White Collar Litigation Update

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The DOJ's and SEC's Recent Focus on Insider Trading: The U.S Department of Justice (DOJ) and Securities and Exchange Commission (SEC) tend to fixate on different categories of fraud at different times. During the early 2000s, options backdating investigations dominated headlines. In the last few years, investigative focus has turned to banks, lenders, and financial service firms involved in the subprime mortgage deals that contributed to the financial market collapse in 2008.

The SEC and DOJ have now set their sights in new directions, including insider trading. *The Wall Street Journal* recently reported that the SEC and DOJ were preparing to announce charges against an array of financial players, including investment bankers, hedge fund managers, financial consultants and research analysts. Two days later, the FBI raided the offices of a number of hedge funds in New York, Connecticut, and Massachusetts.

The raids were foreshadowed in an October speech by the U.S. Attorney for the Southern District of New York, Preet Bharara. Speaking to the New York City Bar Association, Bharara stated that "illegal insider trading is rampant," "[t]he people who are cheating the system include bad actors not only at Wall Street firms, but also at Main Street companies," and "insider trading should … be offensive to everyone who believes in, and relies upon, the market." Bharara's strong words and recent law enforcement activity evidence two shifts in the approach to prosecuting insider trading by the DOJ and the SEC.

First, federal authorities are investigating insider trading more aggressively, as reflected in the DOJ's ongoing prosecution of Raj Rajaratnam, the billionaire founder of hedge fund management firm, Galleon Group. The evidence against Rajaratnam purportedly includes information gleaned from anonymous sources, wiretaps, and secretly recorded the telephone conversations from a number of "tippers," including executives from Fortune 500 technology companies. *The Wall Street Journal* reported in December that FBI agents had pressured an executive of an Oregon-based research firm to record calls with one of his clients, a major hedge fund manager. (He ultimately refused to do so, and e-mailed details of the confrontation to his clients.)

The SEC's recent case against employees of Florida Coast Industries further illustrates the aggressive enforcement efforts. The SEC charged an engineer and a trainman with insider trading. Neither defendant had direct knowledge of a pending takeover; rather, the SEC alleged that they simply observed "an unusual number of daytime tours," among other things, and then traded on that information. The SEC also began using formal cooperation agreements for the first time in 2010. Such deals, which offer leniency to certain individuals in exchange for incriminating information concerning other targets, were historically used only by criminal authorities, not by the SEC.

Second, the DOJ and SEC appear to have implemented a new approach to identifying insider trading targets. Until recently, insider trading investigations primarily focused on discrete trades by individuals. The recent investigations instead focus on alleged systematic insider trading, with multiple repeat offenders engaging in a pattern of trades based on inside information gleaned from networks of tippers.

Whether the government will enjoy widespread success using this new approach to insider trading, coupled with its more aggressive investigative techniques, remains to be seen. What is clear is that with this increased enforcement aggressiveness, companies that may face inquiry should be prepared with internal protocols regarding what to do if confronted with a search warrant, agents attempting to interview employees, or government subpoenas.

Recent Changes and Developments Related to Federal Sentencing Guidelines: The Federal Sentencing Guidelines were issued in 1984 in an effort to promote uniformity in sentencing for federal crimes. Although *United States v. Booker*, 543 U.S. 220 (2005), rendered the guidelines advisory, they have remained an important framework for federal prosecutors, probation officers, and judges making sentencing decisions. Amendments to the Guidelines that took effect on November 1, 2010, gave federal judges more discretion in determining an appropriate sentence, and have provided defense attorneys more leeway to argue for lenient sentences and departures from the applicable guidelines.

The amendments expand the opportunities for alternatives to confinement for lower-level offenders, including intermittent, community or home confinement. Additionally, judges may now consider certain individual characteristics of the defendant in

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deciding whether to depart from Guidelines sentences, such as age, mental and emotional condition, physical condition or appearance, (including substance addictions), and military service or other good works.

Other changes relate to the Guidelines for corporate defendants, allowing a downward departure for defendants who implement strong compliance programs, even when a senior executive was involved in the wrongful conduct. To permit a departure, the corporation must employ a reporting structure requiring that compliance personnel report directly to the board or a subcommittee thereof; the corporation must have detected the offense internally and reported it promptly; and the offense must have been committed without the involvement or knowledge of anyone responsible for the compliance program. The Sentencing Commission also elaborated on what is required when a corporation discovers wrongful conduct, which may include restitution to identifiable victims and other forms of remediation; self-reporting and cooperation with authorities; and assessment of, and modifications to, the compliance program.

A prime example of the increased judicial discretion afforded by the amendments is the sentence granted by Judge Otis Wright in *United States v. Bruce Karatz*. Karatz, a former CEO of KB Homes, was sentenced on November 10, 2010, in the Central District of California for a conviction on felony charges of fraud and making false statements in connection with backdating stock options. The prosecution argued for six years of imprisonment and a $7.5 million fine. Defense counsel, citing the new provisions of the guidelines related to age, argued that Karatz should be granted home confinement due to his age. The prosecution expressed concern that Karatz would be confined to his 24-room mansion on his one-acre estate in Bel-Air and that a sentence of probation would indicate that there was a “two-tiered system of justice, one for well-connected CEOs” and another for “ordinary citizens.” Judge Wright ultimately accepted the probation officer’s sentencing recommendation, sentencing Karatz to five years of probation and eight months of home confinement, as well as a $1 million fine and 2,000 hours of community service. Judge Wright agreed with the probation office that Karatz’s actions had not resulted in any significant damage to the company or its shareholders.

Increasing Trend of Health Care Fraud Prosecution: On October 26, 2010, the DOJ announced a $750 million settlement with GlaxoSmithKline. The DOJ alleged that GlaxoSmithKline, along with its subsidiary SB Pharma Puerto Rico, Inc., knowingly manufactured and distributed adulterated drugs. The government alleged that some batches of pills split apart due to manufacturing defects, while other batches dangerously mixed active ingredients of varying types and strengths. The settlement was divided into $150 million in criminal fines and $600 million in civil penalties. The civil penalties were attributed to false claims submitted to government health care programs because of the adulterated drugs. The settlement was the fourth largest ever paid by a pharmaceutical company to the U.S., and the whistleblower involved in the case stands to receive about $96 million.

The GlaxoSmithKline settlement is the latest in a string of developments evidencing federal regulators’ increased focus on investigation and prosecution of alleged health care fraud. In announcing the settlement, Assistant Attorney General Tony West stated, “From Day One, President Obama and Attorney General Eric Holder have been focused like a laser beam on tackling health care fraud in all of its many forms.” The increased focus on combating health care fraud dates back to May 2009, when the Obama Administration launched a joint Department of Justice and Department of Health and Human Services task force to combat health care fraud. The task force, known as HEAT (Health Care Fraud Prevention and Enforcement Team), has been busy ever since. Statistics indicate that in fiscal year 2009, anti-fraud efforts recovered $2.5 billion for the Medicare Trust Fund.

2010 continued the trend of increased enforcement efforts. In September alone, the Department of Justice announced: a settlement of $313 million against Forest Pharmaceuticals, Inc. for charges related to the illegal promotion and unapproved use of certain drugs; a $420 million settlement with Novartis Pharmaceuticals Corp. to resolve off-label promotions and illegal kickback allegations; and a settlement with Allergan for $600 million for the illegal promotion of Botox. Each company was charged under the False Claims Act for causing false claims to be submitted to federal health care programs.

As a further sign of its heightened commitment to health care fraud prosecutions, the Department of Justice recently announced the appointment of Chuck Labella to serve as deputy chief of the fraud section on the west coast. Chuck has held the positions of United States Attorney in San Diego and Assistant United States Attorney in the Southern District of New York. In connection with his appointment, LaBella expressed his focus on health care fraud stating, “We want to make sure the system is run with integrity.”

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The budget outlay for HEAT and other anti-health care fraud efforts is continuing to grow. The Affordable Health Care Act already provided for $350 million to combat health care fraud. A bill pending in Congress would provide an additional $561 million in funding. The Obama Administration forecasts that the funding will more than pay for itself because it projects that anti-health care fraud efforts will bring in $10 billion over the next decade. Whether the forecast becomes a reality remains to be seen.

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