

AN OVERVIEW AND ANALYSIS OF 18 U.S.C. §1033(e)

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Seminar: Contemporary Issues in Insurance Law  
Fall 2010

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## AN OVERVIEW AND ANALYSIS OF 18 U.S.C. §1033(e)

### I. Thesis statement and introduction

Although not specified by 18 U.S.C. 1033(e)(1)(A) or 1033(e)(1)(B), to successfully prosecute an 18 U.S.C. §1033(e) case in federal court, the government must show the defendant had knowledge of the qualifying felony but need not show knowledge of 18 U.S.C. §1033(e), nor is the government required to consider the status of a California “wobbler” felony once the individual has been convicted and sentenced to the felony-level sentence in state court.

#### Background and overview of 18 U.S.C. §1033

There are many ways, at both the state and federal levels, to prosecute fraud. Examples include charging grand theft, forgery, and check fraud at a state or local level; and mail fraud, wire fraud, and conspiracy at the federal level. However, until 1994, there were no statutes that sought to address the lack of comprehensive enforcement of the pervasive problem of fraud in the insurance industry. In 1994, H.R. 3355, the Violent Crime Control and Law Enforcement Act of 1994 (“the Act”) was signed into law and became effective on that date. The Act was a massive piece of legislation that addressed a variety of crime, including insurance fraud. Title 18 U.S.C. §§1033 and 1034 incorporate the language regarding insurance fraud provisions in the Act. The inclusiveness of 18 U.S.C. §§1033 reflects Congress’ attempt to crack down on pervasive white collar crime after the savings and loan scandals, the failure of several large insurance companies, and insurance commissioners’ urging for stronger laws regulating fraud in the insurance industry. Norman Tolle and Gus Sellitto, *Insurers Face Compliance Issues Under Crime Control Law*, 221 NYLJ 113, col. 1 (1999); National Association of Insurance Commissioners [hereinafter “NAIC”] *Revision of Guidelines for State Insurance Regulators to the Violent Crime Control and Law Enforcement Act of 1994* [hereinafter “NAIC guidelines”] 4

(05/18/2010); and *FBI's Perspective on Criminal History Record Information Checks on Individuals Conducting Insurance Business: Testimony before the House Financial Services Committee* (2001) (testimony of Dennis Lormel, Section Chief, Financial Crimes Section, FBI) [hereinafter "FBI testimony"]. The Act includes not only licensed insurance agents and brokers in the provisions regarding insurance fraud, but anyone engaged in or participating in the "business of insurance." 18 U.S.C. §1033(a) – (f).

The purpose of 18 U.S.C. §1033(e) is to prohibit individuals who have been convicted of felony crimes involving untrustworthiness from participating in any insurance activities. It is meant to ban this category of felons from ever working in the insurance industry unless they obtain written consent from their state insurance commissioner. NAIC Guidelines 4 and FBI testimony. This includes those felons who were already involved in the business of insurance at the time the Act was signed: "While the statute is not retroactive in its application, from that date [September 13, 1994] forward it became illegal for certain individuals – regardless of when their offenses were committed – to either: (1) begin to work in the business of insurance, or (2) continue to work in the business of insurance. Thus, it is applicable not only to licensed insurance professionals and others performing similar work on behalf of insurers, but to everyone acting as an officer, director, employee, or agent of an insurer, and to anyone else authorized to act on their behalf." NAIC Guidelines 4. The NAIC noted that there was "no limitation or restrictions on the applicability of Sections 1033 and 1034 as to which persons are covered so long as those persons are engaged in, or participate in the 'business of insurance' – a term broadly defined by Section 1033." NAIC Guidelines 4. The intent of this prohibition "is to prevent certain persons from having the opportunity to harm the public or insurers." FBI testimony.

The statute is modeled after the same prohibition against such individuals working in the financial industry (see FDIC section below). This may have been, at least in part, in recognition of the convergence of the two industries (see Gramm-Leach-Bliley Act section below).

18 U.S.C. §1033, generally

Title 18 U.S.C. §1033 establishes the criminal violations and punishments while §1034 details the civil sanctions. Title 18 U.S.C. §1033 is comprised of six subsections, which can be categorized as follows:

Section 1033(a): Felony material false statements to insurance regulators for the purpose of influencing the regulators. 18 U.S.C. §1033(a)(1) and (2).

Section 1033(b): Felony embezzlement or misappropriation of funds by someone in the insurance business. 18 U.S.C. §1033(b)(1) and (2).

Section 1033(c): Felony material false statements by someone in the insurance business about the financial condition or solvency of their business. 18 U.S.C. §1033(c)(1) and (2).

Section 1033(d): Felony public corruption or threats to impede administration of law of the insurance business and regulatory proceedings. 18 U.S.C. §1033(d).

Section 1033(e): As will be discussed in this paper, this section makes it a felony to be employed in, or permit the employment of someone in, the business of insurance when that individual has a qualifying felony conviction, punishable by fine and/or up to 5 years imprisonment. 18 U.S.C. §1033(e)(1)(A) and (B). Such a person may, however, obtain the written consent of the state insurance regulatory official to engage in the business of insurance. 18 U.S.C. §1033(e)(2).

Section 1033(f): provides definitions for “business of insurance,” “insurer,” “interstate commerce,” and “State.” 18 U.S.C. §1033(f)(1) – (4).

18 U.S.C. §1033(e)

Specifically, 18 U.S.C. §1033(e) states:

§1033 (e)(1)(A): Any individual who has been convicted of any criminal felony involving dishonesty or a breach of trust, or who has been convicted of an offense under this section, and who willfully engages in the business of insurance whose activities affect interstate commerce or participates in such business, shall be fined as provided in this title or imprisoned for not more than 5 years, or both.

(B): Any individual who is engaged in the business of insurance whose activities affect interstate commerce and who willfully permits the participation described in subparagraph (A) shall be fined as provided in this title or imprisoned not more than 5 years, or both.

(2): a person described in paragraph (1)(A) may engage in the business of insurance or participate in such business if such person has the written consent of any insurance regulatory official authorized to regulate the insurer, which consent specifically refers to this subsection.

As will be discussed below, while state insurance commissioners and agencies have authority to regulate the insurance industry in their states, the criminal enforcement of §1033(e) is the responsibility of the federal government. The states, however oversee 18 U.S.C. §1033(e) waiver requests and determine whether to grant them to the applicants and when to revoke them.

California Department of Insurance's ("CDI") authority to regulate

California's Code of Regulations, Title 10, Chapter 5 implements the provisions of 18 U.S.C. §§1033 and 1034 for regulation by CDI. CAL. CODE REGS Title 10, §2175.1 (2003). The California regulations establish the procedures for governing "prohibited persons," those persons prohibited from engaging in the business of insurance under 18 U.S.C. §1033(e). It defines terms used in 18 U.S.C. §1033(e), states who must comply, and sets forth the procedures for filing an application for written consent [hereinafter "waiver"], pursuant to 18 U.S.C. §1033(e)(2), and the standards for reviewing and granting the waiver. CAL. CODE REGS. Title 10, §2175.2 – 2175.10 (2003). They also detail the process for denial, expiration, or termination of

written consent and hearing procedures. CAL. CODE REGS. Title 10, §§2176-2177 (2003).

California requires any prohibited person who wishes to engage in the insurance business in the state to apply for a waiver, regardless of whether the person has already obtained a waiver in another state. Any decisions to grant or deny a waiver by another state will be considered in California's decision to grant or deny its own waiver to an applicant. CDI's webpage "Agents & Brokers: Questions and Answers, 18 U.S.C. §1033-1034," found at <http://www.insurance.ca.gov/0200-industry/0200-prod-licensing/0100-applicant-info/0600-1033-application/faqs.cfm>.

Although California requires a qualifying individual to seek a waiver specifically from California, the federal statute indicates a waiver from any state in which the individual engages in the business of insurance would be sufficient for compliance with the federal law: "A person described in paragraph (1)(A) may engage in the business of insurance or participate in such business if such person has the written consent of any insurance regulatory official authorized to regulate the insurer, which consent specifically refers to this subsection." 18 U.S.C. §1033(e)(2).

CDI posts its Title 10 and waiver information on its website, [www.insurance.ca.gov](http://www.insurance.ca.gov), through various links and menu options. The website is meant for use by those engaged in the business of insurance or interested in becoming so, as it provides detailed information about its online services for such individuals and entities, as well as information on applying for, renewing, updating, etc. insurance licenses and applying for the 18 U.S.C. §1033(e) waiver.

Although, as will be discussed below, it is not necessary for a defendant to know specifically about 18 U.S.C. §1033(e) to successfully prosecute a violation of that statute, it is reasonable to believe a 18 U.S.C. §1033(e)-prohibited person, or an insurance business employer

who must not hire a prohibited person, learns specifically of 18 U.S.C. §1033(e) when they utilize the CDI website for routine matters related to the business of insurance and their licensing requirements. There is a duty to use the website in order to comply with certain regulatory requirements, such as submitting information regarding bail agents' business and employees to CDI. The website explains 18 U.S.C. §1033(e) in detail, defines "prohibited person," provides a link to the application for the 18 U.S.C. §1033(e) waiver, as well as a link to "frequently asked questions" regarding 18 U.S.C. §1033(e). It also states: "It is the responsibility of insurers and producers to make a diligent effort to identify employees or prospective employees who may be prohibited persons, and to ensure that prohibited persons are not engaging in the business of insurance in violation of the Act or CDI's regulations." <http://www.insurance.ca.gov/0200-industry/0200-prod-licensing/0100-applicant-info/0600-1033-application/index.cfm>. This is also stated in CDI's regulations: "... insurers and other employers must actively seek to determine whether or not Prohibited Persons are in their employ and are engaging in or transacting the business of insurance." CAL. CODE REGS. Title 10, §2175.5(a) (2003).

CDI sent notice to those in the insurance industry regarding 18 U.S.C. §1033 when California implemented its codes. It has also notified those in the business of insurance when there were changes or developments relating to its policy or procedures regarding 18 U.S.C. §1033. For example, CDI sent a notice in September 2007 to "Admitted Insurers and all Other Interested Parties" regarding a reduction in the fingerprint fee for the waiver application. Notice from CDI to Admitted Insurers and all Other Interested Parties dated 09/28/2007 regarding Fingerprint Fee Reduction – Title 18 U.S.C. §1033 Applicants for Written Consent ("CDI §1033 Fingerprint Fee Notice"). The first sentence of this notice is: "Title 18 U.S.C. Section 1033 states that it is a criminal offense for an individual who has been convicted of a felony involving

dishonesty or breach of trust or any violation of 18 U.S.C. §1033, to willfully engage or participate in the business of insurance unless that person has first obtained the written consent of the appropriate regulatory official.” CDI §1033 Fingerprint Fee Notice. It goes on to explain that it is a criminal offense to willfully employ such a person or permit them to participate in the insurance business without a waiver. The notice also defines “prohibited person” and advises that all waiver applicants are required to submit fingerprint impressions to California Department of Justice and the Federal Bureau of Investigation before CDI will process the application (the fee for which, it announces, was reduced from \$24 to \$19). The notice provides guidance to both California residents and nonresidents for obtaining fingerprint impressions for purposes of the §1033 waiver application. CDI §1033 Fingerprint Fee Notice. Information about 18 U.S.C. §1033(e) is also provided to those in the business of insurance through training for licensing and required continuing education.

Even if the applicant’s or employee’s felony status was not discovered, the standard of the employer’s duty to make a “diligent effort” to “actively seek” to determine an employee’s felony status would arguably be met if the employer could show that the employer required disclosure of criminal history on the job application, questioned the applicant or employee about criminal history, followed up on references and previous employment, and ran standard internet and legal records checks on employees and prospective employees. Simply having a question about the applicant’s criminal history on the job application would not suffice if the employer took no further steps to confirm the applicant’s answer. This is especially true for the types of crimes at issue for 18 U.S.C. §1033(e), since someone previously convicted of a felony involving dishonesty or breach of trust has already proved themselves untrustworthy in at least certain aspects of his or her life. When an applicant answers “yes” that they have a criminal history, the

employer must inquire as to the nature of the criminal history, rather than intentionally choosing to remain ignorant.

Even though CDI regulates the 18 U.S.C. §1033(e) waivers and provides detailed information, the criminal enforcement of 18 U.S.C. §1033(e) remains federal jurisdiction: “Any and all Prohibited Persons engaging in, or transacting, the business of insurance, without the express Written Consent of the Commissioner, are in violation of the Act and risk federal criminal sanctions.” CAL. CODE REGS. Title 10, §2175.4(d) (2003).

II. Key Element: Interstate Commerce: Insurance business affects interstate commerce and may also be a channel from which interstate commerce flows and therefore the federal government may prosecute 18 U.S.C. §1033(e) cases even when states regulate the insurance industry.

Title 18 §1033(e) requires the prohibited felon or the employer be engaged in the business of insurance “whose activities affect interstate commerce.” 18 U.S.C. §1033(e)(1)(A) and (B). The statute defines “interstate commerce” and case law holds that 18 U.S.C. §1033(e) is constitutional and Congress did not exceed its authority in enacting the statute. Title 18 §1033(e) does not preempt state laws, rather it is meant to enhance state law enforcement and serve as a deterrent to, and punishment of, those committing insurance fraud. FBI testimony and NAIC Guidelines 4, 6.

The definition provided in 18 U.S.C. §1033(f)(3) for “interstate commerce” includes commerce within the District of Columbia, any state, territory, or possession; all commerce between any of those and any point outside of them; and all other commerce within federal jurisdiction. 18 U.S.C. §1033(f)(3). California regulations adopted the same language as that of 18 U.S.C. §1033(f)(3). CAL. CODE REGS Title 10, §2175.2(i).

*The McCarran-Ferguson Act*

Congress enacted the McCarran-Ferguson Act in 1945, 15 U.S.C. §1011 et seq., which allowed the states to continue regulating insurance despite the interstate aspects of the regulation. The act, originally entitled “An Act to express the intent of Congress with reference to the regulation of the business of insurance,” remains the law today. 15 U.S.C. §6701(a). It granted concurrent jurisdiction to both the states and the federal government, permitting the states to regulate the insurance industry. 15 U.S.C. §1011 et seq.

### Case Law

In *United States v. Turner*, 301 F.3d 541 (7th Cir. 2002), Turner argued Congress exceeded its constitutional Commerce Clause authority when it enacted 18 U.S.C. §1033 because intrastate crimes (in Turner’s case, embezzlement) were not encompassed within the Commerce Clause and because, even if some insurance business involves interstate commerce, Turner’s conduct was wholly intrastate and the statute did not regulate instrumentalities or things of intrastate commerce. *United States v. Turner*, 301 F.3d 541 (7th Cir. 2002). Turner also claimed that, because the McCarran-Ferguson Act allowed states to regulate the insurance industry despite the interstate aspects of the industry, the insurance industry and criminal acts like embezzlement were the jurisdiction of the states. *Turner*, 301 F.3d at 544.

The court first held that, despite concurrent jurisdiction granted by McCarran-Ferguson, the business of insurance can and does affect interstate commerce and Congress may choose to regulate it in whole or in part. *Id.* The court also reviewed the three categories of activities Congress may regulate with its Commerce Clause power, *Turner*, 301 F.3d at 543, citing *United States v. Lopez*, 514 U.S. 549, 558-559 (1995): Channels of interstate commerce; instrumentalities, persons, or things in interstate commerce even when the threat is only from intrastate activities, citing *Lopez*, 514 US at 558-559; and activities having a substantial relation

to or substantial affect on interstate commerce. *Id.* After examining the case in light of these three categories, the court held the business of insurance falls within Congress' Commerce Clause power because it either affects interstate commerce or may itself be a channel of commerce even when the activity in question is intrastate. *Turner* at 548. Therefore, Congress may "regulate the insurance industry and those activities which positively or negatively affect the business as incidental to the larger regulatory scheme," including embezzlement since it negatively impacts the industry. *Id.*

Turner's petition for writ of certiorari to the U.S. Supreme Court was denied in December 2002. *Turner v. United States*, 537 U.S. 1077 (2002).

### Conclusion

Congress had the authority to enact 18 U.S.C. §1033, and although states regulate the insurance industry and are responsible for granting waivers, criminal prosecution under 18 U.S.C. §1033 is left to the federal government. NAIC Guidelines 7, *Turner*, and FBI testimony.

III. Key Element: "Business of Insurance": "Business of insurance" encompasses all activities necessary or incidental to the writing of insurance or the reinsuring of risks.

The "business of insurance" for purposes of 18 U.S.C. §1033, includes activities performed by individuals who are not the licensed agent or broker. Under 18 U.S.C. §1033, the business of insurance includes not only the writing of insurance and the reinsuring of risks, but *everything necessary or incidental* to that writing or reinsuring. 18 U.S.C. §1033(f)(1) (italics added). This applies to the activities of people who are, or act as, agents, directors, employees of insurers, or other people authorized to act on those individuals' behalf. U.S.C. 18 §1033(f)(1). This broad term is clarified by the accompanying definition of "insurer": "Any entity the business activity of which is the writing of insurance or the reinsuring of risks, and includes any

person who acts as, or is, an officer, director, agent, or employee of that business.” 18 U.S.C. §1033(f)(2).

California regulations on their face do not provide further guidance, as they adopt the same definitions for the terms “business of insurance” and “insurer.” CAL. CODE REGS Title 10, §§2175.2(e) and (h).

Legislative intent, as will be discussed in detail below, is for broad interpretation and enforcement of 18 U.S.C. §1033. The NAIC Guidelines elaborate that the term “other persons” who are authorized to act appears to include “any subcontractors, third-party administrators, consultants, professionals and the like.” NAIC Guidelines 5. The NAIC guidelines note that where “insurer” is used in the statute, it means to “include the entire universe of individuals.” *Id.*

#### Case law

Some positions and activities are easily found to be within the definition of “business of insurance”: In *United States v. Segal and Near North Insurance Brokerage*, the defendants, who were convicted of a scheme to defraud their insurance customers and the federal government, claimed they were not engaged in the business of insurance because they were brokers. They argued that, because they did not write insurance or reinsure risks, 18 U.S.C. §1033(f)(1) did not apply to them. *United States v. Segal and Near North Insurance Brokerage*, 2004 U.S. Dist. LEXIS 25355 (ND Illinois, 2004). The court held there was enough evidence presented at trial for a reasonable jury to find the defendants, as brokers, were agents of insurance carriers and had “the authority to act on behalf of insurance carriers.” *Segal* at 12 and footnote 8. Therefore, defendants were engaged in the business of insurance.

California legislature amended §1732 of the insurance code (effective January 1, 2009) to clarify the difference between an insurance agent and insurance broker. It states, in part, that a

broker may, “on behalf of an insurance company,” collect and transmit, or return, premiums and deliver policies and documents of insurance without these actions being construed to mean the person is an insurance agent (as opposed to broker). CAL. INS. CODE §1732 (available at <http://www.insurance.ca.gov/0200-industry/0080-make-changes/AB2956WebPage.cfm>). An insurance broker is still a person who transacts insurance, even if on behalf of the consumer, and is licensed by the insurance commissioner. Therefore, if the court in *Turner* decided the issue in a California court, it would likely still have held the brokers were engaged in the insurance business, regardless of their classification of “broker” rather than “agent.”

When it comes to other positions not so directly engaged in conduct that can be considered insurance activity, courts may still broadly interpret whether that activity falls within the “business of insurance.” In *Beamer v. NETCO*, the court held that a contractor (Beamer) who provided software for use by title agents to produce title insurance forms, commitments, policies, and to accept title offers, was in the “business of insurance” for purposes of 18 U.S.C. §1033. *Beamer v. NETCO*, 411 F.Supp.2d 882 (S.D. Ohio, 2005). In *Beamer*, Beamer contracted several times to provide his title insurance software to NETCO, an insurance refinancing business that dealt with lenders and others who provided loan products for residential mortgages. In 1985, prior to at least the last contract with NETCO in 1999, Beamer was convicted of felony interstate transportation of stolen checks. *Beamer*, 411 F.Supp.2d at 885-886.

When a contract dispute arose, Beamer accused NETCO of tortiously interfering with the contract, to which NETCO argued Beamer’s prior felony conviction put Beamer in violation of 18 U.S.C. §1033 and therefore rendered his contract with them in the business of insurance void. *Id.* at 888. Beamer argued that, as a software provider, he was not in the “business of insurance” and therefore his contract was valid. *Id.* The court examined the definition of “business of

insurance” in 18 U.S.C. §1033(f)(1) and concluded “Beamer engaged in the business of insurance by developing and creating a software program which produced insurance forms for insurance title agencies.” *Id* at 889.

While the court did not expressly articulate what conduct would not be considered engaging in the business of insurance, the court implied that had Beamer been merely a software salesman, he may not have been found to be engaging in the business of insurance. *Id.* at 890. However, here, Beamer actually created the software used by the insurance business with which he contracted, initiated and maintained contacts, and negotiated contracts with those in the insurance industry. For those reasons, the court found the definition of 18 U.S.C. §1033(f)(1) applied to Beamer. *Id.*

Because Beamer was found to be illegally engaged in the business of insurance, his contract with NETCO was invalid, pursuant to Florida contract law. Beamer’s contract was deemed invalid due to the 18 U.S.C. §1033(e)(1)(A) violation, even though Beamer was not convicted of a violation of 18 U.S.C. §1033(e)(1)(A). Therefore, Beamer had no cause of action because NETCO could not have tortiously interfered with an invalid contract. *Id.* at 889-890.

Although *Beamer* is a civil case, it is an example of a non-agent or broker being declared in violation of 18 U.S.C. §1033(e) for engaging in the business of insurance because of the type of activities in which he was engaged and the nature of his relationship with the insurance companies. Beamer contracted directly by the insurance agencies for his work and the nature of his work was to directly further their individual businesses and profits by providing their system (the software program he created) used to write insurance.

### Conclusion

While many activities and job roles clearly meet the definition of business of insurance, the definition is broad enough to encompass a wide range of positions and activities that in some way have contact with an insurance business. Theoretically, taken to the extreme, even the janitor who empties an insurance office's trash could be considered a necessary or incidental activity in the insurance industry. Remembering the legislative intent for wide-sweeping reform and enforcement, as well as the fact that regardless of job position, many individuals have access to "sensitive and valuable information," NAIC Guidelines 4 – 5, including the janitor who sees what is on people's desks while emptying their trash – supports an inclusive interpretation of 18 U.S.C. §1033(f)(1)'s inclusion of “. . .*everything necessary or incidental*” to writing of insurance or reinsuring. 18 U.S.C. §1033(f)(1) (italics added).

This, however, would be too broad and ambiguous an interpretation of the definition, as indicated by the statute and the opinion in *Beamer*. The statute clarifies that the “necessary and incidental” activities are those of the insurance agents, directors in the business, employees of the insurers, or others *authorized to act on their behalf*. 18 U.S.C. §1033(f)(1) (italics added). Someone such as a janitor would likely not be authorized to act on the insurer's behalf. By contrast, someone who manages other employees of the insurer is acting on the insurer's behalf, as is someone who appears in court and/or in administrative proceedings representing the insurer. Additionally, skip tracing and collecting the funds owed to the insurer for the insurer's services are also tasks taken on behalf of the insurer, as are any fiduciary duties an employee or contractor has to the insurer.

Indicating this distinction in between qualifying and non-qualifying activities, the *Beamer* court included software development in the “business of insurance” and clarified a software salesman with no other connections to an insurance business may not so easily have

been found to qualify. Ultimately, determining whether a particular person is engaging in the business of insurance, or whether a particular activity constitutes business of insurance, will be determined by examining the facts of the individual case, including the specific role(s) and authorization(s) the individual(s) were given by the insurer.

IV. Key Element: Qualifying Felonies: To trigger 18 U.S.C. §1033(e) violations, the qualifying felony must be a “felony involving dishonesty or a breach of trust.”

Both 18 U.S.C. §1033(e)(1)(A) and §1033(e)(1)(B) require a previous conviction of a felony “involving dishonesty or a breach of trust,” yet the statute does not provide definitions of either “dishonesty” or “breach of trust,” nor does it provide a list of qualifying felonies. There does not appear to be federal case law delineating these terms as they apply to 18 U.S.C. §1033(e) and each state establishes what is, or is not, dishonesty or breach of trust. FBI testimony. Therefore, an examination of a state’s definition is necessary when evaluating an 18 U.S.C. §1033(e) case. Additionally, there are other federal statutes that have similar language and provisions, including 12 U.S.C. §1829, which provide appropriate guidance for applying these terms to 18 U.S.C. §1033(e). NAIC Guidelines 20, FBI testimony.

*The FDI Act and FDIC authority to define “dishonesty” and “breach of trust”*

Title 12 U.S.C. §1829 codifies Section 19 of the Federal Deposit Insurance Act (“FDI Act”), which prohibits individuals convicted of crimes involving dishonesty or breach of trust or money laundering from participating in or being affiliated with, an institution insured by the Federal Deposit Insurance Corporation (“FDIC”). Title 12 U.S.C. §1829 provides in part:

- (1) In general, Except with the prior written consent of the Corporation—
  - (A) any person who has been convicted of any criminal offense involving dishonesty or a breach of trust or money laundering, or has agreed to enter into a pretrial diversion or similar program in connection with a prosecution for such offense, may not—
    - (i) become, or continue as, an institution-affiliated party with respect to any insured depository institution;
    - (ii) own or control, directly or indirectly, any insured depository institution; or

(iii) otherwise participate, directly or indirectly, in the conduct of the affairs of any insured depository institution; and  
(B) any insured depository institution may not permit any person referred to in subparagraph (A) to engage in any conduct or continue any relationship prohibited under such subparagraph. 12 U.S.C. §1829(a)(1)(A) and (B).

Subsection (b) of 12 U.S.C. §1829 designates the penalty for violation of subsection (a) as a fine of not more than \$1,000,000 per day of violation and/or imprisonment up to five years.

Like 18 U.S.C. §1033, 12 U.S.C. §1829 serves as a statutory bar to participation in a financially related industry by someone with a qualifying felony, absent written consent (in the case of 12 U.S.C. §1829, that written consent must be from the FDIC). Title 12 U.S.C. §1829 also does not define “dishonesty” or “breach of trust,” but the FDIC has promulgated guidelines that do define the terms. FDIC, *FDIC Statement of Policy for Section 19 of the FDI Act* [hereinafter “FDIC policy statement”] (1998), available at <http://www.fdic.gov/regulations/laws/rules/5000-1300.html>.

The U.S. District Court, District of Columbia, affirmed that it was FDIC’s responsibility to determine whether a crime involved dishonesty or breach of trust for purposes of 12 U.S.C. §1829. *Feinberg v. FDIC*, 420 F.Supp. 109 (D.C. 1976). In *Feinberg*, the court determined the FDIC had deprived Feinberg of due process by issuing a Notice and Order of Suspension based solely upon the return of an indictment for conspiracy to commit mail fraud (a violation of 18 U.S.C. §1341) without first providing a hearing. The court held the FDI Act, specifically 12 U.S.C. §1818(g)(1), “by its very language, requires that the agency decide whether the crime charged is one ‘involving dishonesty or breach of trust.’” *Feinberg*, 420 F.Supp. at 116-117. The court said the FDIC must exercise its discretion in determining which offenses qualify under the statute and that this discretion was “enhanced by the lack in the statute of a definition of a crime of ‘dishonesty or breach of trust.’” *Id.* at 117.

The FDIC has subsequently defined, for purposes of 12 U.S.C. §1829, “dishonesty” as follows:

“ ‘Dishonesty’ means to directly or indirectly to cheat or defraud; to cheat or defraud for monetary gain or its equivalent; or wrongfully to take property belonging to another in violation of any criminal statute. Dishonesty includes acts involving want of integrity, lack of probity, or a disposition to distort, cheat, or act deceitfully or fraudulently, and may include crimes which federal, state or local laws define as dishonest.” FDIC Policy Statement.

The FDIC defined, for purposes of 12 U.S.C. §1829, “Breach of trust” as follows:

“ ‘Breach of trust’ means a wrongful act, use, misappropriation or omission with respect to any property or fund which has been committed to a person in a fiduciary or official capacity, or the misuse if one’s official or fiduciary position to engage in a wrongful act, use, misappropriation or omission.” FDIC Policy Statement.

To determine whether a crime involved dishonesty or breach of trust, the FDIC requires an examination of the statutory elements of the criminal statute itself, regardless of whether that statute is a state or federal one. FDIC Policy Statement.

*Federal Rule of Evidence 609(a)(2)*

In its discussion of the terms “dishonesty” and “breach of trust,” the NAIC Guidelines also turned to Federal Rules of Evidence 609(a)(2). Fed R. Evid. 609(a)(2) states, “For the purpose of attacking the character for truthfulness of a witness, evidence that any witness has been convicted of a crime shall be admitted regardless of the punishment, if it readily can be determined that establishing the elements of the crime required proof or admission of an act of dishonesty or false statement by the witness.” Fed. R. Evid. 609(a)(2).

NAIC Guidelines noted that both Fed. R. Evid 609 and the FDI Act “are concerned with crimes that bear on a person’s credibility.” NAIC Guidelines 22. The Notes of Advisory Committee on 1990 amendment of Rule 609 [hereinafter “Advisory Committee Notes 1990”] note the words “dishonesty or false statement” were not explained in the original Advisory Committee Note accompanying 609, despite being used in the notes. Fed.R.Evid. – Notes to

Rule 609 (LII 2007 ed.), Advisory Committee Notes 1990, available at <http://www.law.cornell.edu/rules/fre/ACRule609.htm>. The notes explain Congress “extensively debated the rule” and the Report of the House and Senate Conference Committee stated the Conference meant the words “dishonesty or false statement” to mean “ ‘crimes such as perjury, subordination of perjury, false statement, criminal fraud, embezzlement, or false pretense, or any other offense in the nature of *crimen falsi*, commission of which involves some element of deceit, untruthfulness, or falsification bearing on the accused’s propensity to testify truthfully.’ ” Id., quoting Report of the House and Senate Conference Committee. The Advisory Committee concluded that no amendment was necessary and the Conference Report gave sufficient guidance to trial courts, even with the indication that some trial decisions took an unduly broad view of “dishonesty.” Id.

Although there is no reference to confirm Congress had the same intent when it included the terms “dishonesty” and “breach of trust” in 12 U.S.C. §1829 and 18 U.S.C. §1033 as it had when it used the terms “dishonesty” and “false statements” in Fed. R. Evid. 609, NAIC Guidelines focused on the similarities: “If a person has been convicted of a crime involving an element of deceit, there exists substantial reason to question that person’s tendency to testify truthfully, and to direct the affairs of a bank honestly.” NAIC Guidelines 22.

#### *Gramm-Leach-Bliley Act*

The Gramm-Leach-Bliley Act (“GLB Act”), also called the Financial Services Modernization Act of 1999, repealed the Glass-Steagall Act of 1933, which had prohibited the consolidation of banks, securities firms, and insurance companies. As the services provided by banks, securities firms, and insurance companies have converged, there has also been an increased commonality among the regulators of those industries. FBI testimony.

GLB Act recognized the need for regulatory coordination between the industries. Id. With the crossover between financial and insurance services, the need arose for consultation between all impacted regulators: GLB Act “highlighted the importance of consultation and information sharing among federal financial regulators and state insurance regulators.” Id. As a result of GLB Act, there has been a migration of “undesirable persons,” Id., such as those convicted of felonies involving dishonesty or breach of trust, among the now more open channels between the financial industry and insurance industry.

### California Title 10

Unlike the federal statutes, California regulations define the terms “dishonesty” and “breach of trust” as they pertain to the business of insurance and 18 U.S.C. §1033. California’s definitions, therefore must also provide guidance when federally prosecuting 18 U.S.C. §1033(e) cases in the state of California.

Under CAL. CODE REGS Title 10, §2175.2(f), dishonesty “refers to a crime or offense which includes, but is not limited to, any offense constituting or involving perjury, bribery, forgery, counterfeiting, false or misleading oral or written statements, deception, fraud, schemes or artifices to deceive or defraud, material misrepresentations and the failure to disclose material facts.”

Under CAL. CODE REGS Title 10, §2175.2(c), “Breach of Trust” refers to:

“certain crimes or offenses, including, but not limited to, any offense constituting or involving misuse, misapplication or misappropriation of (1) anything of value held as a fiduciary (including, but not limited to, a trustee, administrator, executor, conservator, receiver, guardian, agent, employee, partner, officer, director or public servant) or (2) anything of value of any public, private or charitable entity. CAL. CODE REGS Title 10, §2175.2(c).

### Conclusion

Because the states regulate the insurance industry and were tasked with implementing rules and regulations to address the requirements of 18 U.S.C. §1033, the states' evaluation of what are and are not crimes of "dishonesty" and "breach of trust," as well as the state's definitions, should be examined in any analysis for federal prosecution of a 18 U.S.C. §1033(e) case. Title 18 U.S.C. §1033(e)'s similarity to 12 U.S.C. §1829 and the convergence of the financial and insurance industries indicate FDIC's definitions and procedures must also be given serious consideration. Not only is the language of the two statutes very similar, the legislative intent of coordinating regulation of the financial industry and insurance industry implies that using the same definitions for these terms was intended by Congress.

V. Key Element: Qualifying Felonies: The federal government need not consider a reduction of a conviction of a felony to a misdemeanor under the California "wobbler" practice once the individual has been sentenced under felony provisions.

California's practice of reducing some felonies to misdemeanors will not impact an 18 U.S.C. §1033(e) prosecution as long as the qualifying violation was charged as a felony and the sentence imposed was that of a felony sentence. California's penal code provides for certain violations to be treated as either a felony or misdemeanor and allows for a felony conviction under one of these qualifying statutes to be reduced to a misdemeanor. CAL PENAL Code §17(b). These violations are commonly called "wobblers" because they can be charged either as a misdemeanor or a felony and, if charged as a felony, can still later be reduced to a misdemeanor or expunged, post-conviction.

#### California wobblers generally

For a felony to be a wobbler, it must provide for a sentence of time in either county jail or state prison. Alternatively, the felony may be reduced to misdemeanor when it is punishable by state prison OR a fine, with no alternative sentence for time in county jail. A felony is not a

wobbler when it is punishable only by time in state prison. CAL CRIM. PROC. AND PRACTICE §8.40. A court may reduce a felony to misdemeanor on its own motion or on that of defense counsel. *Id.* When considering whether to reduce a felony to misdemeanor, the court looks to sentencing factors. If the court decides to reduce, the charge is then treated as a misdemeanor for all purposes except one: It retains the felony statute of limitations. *Id.*

*Applicability of case law for 8 U.S.C. §1227(a)(2)(A)(i) to 18 U.S.C. §1033(e)*

As there are state violations, such as grand theft (CAL PEN. CODE §487(c)), that may be qualifying felonies under 18 U.S.C. §1033(e) but are wobblers under California, how these violations are charged and sentenced may impact the enforcement of 18 U.S.C. §1033(e). Title 18 U.S.C. §1033(e) does not address state wobbler felonies. Nor does there appear to be federal case law specifically addressing 18 U.S.C. §1033(e) and state wobblers. However, federal cases have addressed state wobblers in federal immigration law. Federal courts have determined that, for purposes of 8 U.S.C. §1227(a)(2)(A)(i), the reduction or expungement of an individual's state felony conviction and sentence is not a factor in federal law. Title 8 U.S.C. §1227(a)(2)(A)(i) mandates an alien convicted of and sentenced for a crime involving moral turpitude, punishable by a year or more, committed within five years after the date of admission to be removable from the United States. 8 U.S.C. §1227(a)(2)(A)(i).

Title 8 U.S.C. §1227(a)(2)(A)(i) only applies to crimes of moral turpitude that are punishable by more than one year imprisonment. Therefore, misdemeanors do not qualify. Numerous individuals potentially subject to 8 U.S.C. §1227(a)(2)(A)(i) have argued this "petty offense exception" to 8 U.S.C. §1227(a)(2)(A)(i): That their conviction and/or sentence does not meet this requirement so 8 U.S.C. §1227(a)(2)(A)(i) therefore does not apply to them, making them unremovable under that statute. Case law has helped to define when an 8 U.S.C.

§1227(a)(2)(A)(i) petty offense exception exists. Some of the reasoning in these cases can be applied to understanding when a wobbler conviction will qualify as a felony for purposes of 18 U.S.C. §1033.

Although obviously different in significant aspects, 8 U.S.C. §1227(a)(2)(A)(i) is like 18 U.S.C. §1033(e) in that it seeks to bar individuals convicted of felonies involving dishonesty and breach of trust from a particular realm (8 U.S.C. §1227(a)(2)(A)(i) qualifying felonies of “moral turpitude” encompass more types of crime than 18 U.S.C. §1033(e)). For the purposes of 8 U.S.C. §1227(a)(2)(A)(i), the realm is the physical realm of the United States and in 18 U.S.C. §1033(e), it is the realm of the insurance industry. The two statutes are also similar in that their elements require a qualifying felony conviction and allow for exceptions under appropriate circumstances (18 U.S.C. §1033(e) allows for written waivers granted by state insurance commissioners, and 8 U.S.C. §1227(a)(2)(A)(i) exempts misdemeanor convictions of crimes of moral turpitude, such as petty theft, thus allowing for a wobbler conviction that was sentenced as a misdemeanor to qualify for an exception).

*Case law for wobblers in 8 U.S.C. §1227(a)(2)(A)(i) cases is relevant for application in 18 U.S.C. §1033(e) cases*

The Ninth Circuit has acknowledged that, under California law, “where the offense is alternatively a felony or misdemeanor, it is regarded as a felony for every purpose until judgment.” *United States v. Robinson*, 967 F.2d 287 (1992), referencing *People v. Banks*, 53 Cal. 2d 370, 387 (1959). However, the Ninth Circuit has ruled this presumption does not apply to uncharged conduct. *United States v. Denton*, 611 F.3d 646, 652 (2010).

Grand theft is considered a crime of moral turpitude under 8 U.S.C. §1227(a)(2)(A)(i). *United States v. Garcia-Lopez*, 334 F.3d 840 (9th Cir. 2003), quoting *Rashtabadi v. INS*, 23 F.3d

1562, 1568 (9th Cir. 1994). In *Garcia-Lopez*, the court determined the state court's declaration that Garcia-Lopez's grand theft guilty plea conviction was a misdemeanor was binding on Garcia-Lopez's subsequent immigration proceedings. *Garcia-Lopez*, 334 F.3d at 842. This was because Garcia-Lopez was never sentenced to imprisonment in state prison for his grand theft conviction. Instead, he was sentenced to time in county jail and probation.

The court distinguished *Garcia-Lopez* from *United States v. Robinson*, which held a suspended sentence on a wobbler was to be treated as a felony for purposes of the Federal Sentencing Guidelines when there was no subsequent action by the state court to designate the offense as a misdemeanor, *Robinson*, 967 F.2d at 293, noting the state court in *Robinson* never determined the wobbler in question was a misdemeanor. A state court expungement of a conviction was qualitatively different from an order to classify an offense or modify a sentence. *Id.* at 846. Therefore, because Garcia-Lopez's penalty did not exceed imprisonment for one year and he received an actual sentence of less than six months, the federal court accepted the state court's determination of Garcia-Lopez's grand theft violation as a misdemeanor for purposes of 8 U.S.C. §1227(a)(2)(A)(i). *Id.*

The Ninth Circuit again recognized grand theft as a crime of moral turpitude in 2005 in *Salazar v. Gonzales*, 156 Fed Appx. 897 (9th Cir. 2005). In *Salazar*, another 8 U.S.C. §1227(a)(2)(A)(i) case, Salazar pled guilty to grand theft, his sentence of up to three years in state prison was suspended and he was granted five years of probation. The court held that, because Salazar could have been imprisoned for more than one year for his conviction, he was not eligible to classify his wobbler felony as a misdemeanor. *Salazar*, 156 Fed Appx. at 899. The court explained this was because, as it stated in *Robinson*, "a suspended sentence on a wobbler is treated as a felony for purposes of the Sentencing Guidelines when there is no

subsequent action by the sentencing court to designate the offense as a misdemeanor.” *Ibid* at 899, referencing *Robinson*, 967 F.2d at 293).

*Courts have previously applied decisions about wobblers in 8 U.S.C. §1227(a)(2)(A)(i) cases to federal cases when there was no federal precedent.*

When federal statutes and case law are silent but federal case law involving state statutes can provide guidance, the court may look to those decisions, as it did in *Mendez-Mendez v. Mukasey*, 525 F.3d 828 (9th Cir. 2008). In *Mendez-Mendez*, the court determined that, for purposes of 8 U.S.C. §1227(a)(2)(A)(i), qualifying federal violations do not meet the exception for 8 U.S.C. §1227(a)(2)(A)(i) when the maximum penalty recommended by federal sentencing guidelines is less than one year imprisonment but the maximum statutory penalty is over one year. *Mendez-Mendez v. Mukasey*, 525 F.3d 828 (9th Cir. 2008). *Mendez-Mendez* relied upon *Garcia-Lopez* and other cases addressing the state wobbler issue as there had not yet been case law regarding this issue for federal violations and the federal sentencing guidelines as they applied to the 8 U.S.C. §1227(a)(2)(A)(i) petty offense exception. *Id.* at 834.

### *Conclusion*

Federal decisions regarding how wobblers impact federal law are applicable to 18 U.S.C. §1033. The key for federal courts in determining whether a wobbler conviction has been classified as a felony or misdemeanor for purposes of application of federal law, is to examine the sentence imposed by the state court rather than the actual serving of the sentence. Neither probation, the violation of which would result in serving more than one year in state prison, nor a suspended sentence of more than one year, convert a felony conviction and sentence to that of misdemeanor.

Hence, when determining whether an individual's past criminal felony conviction qualifies as a felony triggering the 18 U.S.C. §1033(e) prohibition on employment in the business of insurance, it will be determined by the state sentence imposed for the conviction. A later reduction or expungement by the state does not change the qualifying felony status for purposes of 18 U.S.C. §1033(e). In the case of a qualifying federal felony, the status of the conviction as a felony will be determined by the statutory maximum sentence being over one year imprisonment, not whether the federal sentencing guidelines recommend a maximum of over one year imprisonment.

V. Key Element: "Willfully": Although not specified by 18 U.S.C. §1033(e), to successfully prosecute a case in federal court, the government must show the defendant had knowledge of the qualifying felony but need not show specific knowledge of the statute.

There has been debate over whether the term "willfully" in 18 U.S.C. §1033(e)(1)(A) and §1033(e)(1)(B) means the individuals subject to the statute (in 18 U.S.C. §1033(e)(1)(A), the individual with the qualifying felony and in 18 U.S.C. §1033(e)(1)(B), the employer) must be aware of the qualifying felony in order to have the requisite intent, or whether the individual must also have specific knowledge of the existence of 18 U.S.C. §1033(e). An examination of the language of the statute, definitions in model jury instructions, the legislative intent, and the case law clearly indicate a defendant need not be specifically aware of the existence of the statute 18 U.S.C. §§1033(e)(1)(A) or (B) to be "willfully" in violation of the statute. What is less clear is whether the defendant must have knowledge of the felony, and that the felony involved dishonesty or breach of trust, to meet the requirement of willfully engaging the convicted felon in the business of insurance.

Language of the statute

Title 18 U.S.C. §1033(e) does not state that a defendant be specifically aware of the existence of the statute. However, it does state the individual with the qualifying felony must *willfully* be engaged in the business of insurance; or that the employer must *willfully* permit the person with the qualifying felony to participate in the business of insurance (italics added). 18 U.S.C. §§1033(e)(1)(A) and (B), respectively. The section does not define “willfully.” Black’s Law Dictionary defines “willfulness” as, “The fact or quality of acting purposely or by design.” It also gives a second definition that could indicate a specific knowledge requirement: “The voluntary, intentional violation or disregard of a known legal duty.” *Black’s Law Dictionary* 779-780, (Bryan a. Garner ed., Thompson West 2006) (1996). Therefore, the language of the statute and language of the dictionary are inconclusive in and of themselves.

*Model Jury Instructions state a Defendant need not have specific knowledge of the existence of 18 U.S.C. §1033(e) unless the statute actually states such a requirement.*

The *Ninth Circuit Manual of Model Jury Instructions – Criminal*, the recommendation is that no instruction defining “willfully” be given to a jury unless the word is in the statute defining the offense being tried. MODEL CRIM. JURY INSTR. 9TH CIR. §5.5 (2003). It also notes the Ninth Circuit’s position is that “willfulness requires that an act be done knowingly and intentionally, not through ignorance, mistake or accident.” *Id.*, quoting *United States v. Morales*, 108 F.3d 1031, 1036 (9th Cir. 1997), citing MANUAL OF MODEL CRIM. JURY INSTR. 9TH CIR. §5.05 (1995). This is differentiated from the Ninth Circuit’s requirement for prosecuting false statements on corporate tax returns: “An act is done willfully if done voluntarily and intentionally with the purpose of violating a known legal duty.” *Id.*, quoting *United States v. Sehnal*, 930 F.2d 1420, 1427 (9th Cir 1991). Thus, the Ninth Circuit’s jury instructions as applied to 18 U.S.C. §1033(e) would be the definition of *Morales* rather than the definition of

*Sehnal* (*Sehnal* requires the intent of violating a known legal duty and is closer to the second definition in *Black's Law Dictionary*).

As “willfully” is in the statute, we must examine whether the act was “done knowingly and intentionally, not through ignorance, mistake or accident.” The Ninth Circuit model jury instructions explain that an act is done “knowingly” if: “the defendant is aware of the act and does not [act] [fail to act] through ignorance, mistake, or accident. [The government is not required to prove that the defendant knew that [his][her] acts or omissions were unlawful.] You may consider evidence of the defendant’s words, acts, or omissions, along with all the other evidence, in deciding whether the defendant acted knowingly.” *Id.* at §5.6. The comment to this section notes the second sentence of the instruction is not to be given when an element of the offense actually does require the government prove the defendant knew what he or she did was unlawful. *Id.* Therefore, as applied to 18 U.S.C. §1033(e), the jury instructions do not require the government prove knowledge of the statute itself.

*Legislative intent supports a willfulness requirement but not specific knowledge of the statute*

Title 18 U.S.C. §1033(e) was enacted as part of the largest federal crime fighting legislation at that time. Fact Sheet, U.S. Department of Justice, Violent Crime Control and Law Enforcement Act of 1994, available at [www.ncjrs.gov/txtfiles/billfs.txt](http://www.ncjrs.gov/txtfiles/billfs.txt). Among many other aspects of its expansions of white collar crime enforcement, the Act created new insurance fraud categories, embodied in 18 U.S.C. §1033. As a result of concerns raised by the savings and loan scandal and insurance company failures, the Act was part of Congress’ attempt to address the lack of enforcement of the insurance industry. FBI testimony.

Congress conducted a five-year investigation on the insurance industry, which included oversight hearings before the Energy and Commerce Committee's Subcommittee on Oversight and Investigations. In 1990, the subcommittee issued its report, "Failed Promises," which indicated insurance regulation enforcement was one of the weakest links in the insurance regulatory system. *Id.* The report examined the failure of four major insurance companies, concluding state remedies were ineffective against the fraudulent activity that caused the companies to fail, and that there was a need for federal criminal legislation to address the serious problem of insurance fraud. *Id.* Congress enacted 18 U.S.C. §§1033 and 1034 with the intent to help insurance regulators stop insurance fraud. *Id.*

Congress' goal was to stop fraudulent activity by insiders in the insurance business and it gave a broad definition to "business of insurance" and included within that definition a wide range of individuals ("officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons"). 18 U.S.C. §1033(f)(1). The NAIC issued its guidelines for state insurance regulators for 18 U.S.C. §1033 and §1034 in 1998. Upon the examination of the wording of the statute, the NAIC determined "willfulness" should apply to the "actual knowledge of the insurer and the affirmative action taken by that insurer to determine whether the individual is a prohibited person." Norman Tolle and Gus Sellitto, *Insurers Face Compliance Issues Under Crime Control Law*, 221 NYLJ 113, col. 1 (1999), quoting NAIC Guidelines for State Regulators to the Violent Crime Control and Law Enforcement Act of 1994, adopted 1998, at 26.

Given Congress' intent to combat an expansive array of crime, including financial and insurance fraud, the timing of the Act (after the savings and loan scandal, the insolvency of several large insurance companies, and the congressional investigation and hearings into

insurance fraud), and the exclusion of an express requirement of knowledge of the statute, it is clear the Congress did not intend to require specific knowledge of 18 U.S.C. §1033.

*The term “willfully” may apply to each subsequently listed element of the crime.*

Recently, the U.S. Supreme Court held that “knowing” must apply to each subsequently listed element of the crime. *Flores-Figueroa v. United States*, 129 S. Ct. 1886 (2009). The issue in that case was the construction of the federal statute for aggravated identity theft, 18 U.S.C. §1028A(a)(1). The Court resolved a split in the circuits by holding that particular statute required proof the defendant knew the means of identification he unlawfully transferred, possessed, or used belonged to another person because, the Court said, “knowingly” must apply to all of the subsequently listed elements of the crime.

The *Flores-Figueroa* ruling has already been distinguished in several cases and it could be argued that, for purposes of 18 U.S.C. §1033(e), “willfully” would not apply to each additional element in the statute, especially as the violation is not classified as an aggravated crime. However, even following *Flores-Figueroa*, to apply “willfully” to subsequent elements in 18 U.S.C. §1033(e) would indicate the defendant did not have to know about the qualifying felony, as that element comes before the term “willfully” in both 18 U.S.C. §1033(e)(1)(A) and §1033(e)(1)(B). As will be discussed below, in addition to NAIC guidelines, case law requires the defendant be aware of the qualifying felony (although, under certain circumstances, a willfully ignorant defendant may also meet the requirement of knowledge of the felony. MODEL CRIM JURY INSTR. 9TH CIR. §5.7 (2003) and *United States v. Ferrarini*, 219 F.3d 145 (2nd Cir. 2000).).

*Case law*

In *United States v. Peterson*, Peterson argued his indictment with 18 U.S.C. §1033(e)(1)(A) should be dismissed on the grounds the statute was unconstitutionally vague. Alternatively, Peterson argued the government must prove he had actual knowledge of the prohibition in the statute and that he had specific intent to violate the statute when he engaged in the “business of insurance.” *United States v. Peterson*, 357 F.Supp.2d 748, 754 (SD NY 2005). Peterson had held himself out to be an insurance broker after his license to engage in the insurance practice was revoked in 1999 and after he was convicted of bankruptcy fraud, a felony involving dishonesty or breach of trust, in 2001. *Peterson*, 357 F.Supp.2d at 750. The court applied the rule that a criminal statute is void for vagueness and violates due process if it does not “give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he [or she] may act accordingly.” *Peterson*, quoting *Grayned v. City of Rockford*, 408 U.S. 104, 92 (1972). Acknowledging that a statute of an offense was not required to define an offense with “mathematical certainty,” *Peterson*, 357 F.Supp.2d at 753, quoting *Grayned*, 408 U.S. at 110, the *Peterson* court stated “a court must resort to ‘every reasonable construction’ to save a statute from unconstitutionality.” *Peterson*, 357 F.Supp.2d at 753, quoting *United States v. Chestaro*, 197 F.3d at 605 (quoting *Chapman v. United States*, 500 U.S. 453, 464 (1991)).

The *Peterson* court applied the rule that, “where First Amendment rights are not implicated, a statute is “assessed for vagueness only ‘as applied,’ i.e., ‘in light of the specific facts of the case at hand and not with regard to the statute’s facial validity.’” *Peterson*, 357 F.Supp.2d at 753, quoting *United States v. Rybicki*, 354 F.3d 124, 129 (2d Cir. 2003) (quoting *United States v. Nadi*, 996 F.2d 548, 550 (2d Cir. 1993)). Here, the court said even if the statute’s definition of “business of insurance” was vague as to “employees,” the statute must be

assessed for vagueness “as applied” to Peterson. As applied to Peterson, who held himself out to be an insurance broker and collected insurance premiums, the term was not vague. *Peterson*, 357 F.Supp.2d at 753 - 754. Peterson should have reasonably known that his conduct constituted engaging in the “business of insurance” as defined in 18 U.S.C. §1033(f)(1). *Id.* at 754. The court concluded that, quoting Judge Learned Hand, “willful” here “means no more than that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.” *Id.*

The U.S. District Court denied Peterson’s motion, ruling the government was not required to prove Peterson’s specific intent to violate the statute in order for Peterson to be convicted of willfully engaging in the business of insurance after his felony conviction involving dishonesty or breach of trust. *Id.* The court held the government need only prove Peterson acted knowingly and purposefully in engaging in the insurance business after his conviction. *Id.* at 754. The court examined the language of the statute and concluded “on its face the statute does not require the specific intent that Peterson suggests.” *Id.*

Even more recently, in *United States v. Kernan*, the U.S. District Court, Northern District of New York, held that “willfully” describes the term “permit” in 18 U.S.C. §1033(e)(1)(B), thereby indicating the person “must ‘knowingly’ or ‘actively’ permit one who has been convicted of a felony involving dishonesty or a breach of trust to participate in the business of insurance.” *United States v. Kernan*, 2009 WL 606146 (ND NY, 2009). Kernan filed a motion with the court to dismiss the one count of 18 U.S.C. §1033(e)(1)(A) in a superseding indictment for being unconstitutionally vague as applied to her. Kernan was the president of a company that served as an agency on behalf of an insurance company owned by her husband. Kernan and her husband employed Robert Anderson, who had previously been convicted three times of felonies

involving dishonesty or breach of trust (bank fraud and bankruptcy fraud in 1988, grand theft in 1988, and conspiracy and mail fraud in 1996). Both Kernan and her husband were aware of Anderson's felony convictions and they compensated Anderson for his services by paying Anderson's wife, who did not provide any goods or services to them.

In addressing the issue of vagueness, the court relied upon *Humanitarian Law Project v. Mukasey*, stating that, "although 'due process does not 'require "impossible standards" of clarity'" when criminal sanctions are at issue, "the statute 'must be sufficiently clear so as to allow persons of ordinary intelligence a reasonable opportunity to know what is prohibited.'" *Kernan*, quoting *Humanitarian Law Project v. Mukasey*, 509 F.3d 1122, 1133 (9th Cir. 2007). Again, the court acknowledged that when a statute did not involve a First Amendment issue, a court is to examine it for vagueness in light of the facts of the particular case. *Kernan*, citing *Arriaga v. Mukasey*, 521 F.3d 219, 223 (2d Cir. 2008).

In examining 18 U.S.C. §1033(e)(1)(B) for vagueness, the court applied a two-part test: "(1) does the statute provide sufficient notice and (2) does the statute provide limits on the discretion of law enforcement authorities." *Kernan*, citing *Arriaga*, 521 F.3d at 224. The court noted that, because the statute is judged on the basis of the facts of each case, " . . . one whose conduct is clearly proscribed by the statute cannot successfully challenge it for vagueness.'" *Kernan*, quoting *United States v. Nadi*, 996 F.2d 548, 550 (2d Cir. 1993). The court examined the facts of the case and concluded that Kernan's argument that 18 U.S.C. §1033(e)(1)(B) was vague as applied to her was without merit. *Kernan* at 3. The court addressed Kernan's argument that the term "permit" in 18 U.S.C. §1033(e)(1)(B) could be construed as either "active" or "passive" and a reasonable person could not know what behavior was prohibited by the statute. *Id.* The court concluded that "willfully" describes the term "permit" in 18 U.S.C.

§1033(e)(1)(B), thereby indicating the person “must ‘knowingly’ or ‘actively’ permit one who has been convicted of a felony involving dishonesty or a breach of trust to participate in the business of insurance.” The court held 18 U.S.C. §1033(e)(1)(B) was not unconstitutionally vague as applied to Kernan because she met all elements of the crime by being engaged in the business of insurance, which affects interstate commerce, and she willfully permitted Anderson, an individual with the qualifying felony conviction, to participate in that business. *Id.*

The *Kernan* court did not expressly include knowledge of the nature of the employee’s felony conviction(s) as a requirement in its ruling that “willfully” describes the term “permit” in 18 U.S.C. §1033(e)(1)(B). However, the facts stated Kernan knew of Anderson’s felony convictions and took action to disguise payments to him (by paying his wife), and the court articulated Kernan met the element of willfully permitting an individual with a qualifying felony conviction to participate in the insurance business. Therefore, it is reasonable to imply the *Kernan*’s ruling regarding “willfully” permitting a qualifying individual includes the person who is willfully employing the individual knows about the qualifying felonies.

*California requires insurers and employers to identify prohibited persons*

As previously discussed, California makes it the responsibility of the insurers and any other employer engaging in the business of insurance to “actively seek to determine” whether their employees are “prohibited persons” for purposes of 18 U.S.C. §1033(e) and whether the employees are in violation by participating in the business of insurance. CAL. CODE REGS. Title 10, §2175.5(a). As the requirement is to “actively seek” to determine status as prohibited person, not confirm the status absolutely, an employer who makes a reasonable good faith effort to to determine an applicant or employee’s status (criminal history questions and 18 U.S.C. §1033(e) disclosure on job applications and interviews, submitting fingerprint impressions, internet

searches, contracting with legal records checking businesses, etc.) but still does not discover a qualifying felony would not be in violation of California regulation or 18 U.S.C. §1033(e).

An employer who actively sought and *did* determine an employee had a qualifying felony and continued to employ the person would be in violation of 18 U.S.C. §1033(e) for willfully employing a prohibited person.

### Conclusion

As 18 U.S.C. §1033(e) does not define “willfully,” or expressly list specific intent as an element, a reading of the statute on its face clearly indicates no specific intent or knowledge of 18 U.S.C. §1033(e) is required. Legislative intent shows a desire to cast a wide net to reign in fraud in the insurance industry and the exclusion of an expressly required specific intent indicates Congress meant for the statute to require general knowledge of the qualifying felony, rather than specific knowledge of the statute. The NAIC’s evaluation of the statute and its use of “willfulness” also do not indicate a need for actual knowledge of the 18 U.S.C. §1033(e). Rather, NAIC applies willfulness to the knowledge of whether the individual had a felony involving dishonesty or breach of trust. Additionally, the wording of the Ninth Circuit’s model jury instructions for criminal cases does not support instructing a jury that “willfully” includes intentionally violating a known legal duty for application to 18 U.S.C. §1033(e).

The federal courts provide guidance with their rulings in *Peterson* and *Kernan*: For 18 U.S.C. §1033(e)(1)(A), *Peterson* held the government was not required to prove the qualifying individual’s specific intent to violate the statute in order for the individual to be convicted of willfully engaging in the business of insurance after his felony conviction involving dishonesty or breach of trust. The government need only prove the individual acted knowingly and purposefully in engaging in the insurance business after the qualifying conviction. *Peterson*, 357

F.Supp.2d at 754. Presumably, of course, an individual would be aware of his or her own conviction and the nature of that conviction (whether it involved dishonesty or breach of trust).

For 18 U.S.C. §1033(e)(1)(B), *Kernan* held that the statute was not unconstitutionally vague as applied to Kernan and that “willfully” pertained to “permitting” an individual with the qualifying felony to participate in the business of insurance. Kernan knew of Anderson’s qualifying felonies and still employed him. The *Kernan* court took into consideration the 9th Circuit’s ruling that due process requires the statute to clearly delineate the conduct it proscribes. *Kernan* at 2, quoting *Humanitarian Law Project*, 509 F.3d at 1133.

In the state of California, employers engaging in the business of insurance are required by state law to “actively seek to determine” whether their employees have felonies involving dishonesty or breach of trust and, if the employee does have such a felony, that the employee is not participating in the business of insurance.

From the foregoing, it is clear 18 U.S.C. §1033 is not unconstitutionally vague and there is no requirement that someone subject to either 18 U.S.C. §1033(e)(1)(A) or §1033(e)(1)(B) must know of the existence of the statute. What is required, however, to fulfill the elements of the crime is that the individual be aware of the felony conviction and that the nature of the felony involved dishonesty or breach of trust. With that awareness and the person’s continued participation in, or the employer’s permitting of the continued participation in the business of insurance, the knowledge requirement is met.

## VI. Conclusion

Some of the key factors that may arise in prosecuting an 18 U.S.C. §1033(e) case include:

*Federal Jurisdiction: Interstate Commerce:* The business of insurance affects interstate commerce and may also be a channel from which interstate commerce flows. Therefore, the federal government may prosecute 18 U.S.C. §1033(e).

*What Constitutes the “Business of Insurance”:* “Business of insurance” encompasses all activities necessary or incidental to the writing of insurance or the reinsuring of risks by the insurer and/or the insurer’s officer, directors, agents, employees, or others authorized to act on behalf of those persons. Activities of these individuals would include those authorized by the insurer on the insurer’s behalf, such as managing employees, collecting monies owed the insurer for the insurance the insurer provided, representing the insurer in legal and administrative proceedings, and serving the insurer in a role that bestows fiduciary duties to that person. A federal prosecutor does not have discretion in determining what may or may not be designated as the business of insurance, nor who does or does not qualify as a prohibited person. Rather, these are determined by examining whether the facts of each case meet the elements of 18 U.S.C. §1033(e).

*Determining whether a felony conviction qualifies to trigger a violation:* Because the federal government left to the states the task of establishing what are and are not crimes of “dishonesty” and “breach of trust,” the state’s definitions should be given consideration in any analysis for federal prosecution of a 18 U.S.C. §1033(e) case. The FDIC’s definitions of “dishonesty” and “breach of trust” also provide relevant guidance applicable to 18 U.S.C. §1033(e). FDIC procedures of reviewing the elements of the crime for the felony under review may also be applied when determining whether a felony triggers an 18 U.S.C. §1033(e) violation.

It should be remembered that California wobblers may impact whether a felony qualifies under 18 U.S.C. §1033(e). Immigration case law provides helpful guidance on this topic: The government need not consider a reduction of a conviction of a felony to misdemeanor once the individual has been sentenced under felony provisions.

*What is necessary to show “willfulness”*: The government must show the defendant had knowledge of the felony involving dishonesty or breach of trust but need not show knowledge of 18 U.S.C. §1033(e) itself.

Congress’ intent for 18 U.S.C. §1033, including §1033(e), was to bolster and expand the government’s law enforcement authority over the insurance industry. Although some of the terms in the statute were not specifically defined, or were given definitions that encompassed a wide span of activity and individuals, the examination of legislative intent, similar federal laws in the financial industry, state definitions and regulations, and case law all indicate 18 U.S.C. §1033 does not have a specific intent requirement. Additionally, the Ninth Circuit Jury Instructions state specific intent is not necessary in criminal cases unless the statute expressly requires it. Finally, the convergence of the insurance and financial fields and the similarities between 18 U.S.C. §1033 and 12 U.S.C. §1829 support the legislative intent of uniform enforcement of these two statutes to protect the public from white collar criminals who will otherwise migrate within these merging industries.

## LIST OF AUTHORITIES

### Statutes, codes, and rules

8 U.S.C. §1227(a)(2)(A)(i)

12 U.S.C. §1829

15 U.S.C. §1011 et seq

15 U.S.C. §6701(a)

18 U.S.C. §1033

CAL. CODE REGS Title 10, §§2175-2177 (2003)

CAL CRIM. PROC. AND PRACTICE §8.40

CAL. INS. CODE §1732

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*Flores-Figueroa v. United States*, 129 S. Ct. 1886 (2009)

*Mendez-Mendez v. Mukasey*, 525 F.3d 828 (9th Cir. 2008)

*Salazar v. Gonzales*, 156 Fed Appx. 897 (9th Cir. 2005)

*Turner v. United States*, 537 U.S. 1077 (2002)

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*United States v. Garcia-Lopez*, 334 F.3d 840 (9th Cir. 2003)

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*United States v. Peterson*, 357 F.Supp.2d 748, 754 (SD NY 2005)

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*United States v. Segal and Near North Insurance Brokerage*, 2004 U.S. Dist. LEXIS 25355 (ND Illinois, 2004)

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Fact Sheet, U.S. Department of Justice, Violent Crime Control and Law Enforcement Act of 1994

*FBI’s Perspective on Criminal History Record Information Checks on Individuals Conducting Insurance Business: Testimony before the House Financial Services Committee* (2001)  
(testimony of Dennis Lormel, Section Chief, Financial Crimes Section, FBI)

National Association of Insurance Commissioners, *Revision of Guidelines for State Insurance Regulators to the Violent Crime Control and Law Enforcement Act of 1994* (05/18/2010)

Norman Tolle and Gus Sellitto, *Insurers Face Compliance Issues Under Crime Control Law*, 221 NYLJ 113, col. 1 (1999)

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