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White Collar and Government Enforcement Practice

White Collar Watch

The Newsletter of the White Collar and Government Enforcement Practice

Contents

The true cost of fines: Bills would address tax break for corporate fines

By Nicholas C. Stewart and Christopher R. Hall

IN BRIEF

- **Both the U.S. House and Senate are floating proposals to close a loophole that allows tax deductions when there is a question of whether a fine is punitive.**
- **Debate centers on whether the deduction encourages settlements that reduce public spending on legal expenses or soothes the pain of fines at taxpayer expense.**

Two members of the U.S. House of Representatives want to limit a tax deduction on settlements paid to the government by companies accused of wrongdoing. The bill – proposed by Reps. Peter Welch (D-Vt.) and Luis Gutiérrez (D-Il.) – would prevent companies from deducting fines and other penalties, whether imposed via a court judgment or a settlement agreement. Under current law, companies are prohibited from deducting "punitive" fines paid directly to the government. Often, however, it is not clear which fines are punitive, or the fines are paid to a "non federal entity," such as the regulatory arm of Fannie Mae and Freddie Mac.

The impetus for the proposed House bill stems from the recent settlement announced between the Department of Justice and JPMorgan Chase & Co. over JPMorgan's involvement in mortgage-backed securities. The parties have reached a settlement that will require JPMorgan to pay $13 billion in fines. As the law currently stands, JPMorgan may be able to deduct nearly $7 billion of that settlement from its taxes. A group of five Senate Democrats also wrote a letter to Attorney General Eric Holder in late October expressing concern that allowing JPMorgan to write off a portion of any settlement would limit the deterrent effect of the government's enforcement actions.

The House bill is known as the Stop Deducting Damages Act, and is similar to a Senate bill proposed by Sens. Jack Reed (D-R.I.) and Charles Grassley (R-Iowa) called the Government Settlement Transparency and Reform Act. As a general matter, the House bill would eliminate the tax deduction altogether, while the Senate bill would take a more nuanced approach. The latter would treat quasi-governmental entities as government agencies, require that every settlement specify the tax treatment of fines, and clarify what types of fines are punitive.

Critics of the bills point out that these tax deductions incentivize companies to settle claims out of court, thereby saving taxpayers the expense of lengthy and costly litigation. However, others say that such deductions amount to taxpayer subsidies to companies that blunt the effect of fines resulting from the companies' own improper activity. From a practical perspective, eliminating or substantially reducing this tax deduction would increase the true cost of a fine, as companies would have to pay more of the settlement amount. However, in the future, it is likely that the parties to a settlement agreement would appreciate the true cost of any fine and ultimately reach a lower overall amount – consistent with the penalties imposed by similar settlements in the past.

These legislative proposals stand to impact numerous companies and individuals who may be considering settlements with government entities. Saul Ewing's White Collar and Government Enforcement Practice will continue to monitor these developments and keep you informed.

Senate approves new protection for criminal antitrust whistleblowers

By Christine M. Pickel

This month, the U.S. Senate unanimously approved proposed legislation which would protect whistleblowers who alert authorities or their employers to suspected criminal antitrust activity (referred to as the Criminal Antitrust Anti-Retaliation Act of 2013). This bill would amend the Antitrust Criminal Penalties Enforcement and Reform Act of 2004 ("ACERPA") and follows a 2010 report by the U.S. Government Accountability Office ("GAO") which found "wide support for adding anti-retaliatory protection" to ACERPA. ACERPA encourages self-reporting of antitrust misconduct with the promise of leniency for cooperators in parallel civil proceedings. ACERPA is perceived by some in its present form as protecting wrongdoers who cooperate in civil actions brought against them, while affording no protection to whistleblowers who experience negative effects for reporting the same type of conduct.

Companies are already familiar with anti-retaliatory rules in other contexts (like Sarbanes-Oxley), and the same general framework would apply here. Employers, as always, should tread cautiously and involve counsel in situations where a whistleblower is involved. Under the new bill, a company's actions, through its employees or agents, might increase the company's legal risk exposure if a whistleblower believes that he or she has been discriminated against in connection with providing information about, or assisting the government in pursuing, potential antitrust misconduct.

Highlights of the bill:

Who does the bill protect?

Employees, contractors, subcontractors, and agents of the employer. "Employer" includes a person, corporation, association or any officer, employee, contractor, or agent of a corporation or association as defined in the Clayton Antitrust Act of 1914.

How does the bill define retaliatory conduct?

Discharging, demoting, suspending, threatening, harassing or in any other manner discriminating against the whistleblower because the whistleblower:

- Provided to the employer or federal government information about an actual or perceived violation of antitrust laws or another criminal law (if allegedly committed in conjunction with a violation of antitrust laws or Department of Justice investigation); or

- Filed, testified or otherwise assisted in an investigation or proceeding filed or about to be filed relating to an actual or perceived violation of antitrust laws or another criminal law (if allegedly committed in conjunction with a violation of antitrust laws or Department of Justice investigation).

How would a whistleblower enforce the statutory protection?

- By filing a complaint with the Secretary of Labor; and
- If the Secretary has not issued a final determination within 180 days, by filing a complaint in federal district court.

What are the proposed remedies for whistleblowers who establish retaliation?

- Reinstatement with the same seniority status the whistleblower would have had but for the discrimination;
- Back pay with interest; and
- Compensation for special damages including litigation costs, expert witness fees and reasonable attorneys' fees.

Saul Ewing's White Collar and Government Enforcement Practice will continue to track this bill as it moves through the legislative process.

Justice Department sinks ex-Navy engineer's 15-year kickback scheme

By Brian Simons and Christopher R. Hall

IN BRIEF

- **Defendant's sentence includes jail time, restitution of $18 million and a fine.**
- **Case highlights importance of government contractors using compliance programs to identify wrongdoing and avoid operational consequences, including business closure.**

In another win for President Obama's Financial Fraud Enforcement Task Force, Ralph M. Mariano, a former Navy engineer who directed an $18 million kickback scheme, has been sentenced to 10 years in prison and ordered to restitute the money.

Mariano was a civilian program manager and senior systems engineer for the U.S. Navy's Naval Undersea Warfare Center ("NUWC") in Newport, R. I. and Washington, D.C. He admitted in May 2013 to having used his position for the last 15 years to direct over $120 million in Navy contracts to a technology services firm called Advanced Solutions for Tomorrow ("ASFT"). ASFT then passed roughly $18 million to a series of subcontractors that Mariano had helped to set up, and that money eventually went back to Mariano and others close to him, including his 82-year-old father, Ralph Mariano, Jr. The illicit funds were paid out to Mariano himself, his family and co-conspirators – including the founder and CEO of ASFT, Anjan Dutta-Gupta. Mariano's father had received $2.5 million, and was recently sentenced to four years of probation. Others involved in the fraud will be sentenced shortly. According to his indictment, the younger Mariano was responsible for monitoring the quality of work performed under the Navy contracts, which put him in position to prevent the unlawful activity from being noticed.

ASFT shuttered its doors after the charges were announced, laying off hundreds of staff at locations in Rhode Island, Virginia, and Georgia. When news of the scandal broke, the Naval Sea Systems Command ("NAVSEA") temporarily revoked the authority of the NUWC to issue new contracts or delivery orders on existing contracts. Those decisions had to pass through an additional level of review at NAVSEA, which greatly disrupted payments to the many contractors and subcontractors working with the NUWC.

In May, in the U.S. District Court for the District of Rhode Island, Mariano pleaded guilty to charges of theft of government funds under 18 U.S.C. § 641 and to conspiracy under 18 U.S.C. § 371. He also pleaded guilty to one count of tax evasion under 26 U.S.C. § 7201, for failing to pay over $700,000 in taxes on a portion of his criminal income.

At sentencing on November 1, Mariano was ordered by U.S. District Court Chief Judge Mary M. Lisi to repay the $18 million he siphoned from the Navy, to pay a $10,000 fine, to serve 10 years in prison, and then to serve three additional years of supervised release. He was directed to self-surrender to the Bureau of Prisons by November 26, 2013.

The scope of Mariano's wrongdoing and the disruptions it caused throughout the community of contractors working with the Navy highlight the need for contractors to develop compliance programs that can quickly uncover wrongdoing. It is possible that such a program could have brought Mariano and Gupta's scheme to light at an early stage, which could have prevented the job losses and delayed payments that they ultimately caused.

Johnson & Johnson settlement spurs consideration of Pennsylvania False Claims Act

A Pennsylvania legislator has revived a proposal for a Pennsylvania False Claims Act following this month's settlement between the federal government and Johnson & Johnson ("J&J"), arising from the company's alleged violations of the federal False Claims Act.

In proposing the Pennsylvania law, state Rep. Brandon Neuman pointed to the successes the federal government has had in using the False Claims Act to penalize actions such as J&J's allegedly improper marketing of three of its main drugs. The proposed Pennsylvania Act would allow the state to prosecute individuals and companies for similar conduct when the party has received state funds. The Act would also stand to boost the state's recovery in federal False Claims Act cases because the federal statute increases states' shares of repayment if they have implemented their own False Claims Act. A Pennsylvania False Claims Act would potentially subject many businesses and individuals to increased state enforcement.

Saul Ewing's White Collar and Government Enforcement Practice will continue to advise you on this development.

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