WHITE-COLLAR DEFENSE

WHITE-COLLAR PROSECUTIONS CONTINUE TO ARISE RELATED TO RESIDENTIAL mortgage-backed securities in the wake of the financial crisis. Other key concerns for defense lawyers and prosecutors continue to be health care fraud, off-label prescribing, new and burgeoning investigation techniques, and financial industry fraud. *California Lawyer* met for an update with Frank Burke of Foley & Lardner; Jan Handzlik of Venable; John Libby of Manatt, Phelps & Phillips; Thomas McConville of Orrick, Herrington & Sutcliffe; and Richard Robinson, chief of the major frauds division of the U.S. Attorney's office for the Central District of California, which is based in Los Angeles. Laura Impellizzeri moderated the discussion, and it was recorded by Laurie Schmidt with Barkley Court Reporters.

EXECUTIVE SUMMARY

MODERATOR: What are the latest trends you are seeing in cases concerning residential mortgage-backed securities (RMBS), and how are you responding?

FRANK BURKE: I'll try to be provocative. Mortgage fraud and residential mortgage-backed securities are an extremely high priority of the FBI and the Department of Justice. And the pattern that I see has developed is that the closer you are to the point of loan origination—local banks or appraisers or real estate agents or lending officers—then the cases have tended to proceed on a criminal basis.

The government charged the Bear Stearns case early on against a major Wall Street hedge fund that was full of real estate securities that Bear Stearns had put together, and it lost the case. Since then, what we have seen is that all the RMBS enforcement actions against banks have been under FIRREA (the Financial Institutions Reform, Recovery and Enforcement Act of 1989), and they've had some wonderful successes: Bank of America, $2 billion; JPMorgan, $2 billion in one case, $614 million in another; CitiMortgage, $158 million; a couple of SEC matters; the Mozilo settlement for $67.5 million; Goldman Sachs, $550 million.

I think it's a practical response to a difficult problem, which is, the further away you are from the point of the loan origination, the harder it is to prove criminal intent.

JOHN LIBBY: Taking the discussion a bit broader, one of the things we're seeing is a change in the government's view of financial institutions. Banks used to be seen as victims of crime. Now, they've been deputized by the government to enforce anti-money-laundering laws, and when they don't do a good job, they end up getting prosecuted. We've seen the government obtain deferred-prosecution agreements from HSBC and other international banks to ensure that banks comply with the law, and pay for their past misconduct. Another example is Operation Choke Point, in which DOJ is using FIRREA to investigate banks that provide services to payment processors and payday lenders. In a recent settlement with a North Carolina Bank called Four Oaks, DOJ gave us a road map for how it is thinking about these cases, in which the bank allegedly allowed its customer, a payment processor, to assist payday lenders in defrauding customers. I expect this investigation to expand with additional settlements with banks and payment processors.

JAN L. HANDZLIK: For corporate defendants, deferred-prosecution agreements enable the government to get all the attributes of a criminal conviction other than a plea of guilty. DOJ has been quick to threaten criminal prosecutions but then allow targets to enter into a DPA. It is puzzling to me that we haven't seen more deferred prosecutions in the mortgage-backed securities cases.

THOMAS S. McCONVILLE: The government is taking one set of facts surrounding RMBS, and then using different statutes in a serial manner. For example, when a criminal statute didn't work, the government turned to the Securities and Exchange Commission framework. Following that, the government then turned to FIRREA. Rather than looking historically at conduct involving the same set of facts that occurred more than six years ago, maybe the government can start looking prospectively at new matters.

RICHARD ROBINSON: First, the opinions I'm going to express are

solely my personal opinions, and do not necessarily reflect those of the Department of Justice or the United States Attorney's office, where I work. In my view, the government has a variety of tools that it can use to address the financial crisis wrongdoers. A civil FIRREA action is simply one of those tools. It has certain obvious advantages for the government, including the lower preponderance standard of proof and a ten-year statute of limitations. And if the defendant is an entity that can't serve time in jail, so money is the major sanction, it provides for very large potential monetary penalties.

MODERATOR: Is falling back on FIRREA also beneficial for defendants?

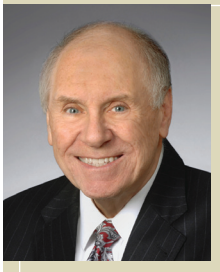
LIBBY: There are common elements of civil and criminal settlements with the government. There's the imposition of some type of compliance program, injunctive relief, et cetera, whether it's a civil FIRREA settlement or a deferred-prosecution agreement. There are settlement amounts negotiated based on the nature and scope of the conduct, the penalties available, and the corporation's ability to pay.

A civil settlement under FIRREA, as opposed to a deferred-prosecution agreement, could be beneficial from a reputational standpoint. But so many major banks have entered into deferred-prosecution agreements that the reputational risk seems to have been discounted by the financial industry.

BURKE: The deferred-prosecution agreement usually comes with mandatory remediation of some kind, often funded as part of the settlement, a corporate monitor who could be there for a couple of years; that can be very burdensome and expensive. From the defense lawyer's perspective, your first hope is that the government won't find the case to be criminal in nature because a civil settlement is always better than a criminal settlement. Under a deferred-prosecution agreement, if there is a misstep during the period of the deferral, you can wind up with a criminal charge, and it can be disastrous.

MODERATOR: Are there other pitfalls in deferring prosecutions for defendants?

McCONVILLE: One challenge with a DPA is that an agreement for continued monitoring could lead to the company reporting on itself to the government. This could lead to more challenging issues down the road because that report could include conduct which is different from what led to the monitoring in the first place.



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THOMAS S. McCONVILLE, a partner with Orrick, Herrington & Sutcliffe, has more than 20 years of combined federal prosecutorial and private sector experience. His practice includes white-collar defense, internal investigations, and complex commercial trials. In 2012, Mr. McConville was honored by *California Lawyer* magazine as a "Lawyer of the Year." He represents companies, officers, and directors in a range of matters, including those involving the FCPA, securities fraud, false claims, and defense procurement.

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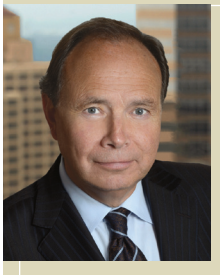

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LIBBY: But presumably they're reporting on isolated incidents, instead of a course of conduct that pervaded the company.

McCONVILLE: Then you ultimately rely on the discretion of the government to see it as an isolated incident.

MODERATOR: Does deferred prosecution give the government a little bit more leverage?

HANDZLIK: The sanctions on the bank are about the same, whether the resolution is civil or criminal. A DPA enables the government to avoid having to prove its case. And in 99.5 out of 100 cases, a corporate target will agree to a DPA. The government gets to have its cake and eat it too. Obviously, the banks see an advantage to avoiding a quasi-criminal sanction.

ROBINSON: The case law concerning FIRREA monetary penalties is sparse and still developing. The calculations of civil penalities vs. criminal fines and restitution may be quite different, depending on the facts of the case. District Judge Margaret Morrow's recent analysis of FIRREA penalties in *U.S. v. Menendez* (2013 WL 828936 (C.D. Cal. Mar. 6, 2013)) is instructive, and it will be interesting to see how District Judge Jed Rakoff decides the FIRREA penalties to be imposed against bank and individual defendants in the Countrywide HSSL loans fraud case (*U.S. ex rel O'Donnell v. Bank of America Corp.*, No. 12-CV-1422 (S.D.N.Y.)).

MODERATOR: Moving on to health care fraud, particularly the new provisions of the Affordable Care Act and the continuing proliferation of False Claims Act cases, what are your recent experiences?

McCONVILLE: When I was with the government and handling False Claims Act cases, the focus was on hospitals and how they were using codes to bill for procedures. You looked at statistics to find a skewed outlier and then tried to put together a case to show that an entity was inappropriately coding some procedure and overbilling. Now, the focus is on the quality of care that's being provided, principally in nursing homes, which creates other challenges both for the government and for clients.

LIBBY: Combine that with the fact that any HR problem within a health care provider or payor can create a potential whistleblower, and you've got a recipe for explosive growth. My sense is the government's actually doing a better job in the last four, five, six years of winnowing the flood of False Claims Act cases, and may be declining to intervene in more cases. Judges are also telling the government to make a decision faster over whether to intervene, and if the government declines, the case is unsealed, and the whistleblower goes off and litigates it. Having said that, there is still a lot of government activity in the investigation and prosecution of health care fraud.

HANDZLIK: These are very difficult cases to prove in a criminal context. The criminal intent element may be lacking. But this area of criminal investigations will continue to grow. Most of these investigations will result in civil settlements in the face of the threat to prosecute criminally.

BURKE: We're seeing a high level of enforcement activity, both in prosecutions and in false claims cases. We've got a Medicare Fraud Strike Force and the Department of Health and Human Services at the federal level; at the state level, we've got Medicaid fraud control units. On the health care side, we're seeing both prosecutions and False Claims Act cases against doctors, hospitals, labs, HMOs, ambulance companies, and medical equipment providers. Those can involve false and fraudulent billing, false certifications, and violations of the Anti-Kickback Statute. Against pharmaceutical companies, most of the cases have involved off-label marketing, brought as civil false claims and criminal misbranding charges. And the DOJ's Foreign Corrupt Practices Act (FCPA) unit is doing a sweep of the pharmaceutical and medical devices industries.

Then, as others have pointed out, the gloss on top of all that is that you have whistleblowers, encouraged by state and federal False Claims Acts. They provide essentially a bounty, depending on whether the government intervenes, anywhere from 15 to 50 percent of the recovery.

The most significant health care False Claims Act case last year was *United States ex rel. Drakeford v. Tuomey Healthcare Systems, Inc.*, No. 13-2219 (4th Cir.)(pending). A South Carolina hospital had entered exclusive above market 10-year employment agreements with doctors, who became employees of the hospital. These agreements had incentive clauses: If the doctors referred patients to the hospital they would get a portion of the receipts. The resulting Stark Law violations tainted the affected Medicare and Medicaid bills, leading to 21,500 false claims and a $237.5 million judgment.

So the combination of very active state and federal enforcement and regulatory agencies and whistleblowers has led to a real explosion that I don't think is going to abate anytime soon. Health care is such a large percentage of our economy.

MODERATOR: How is the proliferation of cases playing out for federal prosecutors?

ROBINSON: Well, in the health care fraud area, the qui tam or whistleblower cases are definitely up. And there's been an emphasis on focusing criminal prosecutions on medical professionals. They're viewed as gatekeepers who can enable great harm. The basic schemes don't really seem to change that much over time. In addition to the other billing schemes that you've mentioned, there's basically charging for products or services that are either never delivered or unnecessary.

One of the things I'd like to raise with the panel is that you, as defense attorneys, always have to confront with your clients when to self-report. The way it works at our U.S. Attorney's office—and I suspect in many others—is the civil division AUSAs who specialize in health care fraud review the qui tam cases and send them over to the criminal division. Then we look at them and, if we decide there's criminal merit, participate in the interview of the qui tam plaintiff. And all that can go on without the company knowing about it.

That, coupled with the incentives for self-reporting, should encourage defense counsel and their clients to come forward. If it turns out your client doesn't, and we pursue that investigation, and then you come forward—but we already know much of what you're telling us—your client is going to be viewed much less favorably.

McCONVILLE: Well, that's the challenge: the government can't quantify the benefit you're going to get for your client if you come in and self-disclose. You're relying on the judgment and integrity of the person on the other side of the table. And not everybody is reasonable. So, when your client says, "Well, what benefit do I get," you can't really say, "Well, you get the benefit of being viewed better." Can you quantify that? No. When the outcome is contingent on which government attorney is handling the case I think that demonstrates a flaw in the system.

LIBBY: The other tension in what Rich [Robinson] is saying is, if you're dealing with a large corporation or health care provider, it usually takes some time to investigate. So that delays the decision to self-disclose. And in the meantime, the whistleblower is feeding information to the government, the government is serving subpoenas and interviewing people. So it's almost a race to the U.S. Attorney's office; that could argue for self-reporting early, and saying, "We're looking into it. Give us some time."

HANDZLIK: Corporate counsel have become much more skeptical about the potential value of self-reporting. It opens a Pandora's Box of possibilities, none of which has much value except in the most egregious cases in which discovery is inevitable. For example, an NYU Law School study found that in FCPA cases, self-disclosure didn't result in any benefit and in fact resulted in harsher treatment.

ROBINSON: I read that academic research paper differently. Its authors concluded that there wasn't consistent statistical evidence that mitigating activites (including voluntary disclosure) by FCPA defendants correlated with a reduced sanction. In any event, the recent DOJ and SEC Resource Guide to the FCPA gives examples of past declinations that illustrate the benefits of cooperation.

MODERATOR: When would reporting early not be beneficial?

LIBBY: If you have just an allegation and you don't know the scope. Say it's a billing issue, and you don't know how far it goes back, you don't know whether it was a mistake or a deliberate conduct. As counsel, that's all stuff I want to know before I start talking to the government.

ROBINSON: Let me add one more thing to the mix. Data mining has become even more prominent for us with the Affordable Care Act. So, in addition to the whistleblower component, we very actively review data for outliers to identify the worst abuses. So defense lawyers should be wary that that well could be going on, depending on the client they're representing.

MODERATOR: Is there any move among defense counsel or companies to get that data proactively?

LIBBY: It's a good idea, and an element of a company that has a good compliance program is actually to measure themselves against market data to head off exactly the sort of thing that Rich [Robinson] was talking about.

BURKE: I think that, to some extent, for the voluntary disclosure discussion, we're not necessarily the right group to address that because we're not general counsel to the client. In the purest form of voluntary disclosure you have mandatory reporting regimes–say you have an environmental spill, you have to disclose that immediately; or, if you're a publicly traded company and you find out something that relates to your stock performance, you've got to report that immediately. That's not necessarily the case in something like health care so in-house lawyers are often sifting through this and trying to handle it themselves. If they can't, or there's a subpoena or something, then we come into the game.

It's often too late to get the highest level of benefit, which is the government didn't know about it, and you report it to them. That's the gold standard. There was one in the Foreign Corrupt Practices Act space last year, where Ralph Lauren found out about a problem in Argentina, and they disclosed it in two weeks. They withdrew from Argentina and put a vigorous compliance program in place.

MODERATOR: Did you see this changing as portions of the Affordable Care Act started taking effect?

BURKE: Well, the Affordable Care Act added a whole new false claim theory: If you find out that you were overpaid—either by the government telling you or on your own—you now have 60 days to return the money, or there's a possibility of treble-damage recovery. It also made more clear that anti-kickback claims definitely lead to false claims liability. And it added liability for payments made through health insurance exchanges that contain federal funds.

ROBINSON: Some of the ACA provisions that are in place are intended to improve anti-fraud and abuse measures by focusing on prevention. I don't see the immediate impact as a criminal prosecutor, but hopefully it will resolve in a way that providers are screened more thoroughly to weed out potential fraudsters. But at this point it's too early to tell. My general experience is that, where there is a lot of government money, sooner or later someone will find a way to take advantage of that by fraudulent means.

The other thing I would point out is that while the qui tams are focused on civil false claims recoveries, we also see private insurer frauds that are as serious, maybe even more serious in a dollar amount, than those covered by the False Claims Act.

McCONVILLE: And it's not only that there is more money. Under the Affordable Care Act, it's another way to access the pool of health care dollars, which could lead to abuse.

LIBBY: The major issue with the 60-day repayment limit is when does the 60 days start? When do you know you have been overpaid?

MODERATOR: Have recent developments in case law under the FCPA limited its application? How is FCPA enforcement changing in IP and other fields?

HANDZLIK: In fact, one of the major difficulties in FCPA matters is that there is very little case law. Almost everyone investigated for possible FCPA violations throws in the towel and agrees to a DPA or non-prosecution agreement. This means DOJ is free to interpret the scope of the act as it sees fit. That, combined with the vague and undefined terminology in the act, leads to uncertainty in resolving compliance issues as well as investigations.

With respect to trends in enforcement, DOJ's efforts to prosecute individuals have met with limited success. Individuals tend to fight for their liberty while corporations tend to capitulate to ensure their survival.

BURKE: There are a couple of unmistakable trends. As I mentioned earlier, the Department of Justice continues to have a sweep going that relates to pharmaceutical and medical devices companies. And the SEC settled an FCPA case last year against medical device maker Stryker concerning doctors and hospitals in several foreign countries. We're also seeing more emphasis on prosecutions of foreign companies, which requires finding pieces of U.S. jurisdiction, either by charging them with conspiracy to act with a U.S. company, or perhaps payments that flowed through U.S. bank accounts, or emails that are sent through computers located on U.S. soil.

The largest case in a long time was resolved in November involving a Swiss company called Weatherford, an oil services company; it resulted in $252 million in sanctions, two deferred-prosecution agreements, a civil settlement, three criminal plea agreements against subsidiaries, two administrative settlements, and two compliance monitors. There was a combination of FCPA and export control problems involving corrupt payments in six foreign countries and sales of controlled items out of the U.S. into five foreign countries.

McCONVILLE: I've seen from my clients such a desire to comply with the FCPA that sometimes people on the ground in foreign countries are conducting investigations into matters that are frankly very minor. The potential threat of FCPA exposure has definitely informed how companies respond to allegations of misconduct.

LIBBY: So you have a situation in which you have a broad law that can be applied, you know, to conduct anywhere in the world. And you can understand why the government has made it a priority. It is a problem. But there has to be some discretion applied to those situations so companies don't spend a lot of time dealing with relatively minor issues.

HANDZLIK: Since DOJ has almost unbridled discretion to investigate and prosecute FCPA matters, companies are many times cowed into submission by the threat of prosecution. Whether the government can actually prove its case at trial has, in many cases, become a quaint notion. When actually put to its proof, DOJ has come up short on numerous occasions. But don't get me wrong. In those cases in which liability is clear and a trial would most likely result in conviction, an agreed-upon resolution is the best course of action. So the FCPA has become a real money-maker for DOJ.

McCONVILLE: It's my impression that most FCPA cases arise because a company has conducted an internal investigation and disclosed it to the government. I wonder if you have seen any whistleblowers on the FCPA front, given the SEC's role in both the FCPA and Dodd-Frank's whistleblower provisions? Whistleblowers may be another source for the government in FCPA cases.

MODERATOR: What kinds of corporate crime victims have you represented, and in what kinds of cases?

McCONVILLE: The typical case is when someone has taken a trade secret and gone to another location. On occasion, what we have done is conduct some investigation and then, assuming we believe the evidence is there, try to contact the FBI or law enforcement to report the victimization. But there's definitely a balancing between referral to law enforcement and the company proceeding civilly.

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>
> —THOMAS McCONVILLE

HANDZLIK: Much of my practice is devoted to the representation of companies implicated in purported wrongdoing by their officers and employees. These suspicions lead to internal investigations and, almost always in the case of publicly traded companies, voluntary disclosures of material wrongdoing. It goes without saying that establishing a relationship based on trust, candor, and confidence with prosecutors like Rich [Robinson] is essential.

LIBBY: We've handled similar types of cases, trade secret thefts and other types of fraud on companies. Unless the company has an obligation report, like a financial institution, there's always a tension between reporting it and having the government carry the ball criminally versus filing a civil lawsuit on behalf of the company and trying to recover that way. It depends on whether the other party has the resources or assets to pay a civil judgment.

MODERATOR: With a trade secret, is that going to be a constant tension?

McCONVILLE: For example, we represent a very large maker of computer components facing theft and counterfeiting of their IP and products by someone in China. So the ability to recover civilly is very difficult. Even to get jurisdiction over them for the government criminally would be a very difficult. But it's a reality that clients are dealing with, that their trade secrets are going overseas, and they don't have a very good vehicle, whether civilly, criminally or administratively, to get redress.

LIBBY: Even if a company can't recover under these circumstances, however—or the person is out of reach of the jurisdiction—many corporate victims feel there's a deterrent value in bringing the cases, whether civilly or criminally.

MODERATOR: What new investigative techniques are you seeing popping up, and what do you think of them?

BURKE: Well, I would be very interested to hear Rich [Robsinon]'s perspective. There was a forum a couple weeks ago, where I asked the U.S. Attorney in San Francisco about wiretaps and consensual recordings, which historically were unusual in white-collar cases until the department had such spectacular success in the Galleon wiretap. That led to its use in many insider trading prosecutions, a couple of FCPA cases, and a major health care fraud prosecution. So the U.S. Attorney from Northern California's response to the question, "Do you see this as a future trend?" was, "No, I see it as a present trend. We're using it as much as we can, and as often as we can."

The department has even unraveled some Ponzi schemes that were ongoing. Historically, they waited for Ponzi schemes to sort of collapse and victims to come forward and say, "I didn't get paid." But that's very unsatisfactory.

ROBINSON: The FBI and other law enforcement agencies may use consensually-monitored phone calls and wired-up cooperators (wearing a concealed recording device, in other words) on a daily basis. Now, with the increasing use of whistleblowers, that practice is expanding even more.

I put wiretaps in a different category for several reasons. First of all, wiretaps are supposed to be the last resort as an investigative tool. You have to establish before a district court judge that it's necessary to use a wiretap, so they are hard to get, and they are resource-intensive to maintain. Having said that, we brought two major indictments last year that were based on about eight months of wiretaps on more than ten phone lines, against 15 defendants allegedly involved in market manipulation. So, yes, we use wiretaps selectively, but we would not hesitate if we thought it was necessary and well suited to develop a particularly important investigation.

McCONVILLE: Following up on what both Frank [Burke] and Rich [Robsinson] just said, the evidence that's derived from a wiretap is really, really difficult for a defendant to get around: their own recorded calls.

ROBINSON: If I may, let me give an example of how it can work. We prosecuted a case last year in which a senior partner at KPMG, Scott London, was convicted of securities fraud for giving tips to an associate in exchange for consideration. (*U.S. v. London*, No. 13-CR-00379-GW (C.D.Cal.)). We did not rely on wiretap evidence. Instead, the case started with FINRA (the Financial Industry Regulatory Authority, a private group that polices the industry) analyzing trades and finding anomalies. FINRA shares that information with the SEC, which also finds it looks suspicious. They start developing the case, and get the U.S. Attorney's office involved. The person making the trades was approached; he admitted he had received tips from London and agreed to cooperate. He agreed to be wired up and participate in a sting, where he gave money to London in exchange for tips. That was all captured by the FBI on video. So we were able to go from a market surveillance lead to guilty pleas in a signficant insider trading case in a matter of months. The SEC also successfully pursued a parallel civil case against London.

And that reflects the kind of coordination and cooperation we've really worked to expand in recent years with the SEC, FINRA, and other agencies. In 2012, Attorney General Eric Holder issued a memo directing all the U.S. Attorneys and other Department of Justice components to work with the SEC and other regulatory agencies to address financial fraud in a cooperative mode and share information to the maximum extent possible, consistent with grand jury secrecy and other limitations.

Years ago, frankly, some prosecutors would often look at the SEC as something of an obstacle or a distraction, thinking that if we got them involved, we lost some level of control over a criminal case. And, in fairness, SEC lawyers may have thought similarly about us. Now, we see them as a partner and often work together to develop cases. And many recent resolutions, as in the Scott London case, have been much better for us and the SEC as a result.

MODERATOR: Are there any other developments anyone else would like to highlight?

ROBINSON: We see a continuing series of scams that involve people raising money and telling investors it's going to be used to produce a motion picture.

LIBBY: My last case at the U.S. Attorney's office was a motion picture fraud case—in 1995.

ROBINSON: Whack-a-Mole comes to mind, yes. There also are concerns about potential for fraud and abuse in the EB-5 visa program, where money can be raised from foreign investors who want a U.S. visa; there can be issues about where that money truly came from. And sometimes these arrangements have to do with investing in a U.S. company, and there can be questions about whether the company really exists and operates the way it's represented.

Another area of concern is the increased use of crowd funding. In general, high-tech investing, where the ability to assess realistic risk and reward is not high, makes it easier for a scam artist to falsely portray what's involved without an investor saying, "That makes no sense at all." ■