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Schemes, Scams and Swindles: Legal Challenges During the COVID Crisis

Fake cures and tests seem to be flooding social media these days and thus it will be interesting to see how many hit the radar of the authorities.

By Julia Mezhinsky Jayne and Bruce Gerstman

Bruce Gerstman and Julia Mezhinsky Jayne.

Keith Middlebrook promised investors he was developing a cure to the coronavirus, and he claimed it was coming soon.

He created a phony company, Quantum Prevention CV, Inc., offered shares, and told potential investors that basketball legend Magic Johnson was involved, prosecutors alleged in a March 25 complaint filed in the Central District of California. He claimed that he already had a $10 billion offer from a company in Dubai and guaranteed that those making a $300,000 investment would get a return of $30 million. He also claimed that the company would be used to market pills that would prevent coronavirus infections, plus an injectable cure for those already suffering from COVID-19.

Middlebrook, an actor with recent small roles in the Marvel films "Iron Man 2," "Iron Man 3" and "Thor" used his modest celebrity status to encourage investment. He posted videos and other promotional materials on YouTube and Instagram, which purportedly claimed that he had already developed a COVID prevention pill and injectable cure.

In March, the FBI arrested him after an undercover agent, posing as an investor, arranged to meet him. He is charged with attempted wire fraud.

While Middlebrook's alleged crime is similar to traditional investor frauds, it provides a window into a new variety of charges we may see from now through at least the end of the year that take advantage of the COVID crisis. In the current environment of stay-at-home orders, unemployment and unpredictable personal health problems, it is not surprising to see an uptick in investigations and arrests pertaining to COVID-related fraud and scams. Law enforcement is keen to uncover the computer crimes, fraud schemes, investment scams, and fake treatment options. Since the start of the crisis, the U.S. Federal Trade Commission has reported more than 40,000 consumer complaints and nearly $30 million lost to COVID-related crimes.

Advertising and Selling Drugs as 'Cures'

Since the beginning of the COVID crisis, the Federal Trade Commission has warned 127 companies to stop advertising COVID cures. However, selling so-called "cures" can lead to more than a stern letter from the FTC.

Prosecutors alleged that Jennings Ryan Staley, a physician and operator of Skinny Beach Bed Spa in San Diego, California, advertised and sold a "magic bullet" that would cure COVID-19 "100%" and immunize people without COVID for at least six weeks. According to the complaint, Skinny Beach sent an email touting their COVID-19 "treatment packs," which contained the anti-malarial drug hydroxychloroquine, azithromycin, an antibiotic, and anti-anxiety medication "to help you avoid panic … and help you sleep." Promising customers, including an undercover FBI agent, a "concierge medical experience," Staley priced the packages at $3,995 for a family of four.

Last month, the DOJ charged Staley with mail fraud, alleging that he later shipped the undercover FBI agent "azithromycin tablets in a box; generic Xanax and Viagra in bottles; hydroxychloroquine in small brown envelopes; and chloroquine in small, clear plastic bags."

Fake cures and tests seem to be flooding social media these days and thus it will be interesting to see how many hit the radar of the authorities. The FBI began investigating Staley upon receiving a tip from the public and shortly thereafter introduced an undercover agent.

Price Gouging and Hoarding

Face masks and other personal protective equipment, or PPE, are in short supply these days. Perhaps that's why the man answering the phone didn't believe William Young when Young allegedly reached out regarding 40 million N95 masks that could be sold for double or triple the purchase price. The man, referred to as "Investor-1" in a recently unsealed complaint, was an FBI informant previously convicted of federal securities fraud.

According to a complaint filed in the Eastern District of New York, Young and his colleague Kent Bulloch searched for investors interested in buying 1 million KN95 respirator masks. They then told investors that the masks, priced at $3.80 per unit, could be sold for double or triple the purchase price. To hide the price gouging, Bulloch, a California-based attorney, allegedly created and sent a false escrow agreement to an undercover informant. The contract included wiring instructions for Bulloch's trust account.

The use of undercover informants in this context is in line with how federal law enforcement often investigates and develops cases. In this particular situation, the undercover Investor-1 was previously convicted of federal securities fraud and cooperated with the government. Similar tactics could be employed in a variety of upcoming price gouging cases.

Young and Bulloch are charged with conspiracy to violate the Defense Production Act. Executive Order 13909, issued in March 2020, criminalizes gathering scarce medical supplies in order to hoard or sell at an excessive price. The first reported prosecution of a violation of this law in the post-COVID world involved a man accused of hoarding several tons of PPE needed by first responders and health care workers. He allegedly sold it at his Long Island store at a huge mark-up. The Eastern District of New York complaint states that Amardeep Singh received more than 1.6 tons of face masks, 1.8 tons of hand sanitizer and shipments of surgical gowns weighing more than 2.2 tons. Prosecutors accuse him of selling face masks for $1 that were normally worth 7 cents. The violation of Hoarding of Designated Scarce Materials is found at 50 U.S. Code Section 4512 and is a misdemeanor.

Defrauding the Paycheck Protection Program

Two New England men were arrested this month after allegedly attempting to defraud the Small Business Administration's newly-created Paycheck Protection Program. PPP was created as part of the Coronavirus Aid, Relief, and Economic Security, or CARES, Act, and the program is intended to help small businesses weather the economic storm by providing these companies with low-interest loans.

Federal prosecutors allege that the two men, David Staveley and David Butziger, filed loan applications for people and businesses that didn't exist. Prosecutors charged the men with conspiracy to make false statements to influence the SBA and conspiracy to commit bank fraud. Additionally, Staveley is charged with aggravated identity theft, and Butziger is charged with bank fraud.

This is the first case brought under the PPP, and one can expect to see more prosecutions of this nature as banks begin to question applications and report potential abuses. The relatively quick turnaround on the relief aid and the pressure on banks to process applications opens up opportunities for fraudulent conduct. While Staveley's case appears to be somewhat straightforward in that he is alleged to have fabricated the existence of his businesses, other types of PPP fraud may be more nuanced. Expected concerns may be the outcome of SBA's auditing process for economic need, the eligibility of applicants, and the potential for False Statement prosecutions under Title 18, Section 1014 and Title 15, Section 645, which criminalizes making a false statement to the SBA in a loan application. With such charges, the government would have to overcome the hurdle of proving criminal intent.

While we expect to see a major uptick in allegations like those above, the COVID-related fraud offenses mostly play on traditional ones, which continue to rely on standard white collar criminal statutes, undercover law enforcement tactics, and assessments of financial loss.

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