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Honorable Arnold Schwarzenegger
State Capitol Building
Sacramento, CA 95814

RE: Proposed Reduction of Specified Felonies to Misdemeanors

Dear Governor Schwarzenegger:

It has come to my attention that there is under consideration a proposal to reduce certain felonies and crimes that may be charged as either felonies or misdemeanors (wobblers) to straight misdemeanors. While there are pressing needs for budgetary reduction, I harbor grave concerns regarding this proposal. By reclassifying certain felonies as misdemeanors to "save costs," these proposals engender severe and unintended consequences to public safety while merely transferring costs and burdens. These consequences pose such serious impacts to potential victims as well as the efforts of law enforcement to interdict and prosecute these crimes that I feel constrained to point out the full implications of the proposed reductions.

Many of proposed reductions involve crimes of fraud, conspiracy to defraud, the receipt and concealment of the proceeds of fraud, or the fastest growing crime of all, identity theft. (Penal Code §§ 182(a) (4), 470a, 470b, 473, 476, 483.5(f), 484i(c), 489, 496, 499c(c), 530.5, 535, 532a (4), 538.5, 549, 550, 551, 560) Since the essence of these crimes is concealment and deception, they are notoriously difficult to uncover and investigate. In addition, the conspiracy to commit them has been acknowledged by the courts as already more dangerous and more difficult to combat. (See *People v. Williams* (1980) 101 Cal App. 3rd 711, 721)

For these reasons, lawmakers and judges have recognized that these felonies require a longer statute of limitations to compensate for their stealth nature and the need for lengthy and thorough investigations. Reducing these crimes to a misdemeanor automatically reduces the applicable statute of limitations to one year from the date of the offense. This will now make it even more difficult, if not impossible, to effectively investigate and successfully prosecute these offenses. Compounding this is the fact that, with few exceptions, search warrants may only be issued for evidence of a felony (Penal Code § 1526). Law enforcement will be unable to get authorization from a magistrate to search a suspect's property and seize the elicited evidence. Search warrants are vitally needed and extensively used in the investigation of fraud cases. Reduction of these crimes to misdemeanors will virtually eliminate them as crimes.

The consequences of this will be unavoidable: In the case of large, complex fraud cases, given their size and scope, and with no ability to search for and seize evidence, there is simply no reasonable expectation that such crimes could be, discovered, investigated and prosecuted within a one year period. Conspiracies to commit fraud will be even more difficult as the defining characteristic of such crimes is secrecy itself.

Insurance Crimes

These conclusions are even more valid in the case of insurance frauds. (Penal Code §§ 530.5, 549, 550, 551, Insurance Code § 11880), which are ordinarily first investigated by the insurance companies themselves, prior to referral to law enforcement for investigation. This adds another step delaying the process. For no logical reason I can see, the Legislature is contemplating reducing Insurance Code § 11880 which converts premium frauds against the State Compensation Insurance Fund (SCIF) from a felony to a misdemeanor, while leaving premium fraud against private insurance companies a felony under Insurance Code § 11760. This is clearly unsound considering that SCIF underwrites all uninsurable businesses that apply (mandated by statute to do so) including those that can no longer get insurance from private carriers.

Mortgage Fraud

Another fraud crime that is ordinarily discovered long after they have been committed involves mortgage fraud and rent skimming schemes. These schemes involve the victimization of distressed homeowners facing potential foreclosures. Unscrupulous operators promise homeowners that they can save their homes and restore their credit if victims assign their mortgage obligation to them and pay them rent. They then promise to satisfy the mortgage holder and stop the foreclosure. Instead these schemers take the rent and do nothing. Homeowners are left worse off and end up losing their home and the “rent” money they paid out to the fraudulent operators. To add insult to injury, homeowners’ credit ratings are destroyed, crippling their future ability to recover from their financial distress. Penal Code § 506b making it a felony to misappropriate installment payments made pursuant to a real estate contract is a valuable tool in combating this crime. Its reduction to a misdemeanor will seriously impair law enforcement’s ability to stop the thieves who defraud distressed homeowners.

Automobile Thefts and Chop Shops

If the proposed reductions in Penal Code §§ 666, 666.5 and Vehicle Code §§ 4463, 10801, 10802, 10803, 10851 are carried out, California will see a huge proliferation of automobile theft rings and “chop shops” where stolen vehicles are torn apart and their parts removed and installed in other vehicles. These crimes, often as complicated and time consuming as major fraud cases, pose a continuing and substantial financial drain on California’s economy by directly causing higher insurance rates and repair and replacement costs on California’s citizens. The poorest will bear the heavier burden. These crimes are often engaged in by those with violent or felonious records. In addition, the proposed reduction of Penal Code §§ 666 and 666.5 means that many of these felons, including third strikers, would now escape prosecution.

Foreign Money Laundering

If California reduces Penal Code § 500(b) (2) to a misdemeanor, criminals participating in fraudulent schemes will be able to conceal or “launder” their ill gotten gains in foreign countries. Frequently, by the time victims learn that they’ve been defrauded their money has already been shipped out of the country. Reducing the penalty of this crime to a misdemeanor precludes the effective investigation and prosecution of these offenses foreclosing the potential recovery of the stolen funds.

Sales of Securities

If California reduces violations of Corporations Code § 25541 to a misdemeanor, it will effectively eliminate an important safety net to protect investors from swindlers. Complicated fraudulent schemes that escape early detection can wreak long term havoc on the market and the economy. Corporations Code § 25541 which makes it a felony to use fraud or deceit in the sale of any security has been an important and vital tool of law enforcement in attacking this scourge. Since the core of the offense is the investment made by victims in a swindlers’ scheme, once the fraud or deceit is established, each sale can be prosecuted no matter how old or complicated the scheme. Cases that would otherwise have been lost due to the passage of time or the expiring of the statute of limitations have been prosecuted under this section. Reducing it to a misdemeanor means that this “last ditch” tool would be eliminated.

This provision also allows law enforcement to prosecute those who employ complex fraudulent investment schemes where it is difficult or impossible to prove fraud at the scheme’s inception but where provable fraud manifests itself as the scheme later develops. In fact, many classic “Ponzi” schemes and real estate frauds start out as viable investments but develop into a fraud at some point after the victim makes his initial investment. There have been several multi-million dollar schemes in the mortgage and real estate industry which may only be addressed through the use of Corporations Code § 25541. If the Legislature reduces this section to a misdemeanor, this will result in criminals successfully swindling tens of millions of dollars from investors while facing no more than one year in jail. Such a result will have the effect of encouraging swindlers to take the risk of detection and prosecution of their fraud, reward those who engage in this crime, and significantly reduce the number of serious con artists prosecuted for their crimes. The incidence of these types of crimes can therefore be expected to significantly rise.

Tax Fraud

Fraudulent schemers avoid declaring their ill gotten gains in order to maintain the concealment of their fraudulent enterprise. Most criminals who commit fraud also cheat the State by filing false or fraudulent tax schemes. The falsification often amount to hundreds of thousands to millions of dollars. Taxation Code § 19706 makes it a felony to file a fraudulent tax return. Since detection of these crimes almost always takes longer than one year, reducing this crime to a misdemeanor effectively eliminates this as a crime. More false or fraudulent tax returns can be expected to be filed reducing the tax collected, in effect short circuiting the stated rationale for reducing the crime in the first place, saving state money.

Effect on Pending and Previous Adjudicated Cases

The constitutional provision against *ex post facto* laws prevents the imposition of greater punishments for crimes committed prior to the enactment of those greater punishments. The rule is exactly the opposite when punishments are reduced. Defendants whose cases are pending, have been convicted or are serving sentences are entitled to the benefits of the reduction in punishments. (*People v Nasalga* (1996) 12 Cal. 4th 784.) Not only must the sentences of those serving a prison term be commuted, but pending felony prosecutions may suddenly be extinguished. Since the statute of limitations for offenses reduced to misdemeanors is but one year, felony cases that took longer than one year to investigate and prosecute may be dismissed. This will literally fling open the prisons for already convicted felons and grant a “get out of jail free card” to those pending trial. In addition those serving prison sentences including three strikes sentences will be entitled to be released if the felonies upon which they were convicted are reduced to misdemeanors.

Even if this is not the immediate result, this reclassification would create substantial additional litigation on this point. Instead of focusing their energy and efforts to prosecute substantive offenses, prosecutors and the courts will now be diverted to re-hash and re-litigate whether or not the statute of limitations has run on offenses now reduced to misdemeanors. This will obviously negate the “cost saving” rationale of reclassifying these serious crimes.

The Harmful Effect of the Current Proposal on Some Examples of Pending and Adjudicated Cases

The potential real world effect of this proposal can be seen by noting just a few examples of pending major fraud prosecutions Orange County.

1. *People v. Michael Petronella and Devon Kile*

Petronella and his wife Kile are charged with 106 felony counts including conspiracy to commit a crime, grand theft, insurance fraud, filing a false tax return, willfully failing to file or filing fraudulent tax returns, misrepresenting facts to SCIF, making fraudulent statements, making false statements to discourage an injured worker from claiming benefits, misrepresenting facts to workers’ compensation insurance companies, and failing to file a return with the intent to evade tax. The defendants both face sentencing enhancements and allegations for aggravated white collar crime over \$2.5 million, \$500,000, and \$100,000. If convicted on all counts, the defendants each face a sentence ranging from five years and four months up to 102 years in state prison. The initial bail was set at \$10 million bail based on the amount of theft. We would lose more than half of the filed charges, involving Insurance Code § 11880 and Taxation Code § 19706 and all of the sentencing enhancements, if the Legislature reduces these cases to a misdemeanor. As we will note in more detail below, in the section on three strikes prosecutions, this will constitute a significant increase in the threat to public safety.

In this case, the defendants are accused of conspiring in a massive a scheme to underpay Workers’ Compensation Insurance premiums bilking three government agencies including SCIF, the Employment Development Department (EDD) and the Franchise Tax Board (FTB) of more

than \$38 million. Not only were the State's taxpayers defrauded, employees who worked for the defendants, many of whom are poor immigrants with little resources, were left without Workers' Compensation Insurance protections. This couple is accused of committing this crime to fund their lavish lifestyle and extravagant shopping sprees. Other legitimate businesses who obeyed the laws and paid their premiums and taxes lost business and workers through the competitive advantage obtained by the defendant's fraud.

2. People v. Mario Rosenberg et al.

This case involves 19 defendants in a massive medical insurance fraud. Three medical doctors, an attorney, an accountant, five administrators, and nine cappers conspired with each other for two years to fraudulently bill over \$154 million while collecting \$20 million in a 9-month period from insurance companies after performing dangerous and unnecessary surgeries on healthy patients. This investigation initially took three years before filing, and the Orange County District Attorney continued to investigate after the filing of the case. Almost all of the relevant evidence in this case resulted from execution of search warrants. The evidence involved in this case amounts to over four terabytes of material.

This case represented a real life "invasion of the body snatchers" where doctors performed risky and dangerous surgeries on healthy patients just to make a quick buck. The tax fraud alone is over \$6 million. These types of organized conspiracies drive up the cost of health insurance imposing a piratical tribute on businesses and consumers alike; severely impacting those who can least afford these rising costs.

The defendants are pending trial on over 175 felony counts and 242 enhancements for thefts of over \$2.5 million including charges of insurance fraud and tax fraud in violation Penal Code § 550 and Revenue and Taxation code § 19706. Both of these statutes are on the chopping block for reduction to misdemeanors. If they are reduced, the case will be gutted with over 100 of the charges and over 150 of the enhancements subject to dismissal.

3. People v. Richard Engel

This case involves the failure to report \$190 million in income and failing to pay the state \$11 million in taxes, penalties and cost of investigation. The investigation of this case took two years to complete, and many of the key evidence came from the search warrant that was executed. This investigation culminated in charges of eight counts of failing to file taxes in violation of Revenue and Taxation § Code 19706, four counts of filing fraudulent tax returns in violation of Revenue and Taxation Code § 19705(a)(1) and 40 sentencing enhancements for the extraordinary amounts of the thefts. Reducing a violation of Revenue and Taxation Code § 19706 to a misdemeanor would gut two thirds of this case resulting in a dismissal of all eight counts of violation of § 19706 and 28 of the enhancements. Making this case a misdemeanor, would result in a grossly unjust compared to those who are convicted for stealing a few hundred dollars.

4. People v. Kathy Chen, Richard Gonzalez, and Daniel Gonzalez

This case involved a conspiracy to commit over \$17.5 million in real estate fraud. The conspiracy involved the purported purchasing of properties under other people's names then defaulting on the loans to steal the loan proceeds. One of the victims was 89 years old. Not only did these defendants bilk loan companies out this large amount of money, but they wreaked havoc on the credit ratings of those whose names they appropriated to use in their fraudulent scheme.

The defendants are now charged with 157 felony counts including conspiracy (Penal Code § 182), 47 counts of grand theft (Penal Code § 487), one count of attempted grand theft (Penal Code § 664-487), 40 counts of forgery (Penal Code § 470), 30 counts of recording false documents (Penal code § 538.5), 30 counts of identity theft (Penal Code §§ 530.5, 532, 535), one count of elder financial exploitation, and four counts of forging an official seal. The proposed reductions of some of these charged felonies would extinguish two-thirds of this case, resulting in the dismissal of over 100 of the felony charges.

5. People v. Rolando Enammorando

This case involved a conspiracy to steal numerous vehicles, affix stolen license plates to them, fabricate falsified documents for the vehicles, and then sell them to unsuspecting customers. The victims, all of modest means, lost both their vehicles and the money that they paid to the conspirators. There were 27 felonies charged against the defendants including 12 counts of violation of Vehicle Code §§ 10851 and 4463(a). Defendants were convicted of these charges and sentenced to prison. If these Vehicle Code sections are reduced to misdemeanors as proposed, in all likelihood these defendants would have to be released. The ability of prosecutors to prosecute, secure restitution and thereby deter these types of criminal enterprises would be significantly reduced. As a result, we can expect these types of crimes to proliferate and victimize the poor and vulnerable.

As illustrated by the above cases, the defendants in many of the major fraud cases are professional defrauders. These schemers tend to target and victimize the most vulnerable members of society, as the less fortunate are more in need of help, less able to protect themselves, and by human nature more likely to cling to false promises of hope. These include the poor, the elderly, the sick and the disabled. The maximum punishment of these white collar criminals, such as those summarized above will now be reduced to one year in jail not because what they did was "less bad," but because lawmakers decided to reclassify it as less "bad." All of the sentencing enhancements for the large amounts of money normally attached to felony charges will also be lost.

Many of those who commit these types of crimes are professionally licensed and seldom go to prison. This arbitrary reclassification will reduce the deterrent effect of the threat of a felony conviction and a prison sentence. Licensing agencies will seldom remove professional licenses for misdemeanor convictions. Likewise, the threat of only misdemeanor punishment provides a weak inducement for these criminals to make restitution to victims, even if their schemes are uncovered and they are prosecuted. Without the threat of prison incarceration, with the time

afforded to law enforcement to investigate these crimes severely limited and with its ability to effectively investigate them effectively hobbled, these crimes will substantially proliferate, especially in tough economic times.


Third Strike Prosecutions

Finally the proposed reduction of Penal Code § 666, called “petty theft with a prior” significantly impairs the usefulness of the “Three Strikes Law” to prosecute career criminals. Actually referring to that section in the Penal Code discloses that the specific priors are not just other “petty thefts” as the proposal implies, but are burglary, robbery and carjacking, all serious or violent felonies. The proposal seems to assume that those who commit petty thefts cannot be serious or violent felons, an assumption which the Penal Code itself does not support. An extensive statistical analysis on three strikes prosecutions in Orange County showed that three strike felons sentenced to life sentences had similarly dangerous records, whether their most recent conviction was for serious or violent felony or a non serious or violent felony such as petty theft. Of all those charged with three strikes only around 10 per cent are actually sentenced to a life term. There is a reason for this. Despite the nature of their final conviction, their records demonstrate that they are the worst of the worst. The records of those convicted and sentenced to life upon a third strike conviction exhibited nearly identical serious or violent felony records indicating that they were anything but “low risk.” Deciding that convicted felons are “low risk” on the basis of their last conviction, which the Legislature will in essence be doing by reducing to misdemeanors all theft with prior felony convictions, will result in the immediate release of violent felons, including those with previous convictions of carjacking, armed robbery and other serious offenses.

Conclusion

Prosecutors currently reserve felony prosecutions only for the most serious of crimes. These cases target criminals with records of serious and violent crime or involve extremely large loses which victimize large numbers of the most vulnerable members of our society. If the Legislature declines to recognize the consequences of reclassifying these felonies as misdemeanors, I believe these crimes will dramatically increase without the means of adequately investigating and prosecuting them, and stopping the victimization of our law abiding citizens. These crimes directly impact the lives of our people and our economy. I respectfully but strongly urge the members of the Legislature and the Governor to reject this proposal and refrain from allowing felons to continue victimizing some of the most vulnerable of Californians.

Sincerely,


Tony Rackauckas
District Attorney

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