



CLAY V. UNITED STATES: WHEN EXECUTIVES RECEIVE JAIL TIME FOR ORDINARY BUSINESS DECISIONS

by Matthew G. Kaiser

Imagine a provision of the Internal Revenue Code that can be reasonably interpreted one of two ways. One interpretation requires you to pay \$10,000 extra in taxes. Another would save you that \$10,000. Suppose, too, that no formal guidance or rule on how to interpret that provision exists.

You make the reasonable choice of interpreting the statute in a way that saves you \$10,000 and file your tax return. Then, an Internal Revenue Service (IRS) agent contacts you, demanding that you pay the \$10,000 (plus interest) because the agent interprets the provision differently. He cites no written IRS policy or regulation to support his determination. If you fail to amend your return and pay the extra \$10,000, should the IRS be able to assess penalties against you? Should you be subject to criminal prosecution? This issue—or its close cousin—is currently on appeal before the U.S. Court of Appeals for the Eleventh Circuit in *Clay v. United States*.¹

The indictment and *conviction* of C-suite executives in *Clay* offers a troubling case study in overcriminalization and the improper application of prosecutorial discretion. The context in which the prosecutions arose—health care—implicates compliance with thousands of complex laws and regulations. The complexity of those numerous laws, and the availability of criminal sanctions for violating many of them, is hardly unique to health care, though. Thus, all regulated businesses, and their in-house and outside counsel, should pay close attention to *Clay* as it winds through the appeals process.

Background

In 2007, approximately 200 Federal Bureau of Investigation and other law-enforcement agents conducted a highly publicized raid of the corporate offices of Wellcare, a publicly-traded managed-care company. Based on information acquired in the raid, federal prosecutors indicted Wellcare's executives, including the chief executive officer, the chief financial officer, and the general counsel. A jury convicted them of health care fraud, and the judge sentenced each of them to prison.²

Wellcare provided health care services under Florida's Medicaid program pursuant to its so-called 80/20 Statute.³ Under the 80/20 Statute, a health care provider must spend 80 percent of the premiums it receives "for the provision of behavioral health care services." If it spends less than 80 percent for those services—because, for example, it incurs higher administrative costs—then the provider must return the difference to the state.

¹ No. 14-12373 (11th Cir.) (appeal pending).

² The prosecution of the company's general counsel was deferred pending the disposition of the appeal.

³ Fla. Stat. § 409.912(4)(b).

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Wellcare interpreted the statutory phrase “for the provision of behavioral health care services” such that it could lawfully set up a subsidiary to provide patient services. In that scenario, the subsidiary would be the health care provider and would be paid a portion of the premium dollars that Florida’s Medicaid program paid for these services. Wellcare reported the payments made to the related subsidiary as expenses under the 80/20 Statute, and it returned unspent premiums to the state under the formula. No state statute, rule, or contract provision prevented this method of calculating the payback to the state. Moreover, other managed-care providers in Florida interpreted the 80/20 Statute in a manner identical to Wellcare’s interpretation.

Florida’s Agency for Health Care Administration (AHCA), which implements the state’s Medicaid program, did not promulgate a regulation on whether payments to subsidiaries were an allowable expense under the 80/20 Statute. Indeed, at the criminal trial, the government’s own witnesses, including the statute’s primary author, testified that Wellcare’s interpretation of the 80/20 Statute was reasonable. Moreover, among the other managed-care providers embracing Wellcare’s interpretation, only one was sued. That provider settled a civil case with AHCA. Instead of paying a penalty, the provider agreed to employ Florida’s suggested method in the future.

United States v. Whiteside’s Protection Against Arbitrary Fraud Prosecutions

In a 2002 decision, *United States v. Whiteside*,⁴ the Eleventh Circuit held that the government can prevail in a false statement or fraud case only if there is no objectively reasonable interpretation of the law that makes it true. The falseness of a statement, under *Whiteside*, is a part of the *actus reus*, a *legal* question for the court to decide—not the *mens rea*, a *factual* element of a crime for the jury to decide.

Nevertheless, the trial court declined to rule on the legal question of whether the 80/20 Statute could be reasonably read as Wellcare interpreted it. Instead, the trial court instructed the jury that if there were an objectively reasonable interpretation of the statute that would render the Wellcare statements true, that was a sufficient defense. The court thus left to the jury—lay people lacking experience with highly technical health care regulations—the complex question of how to interpret the 80/20 Statute.

The jury originally deadlocked after a month’s deliberation. It subsequently acquitted the defendants or hung on most of the charges, but it found them guilty of fraudulent expenditure submissions for just one of several years charged. At sentencing, the judge rejected the Department of Justice’s (DOJ) request for draconian 20-year sentences, and instead imposed sentences ranging from one to three years.

On appeal, the Wellcare executives’ briefs make compelling legal and policy arguments as to why the Eleventh Circuit should overturn their convictions. They argue that the *Whiteside* issue of whether the defendants’ interpretation of the 80/20 Statute was reasonable implicates due process, fair notice, and the rule of lenity. If the defendants’ interpretation of the statute was objectively reasonable, then there was no criminal act or *actus reus*. Moreover, CEO Todd Farha’s brief argues that the evidence at trial did not show that he even had the requisite *mens rea*.⁵

A Case Study in the Iniquities of Overcriminalization

The Wellcare executives’ appeal focuses most directly, as it must, on the lower court’s failure to properly instruct the jury and its refusal to apply the dictates of *Whiteside*. But underlying the prosecution, and the defendants’ opposition to it, are broader concerns that touch upon the recent growth in vague laws and prosecutors’ indiscreet enforcement of them.

⁴ 285 F.3d 1345 (11th Cir. 2002).

⁵ Brief of Todd Farha at 19.

Proliferation of Vague and Ambiguous Laws. There are, according to one estimate, more than 300,000 federal regulations that prosecutors can apply criminally.⁶ Many of those regulations are vague thanks to the ambiguities that exist in the federal laws that agencies are implementing. As Justice Scalia has noted, “Fuzzy . . . legislation is attractive to the Congressman who wants credit for addressing a national problem but does not have the time (or perhaps the votes) to grapple with the nitty-gritty.”⁷ The same may be said of state legislators. Technical experts in administrative agencies can temper the ambiguities of “fuzzy legislation” with clarifying regulations, but no such clarification existed for Wellcare in its compliance with Florida’s 80/20 Statute, as AHCA provided none.⁸

Fundamental notions of due process dictate that the government should not prosecute a person where a law’s vagueness prevents him or her from determining whether his or her conduct is violative.⁹ The rule in *Whiteside*, that a statement is true if the legal interpretation of a statute on which it relies is reasonable, is an important complement to the well-settled “void for vagueness” rule.

Businesses must regularly interpret complex laws and regulations impacting their communications with federal and state governments. Tax forms, license applications, claims for payment from the government, and a myriad of other forms demand answers to questions that have more than one reasonable answer. Without the protection of judicial precedents like *Whiteside*, interacting with the federal government becomes a high-stakes game of “Gotcha!”

Administrative and Civil Remedies v. Criminal Prosecutions. As noted above, businesses are subject to thousands of federal laws and rules that can be criminally applied. Many of those laws and rules, however, also offer enforcers the option to pursue administrative or civil remedies. A commonsense application of prosecutorial discretion dictates that criminal sanctions should be reserved for only the most serious and clear wrongful conduct, and that prosecutors should utilize administrative or civil penalties where the correct interpretation of a vague law is in dispute. Indeed, the U.S. Attorney’s Manual provides such guidance.¹⁰ Unfortunately, in recent years, the trend has shifted away from a more sensible use of government resources.¹¹ One former senior DOJ official has argued that prosecutors often eschew civil fines for criminal punishment as a way of advancing their preferred interpretation of statutes or regulations.¹²

United States v. Clay represents a clear departure from administrative or civil enforcement, possibly in the service of prosecutors’ preferred interpretation of the 80/20 Statute. As noted previously, government regulators brought a civil action against another health care provider that interpreted the law similarly to Wellcare.¹³ Prosecutors have provided no explanation as to why it decided to pursue criminal sanctions against Wellcare instead of a breach-of-contract claim.

⁶ *Over-Criminalization of Conduct/Over-Federalization of Criminal Law: Hearing Before the Subcomm. on Crime, Terrorism, & Homeland Sec. of the H. Comm. on the Judiciary*, 111th Cong. 7 (2009) (testimony of former Attorney General of the United States Richard Thornburgh).

⁷ *Sykes v. United States*, 131 S. Ct. 2267, 2288 (2011) (Scalia, J. dissenting)

⁸ In sharp contrast to the absence of any Florida regulation explaining its 80/20 Statute, the federal government has some 20 complex regulations and interpretive guidances interpreting its own analog of the 80/20 law.

⁹ See, e.g., *United States v. Lanier*, 520 U.S. 259, 266 (1997) (“[D]ue process bars courts from applying a novel construction of a criminal statute to conduct that neither the statute nor any prior judicial decision has fairly disclosed to be within its scope.”); *United States v. Chandler*, 388 F.3d 796, 805 (11th Cir. 2004) (no criminal liability where “Defendants’ conduct was not ‘plainly and unmistakably proscribed’” by statute).

¹⁰ See USAM 9-27.250, Non-Criminal Alternatives to Prosecution (“In determining whether prosecution should be declined because there exists an adequate, non-criminal alternative to prosecution, the attorney for the government should consider all relevant factors, including: 1. The sanctions available under the alternative means of disposition; 2. The likelihood that an effective sanction will be imposed; and 3. The effect of non-criminal disposition on Federal law enforcement interests.”).

¹¹ See Darryl K. Brown, *Criminal Law’s Unfortunate Triumph over Administrative Law*, 7 J. L. ECON. & POL’Y 657, 660-61 (2011).

¹² See George Terwilliger III, *Under-Breaded Shrimp and Other High Crimes: Addressing the Over-Criminalization of Commercial Regulation*, 44 AM. CRIM. L. REV. 1417 (2007) (noting that prosecutors, “in the exercise of their broad discretion,” can “set—as a practical matter— regulatory parameters”).

¹³ Brief of Todd Farha at 6-7.

An opinion in the appeal of an insider-trading conviction in New York offers another example of prosecutorial indiscretion. In *United States v. Newman*, the Second Circuit rejected the government's interpretation of when a tippee—someone who receives non-public information that later becomes the basis of a trade—is liable for insider trading.¹⁴ Prosecutors saw the case as an opportunity to expand the reach of securities laws, and they apparently felt a criminal indictment, rather than a civil action, was the best means to do so. In reversing the conviction, the Second Circuit highlighted the novelty of the government's claims and criticized its effort to broaden criminal liability beyond the bounds of established law:

The Government's overreliance on our prior dicta merely highlights the doctrinal novelty of its recent insider trading prosecutions, which are increasingly targeted at remote tippees many levels removed from corporate insiders. . . . We note that the Government has not cited, nor have we found, a single case in which tippees as remote as [those charged in the case] have been held criminally liable for insider trading.¹⁵

More recently in *Yates v. United States*, the U.S. Supreme Court overturned a criminal conviction of a fisherman who was prosecuted for violating the anti-shredding provision of Sarbanes-Oxley for discarding undersized fish.¹⁶ The Court's plurality decision invoked the rule of lenity—and even the dissent acknowledged the overcriminalization of regulatory offenses.¹⁷

The Eleventh Circuit's *Whiteside* rule can curb prosecutors' overreliance on the criminal process when the applicable law provides equally or more effective civil or administrative remedies. Such a check on prosecutorial indiscretion is only effective, however, if judges, not juries, resolve the question at the heart of *Whiteside*: whether a statutory interpretation is reasonable.¹⁸

The Duties of Corporate Officers. Wellcare is a publicly-traded company. Its executives had an obligation to Wellcare's shareholders to maximize profits. If Wellcare's interpretation of the 80/20 Statute was objectively reasonable, then its executives were meeting their fiduciary duty to adopt that interpretation and pursue the subsidiary strategy.

This is not a problem unique to Wellcare. Businesses are often in uncertain regulatory environments and turn to counsel for advice. A rule that punishes a company for using an advantageous and reasonable interpretation of a statute, pre-approved by its counsel, will have a chilling effect on how business is conducted.

Conclusion

Due process and basic fairness demands that people be on notice that their conduct could be criminally sanctioned well before the government prosecutes them—in time to conform their conduct to the law in advance. In *Clay*, the Wellcare executives relied on sound legal advice and common industry practices when implementing their method of computing health care costs. Such reliance, simply put, made their interpretation of the 80/20 Statute reasonable. The business and legal communities have a substantial stake in the outcome of this appeal and should monitor its developments closely. If the Eleventh Circuit fails to overturn the executives' convictions, it will embolden prosecutors to continue their abusive practices, and the erosion of integrity and fairness in our criminal justice system will continue apace.

¹⁴ *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

¹⁵ *Id.* at 448.

¹⁶ *Yates v. United States*, 2015 WL 773330 (U.S. 2015).

¹⁷ See also *Amicus* Brief of Washington Legal Foundation, *Yates v. U.S.* (arguing that open-ended interpretation of Sarbanes-Oxley provision imposes no limits or standards on when prosecution is warranted).

¹⁸ See Jed Rakoff, "Why Innocent People Plead Guilty," NY REV. OF BOOKS, Nov. 2014; Stephen Smith, "A Judicial Cure for the Disease of Overcriminalization," Heritage Foundation Legal Memorandum # 135, Aug. 21, 2014.