November 2011: White Collar Update

Food and Drug Regulators Step up Prosecution of Corporate Officers for Misconduct:

U.S. regulatory authorities recently have made increasing use of a long dormant doctrine to prosecute business executives for their companies' violations of the Food Drug and Cosmetic Act ("FDCA"). Under the "responsible corporate officer doctrine," an officer may be held liable for a first-time misdemeanor or a subsequent felony based on misconduct within their corporation, even if the officer was not involved in or aware of the wrongdoing. Although the doctrine had been little-used since the 1970s, recent enforcement efforts reveal that regulators are now employing it with more frequency.

The responsible corporate officer doctrine was first articulated by the United States Supreme Court in the 1943 case of *United States v. Dotterweich*, 320 U.S. 277 (1943). In that case, the president and general manager of a company that packaged and shipped pharmaceuticals was found personally liable for his company's violations of the FDCA. The Court explained that the FDCA placed "the burden of acting at hazard upon a person otherwise innocent but standing in responsible relation to a public danger."

Three decades later, the Court affirmed and clarified this holding in the case of *United States v. Park,* 421 U.S. 658 (1975). In Park, the president of a national food chain was held personally liable under the FDCA for unsanitary conditions in a warehouse. The president appealed his conviction on grounds that the jury did not find he engaged in any wrongful action. The Court rejected this argument, and held the FDCA required responsible corporate employees "to implement measures that will insure that violations will not occur." However, the Court allowed that "a claim that a defendant was 'powerless' to prevent or correct the violation" could be raised as a defense to charges against a responsible corporate officer.

After falling out of use in the early 1980s, this doctrine has recently returned to favor with regulators. For instance, in November 2010 four executives from Synthes, a medical device company, pleaded guilty to misdemeanor charges brought under the responsible corporate officer doctrine related to the promotion of unauthorized tests of a bone cement product on spinal surgery patients. The executives are currently awaiting sentencing. Likewise, in March 2011 Marc Hermelin, the former CEO of KV Pharmaceutical, pleaded guilty as a responsible corporate officer to two misdemeanor violations of the FDCA involving the improper manufacture and sale of oversized morphine tablets. Hermelin was sentenced to one month in jail, fined $1 million, and ordered to forfeit an additional $900,000.

The potential consequences for conviction under the reasonable corporate officer doctrine go beyond fines or jail time. The U.S. Department of Health and Human Services ("HHS") can exclude executives from participating in federal health care programs for years based on such a conviction. For example, in 2007 three officers of the Purdue Frederick Company entered misdemeanor guilty pleas to charges that they had served as responsible corporate officers during a time when the company manufactured misbranded drugs in violation of the FDCA. As a result of the convictions, the Inspector General of HHS issued notices excluding the executives from participation in all federal health care programs for twelve years. The officers appealed, arguing that the exclusion penalty was not appropriate for convictions under the responsible corporate officer doctrine, since the convictions did not require any evidence of personal wrongdoing. Last year, the District Court for the District of Columbia rejected this argument and affirmed application of the exclusion penalty to responsible corporate officers. *Friedman v.*

Sebelius, 755 F. Supp. 2d 98 (D.D.C. 2010).

Public comments by regulators indicate that we may be entering a new era of prosecutions under the responsible corporate officer doctrine. On August 5, 2011, the Office of the Inspector General of the HHS issued a statement affirming its commitment to sanctioning executives in charge of companies that engage in health care fraud, including "individuals who directly commit fraud as well as the executives in a position of responsibility at the time of the fraud." In this type of regulatory environment, executives at food, drug, and health care companies must be proactive. The best defense against responsible corporate officer liability is the establishment of a robust compliance system to assure adherence to regulations at all levels of the corporation.

Does the Conviction of Galleon Founder on Insider Trading Signal an Increased Use of Wiretapping by Federal Investigators?:

The recent conviction of New York hedge fund founder Raj Rajaratnam on fourteen counts of conspiracy and insider trading sent shockwaves through the financial industry. On October 13, 2011, Rajaratnam was sentenced to 132 months in prison—the longest prison sentence ever for insider trading. He had been widely regarded as one of Wall Street's brightest stars. At the peak of his success, he managed $7 billion of investors' funds and his personal fortune was estimated at $1.8 billion. In 2009, it all came tumbling down, as Rajaratnam and nearly two dozen associates, including senior executives at two Fortune 500 companies and lawyers at major firms, were arrested and charged with illegally trading stocks based on confidential information.

The centerpiece of the government's investigation were the thousands of conversations between Rajaratnam and his associates that were recorded pursuant to court-authorized wiretaps. Prosecutors used only 45 of these recordings during Rajaratnam's trial, but as one juror stated the recordings "pieced everything together." Given the strength of this evidence, many were surprised to learn that this case marked the first time that the government had used wiretaps as part of an insider trading investigation.

Historically, the government has reserved the use of wiretaps for terrorism, organized crime and drug trafficking cases. Wiretaps are particularly well suited for these types of investigations because organized criminal groups are by nature tightly knit and rarely leave a paper trail. Thus, wiretaps are sometimes the only way to obtain incriminating evidence against the members of these groups.

In recent years, the government has stepped up its investigation of financial crimes. Indeed, the prosecution of financial fraud now ranks third in the Department of Justice's list of priorities—below terrorism and violent crime. Rajaratnam's conviction and the increased number of financial fraud investigations have caused hedge fund managers, analysts, and advisors to wonder to what extent even their legitimate calls were being recorded. Perhaps surprisingly, the answer is not very often. Despite the obvious probative value of wiretap recordings, there has not been a significant increase in their use in financial investigations. According to reports issued by the Administrative Office of the United States Courts, in 2009, 621 of the 663 federal wiretap intercepts were for narcotics offenses, a whopping 93.6%. In 2010, the number of federal wiretap intercepts nearly doubled, but narcotics offenses still accounted for 93.4% of all intercepts.

There are legal and practical reasons why the Rajaratnam investigation has not spurred a significant increase in wiretap investigations. In order to obtain a wiretap the government must show that traditional law enforcement techniques have proven unsuccessful and that the wiretap is a necessity. Unlike organized crime or drug cases, white collar cases can leave a paper trail that gives the government solid circumstantial evidence through which to prove its case. Moreover, the Wiretap Act (18 U.S.C. § 2510 et seq.) permits federal courts to authorize wiretap intercepts for only a limited number of criminal offenses. In the Rajaratnam investigation, the government obtained authorization to record Rajaratnam's conversations by claiming that the wiretaps were necessary to investigate wire fraud (a predicate offense for wiretap authorization), but ultimately charged Rajaratnam with insider trading (which is not a predicate offense). Rajaratnam filed a motion to suppress arguing that the government's reliance on the wire fraud statute was a subterfuge because the primary purpose of the wiretap was to investigate securities fraud. The trial court ultimately rejected Rajaratnam's argument, but prosecutors may be reluctant to rely on the opinion of one district court to uphold future wiretap investigations of financial crimes.

Moreover the government must devote significant resources in order to conduct a wiretap investigation. Investigators cannot simply record all conversations that they overhear. Rather, they must take steps to minimize the recording of information that is not relevant to any criminal activity. Investigators are not allowed to record attorney-client privileged communications or any other privileged communications. The failure to follow these rules may result in suppression of wiretap evidence. Indeed, in a recent case growing out of the Galleon investigation, the trial judge criticized the agents for listening to "deeply personal and intimate calls" between the defendant and his wife.

In addition to those logistical issues, financial crimes do not typically lend themselves to wiretap investigations. Wiretaps are an invaluable tool for investigating ongoing crimes involving large groups of individuals. Securities fraud and other white-collar crimes do not often follow this model. Investigations of financial crimes are typically historical in nature, and often start after the fraudulent act or insider trading has already taken place.

Thus, although the Department of Justice has promised to increase its reliance on wiretaps in financial fraud and other white collar investigations, the available data suggests that that has not happened. When and if it does, defense counsel will still be able to rely on a number of potential defenses to challenge the legality of the interception.