicted the perjured story," Recker said.

"In short, the government had evidence in its file which would have belied wholesale perjury by [accountant] Melvin Cherry and yet this evidence was never disclosed to the defense," she said.

Welsh said the case is important because it showed that the government was not willing to correct its own errors.

Giles' decision was also important, he said, because it tackled the question of when to grant a new trial on the basis of perjury by a government witness in a co-defendant's trial.

Barden could not be reached for comment. First Assistant U.S. Attorney Michael Levy declined to comment yesterday. The McLaughlin brothers and their sister, Robin Pavlo, own Building Inspection Underwriters, a closely held corporation that conducts building inspections for New Jersey and Pennsylvania municipalities.

Prosecutors said BIU maintained bank accounts at New Jersey National Bank and First Fidelity Bank in which more than $700,000 in corporate receipts were held but not declared as income on the company's 1988 federal corporate tax return.

BIU's 1988 corporate tax return was prepared by two different accountants. Cherry was BIU's outside accountant from the early 1980s until early in 1989. Upon Cherry's resignation, he was replaced by William St. Clair, who completed the 1988 return.

In the 1996 trial, Mark McLaughlin claimed that the failure to report the income was based on either his or the accountants' belief that the accounts were established for "warranty reserves."

Home warranties are a form of insurance, purchased by home builders, under which BIU guaranteed that it would pay for certain home repairs if any construction defects were discovered after purchase of the home. Under the law, warranty sellers may accumulate collected warranty fees in a bank account to insure that there will be funds available to pay the costs of any warranty repairs that may be required in subsequent warranty years.

As such, warranty fees have tax-deferred status and do not have to be declared as income in the year collected but in the year when the warranty fee no longer can be treated as a reserve against possible repair obligations.

McLaughlin claimed that BIU maintained such a warranty account in the Delaware Trust Bank and that BIU had reported warranty fees deposited in that account as income on its corporate tax returns in the early 1980s.

To the extent that income not used as warranty reserves was omitted from the 1988 tax return, McLaughlin claimed it was an unintentional omission caused by one or both of the outside accountants.

But prosecutor Barden told the jury that McLaughlin purposely hid the existence of the Pennsylvania and New Jersey bank accounts at issue in the case.

She pointed to Cherry's testimony that he had never heard of any of the accounts. In her clos-

ing argument, Barden said McLaughlin had both the ability and the intent to participate in hiding the New Jersey and Pennsylvania accounts because he had regularly hidden the Delaware Trust account from Cherry.

"These defendants hid money in 1988 to the tune of about $720,000. They knew how to do it. They had been doing it for years with the Delaware Trust account," Barden told the jury.

NEWLY DISCOVERED EVIDENCE

Before Russell McLaughlin's retrial, Mark McLaughlin discovered disbursement journals and bundled bank statements that suggested that Cherry lied at the first trial when he claimed he never knew about the Delaware Trust account.

When Cherry was confronted with the new evidence, he admitted — contrary to his testimony at the 1996 trial — that he did know about the Delaware Trust account.

But for Welsh and Recker, the jury's verdict acquitting Russell McLaughlin meant that they were only half done. To make the victory complete, they had to win a new trial for Mark McLaughlin as well.

Judge Giles found that "the use of perjured testimony may provide an independent basis for a new trial."

To grant a new trial on such grounds, Giles said, the court must be satisfied that the testimony given by a material witness was false; that the jury might have reached a different conclusion because of the false testimonv: and that the party seeking a new trial was surprised by the false testimony and unable to meet it, or did not know of its falsity until after trial.

Giles said the defense met the test, finding specifically that "Cherry testified falsely in the 1996 trial, that the outcome of the case was strongly affected by those false statements, and that [Mark] McLaughlin was surprised by and unable to meet that false testimony."

Cherry's false testimony, he found, "so impacted the jury's verdict that the verdict should not be permitted to stand."

It was only when Cherry was confronted with newly discovered evidence that he admitted that he knew about the Delaware Trust account, Giles said.

"It has not been explained to this court's satisfaction why Cherry's memory changed so drastically between 1996 and 1998," Giles wrote.

"This court therefore must find that the trial testimony he gave in 1996 was false. At the 1996 trial, Cherry did not testify that he could not recall the account or that his recollection could be faulty. Rather, he adamantly and repeatedly stated that he had no knowledge of the account," he wrote.

In the second trial, Giles said, Cherry attempted to explain his earlier denials of knowledge by saying that he thought the question related to his knowledge of an account at the time of his affidavit given to the Tax Division in 1990, his grand jury testimony in 1994, and his trial testimony in 1996.

"This interpretation tortures the contours of reasonableness and the record and this court rejects it," Giles wrote.

Cherry's original testimony, he said, allowed the government to argue that McLaughlin purposely kept Cherry in the dark.

Barden argued that Cherry's testimony was not perjurious and that even if it were, it was not significant, given the other evidence in the case.

Giles disagreed, saying, "The impact of Cherry's false testimony so tainted the government's case that the jury verdict based on that false testimony should not be permitted to stand."

BRADY VIOLATION

Giles also found that the government committed a *Brady* violation by failing to disclose that a BIU secretary testified before the grand jury and said she had given Cherry documents relating to the accounts.

Recker said she first learned of the secretary's grand jury testimony when Barden used it to cross-examine her during the hearing before Giles.

If the grand jury testimony had been provided to the defense before the first trial, she said, it would have been valuable in attacking Cherry's credibility.

In his final passages in the opinion, Giles dealt with the most sensitive issue, one that potentially could have made the case much more embarrassing for the government — whether the prosection "knowingly" used perjured testimony.

Welsh and Recker pointed to a letter from the original defense lawyer to tax officials in Washington that said Cherry was lying.

Giles found that the U.S. Supreme Court has consistently held that a conviction obtained by the knowing use of perjured testimony is fundamentally unfair and must be set aside if there is any reasonable likelihood that the false testimony could have affected the judgment of the jury.

"This rule seems also to apply whether the prosecution knew of the perjury or merely 'should have known' of the perjury," Giles wrote.

But after describing the standard for analyzing such a question, Giles effectively dodged it, saying that because he had already granted a new trial based on the presence of the perjured testimony and the *Brady* violation, "it is unnecessary to reach and resolve the factual question of whether the prosecution in the first trial knew or should have known that Cherry was committing perjury based on information in the possession of various federal offices."