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Day Pitney White Collar Roundup – July 2023 Edition

A Lighter Shade of (Varsity) Blues: First Circuit Overturns Bribery Convictions

The Varsity Blues college admissions saga took another interesting turn at the end of June, when prosecutors from the U.S. Attorney's Office for the District of Massachusetts dropped all charges against one defendant, Gama Abdelaziz, and all but one charge against another, John Wilson. This new development comes after the First Circuit Court of Appeals vacated Abdelaziz's and Wilson's convictions on most charges last month. Among the charges leveled at Abdelaziz and Wilson were conspiracy to corruptly influence university employees in violation of the federal programs bribery statute, 18 U.S.C. § 666; honest services and property fraud, 18 U.S.C. §§ 1341, 1343 and 1346; and, for Wilson, additional bribery, wire fraud and tax charges.

In May, the First Circuit held that the government failed to prove that Abdelaziz and Wilson joined the overarching conspiracy among Rick Singer and his clients charged in the indictments. As counsel for Abdelaziz and Wilson argued, this larger conspiracy was a so-called rimless wheel, in that Singer, as the alleged "hub," had connections to each set of parents individually, but the parents did not join a larger conspiracy with each other, thus never completing the "rim." This was prejudicial to Abdelaziz's and Wilson's trials because prosecutors, through the larger alleged conspiracy, were able to introduce evidence of other parents' activities that undermined Abdelaziz's and Wilson's defenses. This created a variance between the charged conspiracy and the proven conspiracy and led to an "unacceptable risk that the jury convicted Abdelaziz and Wilson based on others' conduct rather than their own."

The First Circuit also vacated the honest services fraud convictions under 18 U.S.C. § 1346 because the defendants' payments to the respective universities—the parties whose interests were purportedly betrayed by their agents—did not constitute bribes under Supreme Court precedent. Based on guidance from *Skilling v. United States*, the court endorsed a narrower meaning of "bribery" than the government's broader interpretation encompassing payments like those made in the Varsity Blues scandal. This interpretation may arguably narrow what is considered honest services fraud, or the misuse of a person's position or authority for personal gain or advantage, which, according to the First Circuit, must include a bribe or a kickback to be considered a crime. With no kickbacks alleged and no bribes made, Abdelaziz's and Wilson's convictions on that count could no longer stand.

Finally, the court also vacated the mail and wire fraud convictions under 18 U.S.C. § 1341 and 1343 based on an improper jury instruction stating that admissions slots at the universities in question were property as a matter of law. Rather, that specific issue required further legal and factual development.

The First Circuit's decision and the government's decision to drop almost all charges against the two defendants are almost certain to have ramifications for future conspiracy prosecutions where multiple defendants have a connection to a common ringleader but not to one another. In particular, prosecutors who plan to introduce evidence of malfeasance by the entire conspiracy against particular defendants may first need to better establish the existence of the broader conspiracy. In this case, Wilson still faces sentencing for one count of filing a false tax return.

Operation Fox Hunt Wasn't So Sly

A federal jury in the Eastern District of New York recently convicted three defendants in connection with acting and conspiring to act as illegal agents of the People's Republic of China (PRC). When the complaint was first filed in October 2020, FBI

Director Christopher Wray commented that "the FBI is proud to have this investigation culminate in criminal charges—the first of their kind. Charges that will help China understand that surveilling, stalking, harassing, and blackmailing our citizens and lawful permanent residents carries serious risks."

The three recently convicted defendants include U.S. citizen Michael McMahon and Chinese citizens Zheng Congying and Zhu Yong. The three were part of a campaign, known as "Operation Fox Hunt," alleged to harass, stalk and coerce certain residents of the United States to return to the PRC as part of a global repatriation effort. McMahon, a retired New York Police Department sergeant working as a private investigator, was hired to conduct surveillance and obtain detailed information from government records about the victims and their extended families.

To aid these efforts, the PRC allegedly caused the International Criminal Police Organization to issue so-called red notices for the victims. Such notices alleged that the victims were wanted by the PRC government on corruption-related charges. The convicted defendants and their co-conspirators then brought the father of one of the victims to the United States in an attempt to convince the victim to return to the PRC. When these efforts were to no avail, Congying obtained the victim's address, attempted a forced entry and left a threatening note demanding the victim return to the PRC.

All defendants were convicted for conspiracy to commit interstate stalking and for interstate stalking. In addition, McMahon was convicted for acting as an illegal agent of the PRC, and Zhu Yong was convicted for acting as and conspiracy to act as an illegal agent of the PRC. The defendants now face possible sentences of 10 to 25 years in prison.

In announcing the convictions, U.S. Assistant Attorney General Matthew G. Olsen emphasized the Department of Justice's commitment to holding "accountable those who would help repressive regimes violate the fundamental freedoms of people in the U.S." Picking up on the theme, FBI Special Agent in Charge James Dennehy continued, "We hope this verdict serves as a message to other operatives in the United States working right now" at the behest of the PRC "to silence those who speak out against it. The FBI and our law enforcement partners are watching."

Supreme Court Sets FCA Scienter Standards Straight

Last month, the U.S. Supreme Court reframed the scienter standards under the False Claims Act (FCA), 31 U.S.C. 3729 *et seq*., in an eagerly awaited opinion in the consolidated cases *U.S. ex rel. Schutte v. Supervalu, Inc*. and *U.S. ex rel. Proctor v. Safeway, Inc*.

As we previously discussed here, the FCA requires that the government (or a *qui tam* relator acting on its behalf) prove that an FCA defendant "knowingly" submitted false or fraudulent claims. In addition to actual knowledge of falsity, the statute defines "knowingly" to include situations in which the defendant acts with "deliberate ignorance" regarding the truth or falsity of their statement or acts in "reckless disregard of the truth or falsity" of the information submitted to the government. One significant question in many cases was whether a defendant acted with reckless disregard of the truth when their interpretation was erroneous but "objectively reasonable" and no "authoritative guidance" discouraged such interpretation. A number of lower courts answered in the affirmative, relying on the Supreme Court's previous interpretation of the scienter standard under the Fair Credit Reporting Act in *Safeco Insurance Co. of Am. v. Burr,* 551 U.S. 47, 52 (2007).

The standard articulated in *Safeco* afforded government contractors significant leeway in interpreting regulations, statutes or contracts that are ambiguous on their face. Under this standard, even an erroneous interpretation could be found objectively reasonable if the interpretation was reasonably grounded in the text of the regulation and there was no authority directing or cautioning against it. In the *Schutte* and the *Proctor* cases, the Seventh Circuit Court of Appeals held that the *Safeco* standard applies to the FCA. In *Schutte*, for example, the Seventh Circuit held that a pharmacy benefit manager's actions were objectively reasonable in interpreting the Medicare and Medicaid definition of "usual and customary" prices when it charged the government for the full retail price of prescription drugs. The full retail price was up to 15 times higher than the prices charged to many customers, who frequently accessed deep discounts through a price-matching program.

In its unanimous opinion in June, however, the Supreme Court pumped the brakes and held that what matters for purposes of scienter under the FCA is defendants' own knowledge and subjective belief. The Court wrote, "The FCA's scienter element refers to [defendants'] knowledge and subjective beliefs—not to what an objectively reasonable person may have known or believed." Further, "even though the phrase 'usual and customary' may be ambiguous on its face, such facial ambiguity alone is not sufficient to preclude a finding that respondents knew their claims were false." The Court reasoned that defendants

could have learned the correct meaning of the phrase and, indeed, that plaintiffs had argued that the companies had received notice and understood that the phrase referred to their discounted prescription prices and had tried to hide those prices.

In reaching this result, the Court also explicitly rejected defendants' reliance on the *Safeco* standard. It explained that *Safeco* interpreted a different statute with a different scienter standard. It also disagreed that *Safeco* set forth any purely objective safe harbor of the kind the defendants sought to invoke.

Given the unanimity of the Court and the clarity of its conclusion, the *Schutte* and *Proctor* cases will have significant nationwide implications in reframing the scienter standard in FCA cases involving ambiguous regulatory or other legal requirements and also in corporate compliance programs and policies. Indeed, there's nothing subjective or ambiguous about that.

Connecticut General Assembly Approves Massive Expansion of State's False Claims Law

The Connecticut General Assembly approved legislation that could dramatically expand the scope of the state's version of the federal False Claims Act (FCA). Currently, Attorney General William Tong and private whistleblowers are limited to bringing cases related to state healthcare and human services programs. The General Assembly has now enacted a bill that awaits the Governor's signature would remove this limitation and open up the state's false claims law to almost every state-funded project or program. As a result, companies that do any business with the state could face a surge of new investigations and whistleblower suits.

At the federal level, the FCA imposes liability on anyone who knowingly submits or causes the submission of false or fraudulent claims for payment or approval to the federal government. Anyone violating the FCA is liable for treble damages plus a per claim penalty. While the federal government can pursue these damages and penalties on its own, the FCA also allows private citizens to file suits on behalf of the government (so called "qui tam" suits) and, potentially, share in the government's recovery. This potent combination of treble damages and the incentive for whistleblowers to bring claims on behalf of the federal government has made the FCA one of the most active and contested areas of federal law. For example, the Department of Justice reported that settlements and judgments under the FCA in fiscal year 2022 exceeded $2.2 billion.

Against this federal backdrop, Connecticut first enacted its own version of the FCA in 2009. The elements of Connecticut's law generally track the federal statute with a notable exception—Connecticut's law is limited to the submission of false claims for payment or approval "under a state-administered health or human services program." In other words, while federal law prohibits the submission of false claims to any department or agency of the federal government, Connecticut law only prohibits the submission of false claims in connection with state-run health and human services programs. Pursuant to Connecticut's false claims law, the Connecticut Office of the Attorney General has settled numerous healthcare fraud cases, many of which are handled in conjunction with the U.S. Attorney's Office for the District of Connecticut. Tong recently disclosed having recovered over $181 million in such settlements since 2009.

Now, the Connecticut General Assembly has approved a bill that would amend the state's false claims law to remove the requirement that the false claim be related to a state-administered health or human services program. The bill—which passed the House of Representatives and Senate by large margins and awaits the Governor's signature—would prohibit false claims submitted to *any* state officer, employee, or agent or any contractor using state funds. Supporters of the bill, including Tong, argue that this change would bring Connecticut in line with neighboring states that have similarly-worded statutes.

Opponents of the bill, including industry groups associated with state contractors and construction companies, expressed strong opposition in testimony before the Government Administration and Elections Committee. Opponents argued that the bill would empower the Attorney General and private whistleblowers to extract settlements from defendants threatened with debilitating damages and fines. State courts would also increasingly have to grapple with the difficult legal issues presented by similarities in the new state law and the FCA, which the federal trial and appellate courts frequently interpret. Just last week, the U.S. Supreme Court issued a long-anticipated opinion attempting to clarify the standard required for "knowingly" submitting a false claim under the FCA. As is often the case, the defendants were accused of failing to comply with complicated federal regulations. In a unanimous opinion, the Supreme Court emphasized that liability under the FCA turns on the defendant's own knowledge and subjective belief regarding its compliance with the regulations, as opposed to whether its interpretation of the regulations was objectively reasonable or unreasonable.

At a minimum, passage of the bill would mean that the scope of lawsuits and investigations that could be brought under the state's false claims law would significantly expand, exposing state contractors and businesses to new potential liability. Not surprisingly, the Office of Fiscal Analysis estimated that the Office of the Attorney General would hire at least five new Assistant Attorney Generals and two Forensic Fraud Examiners to assist with the influx of new cases and investigations. The current version of the bill is also set to go into effect on July 1, 2023, leaving little time for companies to prepare for the potential change.

Given the prospect of treble damages and the financial incentive for whistleblowers to bring claims and possibly share in the final recovery, the influx of new cases and investigations in Connecticut could be substantial. Companies that might be impacted should consider reviewing their compliance programs and practices to limit any potential exposure for false claims. In addition, companies should consider reviewing their policies and procedures for addressing claims by whistleblowers, who may also allege claims of discrimination and retaliation if they are discharged, suspended or demoted after making allegations of false claims.

In short, Connecticut contractors and other business should start buckling up now for what may be a bumpy road ahead.

The above article, "Connecticut General Assembly Approves Massive Expansion of State's False Claims Law," written by Matthew Letten, previously appeared in the *Connecticut Law Tribune*. Since publication of the article, the Connecticut bill has become law.

Behind the Digital Curtain: the SEC's Internal Data Breach

The Securities and Exchange Commission (SEC or the Commission) recently issued a report announcing the dismissal of 42 pending enforcement actions and agreed to lift industry bans from almost 50 people whose cases were affected by an internal data breach in 2017. The announcement arrives more than a year after the SEC released an initial report describing the breach as a "control deficiency" between the Commission's enforcement and adjudicatory functions.

In short, the SEC became aware that certain databases containing memorandums intended to be used exclusively by its adjudication group could be accessed by its enforcement staff, which is prohibited by the Administrative Procedure Act (APA). Under the APA, the two divisions—enforcement and adjudicatory—must be completely independent of the other, which means that enforcement staff investigating or prosecuting a matter should not have access to or participate in the Commission's in-house decision-making process regarding those matters.

Following this discovery, the Commission launched an internal investigation to evaluate the scope and consequences of the breach. Its general counsel supervised the investigative review team, and an outside consultant, Berkeley Research Group LLC, was retained to support the review.

The investigation consisted of interviews of more than 250 current and former staff members and an extensive review of data, documents and case files. While a detailed report of the review team's specific findings can be found in the Commission's recent report, a few key takeaways are clear. The investigation revealed that enforcement staff accessed the files of 30 cases as well as internal memoranda pertaining to an additional 61 cases. This led to the dismissal of the 42 pending cases and the lifting of 48 individual bans. The report also asserted, however, that the review team found nothing to indicate that the improper access harmed any respondent or the SEC's adjudications in any proceeding.

In its report, the Commission expressed its regret, saying, "We take this lapse in controls very seriously and are committed to both informing the public about the scope of this issue and preventing any similar lapses in the future." Although the SEC has taken steps to prevent future incidents, the breach is likely to pose ongoing challenges. In particular, the Commission may have to rebuild trust in its adjudicatory process, which had already been called into question by the *Cochran v. SEC* ruling earlier this year, as we previously reported here. Interestingly, Cochran's administrative proceeding was one of the cases affected by the breach and dismissed as a result of the investigation. Additionally, it is likely that other individuals and entities that had administrative matters before the SEC will question whether their cases were affected. These and similar questions are likely to linger for months and years to come.

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