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Contacts:
Christopher R. Hall
Chair
Nicholas J. Nastasi
Vice Chair
Courtney L. Schultz
Newsletter Editor
Justin B. Ettelson
Contributor
Allison Newhart
Contributor
Matthew Smith
Contributor
Charles T. Williams, III
Contributor

Saul Ewing LLP

White Collar and Government Enforcement Practice

White Collar Watch

The Newsletter of the White Collar and Government Enforcement Practice

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SEC Issues Cease and Desist Order Against Goldman Sachs for Pay-to-Play Violations

By Justin B. Ettelson

With campaign season upon us and fundraising efforts by local and national campaigns in full swing, an order issued by the Securities and Exchange Commission (SEC) on September 27, 2012, instituting administrative and cease-and-desist proceedings (Order) against Goldman, Sachs & Co. (Goldman Sachs) for violations of the Municipal Securities Rulemaking Board's (MSRB) pay-to-play rules, is a good reminder for brokers, dealers and municipal securities dealers of the issues and pitfalls associated with making political contributions. According to the Order, the SEC found that Goldman Sachs and Neil M.M. Morrison (Morrison), a former vice president in one of the investment banking division's Boston offices, solicited municipal underwriting business from the Commonwealth of Massachusetts, among other issuers, while Morrison participated in the gubernatorial campaign of Timothy P. Cahill (Cahill), the then-Treasurer of Massachusetts, and made valuable and undisclosed "in-kind" campaign contributions to Cahill through the use of Goldman Sachs resources including phones, e-mail and office space. Prior to his employment with Goldman Sachs, Morrison was employed by the Massachusetts Treasurers' Office and reported directly to Cahill.

The SEC found that, from July 2008 through October 2010, Goldman Sachs participated as senior manager, co-senior manager, or co-manager for thirty negotiated underwritings totaling approximately $9 billion, for which Goldman Sachs received $7,558,942 in fees. Pursuant to the Order and offer of settlement, Goldman Sachs disgorged all of the fees received plus prejudgment interest of $670,033. Goldman Sachs was also ordered to pay a civil money penalty of $3.75 million, of which $1.875 million was transferred to the MSRB. The case against Morrison is pending.

MSRB Rule G-37 provides that, "[n]o broker, dealer or municipal securities dealer shall engage in municipal securities business with an issuer within two years after any contribution to an official of such issuer made by: (A) the broker, dealer or municipal securities dealer; (B) any municipal finance professional associated with such broker, dealer or municipal securities dealer; or (C) any political action committee

controlled by the broker, dealer or municipal securities dealer or by any municipal finance professional." A "municipal finance professional" includes any person "primarily engaged in municipal securities activities" or "who solicits municipal securities business." "Municipal securities business" includes "the purchase of a primary offering of municipal securities from [an] issuer on other than a competitive bid basis (*e.g.*, negotiated underwriting)." An "official of an issuer" is any person who was, at the time of the contribution, an incumbent, candidate or successful candidate for elective office of the issuer or any elective office of a state or political subdivision, "which office has authority to appoint any person who is, directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business by the issuer."

Rule G-37 provides a carve out for contributions made by municipal finance professionals to officials of an issuer if the municipal finance professional is entitled to vote for the official **and** the contributions, in total, are not in excess of $250 per election. As noted by the SEC, there is no requirement to show "that municipal securities business was actually given in exchange for the contribution." Rule G-37 also requires each broker, dealer or municipal securities dealer to file with the MSRB Form G-37/G-38 on a quarterly basis setting forth political contributions made to issuer officials and payments made to political parties of states or political subdivisions, among other reporting items.

In the present case, the SEC found that "Morrison's campaign activities during his Goldman Sachs work hours and use of Goldman Sachs resources constituted valuable undisclosed 'in-kind' campaign contributions to Cahill attributable to Goldman Sachs." Cahill, as Treasurer of Massachusetts, "was responsible for, or had the authority to appoint persons who were responsible for, the hiring of brokers, dealers, or municipal securities dealers for municipal securities business by the Commonwealth of Massachusetts and certain related issuers… ." In addition, Cahill "was a candidate for elective office which has authority to appoint persons who are directly or indirectly responsible for, or can influence the outcome of, the hiring of a broker, dealer or municipal securities dealer for municipal securities business of certain issuers . . . ."

Morrison was listed on Goldman Sachs' list of municipal finance professionals, and thus, fell within the definition of a "municipal finance professional" under MSRB rules. His campaign activities included soliciting contributions for fundraisers and arranging for others to solicit contributions, interviewing campaign consultants, preparing and reviewing campaign documents, participating on campaign conference calls and attending campaign meetings during work hours. Morrison also interviewed in the Goldman Sachs office one possible running mate for Cahill and negotiated and accepted contract terms for the campaign. Moreover, during work hours, "Morrison engaged in (a) fundraising; (b) drafting speeches and fundraising solicitation; (c) reviewing, approving and writing campaign memos, contracts, letters, talking points, campaign position papers, and responses to campaign issues; (d) attending and preparing for press conferences; (e) approving campaign invoices and expenditures; (f) approving personnel decisions, such as salaries and hiring; (g) negotiating with campaign personnel; (h) arranging advertisements and commercials; (i) communicating with reporters on behalf of the campaign; (j) reviewing the campaign's budget; (k) recruiting supporters; (l) reviewing campaign leases for office space; (m) selecting county representatives; (n) interviewing consultants; (o) drafting campaign plans and quotations; (p) providing legal advice; and (q) assisting with debates." Morrison also sent 364 campaign-related e-mails using his Goldman Sachs account.

While working on Cahill's campaign, Morrison actively solicited municipal securities business from the Treasurer's Office. Morrison sent various e-mails during the relevant period to a Deputy Treasurer discussing the selection of underwriters, going so far as to say, "You are in the fight of your lives and need to reward loyalty and encourage friendship. If people aren't willing to be creative with their support then they shouldn't expect business." The SEC also found that Morrison made a "secret, undisclosed cash campaign contribution to Cahill" by arranging for a $400 cash contribution to Cahill from a friend and writing a check in the friend's name for $400.

The SEC concluded that the "in-kind" contribution of Morrison's services was attributable to Goldman Sachs and that, together with the indirect contribution by Morrison, disqualified Goldman Sachs from participating in the

negotiated underwritings directed by the Treasurer's Office. Moreover, Goldman Sachs failed to disclose the contributions on Form G-37/G-38 filings and, in contravention to MSRB Rule G-17, failed to disclose the conflict of interest in the relevant municipal securities offerings.

SEC staff also found that Goldman Sachs violated MSRB Rule G-27 by failing to adequately supervise Morrison's activities. In particular, the SEC found that "Morrison was able to engage in campaign work using Goldman Sachs resources [. . .] without detection in part because he worked in a one-person office and was supervised by a Goldman Sachs employee in New York." In addition, "during an October 2009 compliance review of Morrison's office in Boston, Goldman Sachs compliance personnel did not detect Morrison's use of e-mails for his campaign activities or conduct any specific review of Morrison's compliance with MSRB rules."

In connection with the aforementioned violations, SEC staff also found that Goldman Sachs violated MSRB Rule G-8, by failing to make and keep current records reflecting all direct and indirect contributions and MSRB Rule G-9, which requires brokers, dealers and municipal securities dealers to preserve records reflecting all direct and indirect contributions.

Although there have been few SEC pay-to-play prosecutions in the recent past, this case serves as a reminder that brokers, dealers and municipal securities dealers must remain vigilant with respect to political contributions by the firm and its employees. Specifically, firms should:

- Revisit their policies and procedures to ensure that all campaign contributions are identified and reported. Such policies and procedures should be clearly communicated to all employees that meet or could meet the definition of a municipal finance professional;
- Ensure that they do not, for a period of two years from the date of a disqualifying contribution, solicit municipal securities business from an issuer other than on a competitive basis. Firms should maintain, update and periodically distribute a list of municipal issuers with whom the firm is disqualified from doing business;
- Ensure that they have developed and implemented written supervisory procedures reasonably designed to ensure compliance with MSRB rules, including on-site review of satellite offices and routine review of e-mails by compliance personnel; and
- Prepare and maintain all required books and records.

A Change in Tack: The Government Turns its Attention Away from Pharmaceutical Companies and Toward Medical Device Manufacturers

By Courtney L. Schultz

At a recent conference on October 2, Susan Winkler, former Chief of the Health Care Fraud Unit for the District of Massachusetts, one of the most active offices for health care fraud in the country, stated that medical device firms will be the "new focus." Prosecutors will investigate whether medical device manufacturers fairly and accurately report research results, or whether they instead suppress negative outcomes.

Medical device companies should note this shift and review their protocols for reporting the results of studies. For more information or assistance with assessing how to report the results of investigative studies, please feel free to contact a member of Saul Ewing's White Collar and Government Enforcement Group.

Money Laundering and the Risks Associated With Being an Accomplice to Financial Fraud

By Christopher Hall and Charles T. Williams, III

For as long as criminals have organized their illicit activities, they have used "legitimate" business ventures and other entities as fronts to shield their illegal behavior from authorities. Indeed, banks, operating business entities, non-profit organizations and other third parties often play a role (sometimes unwittingly) in the flow or "laundering" of money from criminal syndicates, through these "legitimate" fronts, and back to the criminals, with the express purpose of avoiding the attention of governments and regulators. Recent investigations by state and federal law enforcement agencies demonstrate that money launderers come in many different forms, but regardless of the form all pose tremendous risks to the business organizations they seek to involve in their illegal conduct.

Several recent high-profile cases illustrate the extent to which otherwise legitimate enterprises, including some of the world's largest financial institutions, facilitate money laundering to the benefit of rogue nations, organized criminal syndicates and terrorist organizations. The financial, reputational and other risks warrant careful attention and require the implementation of robust anti-money laundering controls and processes that will reduce or eliminate these risks.

Financial Institutions and "U-Turn" Transactions – The Cautionary Tale of Standard Charter PLC

Beginning in the 1980s, the United States imposed sanctions against the rogue nation of Iran due to, among other things, its support of terrorist organizations. In 1995, the United States (through Executive Order) created a loophole in these sanctions that was essentially designed to protect the U.S. dollar as the primary currency in oil trading transactions. This loophole permitted so-called "U-Turn" transactions, which permitted Iranian funds to pass through U.S. financial institutions so long as the funds originated from a non-Iranian, off-shore bank and merely passed through a U.S. financial institution on the way to another non-Iranian, foreign financial institution. The purpose of these transactions is to convert foreign currencies into U.S. dollars, and then transfer the dollars out of the United States.

In 2008, the Office of Foreign Assets Control of the U.S. Department of Treasury ("OFAC") promulgated regulations implementing a series of Executive Orders and closed the "U-Turn" loophole with respect to Iranian transactions. OFAC's stated reason for closing the loophole was the "need to further protect the U.S. financial system from the threat of illicit finance posed by Iran and its banks." Of particular concern was the potential use of the U.S. financial system to contribute to Iran's proliferation of sensitive nuclear weapon delivery systems.

In August 2012, Standard Chartered PLC ("Standard"), the fifth largest U.K. bank by assets, agreed to pay $340 million to settle charges that it violated U.S. anti-money laundering laws by engaging in these prohibited "U-Turn" transactions for the benefit of its Iranian customers. U.S. regulators alleged that Standard was involved in a staggering scheme that spanned a decade and involved approximately 60,000 financial transactions totaling more than $250 billion. Standard admitted that it illegally processed these transactions, which initiated outside of the United States and were then cleared through the United States. Among other violations, Standard was alleged to have "stripped" the wire transfers of identifying information that would have otherwise been detected by U.S. regulators. In sum, Standard was apparently motivated by the millions of dollars in fees it earned by processing these transactions, and fostered a culture that not only permitted these transactions to occur, but blatantly flouted clear financial regulations prohibiting the conduct.

Standard is not alone. Indeed, since 2009, U.S. regulators have entered into settlements totaling almost $3 billion stemming from alleged money-laundering operations and schemes. Many of these money-laundering schemes were not perpetrated by shady, underworld money operations, but rather by some of the world's largest banks, such as ING, Credit Suisse, Barclays and HSBC. Regulators will likely continue to focus on these types of transactions, and therefore financial

institutions must ensure that their anti-money laundering (AML) policies and internal compliance systems are rigorous and up-to-date.

Luxury Goods, Entertainment and Other Transactions – The Importance of Knowing your Business Partners

Mexican drug cartels are in the headlines these days, due in large part to the extreme violence that has spread across the U.S. border. But as with many other criminal organizations, the Mexican cartels also engage in financial crimes that have drawn the attention of law enforcement. In June 2012, the Justice Department moved against certain members of Mexico's Zetas drug organization, as well as a U.S. company engaged in horse breeding called Tremor Enterprises ("Tremor"). The Zetas cartel used a web of family and business relationships to cause Mexican businessmen to buy quarter horses on their own account during the past three years and then to sell them to the Tremor front company. Tremor horses went on to win some of the nation's most prestigious races (and largest purses). The Zeta web in the process ensnared a member of a prominent quarter horse family who purchased a horse for the company for close to $1,000,000. While the individual has not been charged with wrongdoing, this episode illustrates how people not guilty of money laundering can be drawn into illicit criminal actions.

As with prize winning horses, any business engaged in high-dollar entertainment or the sale of luxury goods (e.g., cars, jewelry, real estate, etc.) should be vigilant and in some cases have a duty to know those with whom they conduct business. Indeed, casinos are held to standards similar to those applicable to banks, and must report large cash transactions and file suspicious activity reports. Criminal organizations might also seek to utilize purportedly charitable, non-profit organizations to launder money and avoid detection. In each case, these third parties (as well as their advisors, such as lawyers and accountants) have an obligation to ask questions and perhaps notify authorities of possible irregularities. Failing to do so exposes these otherwise innocent third parties to reputational risk, at best, and potential criminal penalties, at worst.

Conclusion

These recent, high-profile settlements and prosecutions should give financial institutions and other business owners pause. While competition for business and the need to earn profits certainly represent key and legitimate drivers in decision-making, companies should also give appropriate weight to reputation risk and the prospect of stiff penalties (including asset forfeiture). To that end, organizations should weave AML compliance procedures into their client intake and financial transaction processes to ensure proper oversight and internal reporting, and to avoid the unwitting facilitation of unlawful activity.

IRS Whistleblower Claims Increase After Whistleblower Convicted in Tax Scheme Receives Record-Setting $104 Million Award

By Nicholas Nastasi, Allison Newhart, and Matthew Smith

Record-Setting Award

On September 11, 2012, the IRS granted a $104 million whistleblower award to Bradley Birkenfeld, a former UBS AG banker who notified authorities of certain UBS AG activity that led to a substantial IRS recovery. This award was reportedly the largest whistleblower award ever made to an individual. Notably, Birkenfeld received a 40-month prison sentence for his involvement in the same scandal on which he blew the whistle. Birkenfeld's hefty award has reportedly led to an influx of recent IRS whistleblower claims and raises significant issues regarding the extent to which whistleblowers with unclean hands are nonetheless able to collect substantial awards for the information they provide.

Birkenfeld worked as a banker at Zurich-based UBS, Switzerland's largest bank and one of the world's largest wealth managers. He was one of many UBS bankers who, despite lacking SEC licenses, traveled to the United States seeking out wealthy clients to help them avoid taxes related to offshore assets.

In 2007, Birkenfeld came forward and provided detailed reports on the manner in which UBS aided clients in avoiding certain tax liabilities. Birkenfeld disclosed to investigators that UBS made $200 million a year by handling $20 billion in undeclared assets. He further divulged the ways in which UBS trained its bankers to avoid detection by United States authorities and assisted American clients in concealing assets held offshore by referring them to sources that set up "nominee and sham entities . . . in tax haven jurisdictions, including Switzerland, Panama, British Virgin Islands, Hong Kong and Liechtenstein."

Birkenfeld sought immunity, but prosecutors opted to charge him with conspiracy to evade taxes due to his failure to fully disclose his own involvement in the fraud. In 2008, he pleaded guilty and was sentenced to 40 months in prison. Birkenfeld began serving his sentence in January 2010 and was released to home confinement after 30 months.

UBS, meanwhile, avoided prosecution by reaching an agreement with the United States in 2009 whereby UBS paid $780 million in fines, penalties, interest and restitution, admitted to fostering tax evasion, and turned over information on thousands of Swiss accounts. Subsequently, in the fallout of Birkenfeld's disclosures on Swiss banking, at least 35,000 Americans have joined a tax amnesty program and voluntarily disclosed offshore accounts to the IRS. IRS officials have reported that the amnesty program has helped recover more than $5 billion in unpaid taxes.

In 2009, Birkenfeld filed a claim with the IRS under Section 7326(b) of the Internal Revenue Code ("IRC"), which allows a whistleblower to collect up to 30 percent of the proceeds recovered through his or her disclosure where the amounts in dispute exceed $2 million. On September 11, 2012, the IRS awarded a record-breaking $104 million to Birkenfeld. In support of the award, the IRS explained that the information provided by Birkenfeld was "exceptional in both its breadth and depth" and led to "unprecedented actions" against UBS.

Fraud Participants Eligible for Rewards

Several legal and tax experts were surprised that Birkenfeld received such a large award in light of his involvement in the UBS tax evasion and, moreover, in light of his conviction.

Section 7623(a) of the IRC authorizes payments to be made for "detecting underpayments of tax." Subsection (b) of the same provides that, where an action is brought based on information provided by an individual, such person is entitled to an award ranging from 15 to 30 percent of the collected proceeds. However, section 7623(b)(3) allows for a reduction in an award where the individual "*planned and initiated* the actions that led to the underpayment of tax." Notably, subsection (b)(3) also provides that "[i]f such individual is *convicted* of criminal conduct arising from [that role], the Whistleblower Office shall deny any award."

Ultimately, the IRS determined that Birkenfeld's conduct fell short of "planning and initiating." Based on the IRS's conclusions with respect to Birkenfeld, the IRS appears to have taken a practical approach toward the interpretation of section 7623(b)(3)—understanding that well-informed whistleblowers with useful inside information will often be, to some extent, involved. Many argue that the allowance of awards for parties with a moderate degree of involvement in a tax scheme is beneficial in convincing future whistleblowers with unclean hands to come forward.

Despite Birkenfeld's award, potential claimants and representatives are still left without full clarification as to exactly how much participation in a tax fraud scheme is permissible before the "planned and initiated" exclusion applies. Nonetheless, the Birkenfeld ruling has enormous implications for whistleblowers.

The award could also hold potential implications for the interpretation of the recently enacted Dodd-Frank Whistleblower Rules. Similar to the IRS program, the Dodd-Frank Whistleblower Rules provide that a person is not eligible to receive an award if he or she is "convicted of a criminal violation that is related to the Commission action or to a related action." The SEC rules further provide that "for purposes of determining whether the $1,000,000 threshold has been satisfied or calculating the amount of an award, the Commission will not count any monetary sanctions that the

whistleblower is ordered to pay or that are ordered to be paid against any entity whose liability is based substantially on conduct that the whistleblower *directed, planned, or initiated*." The IRS's interpretation of the language "planned" and "initiated" might influence the SEC's interpretation of that same language in its own rules. Additionally, the SEC rules appear to promote the same practical approach that the Birkenfeld ruling suggests—that "[t]his final rule provides an incentive for less culpable individuals to come forward and disclose illegal conduct involving others."

Influx of Whistleblower Claims

Predictably, Birkenfeld's award has drawn attention to the IRS Whistleblower Program and caused a reported influx of whistleblower claims, as others seek to cash in on potential large payouts. Numerous whistleblower attorneys have already reported an increase in cases brought to them since Birkenfeld's award last month, and other sources report the IRS witnessing a recent "rush" of whistleblower claims.

This recent uptick comes on the heels of a period of skepticism and criticism of the IRS Whistleblower Program, largely due to the small number of payouts that have been made and long delays in processing claims. The program was revamped in 2006; however, since then over 1,300 claims alleging tax underpayments of at least $2 million apiece have been filed, but only three awards had reportedly been paid through June 2012. Republican Senator Charles Grassley, the main author of the 2006 overhaul of section 7623, praised Birkenfeld's award, citing the potential of the program and the need for more award payments to be made.

In any event, Birkenfeld's reward will likely cause a continued increase in claims under the IRS program. Whether more award payouts will begin to be made has yet to be seen. However, on October 4, 2012, another whistleblower received a $2 million award (his third IRS award of at least $1 million since 2011) from the IRS for helping to uncover an alleged multimillion-dollar tax-avoidance scheme attempted during the 1990s.

The Saul Ewing White Collar and Government Enforcement Practice

Christopher R. Hall, Chair
215.972.7180
chall@saul.com

Nicholas J. Nastasi, Vice Chair
215.972.8445
nnastasi@saul.com

Jennifer L. Beidel
215.972.7850
jbeidel@saul.com

George W. Bodenger
215.972.1955
gbodenger@saul.com

Andrea P. Brockway
215.972.7114
abrockway@saul.com

Brett S. Covington
202.295.6689
bcovington@saul.com

Jennifer A. DeRose
410.332.8930
jderose@saul.com

Cathleen M. Devlin
215.972.8562
cdevlin@saul.com

Justin B. Ettelson
215.972.7106
jettelson@saul.com

Patrick M. Hromisin
215.972.8396
phromisin@saul.com

Sarah F. Lacey
410.332.8791
slacey@saul.com

Allison B. Newhart
215.972.7191
anewhart@saul.com

Joseph F. O'Dea, Jr.
215.972.7109
jodea@saul.com

Amy L. Piccola
215.972.8405
apiccola@saul.com

Christine M. Pickel
215.972.7785
cpickel@saul.com

Courtney L. Schultz
215.972.7717
cschultz@saul.com

Gregory G. Schwab
215.972.7534
gschwab@saul.com

Nicholas C. Stewart
202.295.6629
nstewart@saul.com

Chad T. Williams
302.421.6899
cwilliams@saul.com

This publication has been prepared by the White Collar and Government Enforcement Practice of Saul Ewing LLP for information purposes only. The provision and receipt of the information in this publication (a) should not be considered legal advice, (b) does not create a lawyer-client relationship, and (c) should not be acted on without seeking professional counsel who has been informed of specific facts. Please feel free to contact Christopher R. Hall, Esquire of the Philadelphia, Pennsylvania office at chall@saul.com to address your unique situation.

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