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CORPORATE CRIME REPORTER

HUNTON'S FUHR SEEKS TO TAKE DOWN THEORY OF CORPORATE SCIENTER

Can a corporation commit securities fraud even if its responsible corporate executives did not?

That's the question the Second Circuit considered last week as lawyers argued the case of *Teamsters Local 445 Freight Division Pension Fund vs. Dynex Capital Inc.*

The securities class action case involved allegations of securities fraud against Dynex and two of its executives in Dynex's sale of asset-backed bonds collateralized by mobile home loans.

The plaintiffs alleged that certain former employees failed to comply with mortgage underwriting requirements and that as a result the company's officers made statements that misled investors as to the likelihood of loan defaults.

The district court dismissed the claims against the two individual executives but allowed the plaintiffs to proceed against Dynex, the corporate entity.

Dynex is being represented by Edward Fuhr, a partner at Hunton & Williams in Richmond, Virginia.

Fuhr says that the Teamsters are seeking to use the doctrine of corporate scienter to impose liability on his client.

"The problem with this whole doctrine of collective or corporate scienter is that it seeks to impute to the corporation, or to the senior leadership, every fact or piece of knowledge of anybody at the company," Fuhr told *Corporate Crime Reporter* in an interview last week. "So you can imagine a situation where a janitor or former secretary at an affiliate of the company knows that what you said isn't true. But the corporation had no way of knowing and did not know, the senior executives did not know anything about what the secretary knew."

"The corporate scienter theory establishes in essence a regime of strict liability for corporations," Fuhr said. "It posits that if any individual at the corporation knows that what is being said is not true, that's securities fraud. But that has disastrous consequences for American business."

What if the company set up a system to isolate top executives from the wrongdoing below?

"If the corporation deliberately sets up some regime to isolate the people with certain knowledge, at some point you can create a system that constitutes recklessness," Fuhr said. "And that too can become the basis for securities fraud. But that is not the situation here."

"There is no allegation of that here. And in fact there is no evidence of it. So, it has always been the case under the U.S. securities laws that the scienter you have to find has to be with the people involved with the making of the statement by the corporation."

"A corporation might well then be held liable because of the acts of the individuals," Fuhr said. "But you can't divorce the two.You can't say – no one at the company intended to do something wrong and then say the company intended to do something wrong. That's the essence of the plaintiffs' theory. You do have to have allegations with particularity that lay out in detail that a senior executive responsible for the statements knew what he was saying was false or misleading or omitted something material."

Fuhr says the recent case of the rogue trader who lost $7 billion while trading for the French bank Societe Generale is instructive on this point.

"There may be all kinds of things that may be said about the controls at that bank," Fuhr said. "What does seem pretty clear is that if in fact the only individual who knew about this was the guy who was doing this rogue trading, there is no way that corporation can said to have committed securities fraud."

"The people who were responsible for making the company's statements with regard to its financial health had no knowledge what that rogue trader was doing."

"And so when they made their various statements, they weren't making statements that they knew were false or misleading."

"They weren't reckless. There is no allegation that these individuals had ignored some clear warning sign."

(See Interview with Ed Fuhr, page 12.)

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VICTIMS TO SPEAK OUT
AGAINST BP PLEA DEAL

On Monday, February 4, a federal courtroom in Houston, Texas will be packed with lawyers.

Lawyers for BP. Lawyers for the Justice Department. And lawyers for the victims of a criminal act that killed 15 workers and injured hundreds of others.

The result of that criminal act – the explosion at

a BP facility in Texas City Texas in March 2005 – caused more than just death, destruction and injury.

It caused deep emotional trauma to the friends and family of those working at the facility that fateful day.

Last year, BP plead guilty to criminal violations under the Clean Air Act and was fined $50 million.

"This is a sweetheart deal for BP," said Texans for Public Justice Director Craig McDonald. "BP sucked a billion dollars in profits out of its runaway refinery in the 14 months preceding the blast. If it now walks away with a $50 million wrist slap, then the government has sent a clear message – that global companies can come here and break U.S. laws with impunity. This fine represents less than one day's profits for BP."

The lawyers for the victims will argue in court that given the enormous profit that BP extracted from the Texas City refinery, blast victims are seeking a fine of $1 billion to $2 billion.

The victims will also argue that given the long history of violating safety standards, an environmental monitor should be appointed to ensure that BP complies with the legal and regulatory terms of the plea deal.

Prosecutors and BP also have sought to waive a standard pre-sentence investigation in the case, in which the court would assess the company's extensive criminal history.

While BP acknowledged to the court two prior criminal and civil violations, the company has been fined for wrongdoing on at least 30 occasions.

"BP is a recidivist corporate criminal," McDonald said. "Its lengthy rap-sheet should factor into its sentence."

But in addition to the lawyers, there will be friends and family of the victims of the blast.

They are despondent. They are angry at BP. And they want justice.

Mary Ann Duhan is the mother of Susan Taylor, who was killed in the blast.

"What I feel every day of my life is the most devastating loss a mother can feel," Duhan wrote recently in a victims impact statement submitted last month. "The pain is so deep and widespread in my family that there really isn't a good word for it."

"You willfully took (my daughter) away from me. You have ruined my life because of what you have done and what you didn't do. I don't even know who all killed her. . . How can you live with yourself if I can't even know how to go on without my baby?"

Susan Taylor's father, Ronald Duhan, wrote that he believed that "there is no penalty great enough to atone for the sins of these people."

"In our justice system, if you kill someone, you go to jail," he wrote. "What makes these people different? They killed fifteen innocent people negligently and willfully for the almighty dollar."

"Our family will never again be whole,"Duhan wrote. "And why? Are people's lives worth so little to them that they don't even consider them in their equations of profit/loss? My prayer is that the court will sentence all of them like any other common mass murderers and that God may take pity on their souls."

SIGUE CORPORATION GETS PROSECUTION DEFERRED

Sigue Corporation and Sigue, LLC, San Fernando, California-based money service businesses, entered into a deferred prosecution agreement on charges of failing to maintain an effective anti-money laundering program and will forfeit $15 million to the U.S. government.

Federal officials charged Sigue with one count of failing to maintain an effective anti-money laundering program.

Sigue waived indictment, agreed to the filing of the information, and accepted responsibility for its conduct as described in a factual statement accompanying the information.

The company will pay $15 million to the United States, representing funds that are subject to forfeiture as a result of the criminal charge, and has agreed to commit an additional $9.7 million to improving its anti-money laundering program.

In light of Sigue's remedial actions to date and its willingness to accept responsibility for its anti-money laundering failures, the government will recommend the dismissal of the charge in 12 months, provided the company fully implements the significant anti-money laundering and Bank Secrecy Act measures required by the agreement, and complies in all other respects with the terms of the agreement.

"When companies like Sigue comply with anti-money laundering laws and employ strong oversight, they can play a pivotal role in stemming illicit money laundering activity," said Assistant Attorney General Alice S. Fisher Criminal Division. "Unfortunately when they are not compliant the opposite is true and criminals benefit. While we are pleased that Sigue has accepted responsibility in this case, their conduct was serious and the penalty is both appropriate and necessary."

The Financial Crimes Enforcement Network (FinCEN) has also assessed a $12 million civil money penalty against Sigue for violations of the Bank Secrecy Act, which will be satisfied by the $15 million forfeiture.

The charges arose out of transactions conducted

by Sigue and its authorized agents from November 2003 through March 2005.

Sigue operates by and through more than 7,000 money remitter agents across the country. During this time, more than $24.7 million in suspicious transactions were conducted through registered agents of Sigue, including transactions conducted by undercover U.S. law enforcement agents using funds represented to be proceeds of drug trafficking.

Sigue filed suspicious activity reports (SARS) on the obviously structured transactions, but ultimately failed to identify the broader patterns of money laundering activity and prevent the unlawful activity from continuing. Sigue failed to create systems and procedures to identify suspicious financial transactions being conducted by related senders and beneficiaries, from the same or multiple remitter agent locations on the same day, or over several days, months, and, in some cases, years.

Under the Bank Secrecy Act, money service businesses are required to establish and maintain an anti-money laundering compliance program that, at a minimum, provides for: (a) internal polices, procedures and controls designed to guard against money laundering; (b) the coordination and monitoring of daily compliance with the Bank Secrecy Act; (c) an ongoing employee training program; and, (d) independent testing for compliance. The program must be commensurate with the risks posed by the location, size, nature, and volume of the financial services provided by the money service business.

CEO COMPENSATION PRACTICES LEADING INDICATORS OF SECURITIES CLASS ACTION SUITS, REPORT FINDS

CEO compensation practices that are poorly-aligned with shareholder interests remain a powerful indicator of potential securities litigation, according to a report released last week by The Corporate Library.

In a year when new securities class actions filings rose 43 percent, claims in new areas rose to prominence, including subprime mortgage and related real estate and homebuilder cases, cases involving risk exposure outside the United States, and failed IPOs and mergers.

The report points to another year of increased litigation in 2008 and the growing involvement of institutional investors.

The study examines the second-year effectiveness of The Corporate Library's Securities Class Action (SCA) Risk Ratings to identify and predict the probability of companies being hit with securities class action suits.

The findings include:

* The most poorly-rated companies in mid-2006 were five times more likely to experience an SCA in 2007, matching the results from the Corporate Library's previous SCA studies.

* CEO base pay and annual bonus levels were more predictive than long-term incentives.

* More than 35% of companies in The Corporate Library's coverage universe that were unable to achieve compliance with Section 404 of Sarbanes-Oxley experienced at least one SCA in the past three years.

* Institutional investors hold more than 60% of the traded stock at nearly all companies subject to SCAs.

* Growing numbers of small- and mid-cap companies are being hit with suits.

"Effective prediction is the only real defense against securities litigation, and that is the primary focus of the present report," said Ric Marshall, Chief Analyst and author of the study.

The compensation link is so important that The Corporate Library will release a separate report to focus on that issue specifically in the first quarter of 2008, he said.

EC FINES E.ON $56 MILLION FOR OBSTRUCTION

The European Commission has imposed a fine of $56 million on E.ON Energie AG for the breach of a EC seal in E.ON's premises during an inspection.

The seal had been affixed to secure documents collected in the course of an unannounced inspection in May 2006.

When the Commission came back the next day, the seal was broken.

The inspection formed part of the Commission's enforcement activities against allegations of anti-competitive practices on the German energy markets.

"The Commission cannot and will not tolerate attempts by companies to undermine the Commission's fight against cartels and other anti-competitive practices by threatening the integrity and effectiveness of our investigations," said Competition Commissioner Neelie Kroes. "Companies know very well that high fines are at stake in competition cases, and some may consider illegal measures to obstruct an inquiry and so avoid a fine. This decision sends a clear message to all

companies that it does not pay off to obstruct the Commission's investigations."

The seal had been affixed by Commission officials during an unannounced inspection carried out in May 2006.

The inspection concerned the suspicion of anticompetitive practices on the German electricity market.

It is the Commission's practice to seal rooms when carrying out surprise inspections in order to make sure that no documents can be removed by the company when the inspection team is absent.

The Commission's seals are made of plastic film. If they are removed, they do not tear, but show irreversible “Void” signs on their surface.

When the inspection team returned in the morning of the second day of the inspection, it found that such “Void” signs were clearly visible on the entire surface of one of the seals which had been affixed the evening before. Also pieces of glue were found around the seal indicating that somebody had removed the seal and tried to fix it again.

The broken seal was intended to secure the room in which all documents previously collected by the Commission – highly sensitive documents, were stored. As these documents were not yet listed, the Commission was unable to ascertain whether and which documents were taken by E.ON.

E.ON denied breaking the seal and first argued that the Commission had the only key to the room.

However later it turned out that 20 keys were in circulation among E.ON employees. E.ON also tried to argue that there might be other explanations for the appearance of the "Void" signs on the seal. E.ON's suggested explanations were inter alia: vibrations caused by the preparation of a conference next door, the use of an aggressive cleaning product, the age of the seal, and, a high level of humidity.

In order to assess these arguments, the Commission carried out a very thorough investigation, including the use of outside experts to test the seals, but came to the conclusion that the arguments are not valid. Both the manufacturer of the seal and the independent expert who tested the Commission's original seals confirmed that the state of the seal as found in the morning of 30 May 2006 cannot be explained by any other reasons than by a breach of the seal. Indeed, according to the manufacturer, similar seals have been in use for decades, without any examples of malfunction.

The use of seals is intended to prevent the possibility of evidence being lost during an inspection, thus undermining the effectiveness of the inspection. Breaches of seals are therefore a serious infringement of competition law.

As regards the level of the fine, Council Regulation 1/2003 (Article 23(1) (e)) provides that the Commission can impose a fine of up to 1% of the company's total turnover for a seal broken intentionally or negligently.

When fixing the amount of the fine, the Commission has, however, taken into account the fact that it was the first time that a seal has been broken by a company subject to an inspection and that a fine has been imposed under the provisions of Regulation No 1/2003 concerning obstruction or interference with a Commission anti-trust investigation.

QUENTIN YOUNG, EARLY SUPPORTER OF OBAMA, NOW DISAPPOINTED AND SADDENED

Dr. Quentin Young was an early supporter of Senator Barack Obama.

But now, Young is worried that Presidential candidate Obama is moving right.

Young is a founder of the Chicago-based Physicians for a National Health Program.

He’s a national leader in the grassroots drive for a single payer, Medicare-for-all, Canadian-style health system.

And while Obama may have said early in his career that he supported single payer, clearly he no longer does.

“I knew him before he was political,” Young says of Obama. “I supported him when he ran for state Senate. When he was a state Senator he did say that he supported single payer. Now, he hedges. Now he says, if we were starting from scratch, he would support single payer.”

“Barack’s a smart man,” Young says. “He probably calculated the political cost for being for single payer – the shower of opposition from the big boys – the drug companies and the health insurance companies. And so, like the rest of them, he fashioned a hodge podge of a health insurance plan.”

“And the problem with the hodge podge is that it keeps the insurance companies in the mix,” Young

said. “And the insurance companies cannot be part of the solution because they are part of the problem. And so, in terms of getting single payer passed, Obama is now part of the problem.”

Young said that Obama has “created an image for himself of someone who seeks political progress by creating a mushy middle on all issues.”

“I am disappointed and saddened by this,” Young said. “He knows the better way. But the propensity to surrender before you have a battle on your hands is what is wrong with American politics.”

“I fear that Obama’s posture will have him moving sharply to the right if he gets power,” Young said. “I fear he will find all kinds of reasons to not move out of Iraq.”

Young said that the last time he spoke with Obama was in early 2005. In January 2005, Obama voted to confirm Condoleeza Rice as Secretary of State.

“When I heard about the vote, I wrote him a letter,” Young said. “I told him I was disappointed in him. Rice was the embodiment of everything that was wrong with this administration. So, he called me back and he said – why didn’t you pick up the phone and call me? And he said – do you think Bush would ever send to the Senate a nominee for Secretary of State who I could vote for? I said – you are the Constitutional lawyer. It’s about advice and consent, right? You should have denied him your consent.”

Young says that none of the leading Democratic Presidential candidates supports single payer.

Young was supporting Dennis Kucinich for President. Kucinich sponsored HR 676, the single payer bill that has been signed on to by more than 80 members of the House of Representatives. But Kucinich dropped out the race last week. And now, there is no one left standing in the Presidential field who supports single payer.

Dr. Young is looking for an alternative.

PUBLIC CITIZEN WANTS STRICTER WARNINGS FOR BOTOX, MYOBLOC INJECTIONS

The Food and Drug Administration (FDA) should immediately increase its warnings and directly warn patients and doctors about the use of botulinum toxin – available as Botox and Myobloc – because of serious adverse reactions, including deaths, linked to the drug, Public Citizen said in a petition filed Thursday with the agency.

Unlike drug regulatory agencies in Europe, the FDA has not issued any warnings to patients or doctors about the dangers of using the toxin, which is commonly used in therapeutic and cosmetic procedures. Botox and Myobloc are intended to block nerve impulses to certain muscles, causing them to relax.

However, in some cases, the toxin has spread to other parts of the body with serious consequences, such as paralysis of respiratory muscles and difficulty swallowing (dysphagia), the latter possibly leading to food or liquids entering the respiratory tract and lungs, causing aspiration pneumonia.

A Public Citizen analysis of FDA data found that makers of the drug have reported 180 U.S. cases of people developing these sometimes life-threatening conditions after receiving injections, including 16 deaths; four of the deaths occurred in children less than 18 years of age. The FDA data come from voluntary reports, which have been estimated to account for only 10 percent of actual cases.

The FDA has approved the use of botulinum toxin for a limited number of “therapeutic” conditions, including uncontrollable neck and shoulder muscle contractions, crossed eyes, spasmodic blinking of the eyes and excessive underarm sweating. The only approved cosmetic use is for temporary smoothing of wrinkles between the eyebrows. Most cosmetic uses of botulinum toxin are unapproved.

The FDA should send a warning letter directly to doctors alerting them to the problems associated with the toxin, including cases of hospitalization and death, Public Citizen’s petition said. The petition also asks the FDA to label the products with a “black box” warning, the strongest warning the agency can make, and require doctors to give patients a medication guide at the time of the injection warning them of possible symptoms of adverse reactions, as well as other information about the drug.

“These significantly improved warnings to doctors and patients would increase the likelihood of earlier medical intervention when symptoms of adverse reactions to botulinum toxin first appear and could prevent more serious complications, including death,” said Dr. Sidney Wolfe, director of Public Citizen’s Health Research Group.

“Nobody should be dying from injected botulinum toxin, Educating physicians and patients about what adverse symptoms to look for and when to seek immediate medical attention will save lives,” Wolfe said.

Early symptoms include dry mouth, difficulty swallowing, difficulty breathing, slurred speech, drooping eyelids and muscle weakness.

The Public Citizen analysis of FDA data found that between Nov. 1, 1997, and Dec. 31, 2006, there

were 658 reported cases of people suffering adverse effects from injections of botulinum toxin. Of these, 180 were associated with aspiration (fluid in the lungs), dysphagia and/or pneumonia; 87 required hospitalization.

In fact, cases of dysphagia were common in pre-approval studies of botulinum toxin for therapeutic uses. Although most cases were mild, severe cases did occur, even with the limited number of people exposed in these studies.

The FDA should follow the lead of its counterparts in Europe, Wolfe said. The European Union took steps last year to caution doctors about the dangers of the botulinum toxin, posting warnings on its Web site. Additionally, the U.K. and Germany have sent letters to doctors. So far, the FDA has not required the issuance of direct warnings to either doctors or patients.

FORMER KBR EMPLOYEE PLEADS GUILTY

Wallace A. Ward, 26, of Spring Lake, NC, a former employee of Kellogg, Brown & Root (KBR) who worked at the Bagram Airfield in Afghanistan, pled guilty last week in U.S. District Court to conspiracy to receive bribes, make false statements, and file false claims.

Judge T.S. Ellis III set sentencing for April 11, 2008. Ward faces a maximum sentence of five years in prison, a fine of $250,000 and three years of supervised release.

KBR had a contract to provide support services to the U.S. Army at Bagram Airfield, including unloading truckloads of jet fuel delivered by drivers hired by Red Star Enterprises Limited.

Between May and September 2006, certain KBR employees conspired to accept payments from drivers, who in fact were selling their fuel to parties outside the airfield, in return for providing the drivers with documents falsely showing that the truckloads of fuel had been delivered to the airfield.

Ward admitted to joining the conspiracy in August 2006 and received bribes from several drivers in return for falsifying the paperwork.

Federal officials alleged that more than 80 truckloads of fuel involving more than 784,000 gallons valued at more than $2.1 million were in fact diverted for sale outside the airfield between May and September 2006.

In October 2006, the National Procurement Fraud Task Force was formed to promote the early detection, identification, prevention, and prosecution of procurement fraud associated with the increase in government contracting activity for national security and other government programs.

The National Procurement Fraud Task Force, includes the U.S. Attorneys' Offices, the FBI, the U.S. Inspectors General community, and a number of other federal law enforcement agencies.

FBI OPENS INVESTIGATION OF SUBPRIME LENDERS

The Federal Bureau of Investigation has opened criminal inquiries into 14 companies as part of a wide-ranging investigation of the troubled mortgage industry, the *New York Times* reported.

The FBI. said it was looking into possible accounting fraud, insider trading or other violations in connection with loans made to borrowers with weak, or subprime, credit.

The agency declined to identify the companies under investigation but said the inquiry, which began last spring, involves companies across the financial industry, including mortgage lenders, loan brokers and Wall Street banks that packaged home loans into securities. It is unclear when charges, if any, might be filed, the Times reported.

As part of its investigation, the FBI is cooperating with the Securities and Exchange Commission, which is conducting about three dozen civil investigations into how subprime loans were made and packaged, and how securities backed by them were valued. State prosecutors are also investigating various areas of the mortgage industry.

"It's significant firepower, depending on how far along the investigation is," Carl W. Tobias, a professor at the University of Richmond Law School, told the *Times*.

The FBI has been warning for years that mortgage fraud is a significant and growing problem. In the 2006 fiscal year, it documented 35,600 suspicious-activity reports related to mortgage fraud, up from 22,000 the year before and as few as 7,000 in 2003.

Many of the cases the F.B.I. has brought so far have focused on local or regional mortgage fraud rings that involve speculators, loan officers, brokers and other housing professionals, the Times reported.

BAYOU FUNDS EX-CFO SENTENCED TO 20 YEARS FOR $450 MILLION FRAUD

Daniel Marino was sentenced to 20 years in prison for defrauding investors in the now-collapsed Bayou hedge funds of more than $450 million.

The sentence was imposed last week Colleen McMahon in Manhattan federal court.

Marino pled guilty on September 29, 2005, to conspiracy, investment adviser fraud, mail fraud and wire fraud.

In imposing the sentence, Judge McMahon said that she was sending a message to the securities and other industries that people entrusted with other people's money have an obligation to be truthful and forthright, at whatever cost to themselves.

She described Marino as "the linchpin of the fraud."

Between 1996, when the first Bayou fund was opened, and August 2005, when a series of Bayou funds collapsed, the funds sustained consistent losses.

Investors, however, were regularly told that the funds were reaping substantial gains.

Marino, who was the CFO of Bayou, admitted during his guilty plea that he and Samuel Israel III, the CEO of Bayou, along with James Marquez, who ran the first Bayou fund with Israel, hatched a scheme in 1998, after the fund sustained a second year of losses.

At that time, the three agreed that Marino, a CPA, would form a sham CPA firm called Richmond-Fairfield Associates to sign off on the fraudulent financial statements that were disseminated to future and current investors.

Beginning in 1999, they sent out financial statements, in which Bayou falsely reported profits and falsely asserted that Richmond-Fairfield Associates was an independent auditor that had audited Bayou and certified its financial statements.

The Bayou funds collapsed in August 2005, after Israel and Marino attempted to recoup mounting losses by investing contributions to the funds in private placement transactions in the United States and abroad.

The private placement transactions turned out to be frauds, according to publicly filed documents.

Israel pleaded guilty on September 29, 2005, to conspiracy, investment adviser fraud and mail fraud.

He is awaiting sentencing. Marquez pled guilty on December 14, 2006, to conspiring to defraud Bayou investors between July 1996 and October 10, 2001.

He was sentenced on January 22, 2007, to a term of 51 months' imprisonment, to be followed by two years of supervised release.

The Court also ordered that Marquez forfeit certain property and securities and pay $6,259,650 in restitution to his victims.

The three guilty pleas followed the filing of a civil forfeiture action against the remaining Bayou assets on September 1, 2005, by the United States Attorney's Office for the Southern District of New York.

According to the civil complaint – approximately $100,010,673.68 in Bayou funds were the subject of an Arizona state court seizure order.

CALIFORNIA TO FINE UNITED HEATLH $3.5 MILLION

California insurance regulators will fine UnitedHealth Group $3.5 million in response to more than 130,000 alleged claims handling violations that arose when the company acquired PacifiCare Health Systems Inc.

The regulators said they wanted to "put an end to the practice of unfair claims handling in the health insurance industry."

After receiving hundreds of consumer and provider complaints about claims payment problems by PacifiCare, particularly after it was acquired by United Healthcare in late 2005, the state took action and launched an investigation in 2007 into PacifiCare's alleged practices.

"When they're injured or ill consumers rely on their insurers to pay legitimate claims," said Insurance Commissioner Steve Poizner. "This promise is essential to our health care system, so after years of broken promises to Californians, it is crystal clear that PacifiCare simply can not or will not fix the meltdown in its claims paying process. We're going to put an end to that. If PacifiCare can't carry out the ABCs of basic claims payment, today's regulatory action will help spell it out."

The regulators alleged the company's wrongdoing included:

* Wrongful denials of covered claims
* Incorrect payment of claims
* Lost documents including certificates of creditable coverage and medical records
* Failure to timely acknowledge receipt of claims
* Multiple requests for documentation that was previously provided
* Failure to address all issues and respond timely to member appeals and provider disputes
* Failure to manage provider network contracts and resolve provider disputes

"This is off the charts in terms of the number of violations you see from an insurer," Poizner told the *Wall Street Journal.*

TWO HOUSTON DEVELOPERS INDICTED FOR BRIBERY

A federal grand jury in the Southern District of Texas, Houston last week charged two developers with bribing a former official of the city of Houston.

The grand jury indicted Houston residents Andrew A. Schatte, 54, and Michael D. Surface, 44, for conspiring to bribe and to deprive the citizens of Houston of the honest services of Monique McGilbra, then-Director of the city's Building Services Department (BSD).

In addition, Schatte and Surface were charged with substantive counts of honest services wire fraud, and Surface was also charged with making false statements to FBI agents investigating their relationship with McGilbra.

The indictment charges that Schatte and Surface, operating a company called The Keystone Group Inc., offered and gave McGilbra a series of things of value directly and through her boyfriend to influence her in her official capacity in connection with her administration of two city contracts-one for the development of the Houston Emergency Center and another to develop a consolidated fire station and

In May 2003, McGilbra pled guilty to conspiring to accept, in order to be influenced in her official capacity, the things of value from Keystone and other items from another Houston contractor, Gary Thacker.

She entered a guilty plea in federal court in Cleveland at the same time, in which she also admitted similar unlawful conduct with businessman Nate Gray in connection with his attempts to obtain an energy services subcontract from the city of Houston.

McGilbra was sentenced to concurrent sentences of 36 months in Cleveland and 30 months in Houston. Hardeman was convicted of unrelated charges in federal court in California and was sentenced to a one-year term.

Both Hardeman and McGilbra have cooperated in the Cleveland and Houston cases. Thacker pled guilty and was sentenced to 10 months in prison. Gray was convicted by a jury and sentenced, on charges including but not limited to his conduct in Houston, to 15 years in prison.

FINRA FINES BANC ONE $225,000

The Financial Industry Regulatory Authority (FINRA) fined Banc One Securities Corporation (BOSC) of Chicago $225,000 for making unsuitable sales of deferred variable annuities to 23 customers and for having inadequate systems and procedures governing annuity exchanges.

Twenty-one of the 23 customers were over 70 years old.

In addition to the fine, FINRA is requiring the firm to allow each of the 23 customers to sell their variable annuities without penalty. Ordinarily, these variable annuities would have been subject to a six-year "surrender period" during which time the customers would have been required to pay surrender charges as high as 7 percent of the amount invested if they were sold in the first two years.

The firm will also pay restitution of about $6,500 to two customers who incurred surrender charges when exchanging annuities.

In 2006, BOSC merged with J.P. Morgan Securities, Inc.

“Variable annuities are complicated products with features such as surrender charges that can limit the customer's ability to access the invested funds,” said FINRA chief of enforcement Susan Merrill. “When firms are recommending annuities or annuity exchanges to elderly customers, they must act in the customers' best interests, taking into account all relevant factors – including the customers' ages and liquidity needs, surrender charges, product expenses and investment features. The exchanges at issue in

this case appeared to have no real benefits to the customers, while subjecting them to new sales charges and locking up their money for a new, six-year surrender period."

FINRA found that in each of the 23 transactions between January 1, 2004, and June 30, 2005, BOSC representatives recommended that the customers exchange their fixed annuities then paying a minimum of 3 percent, for variable annuities.

Following the exchange, the customers placed 100 percent of their assets into the fixed rate feature of the variable annuity, which paid a maximum of 3 percent - as recommended by BOSC representatives.

All but one of the fixed annuities were beyond the surrender period - that is, the customers were not subject to any financial penalties if they withdrew any of their funds from the fixed annuity.

Each of the newly purchased variable annuities was subject to a six-year surrender period requiring the customers to pay a penalty if they withdrew more than the sum of their earnings and 10 percent of their principal. FINRA found that each of these 23 recommendations was unsuitable, given the customer's age, investment objective, financial situation and income needs.

The settlement cites one example of an 80-year old customer who exchanged a fixed annuity earning 3 percent for a variable annuity, in which he invested the entire $80,000 balance in the fixed income feature, which also paid 3 percent interest.

This new variable annuity was subject to a six-year surrender period. Within the first year of owning the variable annuity, the customer withdrew $9,000. Sixteen months after buying the variable annuity, the customer liquidated it and incurred a $4,628 surrender fee.

FINRA found that BOSC failed to adequately supervise these transactions and that the firm's supervisory system and procedures failed to require firm supervisors to obtain or consider certain critical information, such as the costs and benefits of features of the new and exchanged product, which are necessary for conducting the required suitability review of a variable annuity exchange.

NOTABLE AND QUOTABLE

Attorney General Michael B. Mukasey was in the advanced stages of securing a lucrative corporate monitor assignment last year but withdrew his name after he was nominated to lead the Justice Department, according to lawyers familiar with the previously undisclosed arrangement.

Mukasey, a former New York federal judge, had been a finalist for a part-time position reviewing the operations of a company that settled with government prosecutors by agreeing to hire an independent overseer to make sure it followed the law. The opportunity arose after Mukasey retired from the bench and joined a law firm, which he left in November when the Senate confirmed him for his current job.

"Michael Mukasey was one of a number of individuals under consideration to serve as a monitor for a corporation subject to a deferred prosecution agreement," said Justice Department spokesman Peter Carr. "He was approached while in private practice but was nominated to be attorney general before the selection process was complete."

Scrutiny of the monitor arrangements and complaints about their secrecy have mounted in recent weeks after a deal worth as much as $52 million was awarded to a consulting firm led by former attorney general John D. Ashcroft. The Justice Department launched a policy review last year to determine whether national standards should be imposed to avoid the appearance of impropriety.

Lawmakers and legal experts have sounded alarms about possible political patronage, raising questions about whether prosecutors have steered the sole-source contracts to people with ties to the Bush administration, the Justice Department and the Securities and Exchange Commission.

In the vast majority of cases, monitors operate without a judge's oversight of their work and their bills. The agreements have risen more than sevenfold in recent years as prosecutors have settled corporate fraud cases rather than bringing them to trial, which might destroy the business and cost employees their jobs. Name-brand companies from AOL and Bristol-Myers Squibb and Merrill Lynch have agreed to monitorships to resolve financial scandals. The identity of the company that Mukasey was in line to oversee could not be determined.

In light of the concerns, leaders of the House and Senate Judiciary committees this month directed the Government Accountability Office to review how monitors are selected and paid. Separately, a New Jersey Democrat last week introduced legislation that would require judges to supervise monitors and force administration officials to follow specific guidelines when choosing monitors. . .

– Mukasey Had Been Overseer Finalist, by Carrie Johnson, Washington Post, January 30, 2008

Some of the nation's most prominent spine surgeons hailed it as a medical breakthrough.

In a study of nearly 240 patients with lower back pain, the doctors said that the Prodisc, an artificial spinal disk, had worked much better than conventional surgery in which patients' vertebrae were fused.

"As a surgeon, it is gratifying to see patients recover function more quickly than after fusion and return to their normal activities more easily," Dr. Jack E. Zigler, a well-known spine specialist and one of the study's lead researchers, said in a 2006 news release announcing the latest results of the Prodisc clinical trial.

As it turns out, Dr. Zigler had more than a medical interest in the outcome. So did doctors at about half of the 17 research centers involved in the study. They stood to profit financially if the Prodisc succeeded, according to confidential information from a patient's lawsuit settled last year.

The companies behind the disks and the surgeons who were willing to comment say the researchers' financial interests had no impact on findings of the research, which they say have been published in various peer-reviewed medical journals. The Prodisc, used on thousands of patients, has been shown to benefit many people with back pain, they say. It is unclear, however, whether the disk's maker fulfilled its legal obligation to inform the Food and Drug Administration of the researchers' financial interests before it used the study's results to approve Prodisc in August 2006. . .

– Financial Ties Are Cited as Issue in Spine Study, by Reed Abelson, New York Times, January 30, 2008

IN BRIEF

JANUARY 28, 2008

Two former civilian employees of the Department of Defense were sentenced in El Paso, Tex., for defrauding the United States of tens of thousands of dollars.

Lilia Delgadillo, 34, of El Paso, who pleaded guilty on Nov. 2, 2007 to one count of wire fraud, was sentenced by U.S. District Judge David Briones in U.S. District Court for the Western District of Texas, to 33 months in prison followed by probation with 100 hours of community service.

Delgadillo was employed by the Defense Finance and Accounting Service (DFAS), a component of DOD, and stationed at Ft. Bliss, Texas.

Delgadillo admitted that from January through March 2007, she and a coworker, Saul Granados, 26, devised a scheme to defraud the United States of up to $700,000 through the misuse of a DOD pay-processing computer system.

Both Granados and Delgadillo improperly accessed the system and submitted fraudulent pay adjustments which resulted in wire transmissions from DFAS headquarters in Indiana to Delgadillo's bank account in Texas.

Delgadillo also admitted that she coded the transactions to make it appear as though the payments were being made to a former member of the Arizona National Guard, when in fact they were deposited into Delgadillo's account.

EDWARD FUHR, PARTNER, HUNTON & WILLIAMS, RICHMOND, VIRGINIA

If no individual executive knew of the wrongdoing at the company, did the corporation know of the wrongdoing?

No, says Edward Fuhr.

Fuhr is a partner at Hunton & Williams in Richmond, Virginia.

And last week, he argued a case before the Second Circuit Court of Appeals – *Teamsters v. Dynex Capital* – that raised the issue of corporate scienter – can a corporation intend to violate the law if no responsible individual within the company intends to violate the law?

We interviewed Edward Fuhr on January 28, 2008.

CCR: You graduated from the University of Chicago Law School in 1987. What have you been doing since?

FUHR: After graduation, I did a one year clerkship on the Sixth Circuit. I clerked in Louisville, Kentucky for Judge Boyce Martin. After I finished my clerkship, I went to Washington. I worked there in the office of legal counsel at the Justice Department from 1988 to 1990. In 1990, I left the Justice Department and joined Hunton & Williams here in Richmond, Virginia. I have been here now since January 1990.

CCR: Tell us about Hunton & Williams. And what is your practice there?

FUHR: Hunton & Williams is a large international law firm. We have offices in Asia, Europe and throughout the United States, from New York to Miami, including Washington and Richmond. We

have approximately 900 lawyers. We are a firm that has been around now for over 100 years.

My practice focuses almost exclusively on securities and corporate governance litigation. I'm a trial lawyer. I also spend a lot of time representing officers and directors in connection with breaches of fiduciary duty allegations. This could include lawsuits brought by shareholders – derivative litigation. We also represent individuals and corporations before the SEC.

We do a lot of work in connection with investigations. We represent companies and special committees in connection with independent investigations of various fiduciary duty issues, financial issues at those corporations.

At least 80 percent of our work is on behalf of corporations. And when I say corporations, I'm including boards of directors and various

FUHR: It varies by year. There have been some years where half of my time has been spent defending against SEC investigations and inquiries. Other times it's maybe 20 percent. The average lies somewhere in between.

CCR: There have been some reports that securities class action lawsuits have declined in recent years. What's your take?

FUHR: I have read some of those reports. I don't think I fully agree. There have been a couple of momentary dips. But right now, there is an increase going on, in part because of the subprime mortgage issues that have been playing out widely in the newspapers as a result of many companies having to sharply cut back their earnings forecasts, which have led to price drops. There has been a spike in securities litigation filings over the last several months.

So, the plaintiffs lawyers filings in general have stayed high and are generally increasing. From time to time the balance and what form they take may shift and evolve. But the overall filings by the plaintiffs lawyers continues to be going higher.

CCR: Does Hunton & Williams have a white collar unit?

FUHR: We do.

CCR: Is your practice part of that?

FUHR: I work with the white collar practice with the former prosecutors who are there.

CCR: What is the securities litigation part of the practice look like in terms of numbers of lawyers?

FUHR: We probably have a couple of dozen lawyers who are involved in one fashion or another with securities litigation in various offices – Dallas, Miami, Richmond, New York. We have lawyers spread out across the firm in that area. I head the securities litigation efforts within the firm. But we subcommittees of those corporations. But we do occasionally represent an individual member of a board. But it is very rare that we represent a private individual against a corporation. We almost never do that.

CCR: You are primarily defense side?

FUHR: Yes.

CCR: What about representing individuals on the defense side?

FUHR: Yes. We represent individual directors or former directors who are parties to litigation. We represent them before the SEC, in defense of shareholder lawsuits, sometimes in defense of derivative litigation.

CCR: What about where your adversary is the SEC as opposed to some plaintiff's lawyer?

have a lot of people who are involved.

CCR: You are making an argument before the Second Circuit on Wednesday. Your client is Dynex.

FUHR: Dynex and Merit are the corporations that are the defendants in the litigation in New York. That lawsuit was filed in 2005. It was filed as a securities class action. It was filed in the Southern District of New York. It was filed against Dynex and Merit. It named two individual officers with the company – Steve Benedetti and Tom Potts.

That lawsuit was filed in 2005. We represented both the individuals and the corporations.

The lawsuit was brought by purchasers of certain bonds that the companies had issued.

CCR: What was the business of the companies?

FUHR: Dynex pooled mortgages. It would pool these mortgages and create bonds that it would then sell. Dynex also had an affiliate that originated the mortgages. So, it attempted to be a vertically integrated entity to take everything from the origination of the mortgages, the pooling of the mortgages, the servicing – creating the bonds – and those bonds would then be sold to the marketplace.

This lawsuit then was brought by an entity, the Teamsters, that had purchased some of these bonds in 1999. Some six years later, after the bonds had been issued, the Teamsters filed suit and said – gee, these bonds haven't been performing the way we thought they had been performing. We don't think that all of the mortgages were issued in conformity with underwriting guidelines that your company had. And we had assumed that everything had been underwritten pursuant to those guidelines. And that constitutes securities fraud.

And so they alleged that the company and two individuals had committed securities fraud when they

sold the bonds and subsequently issued the monthly statements about how the bonds were performing.

That was the essence of the plaintiffs' theory in that case.

CCR: You moved to dismiss the case. What was the result?

FUHR: We moved to dismiss the suit against everybody. The court decided to grant our motion to dismiss as to the two individuals. The court agreed that there was no adequate allegation that either of these two individuals had intentionally done anything wrong. In the securities world, that concept falls under the rubric of scienter. The court found there was no scienter by Mr. Potts or Mr. Benedetti. And so they were dismissed from the lawsuit.

CCR: Potts and Benedetti were officers of Dynex. No officers of Merit were charged, right?

FUHR: Correct. The only surviving defendants, if you will, were the two corporate entities.

We filed a motion asking Judge Baer to reconsider his decision. We did not believe that the law permitted a corporate defendant to remain in a securities litigation lawsuit when the individuals had been dismissed.

We said it makes no sense to say that a corporation intentionally committed securities fraud when there is no allegation that any individual committed securities fraud.

A corporation does not have a mind of its own. Going back close to 100 years, it's been the law in the United States that the corporation has the state of mind of its individual officers and directors. We urged Judge Baer to reconsider his decision. We pointed out that there were a lot of cases across the country that had agreed with the position that we had taken, that if there was no scienter on the part of an individual, the corporation could not be said to satisfy the scienter requirement.

Judge Baer said – you know, there is a lot of case law out there that agrees with what you are saying. This is an issue that ought to be decided by the Second Circuit Court of Appeals. He certified his decision and his order to the Second Circuit. The Second Circuit agreed to hear an appeal on this issue and on that order. And so that is where we are now. We are now before the Second Circuit.

CCR: Okay, so no individual is now being charged. But let's say there is evidence of knowing wrongdoing within the company.

FUHR: The only wrongdoing, if you will, that is alleged is that some former employees issued mortgages not in conformity with the company's guidelines. And they seemed to be referencing activity down in Texas. The individuals are unnamed. The timetable in which this occurred is unstated. So, you have a broad fairly general allegation that some unnamed former employee knew or was aware of mortgages being issued that were not in conformity with the company's underwriting guidelines.

That's the heart of the allegation of wrongdoing.

There is no allegation – and the court agreed with this – that anyone at the top of the corporation such as Potts or Benedetti, had any knowledge or awareness of the alleged wrongdoing.

The senior executives of the corporation are not alleged to have had any awareness of any wrongdoing, even if that wrongdoing had occurred. And that's important because these top officials – Potts and Benedetti – as the plaintiffs admit, were the only individuals that had any responsibility for the corporation's statements. And it's those corporate statements that the plaintiffs alleged constituted the securities fraud. And that's the essence of our position. There were two individuals responsible for the statements at issue. It's the law of this case that those statements were not prepared with any intent to defraud. So, how is it then that a corporation can be said to have intentionally committed securities fraud with those statements? That makes no sense.

CCR: Are you saying that had the plaintiffs plead this differently, they would still be in the ballgame?

FUHR: It is not something they could have cured with better pleadings. The problem is they don't have the facts to make better pleadings. The securities reform act required that plaintiffs plead with particularity the facts showing that somebody intentionally did something wrong. The court gave the plaintiffs a chance to amend their complaint yet again after the motion to dismiss was decided. The plaintiffs chose not to do so. They didn't have anything to add to what is out there. This isn't a problem that they didn't have access to the facts. There is just no evidence that individuals responsible for the company's statements knew what they were saying was wrong or misleading in any way.

The problem with this whole doctrine of collective or corporate scienter is that it seeks to impute to the corporation, or to the senior leadership, every fact or piece of knowledge of anybody at the company. So you can imagine a situation where a janitor or former secretary in an affiliate of the company knows that what you said isn't true. But the corporation had no way of knowing and did not know, the senior executives did not know anything about what the secretary knew.

The corporate scienter theory establishes in

essence a regime of strict liability for corporations. It posits that if any individual at the corporation knows that what is being said is not true, that's securities fraud. But that has disastrous consequences for American business.

CCR: Are you saying that the person who knows of wrongdoing has to be of a certain level in the company?

FUHR: Under U.S. securities laws, not only does the person have to be of a certain level, it has to be the

So, it has always been the case under the U.S. securities laws that the scienter you have to find has to be with the people involved with the making of the statement by the corporation.

CCR: The word recklessness is all over the brief of the plaintiffs. Are you saying they are not alleging recklessness?

FUHR: They talk about recklessness in terms of the origination of the loans. They are not alleging that the people who had responsibility for the company's statements acted recklessly. They are referring to what happened when the loans were originated. But the only individuals that had responsibility for the company's statements are Potts and Benedetti. The plaintiffs make that allegation. So, the focus has to be on – what did Potts and Benedetti know? And did they act with scienter? The district court found that there was no allegation that the people responsible for the statements had acted with fraudulent intent. The plaintiffs did not appeal that decision.

So the decision by the district court was that Potts and Benedetti did not act with fraudulent intent. That's the law of the case, that's the law of this appeal. There is no challenge to that.

They do allege throughout their complaint – and they repeat much of it in their brief at great length – that the loan origination practices at the company were reckless. But as the Supreme Court just stated ten days ago in the *Stoneridge* decision, securities fraud is not intended to cover all of the different types of fraud that a party might allege occurred at a corporation. It is only focused on the statements and activities made in connection with the purchase or sale of a security. So, the allegations that the plaintiffs devote great time to in connection with the activities of the company back in 1999 and even before that are simply beside the point. That's not the focus. The focus has to be when you look at the individuals who made the statements, what did they know, and did they issue statements that they knew or recklessly should have known were inaccurate or misleading?

CCR: Are you saying that a company can't be charged for securities fraud unless a responsible person who is responsible for the statements. Now, if the corporation deliberately sets up some regime to isolate the people with certain knowledge, at some point you can create a system that constitutes recklessness. And that too can become the basis for securities fraud. But that is not the situation here. There is no allegation of that here. And in fact there is no evidence of it.

executive is also charged?

FUHR: A corporation is in the end an inanimate object. It's intent is defined by the intent of its officers or directors – and the individuals responsible for the company's statement. If you know or have allegations that are adequate that the individuals acted with the improper intent, then the individuals and the corporation are at risk. And they can defend themselves on the facts.

A corporation might well then be held liable because of the acts of the individuals. But you can't divorce the two. You can't say – no one at the company intended to do something wrong and then say the company intended to do something wrong. That's the essence of the plaintiffs' theory.

You do have to have allegations with particularity that lay out in detail that a senior executive responsible for the statements knew what he was saying was false or misleading or omitted something material.

CCR: What is the precedent on this?

FUHR: Every U.S. Circuit Court of Appeals that has examined this issue of collective scienter has agreed with us that the doctrine is inconsistent with the federal securities laws. There are a number of circuits that have not examined the issue. But the Third Circuit in *Tyson* came to this conclusion. The Fourth Circuit in *Hunter* came to this conclusion. The Fifth Circuit in *Southland* held that collective scienter cannot be squared with the securities laws and the common law of agency. The Seventh Circuit in *Tellabs* adopted this conclusion. And the Ninth Circuit on several occasions, both in *Nordstrom* and *Apple*, reached this conclusion.

CCR: Does the Second Circuit stand alone?

FUHR: The Second Circuit has not before now had to address this issue four square the way it is going to have to address it now.

The Second Circuit has had a number of decisions over the years in which the court or one or more judges on the court has made statements that a corporation has no mind and the intent of a corporation can only be imputed if a specific individual has the intent you are seeking to impute –

and that person had responsibility for the company's statements. But those comments have for the most part been comments in passing.

But in *Fluor*, the court dismissed charges against the corporation because there was no evidence that the individuals involved had acted with requisite scienter. But the Second Circuit has not had to engage this issue. If you drill down to the Southern District of New York, there are two decisions there that have embraced the theory that the plaintiffs have offered. One is the decision we are appealing from – the decision by Judge Baer in *Dynex*. The second is another decision by the Southern District is *WorldCom* in which the court allowed the plaintiffs' theory of corporate scienter to go forward.

And there are other district court decisions in which the courts have gone with the plaintiffs.

One thing worth noting is that those decisions – like *WorldCom* and *Dynex* – there is no attempt to reconcile a collective scienter theory with federal securities laws or the common law of agency. They just let the theory to through.

So, the fundamental issue before the court in this case is – can a corporation intend to defraud if no one at the corporation intended to defraud?

Last week, we all read on the front page of the *Wall Street Journal* about the French bank that had this rogue trader who loses billions of dollars. He covers his tracks so no one knows until he is caught. The corporation and its senior executives made various statements to the investing public with regard to what the company's earnings were.

Did that company commit securities fraud?

I think it's clear the answer has to be no. While you had a former employee who knew that the corporation had not in fact earned what the senior leadership was saying it earned, he was the only one that knew that. The senior leadership at that bank presumably had no information at all that this individual was costing this company in such dramatic fashion and was losing all of this money.

Under the doctrine of corporate scienter or collective scienter, that corporation would have engaged in securities fraud. There may be all kinds of things that may be said about the controls at that bank.

What does seem pretty clear is that if in fact the only individual who knew about this was the guy who was doing this rogue trading, there is no way that corporation can said to have committed securities fraud.

The people who were responsible for making the company's statements with regard to its financial health had no knowledge what that rogue trader was doing. And so when they made their various statements, they weren't making statements that they knew were false or misleading. They weren't reckless. There is no allegation that these individuals had ignored some clear warning sign.

CCR: We are just going by the initial reports. The lawyers for the individuals give a totally different story, obviously.

What about decisions of the Supreme Court on this issue?

FUHR: Going back to *Ernst*, the Supreme Court made clear that the federal securities laws are not designed to cover negligent conduct or bad corporate compliance programs.

Instead, the laws are designed to cover acts of intentional wrongdoing. And the Supreme Court has made very clear that the federal securities laws ought not be expanded – unless Congress wants to do that. And the Court said the same thing in its recent decision in *Stoneridge*.

When you combine the Supreme Court saying the laws only cover intentional wrongdoing, and the reform act, which Congress passed in the late 1990s, which requires particularized statements of intent to engage in wrongdoing – that combination is a fundamental barrier to the theory of corporate or collective scienter.

The Supreme Court's rulings in this area, and the language of the securities act itself, are showstoppers for this theory.

CCR: If the Second Circuit rules against you, what are the real life consequences for business?

FUHR: If the plaintiffs' theory is considered valid, that will open the door to securities fraud complaints. You will see a dramatic mushrooming of the number of lawsuits. And the reason is this – you will no longer have to allege that the individuals responsible for the company's public statements intentionally acted in ways to deceive. You will simply need to allege that some individual at the company knew that what the corporation was saying was untrue.

So, all of these companies dealing with subprime issues right now will now be vulnerable to a securities litigation claim if somebody at the corporation knew about these losses or should have known about these losses while the responsible corporate executive spoke quite innocently and with the best of intent regarding the corporation's financial well being.

If this suit goes forward, all a plaintiff will have to do is allege that some former employee – and they won't have to name the former employee – knew that what the executives were saying wasn't true.

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