SETTLEMENT

Sanofi’s Genzyme pays $33 million in criminal Seprafilm case

(Reuters) – Genzyme Corp. agreed to pay $32.59 million, admit wrongdoing and enter a deferred prosecution agreement to resolve U.S. criminal charges over its marketing of the surgical implant Seprafilm, the Department of Justice said Sept. 3.


The biotechnology unit of French drug company Sanofi SA was accused of two misdemeanor counts of violating the federal Food, Drug and Cosmetic Act from 2005 to 2010 by allowing Seprafilm to be adulterated and misbranded while being sold. Sanofi bought Genzyme in 2011.

Seprafilm is a clear film used to reduce abnormal internal scarring that can cause organs and tissues to stick together following pelvic and abdominal surgeries known as laparotomies.

But the Justice Department said some sales representatives taught surgeons how to turn Seprafilm into a “slurry” for use in increasingly popular laparoscopic surgery, even though U.S. regulators had never approved the film for that use.

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COMMENTARY

DOJ’s first prosecution for campaign finance coordination — a sign of things to come?

Michael D. Goldklang and Madeleine E. Moise Cassetta of LeClairRyan analyze a recent U.S. Department of Justice prosecution relating to campaign financing and the use of super PAC funds, and they examine the suit’s potential impact on the political process.

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DOJ’s first prosecution for campaign finance coordination — a sign of things to come?

By Michael D. Goldklang, Esq., and Madeleine E. Moise Cassetta, Esq.
LeClairRyan

With the 2016 presidential campaign in full swing, pundits, reformers and the media are once again shining a light on the role of independent-expenditure-only committees, aka “super PACs,” in the American political process. Following the U.S. Supreme Court’s Citizens United decision in 2010, super PACs have become an increasingly prominent part of the campaign finance landscape because they may accept unlimited contributions — including contributions from corporations and labor organizations.

Under the Federal Election Campaign Act, 52 U.S.C. § 30101, expenditures by a person or organization in cooperation, consultation or concert with, or at the request or suggestion of, the agents of a federal candidate or that candidate’s authorized committee are deemed a contribution to the candidate’s campaign. These expenditures are subject to contribution limits imposed by federal law. However, under the Citizens United decision, super PACs may raise unlimited sums from individuals, unions and corporations that are not subject to the federal contribution limits as long as the super PACs do not contribute to or coordinate with political parties or candidates.

The Federal Election Commission was established in the aftermath of the Watergate scandal and has exclusive jurisdiction over civil violations of federal election laws. The Department of Justice has exclusive jurisdiction over criminal violations of those laws, which are misdemeanors when they are knowing and willful and involve amounts of more than $2,000 and felonies when they are knowing and willful and involve amounts of more than $25,000.

The DOJ completed its first successful prosecution of an alleged improper coordination between a campaign and a super PAC earlier this year in the U.S. District Court for the Eastern District of Virginia. The proceedings resulted in a prison sentence of two years for congressional campaign consultant Tyler Harber. Harber, 34, of Alexandria, Va., pleaded guilty to one count of coordinated federal election contributions and one count of making false statements to the FBI. As the government noted in a press release, Harber helped create and operate a supposedly independent super PAC even as he simultaneously managed a candidate’s 2012 congressional campaign. According to the DOJ, “Harber admitted, among other things, that he made and directed coordinated expenditures by the PAC to influence the election with $325,000 of political advertising opposing a rival candidate.” Harber, who used aliases and admitted making multiple false statements to investigators, knew this coordination of funds was against the law.

Following this successful prosecution, commentators have speculated as to whether the Harber prosecution evidences an imminent federal clampdown on illegal campaign coordination. While this was the first federal prosecution of its kind, there are ample reasons to question whether the case signals the institution of more DOJ prosecutions.

Super PACs have become an increasingly prominent part of the campaign finance landscape because they may accept unlimited contributions, including contributions from corporations and labor organizations. The DOJ completed its first successful prosecution of an alleged improper coordination between a campaign and a super PAC earlier this year in the U.S. District Court for the Eastern District of Virginia. The proceedings resulted in a prison sentence of two years for congressional campaign consultant Tyler Harber.

Harber, 34, of Alexandria, Va., pleaded guilty to one count of coordinated federal election contributions and one count of making false statements to the FBI. As the government noted in a press release, Harber helped create and operate a supposedly independent super PAC even as he simultaneously managed a candidate’s 2012 congressional campaign. According to the DOJ, “Harber admitted, among other things, that he made and directed coordinated expenditures by the PAC to influence the election with $325,000 of political advertising opposing a rival candidate.” Harber, who used aliases and admitted making multiple false statements to investigators, knew this coordination of funds was against the law.

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HIGH EVIDENTIARY HURDLE

The government’s announcement of the Harber case’s resolution included some tough talk, including: “The significant prison sentence imposed on Tyler Harber should cause other political operatives to think twice,” and “this case stands as an important step forward in the criminal enforcement of federal campaign finance laws.” In its sentencing brief, moreover, the government cited the growing prospect of coordination-related crime in the wake of Citizens United and requested an prison sentence that would send a clear message to those who intentionally break campaign finance laws.

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The government, in other words, appears eager to limit the impact of *Citizens United* by doing what it can to rein in super PACs. However, the DOJ was also quite frank about the difficulty of detecting and prosecuting improper coordination under the current evidentiary standard. Tellingly, the DOJ has emphasized the importance of self-reporting and whistleblowing.

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**Super PACs may raise unlimited sums as long as they do not contribute to or coordinate with political parties or candidates.**

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**And therein lies the rub**

By many accounts, Harber’s conduct was unusually blatant. He allegedly paid himself $9,000 as a commission and skimmed about $250,000 of contributed funds for personal use — including $138,000 paid to his mother’s company for work that was never performed and $118,000 for so-called personal expenses.

Harber’s own campaign colleagues reportedly supplied the FBI with all the information it needed to act. To use the vernacular, Harber was caught dead to rights.

But few coordination cases are so straightforward. Indeed, the need to prove that alleged violators “knowingly and willfully” broke the law makes the evidentiary standard in coordination cases particularly demanding. Campaign finance laws and regulations happen to be complex and technical, thus increasing the difficulty of proving knowing violations.

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**NEED FOR CASE LAW**

Given these dynamics and the increasing sophistication of political fundraising, improper coordination prosecutions involving the 2016 presidential candidates seem highly unlikely — to say the least — despite the current media attention focused on this issue.

Presidential candidates, after all, are typically well represented by teams of attorneys with extensive knowledge of campaign-finance laws and regulations. Practically speaking, their campaigns and loosely aligned PACs are far less likely to commit clearly defined, prosecutable violations.

At the congressional and state government level, in contrast, hundreds of often-inexperienced candidates operate without the benefit of such extensive legal guidance. The blatant abuses that occurred in *Harber* are a case in point.

Thus, as federal authorities seek to target illegal coordination, the focus most likely will be on the abuses taking place at this lower orbit of the political process. By going after this “low-hanging fruit,” the DOJ may be able gradually to establish case law that addresses many unanswered questions regarding illegal coordination.

The fact that candidates and their campaign committees cannot direct or control funds from super PACs is well understood; what is far less clear is precisely what constitutes illegal coordination.

What, exactly, can and cannot be said during communications between campaigns and super PACs? Could a vague, suggestive “wink-wink” email from a campaign official related to a possible use of funds trigger a successful prosecution, or would more damning and direct communication be required?

Over time, if the federal government were to secure multiple convictions, the emerging case law could eventually make targeting substantive abuses at higher levels of the political process more likely. Gray areas could begin to be clarified.

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**The DOJ was quite frank about the difficulty of detecting and prosecuting improper coordination under the current evidentiary standard.**

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**ROLE OF THE FEC**

The FEC staff is charged with ensuring compliance with the federal election laws by reviewing the reports of political candidates and committees and referring apparent violations and reporting deficiencies to the commission for enforcement action. Outside individuals and groups may also file complaints with the FEC, and government agencies sometimes refer enforcement matters to the commission as well.

Typically, the commission seeks to reach consent agreements with violators by requiring them to pay civil penalties and take other remedial steps. When an agreement cannot be reached, the FEC may file suit in federal court. It also has the authority under the Federal Election Campaign Act to refer possible violations to the DOJ for criminal prosecution. Such referrals require a majority vote of the six commissioners in favor of “probable cause” of a “knowing and willful” criminal violation.

Complaints involving the 2016 presidential candidates are not likely to be referred to the DOJ for criminal prosecution. The FEC’s chief, Ann M. Ravel, has been quite frank about an impasse at the commission. The New York Times reported that Ravel went so far as to state that she has largely given up hope of reining in abuses in the 2016 presidential campaign due to a partisan stalemate among the agency’s six commissioners. “Some commissioners are barely on speaking terms, cross-aisle negotiations are infrequent, and with no consensus on which rules to enforce, the caseload against violators has plummeted,” the newspaper reported.

This long-standing impasse at the FEC represents another obstacle to those who would rein in what they perceive to be campaign finance abuses spawned by *Citizens United*.

Nevertheless, activists seeking to limit the scope of the *Citizens United* decision, as well as political partisans seeking to target rivals, will remain eager to file complaints about any conduct that smacks of improper coordination. In the months and years ahead, coordination likely will become an increasingly fertile ground — certainly in education and risk-management, and possibly in response to federal litigation — for attorneys who represent political and super PAC clients.

**RISK-MANAGEMENT STRATEGIES**

In representing political and super PAC clients, risk-management strategy should include extensive efforts to ensure fundraising operatives at all levels fully understand the imperative to maintain complete separation and independence with respect to the coordination of funds.
This is not simply a matter for the highest echelons of the organization. Indeed, the greatest risk of a violation might well lie with lower-level staffers who may seek to bend the rules in an effort to bolster their status.

For both super PACs and campaigns, a written coordination policy should detail the procedures for interaction and communication based on a reasonably conservative interpretation of the law. Likewise, the governance structure of these organizations should be designed to ensure that there is no impermissible overlap between campaign and super PAC staff.

The DOJ, too, clearly will be on the lookout for violations. In addition, all communications between the two organizations should be thoroughly documented. These communications should be the responsibility of a select few designated individuals who have legal backgrounds or receive clear legal guidance.

CONCLUSION

The *Citizens United* decision cleared the way for a major change in U.S. politics. Opponents of the ruling now seek to ramp up public pressure on the issue and are, to some extent, succeeding. For example, the new End Citizens United PAC, established in March 2015, aims to enact a constitutional amendment that would reverse the Supreme Court’s decisions in *Citizens United* and related cases by giving campaign-finance regulatory power to Congress and the states.

News media continue to cover these developments and to highlight the role of “big money” in politics. For example, recent coverage has highlighted how Republican presidential candidate Jeb Bush’s campaign finance report, filed in July, revealed $114 million in fundraising; of this, only $11 million was raised directly by his campaign, with the rest raised by a loosely affiliated Right to Rise super PAC.

Even President Barack Obama, a staunch opponent of *Citizens United*, recognized the advantages of super PACs and, during the 2012 campaign, acquiesced in implementing those resources. This increased public awareness and scrutiny clearly is part of the reason for the DOJ’s stated intent to focus greater attention on improper coordination between campaigns and the PACs that support them.

The difficult evidentiary standards in play suggest that it is too early to predict whether the *Harber* prosecution portends a significant change in federal enforcement. Nonetheless, the number of improper coordination and other campaign finance-related cases may well increase over time as federal prosecutors target the most obvious abuses, particularly at the congressional level. Political and super PAC clients should work with counsel to redouble their risk-management efforts in the midst of this greater scrutiny.

NOTES

1. 558 U.S. 310, 331 (2010).
7. Id.
While these changes are significant, Brazil continues to be reactive rather than proactive in its investigations. It is also hampered by inefficient procedures that drag proceedings on for years. For the rest of Latin America, antitrust cartel enforcement is not yet a reality. Most of these countries have — at most — a skeletal program in place, and some have no competition laws at all. Few have initiated cartel investigations with implications beyond their own borders.

The increasingly global nature of cartel investigations poses a true test of American countries’ cartel enforcement capabilities. These complex, international investigations require countries to bridge the gap of disparate competition laws to collect evidence across borders and bring individuals abroad to justice.

As Canada, Brazil and other countries in the Americas take part in future international cartel investigations, they should note the significant challenges facing the world’s most established cartel enforcer: the United States.

Although U.S. antitrust laws have broad extraterritorial reach, practical constraints limit the United States’ ability to gather evidence abroad. The United States also faces diplomatic challenges in extraditing individuals charged with antitrust violations, thus limiting its ability to prosecute foreign cartel conduct. As the Americas become more engaged in international cartel investigations, these countries will face similar challenges if they too seek extraterritorial application of their laws.

**CARTEL ENFORCEMENT IN THE AMERICAS**

**United States: Increasing challenges**

The United States has long played a leadership role in cartel enforcement. United States law criminalizes cartel conduct of both companies and individuals, and it imposes steep penalties violations. Companies may be fined up to $100 million, or twice the gain or loss realized by the conspiracy. Individuals face up to 10 years in prison and a $1 million fine.

The U.S. Department of Justice has increased its focus on international cartels, and it has coordinated efforts with the European Union and other jurisdictions to investigate cartel activity in the air cargo, freight forwarding and auto parts industries. The collaboration involves coordinated dawn raids and information-sharing through mutual assistance agreements.

In 2014 the DOJ extracted $1.3 billion in corporate criminal fines. Most were related to international cartel investigations of the auto parts industry and Libor interest rate manipulation schemes.

Libor refers to the London Interbank Offered Rate, a common benchmark used to make adjustments to rates for loans.
Brazil: A reactive enforcer

In 2012, Brazil implemented a new competition law that was aimed, in part, at strengthening and streamlining cartel enforcement. The new law consolidated disparate competition agencies into a single authority called the Administrative Council for Economic Defense, known as CADE. It further called for boosting CADE staff.

In addition, Brazil modified its fines policy for companies and their executives and revised its leniency policy to clarify that leaders of a given cartel may qualify for leniency.

Brazil has since implemented regulations that encourage companies to settle early on by setting predetermined fine reductions depending on when the party comes forward. In return, the government requires companies to admit involvement in the conduct and cooperate in the ongoing investigation.

Since the law was implemented, Brazil has increased its international cartel enforcement efforts, albeit with limited success. For example, it has imposed fines in several international investigations over the past three years, including the air cargo and marine hose investigations. However, the fines are notably less than those imposed in leading jurisdictions.

The Justice Department has faced growing challenges in prosecuting the increasing number of individuals who reside beyond United States jurisdiction.

For example, Brazil ultimately netted only 192.8 million real ($74.5 million), in the air cargo investigation compared with $1.8 billion by the United States and 799 million euros ($1.1 billion). The CADE has also entered into settlement agreements with companies involved in the international freight forwarding, TFT/LCD and DRAM investigations, likely because of the new incentivized settlement program.

Despite this progress, Brazil continues to be reactive rather than proactive. For example, the CADE announced July 2 that it was initiating an investigation into whether banks have manipulated foreign exchange rates affecting the Brazilian real. This announcement came a month after five major banks agreed to pay both the United States and United Kingdom $5.6 billion to settle claims that they had manipulated foreign exchange markets in the so-called forex investigation, which has been ongoing in the United States and other jurisdictions for at least two years.

Brazil did not launch a formal investigation into the auto parts industry until 2014, despite the fact that the global investigation began in February 2010 with coordinated dawn raids conducted by the United States, the European Union and Japan. Since then, it has opened administrative proceedings related to only seven auto parts, with the most recent proceeding against auto parts makers Takata Corp. and Autoliv announced in July.

Brazil’s prosecution of international cartels is also hampered by its cumbersome legal process and long delays. The freight-forwarding investigation is a prime example of the red tape that boggs down Brazil’s ability to timely and effectively resolve investigations.

Brazil issued a technical note, or complaint, in 2009, naming dozens of companies and individuals as defendants in its ongoing freight-forwarding investigation. However, the administrative proceeding remained at a standstill for more than four years, as Brazil was required to serve the complaint
to go before it can be considered a global leader.

Other Latin American countries

Cartel enforcement in the remainder of Latin America is nascent at best. Guatemala has no competition law, and many other Latin American competition authorities are still in their infancy. Countries that have begun to test their cartel laws — such as Chile, Colombia, Peru and Uruguay — have done so largely on the domestic front. Colombia has signaled its interest in promoting international cooperation by signing mutual assistance agreements with the United States and other Latin American countries.

Mexico is the only country in the Americas other than Brazil that coordinates with international enforcers on global cartel investigations. In 2014, Mexico followed other jurisdictions in imposing significant fines against manufacturers of refrigerator compressors equivalent to $17 million. Mexico also demonstrated its commitment to cartel enforcement by adopting new legislation to make cartel conduct a criminal penalty and increase its competition authority’s investigative authority.

KEY CHALLENGES

Uncertainty of extraterritorial reach

The United States’ antitrust laws have a broad extraterritorial reach. The Sherman Act, which criminalizes cartel conduct, provides that “[a]ny contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal.”

Under the Foreign Trade Antitrust Improvements Act, any conduct that “has a direct, substantial, and reasonably foreseeable effect” on United States commerce and that “gives rise to a claim under [Section 1 of the Sherman Act]” falls within the prosecutorial jurisdiction of the DOJ.

The precise meaning of the FTAIA’s “direct” requirement is interpreted, the Sherman Act undoubtedly reaches foreign cartel conduct. The DOJ’s ongoing auto parts cartel probe, for instance, has almost exclusively targeted Japanese corporations and Japanese nationals based on actions taken in Japan. Many of the DOJ’s other major investigations, such as air cargo, TFT/LCD panels and freight-forwarding, likewise focused on foreign cartel conduct.

The DOJ’s investigations thus often require law enforcement to gather evidence located in other countries. When focusing on the Americas, the government’s need to collect evidence abroad imposes practical limitations on its ability to investigate and prosecute foreign cartel conduct.

To facilitate cross-border cartel investigations, enforcement authorities in the United States have sought international cooperation. In certain parts of the Americas, the United States has successfully done so.

Brazil has increased its international cartel enforcement effort, albeit with limited success. Its prosecution of international cartels is hampered by its cumbersome legal process and long delays.

A decision from the 7th U.S. Circuit Court of Appeals provided the government’s sought-after flexibility. In *Motorola Mobility LLC v. AU Optronics Corp.*, the 7th Circuit applied a proximate-cause standard, holding that an effect on United States commerce is indirect and therefore beyond United States jurisdiction only if the foreign price-fixing “filters through many layers and finally causes a few ripples in the United States.”

Under *Motorola Mobility*, the narrow definition of “indirect effect” gives the DOJ more power to investigate and prosecute overseas cartel conduct. In fact, the court expressly preserved the government’s ability to prosecute such conduct even if the conduct does not provide grounds for a civil suit.

The U.S. Supreme Court recently declined to hear appeals in *Hsiung and Motorola*, thus preserving the current state of uncertainty regarding the scope of the DOJ’s ability to prosecute overseas cartel conduct.

Barriers to evidence-gathering

Regardless of how the FTAIA’s “direct” requirement is interpreted, the Sherman Act undoubtedly reaches foreign cartel conduct. The DOJ’s ongoing auto parts cartel probe, for instance, has almost exclusively targeted Japanese corporations and Japanese nationals based on actions taken in Japan. Many of the DOJ’s other major investigations, such as air cargo, TFT/LCD panels and freight-forwarding, likewise focused on foreign cartel conduct.

The DOJ’s investigations thus often require law enforcement to gather evidence located in other countries. When focusing on the United States and Canada, for example, have long collaborated on antitrust investigations and prosecutions through bilateral antitrust cooperation agreements and a mutual legal assistance treaty. As a result, the United States and Canadian authorities have conducted coordinated raids, executed searches on behalf of each other and generally worked together towards more effective antitrust enforcement.

The United States’ cooperation with antitrust enforcement authorities elsewhere is more limited. Other than Canada, the United States has executed bilateral antitrust cooperation agreements with only four American countries — Brazil, Chile, Colombia and Mexico. Among those four, only Brazil is an active cartel enforcer. Furthermore, these four bilateral cooperation agreements are largely toothless, mandating very little in the way of actual cooperation.

In addition to the four agreements, the United States has signed bilateral mutual legal assistance treaties, or MLATs, with 19 American nations. It is also party to the Inter-American Convention on Mutual Legal Assistance, which has been ratified by 13 additional American states. Under an MLAT, the United States can ask the designated central authority of the treaty partner for assistance in gathering evidence in a criminal investigation, including searches and seizures, subpoenas for documents or testimony, and witness interviews. In the United States, the statute of limitations for a crime can be tolled while the request is pending.

Although these treaties promote general cooperation by providing mechanisms for
cross-border evidence gathering in criminal cases, their impact on antitrust investigations in the Americas is limited. A handful of American countries still have not executed an MLAT with the United States, and over half of the 19 existing bilateral MLATs are with small island nations that are unlikely to be involved in international cartel enforcement. Even if an active cartel enforcer, like Brazil, does have an MLAT with the United States, such treaties often contain exceptions under which foreign authorities are not required to act, including when the conduct at issue would not violate the criminal laws of the foreign jurisdiction. Furthermore, the process of requesting assistance under an MLAT can be slow and cumbersome.

Cartel enforcement in much of Latin America is nascent at best.

International cooperation in cartel investigations is even more difficult without an MLAT. Without such treaties, requests for assistance must be made through letters rogatory, which are essentially requests from a United States court to a foreign court seeking international judicial assistance. Even when such requests can be issued, they must comply with numerous procedural requirements that vary by jurisdiction. Because letters rogatory are based predominately on the international legal principles of comity and reciprocity, compliance with them falls within the discretion of the receiving court. Consequently, obtaining assistance through a letter rogatory is time-consuming and unpredictable.

In short, although the Sherman Act has a broad extraterritorial reach in theory, in practice the United States’ ability to investigate cartel conduct occurring abroad is much more limited.

Roadblocks to extradition

Equally limited is the United States’ ability to prosecute foreign cartelists. Even if the DOJ is able to investigate foreign cartel conduct and bring charges against individuals living abroad, those individuals may choose not to voluntarily submit to U.S. jurisdiction. In those cases, the DOJ’s ability to successfully prosecute the individuals will hinge on the willingness of foreign officials to extradite them. That willingness is hardly guaranteed. The DOJ has acknowledged that it faces an uphill battle in extraditing foreign nationals on antitrust charges.9

The DOJ has had limited success in extraditing individuals in antitrust cases. In November 2014, the agency extradited a Canadian national, John Bennett, in a case involving alleged anti-competitive conduct. Bennett, however, was extradited on fraud charges rather than on antitrust charges. In fact, the Antitrust Division has secured only one extradition on pure antitrust charges, and the unusual facts of that case provide little precedential value. Romano Pisciotti, an Italian national, was indicted under seal in the DOJ's investigation into price-fixing in the marine hose industry. The DOJ was unable to extradite Pisciotti from his home country because Italy did not criminalize cartel conduct at the time. The agency was only able to secure Pisciotti’s extradition when, some three years later, he travelled to Germany and was detained pursuant to an Interpol “Red Notice.” Before the Pisciotti extradition, the DOJ had failed to secure the indictment of British national Ian Norris from the United Kingdom solely on price-fixing charges stemming from the department’s air cargo investigation. The U.K. ultimately extradited Norris on obstruction-of-justice charges.

The DOJ also appears to be losing the battle to prosecute foreign executives who refuse to plead guilty in the auto parts investigation. While almost all criminal defendants charged with a crime plead guilty, barely more than half charged in the auto parts probe have done so. Of the 55 individuals who have been charged in that investigation, 25 — all foreign nationals — have been indicted because they refused to plead guilty. Only two of these executives have voluntarily submitted to United States jurisdiction and appeared in a United States courtroom. The DOJ has yet to extradite any of the others.

The DOJ is likely to have similar difficulty extraditing individuals from American countries. Although the United States has executed extradition treaties with 34 American nations, including active antitrust enforcers like Canada and Brazil, many of those treaties contain significant limitations. Some do not provide for extradition in antitrust cases. Others contain exceptions under which foreign authorities are not required to act, including when the conduct at issue would not constitute a criminal offense under the laws of the foreign jurisdiction, when the statute of limitations has run in either country, and when the individual sought is a citizen of the country from which he would be extradited. Many Latin American countries have historically refused to extradite their own nationals. Some, including Brazil, are constitutionally prohibited from doing so.

Even if an individual could be extradited from an American country for cartel conduct, securing that extradition still requires diplomatic negotiations and formal proceedings in the extraditing country. The process may be costly and time-consuming, and success is far from guaranteed.

CONCLUSION

As emerging countries in the Americas and throughout the world seek to build their cartel enforcement capabilities, they are likely to face many of the same practical and legal constraints that limit the United States’ ability to investigate and prosecute cartel conduct abroad. These countries should take heed of hurdles the United States has increasingly faced in cross-border investigations.

NOTES

2 See id. at § 6a.
3 United States v. Hsiung, 758 F.3d 1074, 1094 (9th Cir. 2014).
4 See Brief for United States and the Federal Trade Commission as Amici Curiae Supporting Neither Party at 6, Motorola Mobility LLC v. AU Optronics Corp., No. 14-8003 (7th Cir. Sept. 5, 2014).
5 See id. at 11-20.
6 Motorola Mobility LLC v. AU Optronics Corp., 775 F.3d 816 (7th Cir. 2015), cert. denied, No. 14-1122, 2015 WL 1206313 (June 15, 2015).
7 Id. at 819 (quoting Minn-Chem Inc. v. Agrium Inc., 683 F.3d 845, 860 (7th Cir. 2012); accord Lotes Co. Ltd. v. Hon Hai Precision Indus. Co. Ltd. et al., 753 F.3d 395, 410 (2d Cir. 2014) (requiring a “reasonably proximate causal nexus”)).
8 Id. at 825-27.
United States v. Newman is perhaps the most significant insider trading decision in three decades. In it, the 2nd U.S. Circuit Court of Appeals overturned the conviction of two hedge fund managers for trading on alleged inside tips they had received from their analysts. The appeals court rejected the government’s case because of the lack of objective evidence that corporate insiders received a personal benefit when they tipped analysts regarding corporate earnings.

The 2nd Circuit’s decision correctly applied the U.S. Supreme Court’s seminal ruling in Dirks v. Securities and Exchange Commission, and it reinforced the fiduciary duty standard for regulating insider trading. It also soundly rejected the government’s ongoing effort to impose a much broader “symmetry of information” standard in insider trading cases.

If the Supreme Court agrees to review this case, the securities industry ought to roll out in support of Newman.

THEORIES OF INSIDER TRADING

There are two principal theories of insider trading. The first relies on existing securities antifraud laws to sanction corporate insiders (or others with a duty of confidentiality) who benefit from trading on or passing along material, nonpublic information. The second presupposes that trading on (or sharing for a benefit) material, nonpublic information inherently harms the market and should be prohibited.

The first theory, sometimes called the fiduciary duty theory, bars corporate fiduciaries (or outsiders in positions of trust or confidence) from personally profiting from material, nonpublic information that belongs to others. Expressed in American jurisprudence as either “classical” (applying to corporate insiders) or “misappropriation” (applying to outsiders with a “position of trust”) insider trading, liability under this theory is fundamentally premised on the duty owed by the acquiring party to the party from whom the information was acquired.

Dirks was, in other words, singularly focused on whether an insider had, in the first instance, breached a duty for his personal gain.

In other words, because U. S. law only regulates fraudulent conduct, “when an allegation of fraud is premised upon non-disclosure [i.e. trading on inside information without telling the market], there can be no fraud absent a duty to speak.” According to the Supreme Court’s ruling in Chiarella v. United States, current anti-fraud laws do not impose “a duty to disclose ... from the mere possession of nonpublic market information.”

The fiduciary duty theory recognizes that, in the market, efforts to obtain information that may be nonpublic in nature are common and legitimate aspects of capital formation. One sentiment is that, “[w]hen an analyst acquires nonpublic information not by virtue of any insider status, but through the lawful exercise of his own diligence, and when the information involved would not soon have been revealed to the market in the natural course of events, the analyst ought to be permitted to trade or advise without making a public disclosure or assuming the risk of liability.”

Or, as Justice Powell stated in the conference memo he prepared prior to writing the Dirks opinion, “market efficiency in practice is significantly enhanced by such initiatives to ferret out and analyze information, and thus the analysts’ work [redounds] to the benefit of the investors.” Accordingly, insider trading regulation has largely been limited to the pursuit of individuals — or their effective proxies — who have improperly benefitted by breaching their duties to maintain the confidentiality of insider information.

The second theory of insider trading stands in sharp contrast to the duty-based theory. Under the second theory, policymakers and commentators advocate for a statutory prohibition of any trading based on nonpublic, price-sensitive information. This “symmetry of information” approach prohibits any trading on information that is not generally known and would materially impact the price of a stock. It would, of course, exclude from liability those who have no reason to believe the information they possess was revealed to them inappropriately. In their article “Duty-Free Insider Trading,” the authors posit that this definition would give clear guidance to market participants, regulators and the court, while avoiding the vagaries of applying the fiduciary duty theory to a broad array of market participants.

Under this theory, “If you have material, inside information, you can’t trade on it, period.”
2ND CIRCUIT STRENGTHENS, CLARIFIES THEORY

Under the antifraud provisions of the federal securities laws, the test after the Supreme Court’s 1983 decision in Dirks is whether the insider has breached a duty by conveying the information for the insider’s personal benefit, and whether the tippee knows or at least should know of the breach. In Dirks, the Supreme Court explained that, even in a case against a tippee who trades on inside information:

[T]he test is whether the insider personally will benefit, directly or indirectly, from his disclosures. Absent some personal gain, there has been no breach of duty to stockholders. And absent a breach by the insider, there is no derivative breach [by the tippee].

In other words, Dirks was singularly focused on whether an insider had, in the first instance, breached a duty for his personal gain.

In Newman, two hedge fund managers received allegedly material, nonpublic information from their analysts. The analysts, who had received the information from corporate insiders, pleaded guilty to participating in a fraudulent scheme to obtain — and share — material, nonpublic information.9 After a six-week trial in which the analysts testified for the prosecution, the managers were convicted of insider trading.

The 2nd Circuit ultimately concluded that to prove an insider trading case, the government must establish, beyond a reasonable doubt, that:

• “[T]he corporate insider was entrusted with a fiduciary duty.”
• “[T]he corporate insider breached his fiduciary duty by (a) disclosing confidential information to a tippee (b) in exchange for a personal benefit.”
• The tippee knew of the tipper’s breach [both (a) and (b)].
• The tippee still used the information to trade or tip someone else for a personal benefit.

The 2nd Circuit’s holding with respect to the nature of the “personal benefit” is probably Newman’s greatest legacy.

On appeal, the 2nd Circuit noted, among other things, that the managers “were several steps removed from the corporate insiders and there was no evidence that either was aware of the source of the inside information.” Indeed, the court noted, neither of the corporate insiders were charged criminally, and only one of the two were sued administratively by the Securities and Exchange Commission.

In other words, the 2nd Circuit looked skeptically on the idea that the hedge fund managers (who were their ultimate tippees) would be liable for insider trading.

The 2nd Circuit’s holding with respect to the nature of the “personal benefit” is probably Newman’s greatest legacy.

With respect to personal benefit, the court stated that, “to the extent Dirks suggests that a personal benefit may be inferred from a personal relationship between the tipper and tippee [in situations in which an insider could be said to be “gifting” the information], we hold that such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”

The court went on to note that there must be some sort of quid pro quo in the relationship that will provide the tipper with a potential future pecuniary gain. Newman applies to both the classic and misappropriation tests for insider trading liability under the fiduciary duty theory.10

The Newman court tested the outer boundary of the “personal benefit” requirement, as the 9th U.S. Circuit Court of Appeals immediately responded to address the issue. In United States v. Salman, the 9th Circuit (in an opinion by Southern District of New York Judge Jed Rakoff, by designation) held that Dirks made it plain that an insider can be liable for making “a gift of confidential information to a trading relative or friend.”11

To the extent Newman could be read as requiring more (such as a quid pro quo in the relationship that would provide the tipper with a potential pecuniary benefit), the 9th Circuit “decline[d] to follow it.”

THE FIDUCIARY DUTY THEORY

While there is something to be said for a broad, clear rule — the promise of the theory of market integrity — a market-integrity-type rule would over-regulate the market and chill analysts’ efforts to foment capital formation. Indeed, “[b]y buying low and selling high (or by short-selling high and covering low), stock speculators actually speed up price adjustments and make stock prices less volatile than they otherwise would be.”12 Accordingly, those “profiting from ‘inside knowledge’ actually share that knowledge with the rest of the world through their buying and selling.”13

A blanket prohibition against anything that resembles trading on inside knowledge would certainly dampen this market efficiency. Furthermore, in this day and age, any number of things could arguably look like trading on inside information.

Furthermore, in this day and age, any number of things could arguably look like trading on inside information. For example, satellite imagery technology will soon be available that reimages the Earth twice a day. According to securities analysts, such technology will allow them to predict numbers, and gain other “bird’s-eye” insight into corporate business. If an analyst traded on such information — or encouraged others to do so — the gain from such trading would almost certainly give rise to an investigation by the SEC’s Division of Enforcement, at a minimum.14

Such a rule could also eliminate (or severely limit) the analysts on which speculators rely. This certainly was the Supreme Court’s view in Dirks, in which it noted that “[i]mposing a duty to disclose or abstain [from trading on nonpublic information] solely because a
person receives information from an insider and trades on it would have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market.”

In short, a blanket prohibition against insider trading is likely to have such a negative impact on the market that its perceived positive impacts would be more than erased. Against this backdrop, limiting insider trading regulation to the inappropriate use of inside information by those with a duty not to profit from such information makes perfect sense. In Newman, the 2nd Circuit provided the type of clarity the fiduciary duty test needs. By establishing a quid pro quo standard, Newman made it plain that a corporate insider cannot be tried for insider trading by misplacing trust in his friends and relatives, and that remote tippies will not face expensive investigations or enforcement proceedings simply because they received a “hot tip.”

In this regard, Newman also reinforced the mens rea requirement of insider trading — the requirement that a trader know that what he is doing is wrong. Put simply, while Newman clarifies and strengthens the test for insider trading, it holds true to Dirks. Indeed, the manner in which Newman articulated the quid pro quo that must exist for an insider’s provision of material, nonpublic information to an outsider to be considered an improper tip is in keeping with Dirks’ requirement that insider trading must “focus on objective criteria.”

Had this test been applied in United States v. Salman, it seems likely the outcome would have been the same. In Salman, the prosecution offered objective evidence that:

• The two did mutually beneficial things for each other over the years.
• There was a period of nearly three years in which Maher provided Michael with inside information totally unrelated to Maher obtaining advice needed to do his job.

This is “objective evidence” that Maher intended to provide a gift to Michael of the inside information, with the quid pro quo being the ongoing mutual support of brotherhood. This type of standard — do not gift inside information to your friends and relatives with the intent that they should profit from the information — should not lead to over-enforcement and is clear and easy to follow.

CONCLUSION

In short, the fiduciary duty standard provides appropriate regulation in an efficient capital market. The Newman decision gives needed clarity — absolutely in keeping with Dirks — to that standard, particularly in cases involving information an insider provides without gaining a clear personal benefit. Accordingly, the Supreme Court ought to reject the government’s invitation to impose what is effectively a symmetry-of-information requirement. If it accepts the case, the nation’s securities markets should leap to Newman’s defense.

NOTES

1 773 F.3d 438 (2d Cir. 2014); petition for cert. filed (U.S. July 30, 2015) (No. 15-137).
4 Chiarella, 445 U.S. at 235.
8 James B. Stewart, Congress ought to delve into insider trading morass, N.Y. Times, Dec. 23, 2014.
9 Patricia Hurtado, Ex-SAC Analyst Horvath Pleads Guilty In U.S. Insider Case, Bloomberg (Sept. 28, 2012), http://www.bloomberg.com/news/articles/2012-09-28/ex-sac-analyst-said-to-plan-guilty-plea-in-insider-case. Horvath stated, as part of his plea: “I was part of a group of analysts who agreed to obtain and share information about public companies. Some of the information I received was material nonpublic information which I knew came from public company employees and I knew they were not permitted to disclose or share with outsiders.”
11 United State v. Salman, 792 F.3d 1087, 1092 (9th Cir. 2015).
13 Id.
15 Dirks, 463 U.S. at 658.
16 Id. at 663.
Prior conviction, present danger: Felony liability under the Food, Drug and Cosmetic Act

By Cody S. Harris, Esq.
Keker & Van Nest

Imagine you’re the head of a venerable and successful drug company that develops, promotes and sells pharmaceuticals to medical providers across the country. You know that the Food and Drug Administration is scrutinizing your company’s promotional activities, and you make every effort to comply with the agency’s requirements. The government, however, takes a different view, and you find yourself the target of a criminal investigation into some of your company’s promotional efforts.

This robust enforcement power, which carries with it the threat of mandatory debarment from federal health care programs, raises significant due process concerns.

This is worrisome, you think, but as you mount your defense you take some small solace in the fact that, at worst, you’re facing a misdemeanor charge under the federal Food, Drug and Cosmetic Act. Although serious, a misdemeanor conviction does not carry with it the risk of mandatory debarment from all federal programs. That penalty would effectively destroy your career and severely harm your company, which sells many of its products through Medicare.

Then you remember something. Twenty years ago, you and your company were charged with and pleaded to a misdemeanor violation of the FDCA. It was about conduct completely unrelated to the pending investigation. Many of the executives in charge at that time have long since moved on, and your company doesn’t even sell the drug that was at issue anymore. An unfortunate incident in the company’s otherwise sterling history, the plea and conviction now serve primarily as a cautionary tale handed down within the legal and marketing departments. But as William Faulkner once wrote, “The past is never dead. It’s not even past.” That is certainly true when it comes to criminal enforcement of the FDCA. The act authorizes federal prosecutors to transform a strict liability misdemeanor violation into a felony charge on the basis of any prior FDCA conviction — no matter how old or factually dissimilar the prior conviction was from the conduct now at issue.

This robust enforcement power, which carries with it the threat of mandatory debarment from federal health care programs, raises significant due process concerns that have never been litigated.

FROM STRICT LIABILITY MISDEMEANOR TO FELONY

The statutory background is as follows. Among other things, the FDCA prohibits individuals from “causing” the “adulteration” or “misbranding” of any drug in interstate commerce, or from causing such an adulterated or misbranded product to be introduced into interstate commerce. The government’s criminal enforcement powers are set forth in FDCA Section 333. That provision provides two tiers of liability for FDCA offenses: misdemeanor and felony.

Section 333(a)(1): Misdemeanor liability

Section 333(a)(1) allows the government to charge violators with a misdemeanor, stating that any person who violates the FDCA “shall be imprisoned for not more than one year or fined not more than $1,000, or both.” This provision creates a strict liability offense as the 9th U.S. Circuit Court of Appeals has held a charge may be brought and sustained “pursuant to the misdemeanor provision ‘without any conscious fraud at all,’ thus creating a form of strict criminal liability.”

The lack of any mens rea requirement makes this provision a potent prosecutorial weapon. And under the so-called “Park doctrine,” a company executive can be held vicariously liable for the acts of others within the company, even if he or she knew nothing of the alleged conduct, so long as the executive was in the position to prevent or correct the violation.

Accordingly, executives can be convicted and imprisoned for crimes they personally knew nothing about and played no role in committing. A recent legal challenge to the imposition of such a penalty on due process grounds failed in federal district court.

Section 333(a)(2): Felony liability

FDCA Section 333(a)(2) permits the government to seek a felony conviction, but only in two specific circumstances. The first concerns scienter — if the violation was committed “with the intent to defraud or mislead,” the violation can be ratcheted up to a felony. This intent requirement forms the basis for most felony charges under the FDCA.
But the second, less frequently invoked circumstance may implicate a decades-old conviction. Section 333(a)(2) also provides that the government may bring a felony charge against anyone who “commits ... a violation after a conviction of him under this section has become final.” The statute includes no restriction on how recent the conviction must be; any conviction will do, no matter how old or factually unrelated. Like the misdemeanor charge, this prosecutorial option requires no proof of 

scienter — it remains essentially a strict liability offense. In other words, if a company has been previously convicted of an FDCA violation, no matter how long ago or for what, that company could be charged with a felony the next time the government places the company in its sights. And federal prosecutors could sidestep the heavy burden of proving to a jury beyond a reasonable doubt that someone at the company acted with the affirmative intent to defraud or mislead. The difference between a misdemeanor charge and a felony charge has massive strategic implications. Not only does a felony conviction risk a longer prison sentence, but it also leads to mandatory and permanent debarment of an individual under 21 U.S.C. § 335a(a). It also dramatically increases the possibility of debarment for the entire company under Section 333a(b) as well. Because federally funded programs like Medicare and Medicaid make the government the largest payor for pharmaceuticals and medical devices, “[d]ebarment means losing the company’s largest customer.”

Because even the threat of debarment can be catastrophic, defendants often choose to settle with the government rather than risk a felony conviction. As a result, legal arguments challenging the FDCA’s felony provision often go unmade and remain untested.

DUE PROCESS ISSUES

An FDCA felony charge predicated on a stale and factually dissimilar prior conviction would raise serious due process concerns. When the FDCA is read alongside the Park doctrine, it arguably grants prosecutors the power to charge an executive or company with a strict liability felony — one that could destroy the executive’s career and drive the company out of business — based solely on old and factually dissimilar conduct. Challenging such a felony FDCA conviction on due process grounds would be an uphill battle. The U.S. Supreme Court has held that a convicted defendant “is eligible for, and the court may impose, whatever punishment is authorized by statute for his offense, so long as that penalty is not cruel and unusual, and so long as the penalty is not based on an arbitrary distinction that would violate the Due Process Clause of the Fifth Amendment.”

That’s a high hurdle for a defendant to surmount. And in fact, other criminal statutes — such as the “three strikes” statute, 18 U.S.C. § 3559(c), and the Armed Career Criminal Act, 18 U.S.C. § 924(e) — allow for severe penalties based on prior convictions, yet include no temporal limitation. When defendants have challenged harsh sentences handed down under these laws, courts have refused to infer a temporal limit on prior convictions and have let the sentences stand.

Because even the threat of debarment can be catastrophic, defendants often choose to settle with the government rather than risk a felony conviction.
Any argument challenging a recidivism-based FDCA felony charge would appear to be novel; there seems to be no precedent upholding such a prosecution and conviction, nor any precedent prohibiting it. But the only cases that discuss recidivism-based FDCA charges concern prior convictions that were both very close in time to the second charge and based on identical illegal conduct.

One such case, United States v. Stella D’Oro Biscuit Co., 143 F. Supp. 275 (S.D.N.Y. 1956), is a Southern District of New York opinion from 1956 concerning a biscuit distributor that had been convicted of the exact same offense five years before being tried and convicted a second time, for the same conduct, in the same court. Challenging the felony conviction, the company argued that the earlier conviction hadn’t been alleged in the indictment. The court dismissed this argument, finding that the FDCA required no such procedure and that “[d]ue process ha[d] been fully observed.”

Similarly, in United States v. Roma Macaroni Factory, 75 F. Supp. 663 (N.D. Cal. 1947), a macaroni factory was convicted of shipping food tainted with “insect fragments, rodent hair fragments, hair resembling rodent hair and unidentified hair.” As “revolting” as the court found that conduct, more troubling was the fact that the same defendant had been convicted in the same court, for the same conduct, a mere six months before being indicted again. Based on those facts, the court found a felony charge appropriate, explaining that “very little if anything had been done” to correct the problems between the first and second indictments. “Congress,” the court observed, “had in mind the imposition of that rather severe criminal penalty to avoid the consequences of that type of conduct which we have presently reviewed.”

Although both of these cases upheld a felony conviction based on a prior offense, neither concerned a stale or unrelated prior conviction. If what Congress had in mind with Section 333(a)(2) was preventing true recidivism — i.e., a company continuing to violate the FDCA in an ongoing fashion, in a similar way, and despite a previous conviction — threatening a felony conviction and mandatory debarment based on stale and unrelated conduct may push congressional intent beyond the breaking point.

**CONCLUSION**

The FDCA grants robust enforcement powers to federal prosecutors, and one weapon in their arsenal is the threat of elevating a misdemeanor charge into a felony charge based on any prior FDCA conviction. Seldom litigated, this prosecutorial option raises significant due process concerns given the draconian nature of the penalties associated with a felony conviction under the FDCA, and the lack of any mens rea requirement in the statute.

Whether a court would be receptive to a due process challenge is an open question. In any event, corporate executives and legal advisers would do well to litigate this question to judgment and appeal. In any event, corporate executives and legal advisers would do well to remember that a prior FDCA conviction may be enough to prevent any defendant from litigating this question to judgment and appeal. In any event, corporate executives and legal advisers would do well to remember that a prior FDCA conviction may be enough to prevent any defendant from litigating this question to judgment and appeal.

**NOTES**

3. 21 U.S.C. § 331(a), (b) and (k).
9. A handful of defendants have argued that the debarment provision is unconstitutionally vague or that it is a criminal sanction that violates the double jeopardy or ex post facto clauses. Courts have rejected these arguments, finding that debarment is a civil remedy, not a criminal penalty, and that its terms are clear enough. See Bhutani v. FDA, 161 F. App’x 589 (7th Cir. 2006); DiCola v. FDA, 77 F.3d 504 (D.C. Cir. 1996).
11. Id.
14. The argument may turn on whether the FDCA reflects “a clear statement from Congress that mens rea is not required” to convict someone of a felony under Section 333(a)(2)’s prior-conviction prong. Staples v. United States, 511 U.S. 600, 618 (1994).
Wal-Mart board had to know of Wal-Mex bribery reports, investors tell 8th Circuit

Wal-Mart’s directors must have known a decade ago about bribery allegations at the retailer’s Mexican subsidiary — unless the company’s top officers shirked their duty to inform them, shareholders have argued to the 8th Circuit in a bid to revive their suit over the board’s handling of the scandal.


The investors argue that in a related action, the Delaware Supreme Court in 2014 clearly rejected the reasoning behind the judge’s requirement that to establish director liability, a plaintiff must present “smoking gun evidence” that each and every Wal-Mart director received a full report about the alleged bribery. Wal-Mart Stores v. Ind. Elec. Workers Pension Trust Fund IBEW, 95 A.3d 1264 (Del. 2014).

The state high court said what Wal-Mart’s CEO, general counsel and board audit committee chairman knew about the so-called Wal-Mex bribery scandal— and their duty to report it to the board — is enough to draw a factual inference at the pleading stage that the directors received the reports, the shareholders’ reply brief says.

1 CHAMPION, 1 CHANCE

If the plaintiffs-appellants in this case, who sued on behalf of Wal-Mart in Arkansas, fail to win a reversal of the dismissal, all other investors — including those in a parallel action in Delaware Chancery Court — will be barred from pursing similar derivative actions.

Under Delaware law only one set of plaintiffs may sue derivatively over any given wrong, and they must either let the directors, as company managers, review the validity of their claims or, to survive a motion to dismiss, they must prove the board is unfit to judge. If they lose, the case is over.

Shareholders sued in Arkansas and Delaware after learning that when Wal-Mart’s board heard the stories of rampant bribery of Mexican government officials to speed the retailer’s expansion, the directors allowed the very Wal-Mex officials at the center of the scandal to take over the investigation. Those investigators absolved themselves, the suits said.

Because both sets of plaintiffs sued derivatively but failed to submit their charges for board review, they each could expect to face a motion to dismiss.

2 PLAINTIFFS, 2 TACTICS

But while the Delaware plaintiffs fought a long battle in a books-and-records action to get ammunition to use in their derivative suit, the Arkansas plaintiffs, believing they could easily prove the directors were too biased to fairly review their charges, went straight to court and lost.

While the Arkansas plaintiffs appealed that decision, Wal-Mart filed a motion to dismiss the Delaware suit on the grounds that the advocate of the shareholders had used up its only chance to sue over the Wal-Mex scandal and lost. Oral argument on that motion is scheduled for Nov. 12 before Chancellor Andre G. Bouchard. In re Wal-Mart Stores Del. Derivative Litig., No. 7455, letter confirming oral argument issued (Del. Ch. Aug. 8, 2015).

‘IMPUTED’ OR ‘INFERRRED’?

In the reply brief filed with the 8th Circuit, the shareholders say the Arkansas federal judge’s dismissal order, and Wal-Mart’s defense of it, are based on a “straw man” argument: the false representation of the plaintiffs’ arguments.

First, the brief says, Wal-Mart repeatedly mischaracterizes the claims in the complaint, accusing the plaintiffs of trying to “impute” knowledge of the bribery scandal to the Wal-Mart directors based “solely” on their board membership, along with “conclusions, opinions or speculation.”

In truth, the complaint does not seek to impute knowledge to the board but instead to simply draw a factual inference based
on the top officers’ admitted knowledge of the scandal and their duty to report such information to the board, the reply brief says.

Second, the Delaware Supreme Court rejected that imputation argument and supported the “factual inference” theory based on the reporting duty of the top officers in its 2014 opinion in the related books-and-records action, the plaintiffs say.

Third, the brief says, the Arkansas complaint is supported by “emails from the Wal-Mex investigation that create a paper trail reaching all the way up to Wal-Mart’s board of directors.”

“Faced with an indefensible District Court decision, and recognizing that there is a ‘reasonable doubt’ that at least 10 of Wal-Mart’s 15 directors are incapable of considering a demand, … defendants fabricate a new standard of demand futility, stitched together with legal misstatements,” the reply brief says.

If that standard is adopted, the brief says, it would “decimate the ability of shareholders to protect their companies from disloyal directors and incentivize officers and directors to engage in malfeasance.”

Attorneys:
Plaintiffs: Judith S. Scolnick and Thomas L. Laughlin IV, Scott+Scott, New York
Defendants: Theodore J. Boutrous Jr. and Alexander K. Mircheff, Gibson & Dunn, Los Angeles

Related Court Document:
Reply brief: 2015 WL 5121030

MEDICARE FRAUD

Houston medical services providers charged with Medicare fraud

By Phyllis L. Skupien, Esq., Managing Editor, Westlaw Journals

Three people have been arrested for allegedly billing Medicare $5.6 million for diagnostic tests that were not performed or not necessary, the U.S. attorney’s office in Houston has announced.


Joy Aneke, 47, was charged with conspiracy to defraud Medicare, money laundering and identity theft for her alleged scams at Jadac Unique Health Services Inc., Almeda Physicians Clinic and Bona Care, a home health agency.

Prosecutors allege Aneke fraudulently operated the Almeda clinic and Bona Care. She is accused of using the personal identification information of a medical doctor without the doctor’s knowledge or permission to defraud Medicare through the home health agency.

Aneke also allegedly received about $921,000 in Medicare funds from the Bona

Clinic operator Joy Aneke is accused of using the personal identification information of a medical doctor without the doctor’s knowledge or permission to defraud Medicare.

Also charged are Teodoro Seminario aka Dr. Ted, 48, and the manager of the Jadac clinic, Maureen Henshall aka Ms. Mo, 59, for their roles in the conspiracy.

The indictment was filed under seal July 15 in the U.S. District Court for the Southern District of Texas and unsealed as each defendant was taken into custody.

They were arraigned and pleaded not guilty Aug. 18.

According to the charges, Aneke operated Jadac as a diagnostic clinic from July 2008 through April 2012. Henshall ran the clinic and allegedly paid marketers cash for every Medicare patient they referred there, and Seminario worked at the clinic as an unlicensed physician’s assistant, the indictment says.

Also charged are Teodoro Seminario aka Dr. Ted, 48, and the manager of the Jadac clinic, Maureen Henshall aka Ms. Mo, 59, for their roles in the conspiracy.

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Tax return preparers sentenced for offshore-account offenses

A California federal judge has ordered a father and son who ran a tax return preparation company to serve prison terms for using secret offshore accounts to hide millions of their wealthy clients’ funds from taxation.

The Justice Department said that following trial in the District Court, a jury in December 2014 found the defendants guilty of conspiracy to defraud the IRS and willfully failing to file a Report of Foreign Bank and Financial Accounts, known as an FBAR, with the Treasury Department.

U.S. taxpayers, including citizens, resident aliens and legal permanent residents, are required to list on their tax returns any financial account held in a foreign country and all income gained from such accounts.

The defendants helped their clients transfer money into secret offshore accounts and prepared falsified tax returns that either did not list the funds or indicated they were a business expense or investment loss, according to the government.

The tax returns the Kalais prepared for their URS clients did not list foreign accounts or the income earned on those accounts, prosecutors said. The defendants set up offshore companies in Belize and other countries and helped their customers open bank accounts under these companies’ names at the Luxembourg branches of Israel-based Bank Leumi and another unidentified Israeli financial institution.

The appeals court noted that following trial in the District Court, a jury in December 2014 found the defendants guilty of conspiracy to defraud the IRS and willfully failing to file a Report of Foreign Bank and Financial Accounts, known as an FBAR, with the Treasury Department.

The Kalais also helped their clients transfer money into these secret accounts and then prepared falsified tax returns that either did not list the funds or indicated they were a business expense or investment loss, according to the government.

The defendants’ actions also caused their clients to fail to file FBARs, prosecutors said. In addition, the Kalais did not file FBARs for the 2008 and 2009 tax years with regard to their own Bank Leumi account. They maintained the account, which held more than $300,000, under the name of a Belize-based shell company called Anack Ltd.

“TAX PREPARATION FRAUD


David Kalai and his son Nadav Kalai, both of whom were principals of United Revenue Service Inc., also maintained their own secret account under the name of a shell company at Bank Leumi in Luxembourg, the Justice Department said in an Aug. 10 statement.

U.S. District Judge Terry J. Hatter Jr. of the Central District of California ordered David Kalai to serve 36 months in prison followed by three years of home confinement. He also directed Kalai to pay a $286,000 fine, according to the department.

Nadav Kalai must pay a $10,000 fine and serve a 50-month prison term followed by three years of supervised release.

The taxpayers must also file an FBAR if a foreign account is worth more than $10,000 in an individual year.

According to the Justice Department, United Revenue Service was a tax preparation service headquartered in California with 12 branches nationwide. The Kalais’ co-defendant, David Almog, served as the New York-based supervisor of tax return preparers in the company’s East Coast locations. Almog is currently a fugitive.

The defendants’ sentences imposed today make it clear that the department is aggressively prosecuting financial professionals like...
the Kalais, who assist U.S. taxpayers in concealing assets offshore and evading their tax and reporting obligations,” Acting Assistant Attorney General Caroline D. Cirakolo of the Justice Department’s Tax Division said in a statement.

The agency said three of the defendants’ clients have pleaded guilty to tax-related criminal offenses. Alexei Iazlovsky pleaded guilty in the District Court in July 2013 to signing and filing a false tax return for 2008. Moshe Handelsman, another URS customer, pleaded guilty in July 2013 in the U.S. District Court for the Northern District of California to the same offense for the 2007 tax year.

Another client, Baruch Fogel, entered a guilty plea in February in the District Court, admitting he did not file an FBAR concerning an account at Bank Leumi in Luxembourg, the Justice Department said.

Each of these clients testified at the Kalais’ trial. [4]

Related Court Document:
Superseding indictment: 2012 WL 2375838

See Document Section B (P. 35) for the indictment.

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**CHARITIES**

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**Charities hire criminal investigators as pressure mounts over fraud**

(Reuters) – Rising mistrust of international charities and a public push for greater transparency on spending in corruption-prone crisis zones are compelling some non government organizations to hire a new recruit — the criminal investigator.

In a bid to prevent as well as report fraudulent activity, Plan International, Oxfam GB and International Medical Corps are among those to have appointed trained counter-fraud directors at their head offices.

Others, such as Doctors Without Borders, Handicap International and Action Against Hunger use auditors and finance officers to handle cases of fraud.

A Thomson Reuters Foundation survey revealed a third of humanitarian NGOs with budgets greater than $150 million were not prepared to reveal their annual fraud figures.

The growing trend to hire criminal investigators comes after the “nongovernmental organization” sector has doubled in size in the past decade with a Thomson Reuters Foundation survey finding 50 of the world’s biggest humanitarian NGOs spent $18 billion in 2013-14.

This rapid growth has fueled concerns over a lack of accountability with the annual Edelman Trust Barometer finding NGOs were the most trusted of four institutions but trust slipped in the past year with a perception they had become too money-focused.

One forensic expert said the lack of experienced investigators can be a barrier to financial probity as NGOs faced a unique set of issues such as ghost employees, fictitious invoices, kickback arrangements and “double-dipping” to get funds from more than one donor for a project.

“External auditors, unlike officers, are not necessarily looking for evidence of fictitious receipts or inappropriate spending in the field,” said Matthias Kiener, Zurich-based forensic officer with the consultancy KPMG.

“Sometimes the due diligence is not done. That might be because many charities are founded on the principle of trust. An NGO might be reluctant to ask tough questions of some of those it employs,” said Kiener, whose clients include large humanitarian organizations.

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**OPEN ABOUT FRAUD?**

In July a Thomson Reuters Foundation survey revealed a third of humanitarian NGOs with budgets greater than $150 million were not prepared to reveal their annual fraud figures.

Others, such as BRAC, Direct Relief,Americares, Oxfam US and Sightsavers all said they had not experienced any fraud greater than $10,000 in the last five years.

But critics question the rationale in not reporting fraud data, speculating that it could be an indication of under-detection and less effective management.

Oliver May, Oxfam GB’s head of counter-fraud and a former U.K. organized crime investigator, said NGOs were reluctant to share fraud data, partly for fear of jeopardizing donations, but an increase in NGO fraud reporting would be a welcome change.

Oxfam GB said it lost 0.16 percent of its income to fraud and corruption in 2014-15, although some was recovered.

“Really, fraud is a problem for all organizations. It is an environmental risk for us, and it should be less reassuring when an NGO is not reporting fraud than when it is,” May told the Thomson Reuters Foundation.

“If there is no detection, it is harder to know what the problem looks like. ... What we really want to see is the publication of annual fraud data across the whole NGO sector — that would really be an important step.”

It is important for charities to accept that corruption permeates every corner of the world, and every walk of life, including humanitarian organizations, said Gary Mitchell, Plan International’s director of global assurance.

The charity, employing nearly 10,000 staff globally, has allocated $300,000 (200,000 pounds) annually to staffing anti-corruption efforts.

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**CULTURAL DIFFERENCES**

“In [parts of] Africa, for example, we know extended families are a way of life and we would expect you to hire your uncle’s third cousin because that is the way it is,” said Mitchell.

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[4] Related Court Document:
Superseding indictment: 2012 WL 2375838

See Document Section B (P. 35) for the indictment.
“That’s a reality we have to face in combating fraud. Societies differ in what they perceive to be corrupt.”

Plan's attitude to corruption, like that of Oxfam GB's, contrasts with that of U.S.-based Direct Relief, which has not reported any incidence of fraud over $10,000.

The charity sends medical relief and equipment to partners in disaster zones who then use them in their programs.

“I’m not aware of any circumstance where we haven’t put boots on the ground to oversee the distributions. It would be hard for anyone to get hold of the shipments and misappropriate them,” said Ernie Getto, chair of Direct Relief’s audit committee since 2014.

“We have been audited externally, and everything we have been audited about has come out with a good result. I am not saying we are perfect, but I think we are as close to it as an organization can get,” said Getto.

Getto believes the dearth of fraud reports is partly due to the NGO’s size. Despite having spent over $550 million in the period 2013-2014, he said the charity employs just 65 people at its head office and warehouse in Santa Barbara, Calif.

“Everybody is sitting there in that building — there is not a lot of cash flowing through the organization,” said Getto, adding that he is considering proposing a whistleblowing fraud hotline in the interests of best practice.

Accountability experts questioned the focus on counter-fraud measures.

“The focus on internal fraud is the relatively easy part of the story and satisfies aid-skeptical public opinion in the donor countries,” said Nick van Praag, director of Ground Truth Solutions, an organization that analyzes the impact of charitable aid programs.

“The bigger issue is the failure to be accountable to the people the charities are supposed to serve,” said van Praag.

“Going after internal fraud is not the answer to what is a bigger scandal — one that is far more wasteful of aid.”

(Reporting by Tom Esslemont; editing by Belinda Goldsmith and Ros Russell)

BANKRUPTCY/CHAPTER 7

Firm with no assets or prospects loses Chapter 7 protection

By Donna Higgins, Senior Legal Writer, Westlaw Journals

A company with no assets and no chance of obtaining any more money can gain nothing from a Chapter 7 case other than delaying a lawsuit against it, a federal appeals court has ruled, affirming a ruling dismissing the bankruptcy case.


The 5th U.S. Circuit Court of Appeals’ decision means Cypress Financial Trading Co. must face an avoidance action in Minnesota bankruptcy court seeking recovery of $11.4 million it received as a result of its investments in another company that turned out to be a Ponzi scheme.

According to the court’s opinion, Cypress was formed to invest in Petters Co.

Cypress received about $11.4 million from those investments over several years, including $500,000 in alleged profit, the opinion said.

However, the “profit” was illusory because PCI turned out to be a Ponzi scheme, according to the opinion.

The Bankruptcy Court denied the motion, saying that the Chapter 7 proceeding might have some value to Cypress in winding up its affairs.


‘NO PURPOSE’

The appeals court panel said dismissal was justified regardless of whether Cypress’ petition was filed in bad faith.

“When a bankruptcy serves no purpose, results in no benefit for its creditors or the debtor, and only delays litigation already pending against the debtor, there is ‘cause’ to dismiss the case,” the panel said.

“When a bankruptcy serves no purpose, results in no benefit for its creditors or the debtor, and only delays litigation already pending against the debtor, there is ‘cause’ to dismiss the case,” the 5th Circuit panel said.

PCI filed for bankruptcy in the U.S. Bankruptcy Court for the District of Minnesota, and the trustee there sued Cypress to recover the $11.4 million.

Two years later, Cypress filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of Texas. The Minnesota litigation against Cypress was automatically stayed as a result of the filing.

PCI’s trustee asked the Bankruptcy Court in Texas to dismiss Cypress’ case, arguing that the Chapter 7 petition was filed in bad faith because the company has no money and no hope of obtaining any assets.

Although Cypress has no assets, the District Court opinion noted that PCI’s trustee wants to pursue those he believes received money from Cypress, which Cypress received from PCI.

Attorneys:
Appellant: Gerrit M. Pronske, Pronske Goolsby & Kathman, Addison, Texas
Appellee: James A. Lodoen and Adam C. Ballinger, Lindquist & Vennum, Minneapolis; Mark A. Weisbart, Dallas

Related Court Documents:
5th Circuit opinion: 2015 WL 4747363
District Court opinion: 518 B.R. 373
Genzyme

CONTINUED FROM PAGE 1

Seprafilm sales for off-label uses. If Genzyme complies, the government will dismiss the charges.

Genzyme, based in Cambridge, Mass., said in a statement it is “confident” in the compliance measures it has taken.

Seprafilm is a clear film used to reduce abnormal internal scarring that can cause organs and tissues to stick together following pelvic and abdominal surgeries.

In December 2013 Genzyme reached a $22.28 million civil agreement to resolve claims related to Seprafilm under the federal False Claims Act.

The Justice Department said the current settlement reflects Genzyme’s “significant” cooperation during the probe.

(Reporting by Jonathan Stempel in New York; editing by Diane Craft)

NEWS IN BRIEF

FLORIDA MAN PLEADS GUILTY TO INVESTMENT ADVISER FRAUD

An investment adviser in Florida has admitted to a $9 million fraud scheme involving Facebook stock, according to an Aug. 13 Justice Department statement. Gignesh Movalia, 40, of Tampa, pleaded guilty in the U.S. District Court for the Middle District of Florida to one count of investment adviser fraud. According to prosecutors, Movalia is the founder of OM Global Investment Fund LLC. As part of his plea, he admitted he began soliciting investments for OM Global around 2011 by, among other things, touting access to pre-IPO shares of Facebook, the statement said. He raised more than $15 million by 2012, including $9 million for “side pocket” investments that he represented would be used for purchasing Facebook shares. Movalia admitted, however, that he used the side-pocket funds for other investments without the investors’ knowledge, prosecutors said. OM Global lost about $9 million before it went into receivership in 2013. Movalia, a registered investment adviser, will be sentenced at a later date.


3 VIRGINIA TAX RETURN PREPARERS FACE CRIMINAL CHARGES

A federal grand jury has indicted three operators of a Virginia tax return preparation business on charges of conspiracy to defraud the United States and aiding and assisting the preparation of false federal income tax returns, according to an Aug. 5 Justice Department statement. Erik Pittman, 35, Jeremy Blanchard, 35, and Corey Taylor, 25, allegedly operated three locations of Mo Money Taxes from about December 2011 to early 2012. Prosecutors say the three men, along with others, created fraudulent tax credits to claim refunds that customers were not entitled to receive. All three men are charged with conspiracy to defraud the United States, and each faces additional counts for assisting in the preparation of false federal income tax returns.


LENDING FIRM EX-CEO SENTENCED IN $93 MILLION BANK FRAUD SCHEME

The former CEO of a financial lending firm has been sentenced to 97 months in prison after pleading guilty over a year ago to one count of bank fraud, according to an Aug. 18 statement from the U.S. attorney’s office for the Eastern District of New York. John Murphy, 65, of Nesconset, N.Y., lied to financial institutions and investors about the financial health of Oak Rock Financial LLC since 2009, the statement said. Oak Rock secured lines of credit for businesses nationwide. Prosecutors said Murphy misled banks about Oak Rock’s financial health by giving them false information about businesses that did not make timely loan payments or were in default. His misrepresentations allegedly caused financial institutions and private investors to lose about $93 million.

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