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Two Federal Court Cases Highlight the Thin Line between Deception and Fraud

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Potential whistleblowers often face challenging situations in which they have to discern whether their employer is engaging in fraud. Making the wrong call could cost them the protection of anti-retaliation provisions of whistleblower laws. While employees may find their employers' practices deceptive or potentially harmful to important stakeholders – shareholders, the government, or the public at large – these practices may not constitute civil or criminal fraud. Employees who report questionable conduct that does not meet these standards may not have a viable retaliation claim if their employer takes action against them for reporting the alleged misconduct. Various state and federal anti-retaliation laws as well as *qui tam claims* under the federal False Claims Act have differing standards governing the fraudulent intent an *employer* must have for the employee to later assert whistleblower claims based on complaining about the employer's conduct.

In August, two federal court cases exploring fraud in the criminal context highlighted the thin line between mere deception and fraud. While criminal and civil standards of fraud differ, concerned employees should understand both when monitoring their employers' practices.

The Pharma Bro Case

In *United States v. Shkreli et. al*, Martin Shkreli – nicknamed the "Pharma Bro" for his infamous career as chief executive of Turing Pharmaceuticals – was convicted of securities fraud and conspiracy. His conviction stems from his career prior to Turing, when Shkreli managed two hedge funds and the pharmaceutical company Retrophin. As stated in the indictment against Shkreli and his co-worker, they "knowingly and willfully conspired to use and employ manipulative and deceptive devices and contrivances in connection with the purchase and sale of Retrophin securities."

While his defense attorneys acknowledged that Shkreli made dishonest and deceptive statements, they contended that ultimately, no one was defrauded by Shkreli's acts (since they did not lose money), and therefore he did not have the requisite "fraudulent intent."

While not always true in the civil context, good faith is a defense to a criminal fraud charge. The jurors clearly considered this potential defense and asked the judge for further clarification of the term "fraudulent intent" during their deliberations, but ultimately they convicted Shkreli of securities fraud and conspiracy to defraud Retrophin. The takeaway from the conviction is that Shkreli's actions to deceive investors about the status of their investment constituted fraud, even though the investors received the return they were promised.

The Larry Davis Case

In *United States v. Davis, 2017 WL 3328240 (S.D.N.Y., Aug. 3, 2017),* on the other hand, jurors in the Southern District of New York found that Larry Davis and his steel company, DCM Erectors, had committed criminal fraud by misrepresenting fulfillment of certain contractual provisions, but the judge granted the defendants' motion for acquittal.

Davis's company had entered into a $580 million contract with the Port Authority of New York and New Jersey to furnish and install the structural steel for Tower 1 of the World Trade Center and the PATH Transportation Hub. Davis was charged with fraud and conspiracy for allegedly misrepresenting that he had met goals within the contract to sub-contract work from companies with minority and female ownership that would make Davis's company eligible for future contracts. In setting aside the verdict, the judge found that Davis did not possess fraudulent intent in making his deceptive assurances, because the misrepresentation did not "go to an essential element of the contract or 'expose' the Port Authority to potential or actual economic harm."

To a certain extent, this holding is in tension with the jury's finding in *Shkreli*, in that in both cases the deceived party got the benefit promised, but in one case the deception about the means of performance proved a scheme to defraud and in the other it did not.

Understanding Fraud Requirements

While courts will continue to parse out the criminal fraud standard in the progeny of both cases, prospective whistleblowers would do well to become familiar with the fraud requirements under retaliation statutes. Several other federal whistleblower statutes, such as the False Claims Act, National Defense Authorization Act, the Sarbanes-Oxley Act, and Dodd-Frank, all protect employees who make reports of fraud from retaliation for making those reports. The *Davis* and *Shkreli* criminal fraud cases highlight the complexities of determining fraud in the civil context as well.

For instance, the federal False Claims Act (FCA) protects whistleblowers who investigate or report information in furtherance of potential suits under the act from discharge or other retaliation by their employers. The FCA prohibits persons from making a false or fraudulent claim for payment to the United States, which raises the question: What is fraud? Courts have taken different stances on whether a whistleblower's report or investigation involves a mere breach of contract or knowing fraud on the government that gives rise to FCA liability.

For instance, in 2014 in *U.S. ex rel. Spicer v. Westbrook, 751 F.3d 354 (5th Cir. 2014)*, the Fifth Circuit held that, even if an employer falsely certified compliance with a relevant requirement, it may not be liable under the FCA unless compliance with that requirement was a precondition of government payment. The Fifth Circuit asserted that this precondition determines whether a statement is "false or fraudulent" under the act, presumably because fraudulent intent rests on whether the employer made the statement to receive payment where it otherwise would not, i.e., if the government would have withheld payment had it learned that the employer had not fully complied with the requirement.

In a more recent case, the Second Circuit dismissed a Sarbanes-Oxley Act whistleblower retaliation claim, holding that the employee lacked a reasonable belief that the company engaged in any fraudulent conduct. In *Kantin v. Metropolitan Life Insurance Co., 2017 WL 2377841 (2d Cir. 2017)*, the employee had complained about price anomalies in some of the company's joint life insurance policies. The court rested its decision on the fact that the company had never sold the policies in question when a more beneficial policy was available to a customer. As a result, the "mere existence" of policies without sales could not reasonably constitute fraud, even if the policies are unsuitable for the particular customers to whom they are marketed.

Shkreli as the Exception

While many of these cases indicate that courts are often not willing to extend the definition of "fraud" to contemplated or nonmaterial action by the deceiving party, *Shkreli* serves an exception to this rule. While Shkreli was ultimately able to provide his investors with a healthy return, the jurors seemed to find more important that Shkreli's deliberate statements made to deceive investors could have caused a monetary loss for those investors, and Shkreli's decision to defraud these investors did not rest on a good faith belief that he could regain those funds.

Whistleblowers must be mindful of the risks they face when complaining about fraud to their employers, and take additional steps to document and note whether the employer's actions demonstrate fraud and fraudulent intent. However, *Shkreli* may influence civil court decisions where whistleblowers reasonably believe that their employer's actions constituted fraud where the effects of that fraud are tenuous or only contemplated.