

Testimony of

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Matthew Friedrich, Principal Deputy Assistant Attorney General
and Chief of Staff of the Criminal Division
UNITED STATES DEPARTMENT OF JUSTICE
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Committee on the Judiciary
United States Senate
"Hedge Funds and Independent Analysts:
How Independent are Their Relationships?"

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I.

INTRODUCTION

Good afternoon Chairman Specter, and members of the Committee. Thank you for the opportunity to appear before you today, and for inviting the Department of Justice to testify about recent developments in corporate fraud prosecutions and the Department's overall efforts to combat white collar crime.

We appreciate the Committee's concern about the relationship between hedge funds and industry analysts. We share your concern that we need to ensure the integrity of the financial markets. The additional tools that Congress provided in the landmark Sarbanes-Oxley legislation have been beneficial in this regard. We work closely with our partners at the SEC who oversee the regulation of the financial markets. While it is the SEC who identifies regulatory violations, they refer to the Department at the earliest opportunity matters with potential for criminal investigation. While I cannot discuss any pending matters in the area that is the subject of this hearing - that is analysts and hedge funds - and there are not any currently closed cases in this area, I would like to assure you that the Department shares your concerns regarding integrity in the marketplace. We are dedicated to utilizing our law enforcement tools to ensure the integrity of the markets and protection of investors and the public from fraud.

Toward that end, I would like to take this opportunity to update you on the progress of the Department's Corporate Fraud Task Force. This update comes just short of four years after the passage of the Sarbanes-Oxley legislation. That far-reaching legislation has been of significant benefit to the efforts of the Department of Justice, and we appreciate the substantial work of the members of this Committee, and the Congress as a whole, in securing its passage. It was a significant achievement that sent a powerful message that the Federal government and the American people would not tolerate corporate malfeasance in the wake of the unprecedented corporate scandals of late 2001 and early 2002 that involved the spectacular collapse of such corporate giants as Enron and WorldCom. The sweeping provisions of Sarbanes-Oxley have helped prosecutors, investigators and regulators combat corporate and white collar fraud through a variety of new statutes including expanded securities fraud provisions, requiring Chief Executive Officers and Chief Financial Officers to certify the accuracy of periodic reports under section 1350 of Title 18, enhanced attempt and conspiracy provisions aimed at fraudulent activity, and expanded criminal provisions to address document destruction and obstruction of justice in the corporate and accounting arena. We are also seeing increased success under these new criminal provisions, including the new general securities fraud statute, section 1348 of Title 18.

II.

White Collar Crime Remains A Priority For The Department Of Justice.

While Sarbanes-Oxley has clearly been a well-heralded success, the problem of corporate and white collar crime nevertheless remains a priority for the Department of Justice. The Attorney General reiterated that message earlier this year when he told all Department of Justice employees that "At every level - federal, state and local - we're enforcing the laws that protect the integrity of our government and corporate institutions. I've told prosecutors to operate with one principle in mind: No one is above the law." The Attorney General made it clear that this principle includes Chief Executive Officers, and he added that, "We will hold corporate executives accountable for the duties that they owe to shareholders." As the Attorney General noted, the Department's emphasis on the accountability of corporate officials remains a top priority because, "Integrity in government and business is essential for a strong America."

III.

The President's Corporate Fraud Task Force.

A hallmark of the Department's commitment to prosecuting corporate and white collar crime is the President's Corporate Fraud Task Force, established three and a half years ago. The Task Force's mandate is to clean up corruption in the boardroom; restore investor confidence in our markets; and send a strong message that corporate wrongdoing will not be tolerated. Since its formation, the Department has worked hard, together with its partners, to move aggressively against corporate fraud and other white collar criminal activity.

That partnership is expansive. The Task Force, chaired by the Deputy Attorney General, includes members from the U.S. Attorney community, the heads of the Department's Criminal and Tax Divisions and a broad range of law enforcement and regulatory agencies, including the Federal Bureau of Investigation ("FBI"), the Postal Inspection Service, the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC"), and the Internal Revenue Service ("IRS"). The Task Force meets periodically in Washington, D.C., to map out strategy and identify best practices. At the working level, the agencies interact daily on individual matters. The Task Force has been a resounding success and remains an essential part of the Department's priority in fulfilling its ongoing mission.

From its inception in 2002 through this past December, the Task Force has obtained over 1,000 corporate fraud convictions, and has convicted 92 corporate presidents, 82 Chief Executive Officers, 40 Chief Financial Officers, 14 Chief Operating Officers, 98 Vice Presidents, and 17 corporate counsel or attorneys. The Enron Task Force alone has charged 34 individuals and obtained 25 convictions to date, which include the convictions last month of former Enron CEO Jeffrey K. Skilling and former Enron Chairman and CEO Kenneth L. Lay. Moreover, in addition to bringing corporate and securities fraud prosecutions, the Task Force has also brought a number of tax prosecutions through the Tax Division, although the details of those cases are beyond the scope of my testimony today.

The Department's enforcement efforts have also sought to prevent the recurrence of criminal activity by requiring significant reforms from corporations under investigation. The Department has applied this approach in resolving investigations involving, among others, PNC Corporation and Computer Associates. Those reforms have included requirements that the companies establish a restitution fund, agree to new policies in connection with financial reporting, perform additional internal audits, and, where appropriate, consent to the monitoring of these procedures by independent auditors.

IV .

Recent Success Prosecuting Securities Fraud under Section 1348, Title 18

Section 1348 of Title 18, enacted by Sarbanes-Oxley is proving to be a potent tool in the fight against securities fraud. Just this month, the United States Court of Appeals for the First Circuit affirmed the sentence of 144 months against Carlos Soto-Cruz who pled guilty to violations of Sections 1348 and 1341 of Title 18 in connection with a 12-year scheme to defraud investors by channeling their investments through fictitious corporate accounts into high risk investments, rather than the promised low risk portfolio. Actual losses to his clients, including two banks, exceeded \$10 million dollars.

On February 17, 2006, Timothy C. Moses, former President and CEO of International BioChemical Industries, Inc. ("IBCL"), was sentenced in Atlanta on charges of securities fraud in violation of Section 1348 of Title 18, and perjury.

Moses was sentenced to 6 years, 6 months in federal prison to be followed by 5 years of supervised release, and ordered to pay \$1.65 million in restitution to IBCL shareholders. Moses was convicted on October 27, 2005 following a two-week jury trial. In all, since its enactment, more than 53 defendants have been charged under Section 1348.

V.

Working With Our Law Enforcement and Regulatory Partners

In pursuing these important white collar and corporate fraud prosecutions, the Department of Justice works closely with a variety of law enforcement entities to bring the investigations, both civil and criminal, to a successful conclusion. The most important law enforcement entity in this arena is the FBI. In large part because of the FBI's unique array of resources, which includes talented and experienced agents and supervisors, many of whom have backgrounds as attorneys or accountants, the Department has been able to efficiently investigate and prosecute a broad range of corporate and white collar crimes. The FBI's expertise and resources are a cornerstone of our white collar crime enforcement efforts.

Another of the Department's partners is the Securities and Exchange Commission. The two agencies have historically maintained separate areas of responsibility, with the Department taking the lead in criminal prosecutions while the SEC addresses civil enforcement actions and regulatory oversight. But that subject-matter separation has not stood in the way of the Department's commitment to work cooperatively with the Commission in attacking corporate fraud and white collar crime.

This cooperative effort has garnered several notable successes, including:

? In 2005, the SEC and the Department of Justice announced an agreement to settle a civil enforcement action and resolve criminal charges against Adelphia Communications Corporation for its part in one of the most extensive financial frauds ever committed within a public corporation. The Government was able to recover more than \$1.5 billion in forfeited assets from which Adelphia paid \$715 million in restitution, secure permanent injunctions barring founder John J. Rigas and his sons from further violations of the federal securities laws, and obtain an order barring them from acting as officers or directors of any public company. In a related settlement, Deloitte & Touche LLP agreed to pay \$50 million to settle charges arising from its 2000 audit of Adelphia and consented to a substantial overhaul of its procedures for audits of high risk clients. In conjunction with this investigation, the Department of Justice also convicted Rigas and his sons for crimes stemming from the fraudulent scheme. The Rigases have since been sentenced, with founder John Rigas receiving a sentence of 15 years of imprisonment.

? The Department of Justice successfully prosecuted WorldCom CEO Bernie Ebbers, who was sentenced to 25 years of imprisonment and ordered to pay up to \$45 million in restitution. The SEC obtained court approval of a plan to distribute more than \$500 million and 10 million shares of MCI stock valued at \$250 million, that it obtained from WorldCom, to a fund to compensate the victims of the company's widespread accounting fraud.

? In February 2006, the Department of Justice and the SEC each reached an agreement with AIG Insurance in which AIG accepted responsibility for its involvement in two fraudulent transactions and agreed, among other things, to pay \$25 million in penalties to the United States, to cooperate in the government's ongoing criminal investigation, and to simultaneously pay the SEC a fine of \$100 million and disgorge \$700 million.

These successes, and others, are directly attributable to effective interagency coordination, which ensures focus and maximizes the combined efforts of the Department, including the United States Attorneys, the Criminal Division, the FBI, other key law enforcement agencies such as the Postal Inspection Service, the IRS, CFTC, and the Commission.

VI.

Voluntary Disclosures

In addition, corporations have increased the effectiveness of their compliance programs in the wake of the Sarbanes-Oxley and the stepped up enforcement efforts of the Department and its partners. General Electric Corporation voluntarily disclosed to the Department and the SEC in 2004 that employees of InVision Technologies, a maker of airport security screening devices that GE was considering acquiring, had paid or offered to pay bribes to foreign officials in Thailand, China and the Philippines. GE detected these violations while it was performing due diligence on InVision and voluntarily reported them. In December 2004, the Department entered into nonprosecution agreements with General Electric and InVision Technologies. InVision disgorged almost \$600,000 in profits and paid a criminal penalty of \$800,000, and GE agreed to integrate InVision into its own Foreign Corrupt Practices Act compliance

program.

It is also important to note that our corporate fraud enforcement efforts encompass health care fraud prosecutions. The Corporate Fraud Task Force has encouraged an alternative approach to addressing the unique challenges in health care fraud cases related to publicly-traded health care companies. The Task Force has been largely successful in prosecuting these health care companies and the responsible officers by focusing on public misrepresentations of their financial condition and operations. For example, 17 defendants were convicted in the HealthSouth case, a case that focused on fraudulent accounting practices. At the same time, we have achieved success in addressing the problem of an underlying corrupt corporate culture in cases like HealthSouth, where the company agreed to pay the Government \$325 million plus interest and entered into a company-wide 5-year corporate integrity agreement with the Office of Inspector General of the Department of Health and Human Services. This settlement agreement resolved allegations of Medicare Part A cost report fraud uncovered during the Government's investigation of the company's financial statements. The settlement also resolved allegations that the company submitted false claims to Medicare Part B for certain outpatient physical therapy services

In addition to bringing various corporate fraud and white collar prosecutions, the Department has also placed a premium on training prosecutors and investigators on investigating and charging corporate and white collar cases. Immediately after the passage of Sarbanes-Oxley, the Department undertook an effort to train prosecutors across the country on its landmark provisions. The Department also regularly conducts detailed training programs, incorporating its most experienced personnel in the Criminal Division and United States Attorney's Offices, on securities fraud and white collar crime for prosecutors and investigators. We also use our Securities and Commodities Fraud Working Group to keep prosecutors updated on the latest developments in the field.

VII.

Conclusion.

The story of the Department of Justice's efforts to prosecute corporate corruption is ongoing. Much of that effort has built upon the impressive arsenal of new laws that are contained in the landmark Sarbanes-Oxley legislation and in the Department's commitment to follow through on the clear and unmistakable mandate laid down by the Congress. In partnership with our civil and law enforcement colleagues at the local, state, federal and international levels, we now have the attention of the corporate community, and our corporate citizens are stepping up to the plate to meet these new requirements. These efforts are a cornerstone to the Department's efforts to strengthen the integrity of the market place, protect the public, and restore confidence in our corporate institutions.

Thank you again for the opportunity to testify. I look forward to your questions.