November 1, 2013

White Collar Roundup - November 2013

85 Years for Fraud

The U.S. Court of Appeals for the Second Circuit upheld an 85-year prison sentence in *United States v. Stitsky* over the defendants' claim it constituted "cruel and unusual punishment." The defendants had been convicted of fraud for their role in the scheme, in which 352 victims lost more than $23 million. During the approximately three-year scheme, the defendants allegedly misrepresented their firm's history and assets and failed to mention prior criminal history. (Notably, one defendant was in prison for a prior fraud conviction when he hatched this scheme and was on supervised release when he engaged in it.) After their hefty sentences were imposed, the defendants appealed, claiming the length violated the Eighth Amendment's ban on "cruel and unusual punishment." The Second Circuit disagreed, noting, "While the district court's sentence is severe, the facts it identified in support of its within-guidelines sentence adequately bear the weight assigned to them."

Attorneys Can't Just Blow the Whistle

Attorneys cannot breach their ethical duties and become False Claims Act (FCA) relators, according to the Second Circuit in Fair Laboratory Practices Assocs. v. Quest Diagnostics Inc. In that case, Mark Bibi, former general counsel of Quest's wholly owned subsidiary, Unilab Corp., along with two former executives created Fair Laboratory Practices Associates (FLPA) to bring an FCA claim against Quest and Unilab. Bibi had been Unilab's only in-house lawyer from 1993 to 2000, during the time of the alleged false claims. The defendants moved to dismiss the FCA complaint, alleging Bibi had breached his ethical duties by bringing the suit. The district court agreed and dismissed the complaint. FLPA appealed. The Second Circuit held that the FCA does not pre-empt state ethics rules and that Bibi had violated N.Y. Rule 1.9(c) by disclosing protected client confidences.

Millions Paid for Violating the False Claims Act

The U.S. Department of Justice (DOJ) announced a settlement with Boston Scientific Corp. to settle pending FCA litigation. According to the DOJ press release, Boston Scientific agreed to pay $30 million to settle allegations that between 2002 and 2005 its subsidiaries "knowingly sold defective heart devices to health care facilities that in turn implanted the devices into Medicare patients." One of Boston Scientific's subsidiaries pleaded guilty in February 2010 to criminal charges of "misleading the [Food and Drug Administration (FDA)] and failing to submit a labeling change to the FDA relating to the defective devices."

And for a Hat Trick on the False Claims Act...

The Eighth Circuit endorsed a fraud theory in FCA cases that might expand the act's reach. In *Simpson v. Bayer Healthcare*, the plaintiff-relator alleged Bayer Healthcare had fraudulently induced the Department of Defense (DOD) to enter two contracts for the purchase of its cholesterol-lowering drug, Baycol. The relator claimed Bayer misrepresented the risks and efficacy of Baycol. She alleged Bayer therefore fraudulently induced the DOD to contract to use Baycol, but in her complaint she did not identify any individual false claims paid under the contract. The district court dismissed the complaint, and the relator appealed. The Eighth Circuit (in a 2-1 decision) reversed, holding the relator had adequately pleaded a claim under the FCA by using a fraud-in-the-inducement theory, which the court said the U.S. Supreme Court endorsed long ago in

United States ex rel. Marcus v. Hess, 317 U.S. 537 (1943). The dissenter in *Simpson* claimed the majority in its opinion overlooked the pleading requirements for fraud.

Acronym Soup: FinCEN, NBSC, AML, MOU

The U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) has a new partner in its anti-money-laundering (AML) efforts. FinCEN announced that it is entering into a memorandum of understanding (MOU) with Mexico's National Banking and Securities Commission. As noted in FinCEN director Jennifer Shasky Calvery's statement about the first-of-its-kind MOU with a foreign agency, the impact will be most acute in the efforts to fight drug trafficking and terrorist financing. The amount of information to be shared between the agencies about money-services businesses, such as currency dealers and exchangers, check cashers, and even the U.S. Postal Service, will certainly yield heightened attention on AML efforts for such businesses.

Recording the Evidence of Insider Trading

The Second Circuit, in the course of affirming the insider-trading conviction in *United States v. Jiau*, took up the issue of when recorded calls are inadmissible under the federal wiretap statute. Winifred Jiau was prosecuted for providing material nonpublic information to hedge fund managers at Tribeca Capital Management, Barai Capital Management, Sonar Capital Management and SAC Capital. Her conviction was based, in part, on the introduction of recordings of conversations she had with one of the tippees in her scheme, Samir Barai. The evidence indicated Barai was hard of hearing and authorized his employees to record and transcribe all calls. Jiau unsuccessfully argued in district court that the recordings were inadmissible under the federal wiretap statute, which prohibits the introduction of recordings obtained in violation of the statute. The statute criminalizes the making of recordings except in certain circumstances. One such circumstance is when the recordings are made in the ordinary course of business. Another exception applies when one party knowingly makes the recordings, but not "if the communication is intercepted for the purpose of committing any criminal or tortious act in violation of [law]." Jiau claimed this exception to the exception applied because the calls involved criminal conduct. The district court denied her motion to suppress, and she was convicted. On appeal, the Second Circuit affirmed, noting the focus of the inquiry for the criminal-purpose exception was not on the content of the conversation, but on the purpose of the recording. Because the recording was made to help the tippee conduct his business and not for the purpose of, for example, blackmailing one of the conspirators to ensure he or she continued in the scheme, the recordings were admissible.

Bank Fraud Can Yield Huge Forfeiture, Even Without Much Profit

The "proceeds" of bank fraud for forfeiture purposes include the gross receipts of the crime, not just the profits, according to the Second Circuit in *United States v. Peters*. Peters was the owner of two companies that had bank lines of credit that fluctuated based on the borrowing base at the companies. The companies manipulated their books to fraudulently increase that borrowing base. Peters was convicted, sentenced to 108 months in prison and ordered to forfeit more than $23 million, which included the gross receipts involved in the scheme. On appeal, he argued the forfeiture statute only authorized an order to forfeit the profits. The Second Circuit noted the forfeiture statute is punitive and held the term "proceeds" in 18 U.S.C. 982(a)(2) is not limited to profits. Citing a Ninth Circuit opinion, the court noted, "Congress sought to punish equally the thief who carefully saves his stolen loot and the thief who spends the loot on 'wine, women, and song.'"