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White Collar Roundup - January/February 2020

DOJ Doubles Down on Dismissing Meritless Whistleblower Lawsuits

In keynote remarks at a legal conference, Deputy Associate Attorney General Stephen Cox offered further insight into how the Department of Justice (DOJ) is moving to rein in some cases brought by whistleblowers under the False Claims Act. In his remarks, Cox noted that DOJ declines to intervene and take over almost 80 percent of the qui tam actions filed in a given year. In these cases, the whistleblower can continue the litigation, with DOJ acting in a more or less passive role monitoring the case. But DOJ retains authority under the False Claims Act to move to dismiss the case—even over the objections of the whistleblower.

Historically, DOJ has exercised this authority sparingly; Cox noted that DOJ dismissed 45 cases in the past 30 years. This changed in early 2018, consistent with a DOJ memorandum dubbed the "Granston Memo," which affirmed that DOJ should dismiss whistleblower actions that are not in the public interest. Following its release, there has been a steady uptick in the number of dismissals. In the past two years alone, Cox noted that DOJ has moved to dismiss between 45 and 50 cases, including multiple copycat cases filed by a for-profit investment group against healthcare-related companies and two cases filed by a whistleblower who shorted the stock of the company he was suing. As Cox explained, if a whistleblower raises "frivolous or non-meritorious allegations that the Department of Justice disagrees with or could not make in good faith, we should not let a plaintiff try the case on behalf of the United States." He cautioned, however, that there were over 1,100 qui tam lawsuits filed during this period, and DOJ's exercise of its authority to seek dismissal would remain "judicious."

Petition Seeks to Disgorge the SEC's Ability to Seek Disgorgement

This week, the U.S. Supreme Court is scheduled to hear argument on whether a federal court may order disgorgement in an SEC enforcement action. The SEC has sought and obtained disgorgement in federal court for decades. Last November, however, the Supreme Court agreed to hear an appeal from the U.S. Court of Appeals for the Ninth Circuit squarely presenting the question of whether the SEC may continue to do so.

In *Liu v. SEC*, petitioners Charles Liu and his wife, Xin Wang, raised approximately $27 million from Chinese investors under the EB-5 Immigrant Investor Program, which provides a pathway for foreign nationals to obtain visas by making significant investments in certain U.S. businesses. While they claimed the money would be used to fund a cancer-treatment center, the petitioners diverted funds to their personal bank accounts and elsewhere overseas. Petitioners were found to have violated securities laws, and the district court ordered them to disgorge $26.7 million — its estimate of Liu and Wang's profits. The Ninth Circuit affirmed on appeal, citing long-standing precedent that authorized the remedy of disgorgement, and the petition to the Supreme Court followed.

The groundwork for petitioners' challenge was laid in the 2017 U.S. Supreme Court case of *Kokesh v. SEC*. While that case involved the issue of whether disgorgement was a "penalty" subject to a five-year statute of limitations, which the Supreme Court answered in the affirmative, members of the Court expressed skepticism that the SEC had the authority to order disgorgement, and the Court expressly reserved the question. In their brief, petitioners argue that because disgorgement is a "penalty" under *Kokesh*, it is not a form of equitable relief and falls outside the SEC's authority to seek relief in federal court. In opposition, the SEC contends that Congress has authorized federal courts to order any equitable relief that may be appropriate or necessary, including disgorgement, and that a contrary decision would enable wrongdoers and reduce the deterrent effect of the SEC's enforcement scheme. Numerous amicus curiae have also submitted briefs on the appeal. A decision foreclosing the SEC's use of disgorgement in federal court would remove a powerful enforcement tool and force the

SEC to reconsider and recalibrate where and how it seeks to enforce the securities laws. Whether it will need to do so, only time will tell.

Feds Shine a Light on $1 Billion Ponzi Scheme

The husband and wife owners of a solar energy company pleaded guilty to participating in what the DOJ described in a press release as the biggest criminal fraud scheme in the history of the Eastern District of California. Jeff and Paulette Carpoff owned DC Solar, a company that manufactured mobile solar generators marketed to provide emergency power at sporting events. Investors in the company were promised valuable federal tax credits if they purchased the solar generators and leased them back to DC Solar. DC Solar would then purportedly lease the generators to third parties and return much of the lease revenue to the investors.

According to the release, as part of the scheme, DC Solar raised approximately $1 billion from investors by selling solar generators that did not exist and misrepresenting the existence of lease revenue. DC Solar would then use funds from newer investors to pay its obligations to older investors in a classic Ponzi scheme. The owners also used the funds to support a lavish lifestyle and purchase, among other things, exotic cars, a minor-league baseball team and a NASCAR racecar sponsorship. As part of the guilty plea, the owners of DC Solar agreed to forfeit over $120 million in assets and have already returned over $500 million to the United States Treasury, setting another record, this time for the largest criminal forfeiture in the Eastern District of California. Four others have already pleaded guilty in connection with the scheme, and DOJ's investigation into DC Solar is ongoing.

SEC and DOJ Increase Scrutiny of Initial Coin Offerings

As the proliferation of cryptocurrencies proceeds apace, the government has continued to step up its enforcement game against malfeasance related to initial coin offerings (ICOs). An ICO is the cryptocurrency analogue to an initial public offering. Through an ICO, cryptocurrency promoters market and sell "tokens" to investors. These tokens generally represent units of investment in blockchain-based projects, such as digital platforms or software products. Like shares in a public company, tokens are typically tradable assets and exchanged on secondary markets after the ICO.

The rapid, loosely regulated growth of the cryptocurrency sector has laid a minefield for unwary investors, who are at risk of falling victim to fraudulent ICO schemes. Notwithstanding the novelty of blockchain technology, however, existing securities laws provide a foundation for seeking to bring discipline to the sector. Many tokens, for example, are subject to federal regulation as "securities" under the Securities Act of 1933 and the Securities Exchange Act of 1934.

Federal enforcement activity against ICO promoters has surged in the past several months. For example, recent SEC civil complaints and settlement orders allege offenses in connection with ICOs, ranging from false and misleading statements to investors to sale of unregistered securities and misappropriation of investor funds by ICO promoters. U.S. Attorney for the District of New Jersey Craig Carpenito recently announced felony charges against a Canadian former hedge fund manager and an accomplice for allegedly defrauding investors of $30 million through an ICO campaign that claimed to be raising funds for a blockchain-based auditing tool. The defendants allegedly misrepresented the commercial success of the auditing software by falsely claiming that it already had over 20 clients and was poised for further growth. Across the river, U.S. Attorney for the Southern District of New York Geoffrey S. Berman recently unsealed an indictment against a defendant who allegedly induced investment in an ICO by falsely claiming that the coin offering would help fund United Nations-affiliated development projects. In reality, according to the government, the coin platform was "fraudulent bait" set out to lure unfamiliar investors with promises of guaranteed returns.

It remains to be seen whether the uptick in enforcement activity will bring further order to a sector that has been defined by anonymity and freedom from regulation. In the meantime, there is no substitute for investor due diligence, especially regarding the identity of ICO promoters, when considering whether to participate in a blockchain-based venture.

Every E-Mail an FCPA Violation? A Valentine's Day Decision.

Many companies are well aware of the steep sanctions for violations of the Foreign Corrupt Practices Act (FCPA), whose anti-bribery provisions prohibit the offer or payment of anything of value to foreign officials to obtain or retain business. The FCPA applies not only to corporations and other businesses, but also to individuals, including officers, directors and employees. Each

violation of the anti-bribery provisions carries a fine of up to $2 million for corporations and other business entities and up to $250,000 for individuals, as well as possible alternative fines, civil penalties and collateral consequences.

Where fines for individual violations of the FCPA are already substantial, can every email sent in furtherance of a bribery scheme constitute a separate violation of the FCPA? On February 14, U.S. District Judge Kevin McNulty of the District of New Jersey decided this issue of apparent first impression in *United States v. Coburn,* 2:19-cr-00120 (KM).

In the *Coburn* case, the government charged Gordon Coburn, formerly president of a technology services company based in New Jersey, with three separate counts of violations of the FCPA, among other charges, in connection with an alleged scheme to bribe government officials in India. The three separate counts were based on three separate e-mails sent by Coburn in furtherance of the alleged scheme. As Judge McNulty summarized, Coburn had argued that the appropriate "unit of prosecution" under the FCPA, or the act which a defendant is prohibited from performing, should be viewed as the payment of a bribe. As a result, he sought dismissal of two of the three "duplicate" counts of violations. The government, on the other hand, argued that a unit of prosecution under the FCPA is making use of interstate commerce facilities, such as e-mail, and that the sending of three e-mails in furtherance of one bribery scheme can constitute separate offenses.

While Judge McNulty rendered his decision on February 14, it was not the Valentine sought by Coburn. The court denied Coburn's motion to dismiss based on the statutory language of the FCPA, Congress's intent and, because the parties had not provided a case directly on point, settled law interpreting analogous criminal statutes, such as the mail and wire fraud statutes and the Travel Act. Based thereon, the court reached the "permissible, if not inevitable" conclusion that each e-mail may indeed count as a separate unit of prosecution under the FCPA.

In light of the ubiquity of e-mail communications and the stiff penalties under the FCPA, the implications of Judge McNulty's ruling may appear significant. The court, however, did not leave Coburn, or future defendants charged with violations of the FCPA, entirely lovelorn. Instead, it cautioned that it made "no ruling as to whether overcharging of a large number of communications (as opposed to the three here) could confuse a jury or otherwise prejudice a defendant." It also cautioned that should convictions on multiple counts be obtained, it would "ensure that multiple punishments are not inflicted for the same scheme."

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