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# Corporate Headhunting

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CORPORATE HEADHUNTING

DANIEL C. RICHMAN

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## **Corporate Headhunting**

Daniel Richman ·

Forthcoming in Harvard Law & Policy Review Summer 2014 symposium issue, “Smart on Crime” (Please do not quote from this draft without permission of author).

A wide range of commentators – including some pretty sophisticated ones—have raked through the ruins of the 2008 financial collapse confident that there were significant criminal prosecutions to bring against individuals and that the Justice Department should be faulted for its failure to have brought them. Their confidence that blockbuster criminal cases could have been made and were not rests on shaky grounds however. So too does their faith that the hunting of heads is a socially productive response to the collapse. If anything, a focus on headhunting will only distract from, and reduce the pressure for, efforts to explain it and prevent its recurrence.

In a country where “to make a federal case” out of something is simply to treat it seriously, one can hardly quarrel with the instincts of laypeople who think that federal prosecutions are a fitting answer to – even a solution for – massive institutional failures presided over by extravagantly paid chieftains. All too frequently missing from current debates has been sustained engagement with realities of federal criminal law enforcement – realities that even Judge Jed Rakoff, a masterful Southern District of New York trial judge and one of the nation’s leading white collar crime experts, gave short shrift to in a recent article.<sup>1</sup> The goal of this essay is to bring somewhat prosaic considerations of law and institutional capacity back into the conversation. While I offer little in the way of regulatory or architectural reform, I simply seek to clear away broad rhetoric that can only impede such efforts.

### **I. Why Haven’t More Heads Rolled?**

Before considering the challenges of evaluating the performance of federal prosecutors at any time, we should note that it’s a bit early to pass judgment. To be sure, the five-year statute of

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· Paul J. Kellner Professor of Law, Columbia University School of Law. I am grateful to Miriam Baer, Sam Buell, Jim Comey, Denise Cote, Ray Lohier, Jerry Lynch, Michael Graetz, Kate Stith and Rich Sullivan for very helpful conversations in connection with earlier drafts of this piece. The views expressed here and the mistakes are mine alone.

<sup>1</sup>Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted*, N.Y. Rev. Books (Jan. 9, 2014).

limitations for most federal crimes will preclude the prosecution of any offenses completed at the end of 2008. But § 3293 of Title 18 – passed in response to the Savings and Loan Crisis -- sets a ten-year statute of limitations for a variety of fraud or false statute offenses affecting financial institutions. Moreover, the sophisticated prosecutor with evidence of clear wrongdoing (or who wants assurance that she can use evidence not yet obtained) can take comfort in a variety of money laundering, conspiracy, and racketeering theories that expose bad guys to prosecution for far longer than five years.<sup>2</sup> So there's plenty of time before the grading deadline. And we can expect considerable information will be shaken loose—perhaps even on critical issues like knowledge and intent—as firms fight over who will bear losses; disgruntled individuals seek retribution or qui tam recoveries, and regulatory enforcers work through backlogs.

Although one can't be sure, my sense is that the normal lack of patience that attends almost any prosecutorial response that takes longer than a TV show has been exacerbated by the very different time lines of the Madoff case and the insider trader cases against Raj Rajaratnam and his band of illegal tippers. Coming right after the 2008 collapse and involving Wall Street denizens, those cases may have seemed to promise some accelerated retribution. But Bernard Madoff was virtually a walk-in: No federal criminal investigation was pending against him when he confessed his fraud to his sons and they, in turn, alerted authorities.<sup>3</sup> The precise nature and extent of his scheme has not even been fully determined as of 2014.<sup>4</sup> And Raj Rajaratnam's conspiratorial conversations were intercepted by FBI agents as his scheme unfolded, thanks to wiretaps obtained on the basis of informant accounts.<sup>5</sup> The potent investigative combination of wiretaps and cooperators – so useful in insider-trading cases – requires both real-time leads about on-going criminal activity and conduct so obviously illegal to its participants that their efforts to

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<sup>2</sup> While notions of continuing crime can be remarkably expansive in federal criminal law, there are limits. See *US v. Grimm*, 738 F.3d 498 (2d Cir. 2013) (overturning antitrust conviction on statute of limitations grounds).

<sup>3</sup> See Securities and Exchange Commission, Office of Investigations, *Investigation of Failure of the SEC to Uncover Bernard Madoff's Ponzi Scheme* (2009), available at <http://www.sec.gov/news/studies/2009/oig-509.pdf>; see also *United States v. Castaldi*, \_\_\_ F.3d \_\_\_ (7<sup>th</sup> Cir. 2014), 2014 WL 702207 (affirming sentence of a defendant convicted of a \$40 million Ponzi scheme that government learned about in November 2008 only when he turned himself in).

<sup>4</sup> See Rachel Abrams, *5 Former Madoff Aides Found Guilty of Fraud*, N.Y. Times, Mar. 24, 2014.

<sup>5</sup> See *United States v. Rajaratnam*, 719 F.3d 139 (2d Cir. 2013) (upholding conviction and rejecting defendant's challenge to wiretap application); see also *United States v. Gupta*, \_ F.3d \_ (2d Cir. 2014) (upholding conviction of executive based, in part, on intercepted conversations involving Rajaratnam).

conceal it delineate their criminal intent. Neither can be assumed to be available in cases relating to the financial collapse.

Recent critics of the Justice Department regularly draw invidious comparisons between the allegedly pale response to the 2008 Collapse and the allegedly robust response to the Savings and Loan Crisis of the 1980s, which we are told led to “more than eight hundred” convictions of individual defendants.<sup>6</sup> But to celebrate the S & L Crisis response as the epitome of a white-collar crackdown is to re-write history. The Justice Department was similarly excoriated for its lameness back then.<sup>7</sup> Moreover, as Calavita, Pontell and Tillman found in their valuable study of that Crisis, the criminal activity there -- which generally amounted to straightforward self-dealing for personal gain – had a lot more in common with organized crime than with “traditional corporate crime” done for corporate gain.<sup>8</sup> What amounted to “collective embezzlement”<sup>9</sup> could be pursued the way fraudulent self-dealing has always been pursued, by focusing on the often torturous transactions that led from institutional accounts to private pockets.

Counting up the heads that rolled in the wake of the S & L Crisis from small institutions scattered across the country and comparing the total to the number currently plated just won’t do. Indeed, if one simply wants to count heads, the number of S & L prosecutions (which included plenty of “small fry” defendants) needs to be measured against not the small number of significant financial players prosecuted since 2008 but the large number of federal and state cases brought against the people who took out, gave, or administrated a “liar loan.” Those are just the little guys, and even the seeking of their little heads has been complicated by the

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<sup>6</sup> Jed S. Rakoff, *The Financial Crisis: Why Have No High-Level Executives Been Prosecuted*, N.Y. Rev. Books, at (Jan. 9, 2014); see also Gretchen Morgenson & Louise Story, *In Financial Crisis, No Prosecutions of Top Figures*, N.Y. Times, Apr. 14, 2011, at \_\_\_; Jason M. Breslow, *Were Banks Jailed in Past Financial Crises?*, PBS Frontline, Jan. 22, 2013, available at <http://www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/untouchables/were-bankers-jailed-in-past-financial-crises/>.

<sup>7</sup>See Bruce A. Green, *After the Fall: The Criminal Law Enforcement Response to the S & L Crisis*, 59 Ford. L. Rev. S155, S162-S168 (1991).

<sup>8</sup> Kitty Calavita, Henry N. Pontell & Robert H. Tillman, *Big Money Crime: Fraud and Politics in the Savings and Loan Crisis 2* (1997).

<sup>9</sup> K. Calavita, R. Tillman, H.N. Pontell, *The Savings and Loan Debacle, Financial Crime, and the State*, 23 Am. Rev. Sociol. 19, 28 (1997)

prevalence of the conduct they engaged in. As Judge Richard Posner recently noted, in the course of reversing the convictions of two mortgage applicants:

the bank didn't give a fig about the couple's ability to repay the loan. It planned to sell the loan, which would then be folded with many other loans into a mortgage-backed security that would be sliced and the slices sold around the world, the premise being that the security would be safe because of diversification—the mortgages bundled into the security would be on properties scattered across the United States. A nationwide collapse of the housing market was not foreseen.<sup>10</sup>

According to a recent audit by the Justice Department's Inspector General's Office, the number of federal mortgage fraud prosecutions brought may well have been lower than that touted by the department.<sup>11</sup> Yet the number of such cases<sup>12</sup> – for whatever that's worth – still dwarfs the number of S & L cases, and that is without even counting the state and local mortgage fraud prosecutions, often brought in coordination with federal authorities.

Once we put bad analogies aside and squarely try to figure out whether widespread criminal misconduct drove – or was even associated with – the financial crisis, we face one of the classic accountability problems in federal criminal law<sup>13</sup>: Since a financial collapse is not itself evidence of criminal conduct, and white collar criminal activity is rarely revealed with any clarity except by those responsible for prosecuting crimes, how does one assess the adequacy of those prosecutorial efforts? When even such a savvy observer as Judge Jed Rakoff recently tried to avoid this accountability challenge by invoking alternative authority, his efforts fell flat. The best “official” evidence he could offer “that the crisis was in material respects the product of

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<sup>10</sup> *United States v. Philips*, 731 F.3d 649, 655 (7<sup>th</sup> Cir. 2013).

<sup>11</sup> See U.S. Dep't of Justice, Office of the Inspector General (“OIG”) Audit Division, *Audit of the Department of Justice's Efforts to Address Mortgage Fraud*, 29 (March 2014), available at <http://www.justice.gov/oig/reports/2014/a1412.pdf>. It is worth noting that, adhering to the FBI's classification, the OIG Report differentiated between “mortgage fraud” and “mortgage-backed securities fraud, which involves wrongdoing related to the packaging, selling, and valuing of residential and commercial mortgage-backed securities.” The OIG audited only the former type of cases, not the latter, which the Bureau classifies as “a form of securities fraud.” *Id.* At 2.

<sup>12</sup> OIG Report, *supra* note \_\_\_, at 16 (data indicating 248 filings in 2009; 632 in 2010, and 486 in 2011).

<sup>13</sup> See Daniel Richman, Kate Stith & William Stuntz, *Defining Federal Crimes*, chap. 1 (2014) (forthcoming)

intentional fraud” was the final report of the Financial Crisis Inquiry Commission.<sup>14</sup> But the Commission did and could not identify specific instances of fraud with any authority.<sup>15</sup> Vague talk of “fraud” cannot suffice for Judge Rakoff’s purpose. And that Justice Department officials have failed “to indicate their disagreement” with the Commission’s report is equally beside the point, as any such opining by prosecutors would have been unusual and wholly inappropriate.

Judge Rakoff finds it “surprising” that the Justice Department has found it difficult to show that individuals selling mortgage-backed securities knew they were committing fraud. After all, one needs only to look at the upswing in “suspicious activity reports” of mortgage fraud that banks filed in the years preceding the crisis.<sup>16</sup> Yet if one combines wishful thinking that housing prices would rise forever with insouciance about the loans underlying the particular securities, the criminally culpable bad faith of these individuals is not obvious. (That other parts of the firm may have worried about and hedged against these risks is interesting but hardly dispositive.)

Of course, the difficulty in identifying criminal behavior ought not shield the Justice Department from accountability. Nor should we be satisfied with assurances from its leaders that the Department stands ready to pursue any criminal case that is supported by the facts and evidence. Attorney General Holder has avowed: “To the extent that we have the ability to bring cases against individuals or institutions, criminal charges, we will bring them.”<sup>17</sup> On the way out the door, former Criminal Division Chief Lanny Breuer shook off criticism for not throwing Wall Street executives behind bars and echoed: “If there had been a case to make, we would have

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<sup>14</sup> Rakoff at \_\_.

<sup>15</sup> See Financial Crisis Inquiry Commission Report (2011), available at <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>. See also Peter J. Henning, Crisis May Seem Criminal, but Try Making a Case, N.Y. Times, Jan. 28, 2011 (noting that “[t]he commission’s various conclusions provide a plausible defense for almost any executive who might be accused of securities fraud or misleading investors: it was all the fault of uncontrollable market forces and regulatory laxity.”).

<sup>16</sup> Rakoff at \_\_; see also FBI, 2009 Mortgage Fraud Report, <http://www.fbi.gov/stats-services/publications/mortgage-fraud-2009>; Financial Crimes Enforcement Network, Mortgage Loan Fraud: An Industry Assessment Based Upon Suspicious Activity Report Analysis, Nov. 2006, [http://www.fincen.gov/news\\_room/rp/reports/pdf/mortgage\\_fraud112006.pdf](http://www.fincen.gov/news_room/rp/reports/pdf/mortgage_fraud112006.pdf)

<sup>17</sup> Jim Puzzanghera, Holder Says No Bank “Too Big to Indict,” More Financial Cases Coming, LA Times, Jan. 24, 2014.

brought it. I would have wanted nothing more, but it doesn't work that way."<sup>18</sup> Even when fully credited, such pronouncements go both too far and not far enough. Too far, because the breadth and depth of federal criminal have lead us to expect and demand that prosecutors exercise judgment in the massive discretionary space that Congress has effectively delegated to them.<sup>19</sup> Not far enough, because – particularly in the white-collar crime area -- evidentiary strength is generally a function of prosecutorial effort, priorities, and institutional commitment. The point is not that these assurances should not have been given, merely that they have little content.

Departmental leaders don't help matters when they talk about the challenges of proving criminal intent beyond a reasonable doubt.<sup>20</sup> These are far from trivial burdens, but prosecutors regularly meet them in any number of mundane white-collar cases. Moreover, the facts set out in the recent departmental filings in civil cases and in criminal cases disposed of by non-prosecution or deferred prosecution agreements often suggest a real possibility that more zealous enforcement efforts might allow the satisfaction of those burdens. The "Statement of Facts" in the November 2013 \$13 Billion civil settlement between the Justice Department and JPMorgan Chase, for example, asserts: "[E]mployees of JPMorgan, Bear Stearns, and WaMu received information that, in certain instances, loans that did not comply with underwriting guidelines were included in the RMBS sold and marketed to investors; however, JPMorgan, Bear Stearns, and WaMu did

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<sup>18</sup> Ben Protess, Breuer Reflects on Prosecutions That Were, and Weren't, N.Y. Times, Dealbook, Feb. 13, 2013.

<sup>19</sup> See Daniel C. Richman, Federal Criminal Law, Congressional Delegation, and Enforcement Discretion, 46 UCLA L. Rev. 757 (1999); Daniel C. Richman & William J. Stuntz, Al Capone's Revenge: An Essay on the Political Economy of Pretextual Prosecutions, 105 Colum. L. Rev. 583, 608-18 (2005).

<sup>20</sup> See Peter J. Henning, Making Misconduct a Crime, N.Y. Times, June 24, 2013 (quoting Lanny A. Breuer); available at <http://dealbook.nytimes.com/2013/06/24/making-mismanagement-a-crime/>



not disclose this to securitization investors.”<sup>21</sup> These alternative resolutions may well have been appropriate, but they aren’t obviously so.

While departmental officials’ recourse to black letter law to explain why more top executives have not been led away in chains thus adds little, so too does the similar recourse of critics like Judge Rakoff who note that prosecutors could ease their burden of proving intent by relying on concepts of “willful blindness” or “conscious disregard.”<sup>22</sup> A little more analytical clarity would be useful here. Prosecutors regularly do invoke those theories, often as an alternative ground for obtaining or defending a conviction, sometimes as a primary ground. But they require showing a lot more than recklessness. Rather the government must prove not only that the defendant believed there to have been a “high probability” that, say, underlying loans were bad, but that took “deliberate actions” to avoid learning the truth.<sup>23</sup> The standard stories of executive fecklessness relating to the 2008 collapse have had little to say about the latter. Moreover, my sense is that like the *Pinkerton* rule – another burden-relaxing federal criminal doctrine – “willful blindness” owes its survival as much to careful prosecutorial use as to judicial recognition.<sup>24</sup> Federal criminal law has its fancy aspects, and, given the cognitive biases of their clients, wise counselors are right to be extraordinarily expansive when describing the sweep of potential criminal liability. Any description of possible criminal liability therefore should include the risk of indictment based on a “willful blindness” theory. Yet prosecutors are well aware that if they

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<sup>21</sup> Statement of Facts of Settlement between the Justice Department and JPMorgan, Nov. 19, 2013, available at <http://www.justice.gov/iso/opa/resources/94320131119151031990622.pdf> It is worth noting that this settlement does not preclude future criminal prosecutions of individuals. See Justice Department Press Release, Nov, 19, 2013 (This settlement resolves only civil claims arising out of the RMBS packaged, marketed, sold and issued by JPMorgan, Bear Stearns and Washington Mutual. The agreement does not release individuals from civil charges, nor does it release JPMorgan or any individuals from potential criminal prosecution. In addition, as part of the settlement, JPMorgan has pledged to fully cooperate in investigations related to the conduct covered by the agreement.”), available at <http://www.justice.gov/opa/pr/2013/November/13-ag-1237.html>

<sup>22</sup> Rakoff at \_\_.

<sup>23</sup> See *Global-Tech Appliances v. SEB S.A.*, 131 S Ct. 2060, 2070-71 (2011); *United States v. Goffer*, 721 F.3d 113, 128 (2d Cir. 2013); *United States v. Jinwright*, 683 F.3d 471, 480 (4<sup>th</sup> Cir. 2012); Richman, Stith & Stuntz, at \_\_ (chap 8).

<sup>24</sup> For an exploration of how courts have limited expansive *Pinkerton* theories, see Mark L. Noferi, *Towards Attenuation: A “New” Due Process Limit on Pinkerton Conspiracy Liability*, 33 *Am. J. Crim. L.* 91 (2006).

can't present a clear narrative of moral wrongdoing, a felony case against an individual defendant isn't likely to go anywhere.<sup>25</sup>

The de facto requirement of blatant culpability – demanding that a defendant be shown to have had a subjective awareness of real wrongdoing<sup>26</sup> -- is anchored in our use of general jurisdiction prosecutors and judges and of lay jurors. It isn't a bug in our system but a feature.<sup>27</sup> While pundits and interest groups bewail formal doctrine that turns “mere technical violations” into prosecutable offense and rage at their inability even to count the number of federal crimes,<sup>28</sup> the effective reach of federal criminal law is at least as much a function of the highly constraining institutions charged with its enforcement as it is of substantive law. This is not just a matter of the limited resources that have been allotted to white-collar investigations and prosecutions – and of the competing calls that have been made on the relatively small federal enforcement bureaucracy.<sup>29</sup> It is also a matter of the quiet grammar of actual, as opposed to potential, criminal prosecutions: The complexity and expansive drafting of modern criminal statutes all too frequently hide the core criminality being targeted. But juries, judges and hopefully prosecutors are looking for evidence of lying, cheating and stealing. For all the populist strains in the media and lay opinion, large paychecks and provable criminal violations generally won't be enough to send an individual to jail, in the absence of “real” wrongdoing. The challenge for prosecutors isn't just explaining complex transactions and shifting market conditions, but showing why the defendant is worthy of being treated like a criminal.

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<sup>25</sup> See Gerard E. Lynch, *The Role of Criminal Law in Policing Corporate Misconduct*, 60 *J. L. & Contem. Probs.* 23, 49-50 (1997).

<sup>26</sup> See Samuel Buell, *Novel Criminal Fraud*, 81 *N.Y.U. L. Rev.* 1971, 1985-86 (2006).

<sup>27</sup> Daniel Richman, *Overcriminalization for Lack of Better Options*, in *The Political Heart of Criminal Procedure: Essay on Themes of William J. Stuntz* (Michael Klarman, David Skeel & Carol Steiker, eds.), 64, 72-73 (2012).

<sup>28</sup> See Gary Fields & John R. Emshwiller, *Many Failed Efforts to Count Nation's Federal Criminal Laws*, *Wall St. J.*, July 23, 2011; Brian W. Walsh & Tiffany M. Joslyn, *Without Intent: How Congress Is Eroding the Criminal Intent Requirement in Federal Law* (2010). But see Susan R. Klein & Ingrid B. Grobey, *Debunking Claims of Over-Federalization of Criminal Law*, 62 *Emory L. J.* 1 (2013).

<sup>29</sup> See Daniel Richman, *Political Control of Federal Prosecutions: Looking Back and Forward*, 58 *Duke L.J.* 2087 (2009); see also David M. Uhlmann, *Prosecutorial Discretion and Environmental Crime*, 37 *Harv. Environ. L. Rev.* 37 (2014) (forthcoming) (surveying environmental crimes cases brought between 2005-10 and finding that, notwithstanding the murkiness of the line between criminal and civil violations, aggravating factors appeared in virtually every one), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2365780](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2365780)

To illustrate the challenge, one has only to look at the fizzling of the options backdating prosecutions – at least those brought on the West Coast.<sup>30</sup> The underlying conduct in those cases – the manipulation of the award dates of employee stock-options, which had the effect of suppressing a firm’s compensation expenses -- was hardly the highway robbery that critics insist is at the root of the 2008 financial meltdown. Indeed, that very lack of comparability with the scale of the financial collapse may have hurt those prosecutions, brought before the meltdown but not tried until afterward. Yet the acquittals and courtroom setbacks that ended most of them highlight the heightened jury and judicial scrutiny that attends prosecutions in where “criminality” is contestable. So, conversely, do the guilty verdicts (and preemptive pleas) in the insider trading cases, where, notwithstanding scholarly critiques,<sup>31</sup> “cheating” can be easily inferred and is easy to condemn.

Even the casual reader will recognize how vague I am being about what constitutes “real criminality.” And the more savvy reader will recognize how plastic notions of “cheating” and “stealing” can be. It may well be that a series of well-thought-out prosecutions could show judges, juries, and the public that certain conduct related to the 2008 collapse is just the sort that should put some people beyond bars. The point for now is simply that such demonstrations take more than evidence of rampant profit-maximization (a/k/a “greed) and wishful thinking in the financial industry and more than broad black letter understandings of fraud.

The Justice Department should not be allowed to hide beyond talk of crushing evidentiary burdens. Nor should it get credit for chest-thumping and vague talk about its zealotry and

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<sup>30</sup> Peter Lattman, *Backdating Scandal Ends With a Wimper*, N.Y. Times, Nov. 11, 2010 (noting, of backdating cases, that “on the criminal front, the government had mixed results, winning several trials but also losing a number of prominent cases. In all, 12 executives across the country [] received criminal sentences, five of them prison terms. The others were sentenced to probation.”); Peter J. Henning, *Behind the Fade-Out of Options Backdating Cases*, N.Y. Times, Dealbook, Apr. 30, 2010.

<sup>31</sup> See, e.g. Henry G. Manne, *Insider Trading: Hayek, Virtual Markets, and the Dog that Did Not Bark*, 31 J. Corp. L. 167 (2005).

political commitment. But criticism of its efforts ought not be rest on hyper-speculation that doesn't go much further than the adage that "behind every great fortune there is a crime."<sup>32</sup>

## **II. What Prosecuting More Individuals Would Cost and Accomplish**

Even if we can't figure out whether there actually are worthwhile criminal cases that the Justice Department has failed to bring, let's plunge ahead – making non-trivial inferences about knowledge and intent, and collapsing organizational structures that disaggregate function and dissipate responsibility. Let us assume that there is a class of provably criminal actors out there – perhaps individuals who touted the low risk of securities dependent on subprime mortgages that they knew to be both fraudulent and risky; perhaps executives involved in the fraudulent business model. To be safe, let's imagine that the surrounding facts – if fleshed out – would show at least one such guy to be a greedy sleazebag whose bonus skyrocketed based on these transactions. I suspect a jury would convict him, and a judge wouldn't derail the case or merely slap his wrist.

What exactly have we lost by not prosecuting him and his ilk? The question is harder than it sounds, and the point of asking it is not to minimize the value of prosecuting individuals. Rather it requires us to think clearly about how we are going to identify him, what his prosecution would cost, and what it would gain. And it takes us from substantive law to procedure and institutional capability.

In an ideal world of infinite resources, federal investigators would be well-versed in securitization mysteries and would pore through internal and external corporate communications, interview witnesses, and nail down our guy's culpability on their own. (They would also go after all truly corrupt public officials not being pursued by state or local authorities. And so on....) But in our real world, federal law enforcement agencies, particularly the FBI, are stretched thin and unfamiliar with the financial markets. The Postal Inspection Service – which not that long

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<sup>32</sup> For an analysis of the adage's provenance, in the work of Balzac and others, see <http://quoteinvestigator.com/2013/09/09/fortune-crime/>

ago played a critical role in securities fraud cases – is under pressure to retreat from “investigations that are not inherently related to the Postal Service operations or mission.”<sup>33</sup> and the regulatory agencies with more expertise have just emerging from a long lean period.

The government therefore ends up relying heavily on internal investigations by firms trying to show their cooperation and avoid prosecution. The pressure on firms to dig deep and share information was somewhat reduced in the last years of the Bush Administration, when the Justice Department – under fire from corporate defenders, many members of Congress, and some of the same editorial pages that now complain about the lack of corporate prosecutions – assured firms that they need not waive the attorney-client privilege and deliver up the unfiltered results of their internal investigations when “cooperating” with the government.<sup>34</sup> Still, the pressure remains enough that firms will spend massive amounts on internal probes.<sup>35</sup>

The extent of the government’s reliance on this motivated self-reporting is troubling. It would certainly be better policy if the enforcement bureaucracy had a larger degree of choice about when it let firms – even those represented by former prosecutors, usually with a well-deserved reputation for integrity – take even a first crack at grading their own papers. I completely agree with Judge Rakoff that financial crimes should be given a higher priority, with a greater and more sustained commitment of resources, particularly to the regulatory agencies.<sup>36</sup> Yet the recent record of resource commitment is poor indeed. Not only were regulatory agencies hard pressed, but even prosecutors and the FBI – agencies whose punitive focus generally makes them more

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<sup>33</sup> See Letter from Anthony J. Vegliante, Exec. VP, U.S. Postal Service, to Lucine Willis, Dir. Audit Operations, May 17, 2011 (rejecting recommendation in audit report, *New Approaches to Reduce Costs*), available at <https://www.uspsoig.gov/sites/default/files/document-library-files/2013/FF-AR-11-009.pdf> at p. 34

<sup>34</sup> Berkeley J. Crim. Law, Developments in White Collar Criminal Law and the Culture of Waiver, 14 Berkeley J. Crim. L. 199 (2009); Daniel Richman, Political Control of Federal Prosecutions, *supra* note \_\_, at 2110-16; Daniel Richman, Decisions About Coercion: The Corporate Attorney-Client Privilege Waiver Problem, 57 DePaul L. Rev. 295 (2008).

<sup>35</sup> See Peter J. Henning, White Collar Watch, The Mounting Costs of Internal Investigations, N.Y. Times, Mar. 5, 2012. (“When a corporation is caught in a government investigation, the legal fees can quickly exceed \$100 million – and that’s before the lawsuits even begin.”).

<sup>36</sup> See Daniel Richman, Political Control of Federal Prosecutions: Looking Back and Forward, 58 Duke L.J. 2087, 2118-2121 (2009).

attractive funding targets<sup>37</sup> -- were underfunded. To much acclaim, the Fraud Enforcement and Recovery Act of 2009<sup>38</sup> authorized \$165 million for the Justice Department for fiscal years 2010 and 2011 to pursue financial fraud. But although the U.S. Attorneys' Offices and Main Justice's Criminal Division were authorized to receive \$70 million in 2010 and \$70 million in 2011, Congress end up actually appropriating \$9.3 million in 2010 and \$0 in 2011. The FBI, authorized by the Act to receive \$75 million in 2010 and \$65 million in 2011, was actually appropriated \$25.5 million in 2010 and \$20.2 million in 2011.<sup>39</sup>

Optimally, civil regulators would closely coordinate with criminal enforcers, "contributing their institutional competence to prosecutorial efforts, and picking up those cases meriting less punitive treatment."<sup>40</sup> Accompanying such resource commitments would have to be institutional design measures that reduce the pressure on the SEC, CFTC and other agencies to focus on quantity not quality. This is far easier said than done. Judge Rakoff complains that the SEC has focused "on the smaller, easily resolved cases that will beef up their statistics when they go to Congress begging for money,"<sup>41</sup> but that pathology is endemic to the federal enforcement project. With sprawling jurisdiction, limited resources, and political masters seeking short-term evidence of achievement, federal enforcement agencies – whether dealing with workplace safety, environmental threats, corruption, or narcotics trafficking – have long struggled with the tension between quantity and quality.<sup>42</sup> Whether for lack of motivation or the inherent challenges of the task, neither the bureaucracy nor its masters have made much progress in devising performance metrics "that go beyond case or scalp counting."<sup>43</sup>

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<sup>37</sup> See Richman, *Overcriminalization for Lack of Better Options*, supra note \_\_, at \_\_; Miriam H. Baer, *Choosing Punishment*, 92 *Boston Univ. L. Rev.* 577, \_\_ (2012)

<sup>38</sup> Pub.L. 111-21, S. 386, 123 Stat. 1617 (2009).

<sup>39</sup> *OIG Report*, supra note \_\_, at 2-3.

<sup>40</sup> Daniel Richman, *Federal White Collar Sentencing in the United States: A Work in Progress*, 76 *J. L. & Contemp. Probs.* 53, 65 (2013); see also Lynch, at 54 (noting the importance, "in areas of specialized regulatory enforcement," of "close coordination between criminal prosecutors and regulatory agencies").

<sup>41</sup> Rakoff, at \_\_

<sup>42</sup> Richman & Stuntz, *Al Capone's Revenge*, supra note \_\_, at 615.

<sup>43</sup> Richman, *Political Control*, *Duke L.J.* at 2121; see also Baer, *Choosing Punishment*, at 599 ("Our metrics are not much more sophisticated than tabulating annual enforcement actions, criminal cases, convictions, and fines and pointing out particularly salient wins or losses.").

Let us pause on this resource commitment point, though. Not because it's wrong, but because it's so obviously right – like counterterrorism, another example of how ill-served bureaucratic development and sane regulatory policy are by the swings between under-reaction and over-reaction that are hallmarks of American politics.<sup>44</sup> Even here, though, one needs a nuanced understanding of the nature of the problem. This is not simply a case of our cycling between our periodic commitment to “small” government and our panic or outrage at actual or perceived crises. It also reflects a concern of reasonable people that the institutional investments whose absence we bemoan in time of trouble also can lead to a worrisome policy slack in times of peace and prosperity. Calling for a radical deleveraging of federal corporate crime enforcement is thus a fine opening bid. But -- in our second (or third) best world -- unless one has follow-up suggestions, one will be left cursing at the political economy of corporate crime enforcement from the sidelines. Moreover, if one ignores political realities and simply demands that federal funds be spent on one's particular policy preferences, one still has to explain why the sizeable expenditures needed to create a self-sufficient enforcement capability are better spent here than elsewhere.

Let us next assume that somehow – whether through governmental efforts, internal investigation, or a jilted lover who tapes all conversations – enforcers can identify our mortgaged-backed securities malefactor. After all, employees regularly worry that they will be “thrown under the bus” to appease the regulatory gods.<sup>45</sup> What next? The allure of a few prosecutions of just this sort are enormous: The bringing of criminal charges against an identifiable malefactor makes for beautiful press and allows one to speak of the “bad apples” of capitalism, even as one defends the basic project and the integrity of the industry. And in a law enforcement regime rife with horizontal inequality – where nearly every federal defendant can point to a similarly situated perpetrator who has not faced federal charges<sup>46</sup> – the Wall Street defendant's complaint that “everyone else was doing it” are likely to be met with a shrug (except from the Wall Street Journal editorial board).

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<sup>44</sup> Daniel Richman, *The Right Fight*, Boston Review, Dec. 2004/Jan. 2005, at 6 (on responses to 9/11).

<sup>45</sup> See Bruce A. Green & Ellen S. Podgor, *Unregulated Internal Investigations: Achieving Fairness for Corporate Constituents*, 54 B.C. L. Rev. 73, 99-100 (2013).

<sup>46</sup> See Daniel C. Richman & William J. Stuntz, *Al Capone's Revenge: An Essay on the Political Economy of Pretextual Prosecutions*, 105 Colum. L. Rev. 583, 630 (2005).

Yet the gains in prosecuting our guy shouldn't be overstated. Judge Rakoff has suggested that, as in drug (or insider trading) cases, prosecutors can "flip" their way up the chain to those who put the incentives in place – or created the "culture" – that powered this guy's misdeeds. I'm far less confident. Our guy might well cooperate in exchange for leniency. And maybe he can give the government, or lead it to, powerful evidence implicating more senior executives. But if the goal is identifiable individuals to prosecute, we will have to confront the real possibility that manifest criminal culpability gets too diffuse once we move beyond him. As a matter of socio-economic policy, we should fault those top executives who set performance metrics that leave subordinates seeking advancement with few or no options that don't cross the legal line. We also should devise measures – including prophylactic regulation, institutional design, and civil liability – that target those practices. But that policy condemnation will frequently not easily translate into recognizable forms of criminal liability. The notion of prosecuting "responsible corporate officers" on the basis of criminal misdeeds that occurred on their watch, and presumably because of conditions they fostered, finds some (much contested) support in federal criminal doctrine.<sup>47</sup> Yet in its contemplation of vicarious criminal liability for individuals, it has always been a doctrinal outlier,<sup>48</sup> and I suspect that judges and juries will ensure that it remains so. So we can't assume that those at the top of the corporate chain will tremble at this prosecution.

In the absence of someone to testify against, our guy might go to trial. Odds are that he will be convicted (although some aren't).<sup>49</sup> Or he will plead (because most defendants do) and get a sentence that, although probably not driven by the Federal Sentencing Guidelines – which are not well suited for these cases – will probably be anchored in that regime.<sup>50</sup> Nothing here is an argument against this result. Those looking for cathartic triumphs of accountability are bound to be disappointed, though, for the pace, specificity, and legal technicalities of large-scale white-collar prosecutions makes those moments elusive. (Just think of the long Enron saga, in which the criminal litigation sparked by the 2001 collapse of that firm is only just ending.<sup>51</sup>)

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<sup>47</sup> See Richman, Stith & Stuntz, at 629-30.

<sup>48</sup> See Samuel Buell, *Is The White Collar Offender Privileged?*, 63 *Duke L.J.* 823, 851-52 (2013) (To hold a bank executive responsible for fraud on the basis of having looked the other way, or behavior of that sort, while her traders built up a financial house of cards that was doomed to collapse would [] require discussion about revising principles of responsibility fundamental to criminal law's general part.").

<sup>49</sup> But see Zachery Kouwe & Dan Slater, *2 Bear Sterns Fund Leaders Are Acquitted*, *N.Y. Times*, Nov. 10, 2009.

<sup>50</sup> See Richman, *White Collar Sentencing*, *supra* note \_\_, at 70.

<sup>51</sup> See Peter Lattman, *Ex-Enron Chief's Sentence is Cut by 10 Years*, *N.Y. Times*, June 21, 2013.



But at least there will be deterrence, right? Some, I guess. Probably more than from going after the average street drug dealer, or ID thief. But here again, public expectations cry out for management. Although empirical evidence is scant, most (including me) assume that prosecution of a corporate executive for fraud sends a clearer “message” to the relevant community than the prosecution of the average street criminal. Deterrence gains, however, will be a function of prosecution frequency. Unless we are careful – or are ready for a more sustained commitment of resources – the “message” of relative handful of prosecutions will be “a few heads will roll when the market takes a deep dive and the public seeks retribution.” And the target deterrence audience will weigh the slim chance that lightning will strike them against the enormous financial gains from continued play.

Comparing alternative prosecutorial strategies, Judge Rakoff suggests that “the future deterrent value of successfully prosecuting individuals far outweighs the prophylactic benefits of imposing internal compliance measures that are often little more than window-dressing.”<sup>52</sup> Given how few truly culpable individuals are likely to face prosecution – particularly in a world where the focus on entity cooperation is lessened – this claim is far from clear. Or at least it’s sufficiently unclear as to counsel renewed consideration of how firms are pursued, as the choice not be so binary.

This brings us back to the issue of pursuing firms as well as -- and often instead of -- individuals. It’s worth noting from the start that the current “approach” is very much a work in progress, and that the world of Non-Prosecution Agreements (NPAs) and Deferred Prosecution Agreements (DPAs) is only a few decades old. These are the alternative resolutions prosecutors have developed to give themselves choices beyond the stark ones of convicting a firm and letting it escape criminal liability altogether.<sup>53</sup> It’s also worth recalling that, although these corporate resolutions are frequently excoriated as signs of undue government solicitude for corporate malefactors,<sup>54</sup> they have also been condemned as instruments of government oppression – the

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<sup>52</sup> Rakoff at \_\_.

<sup>53</sup> For a recent review of the history of DPAs and the literature about them, see Golumbic & Lichy, *supra* note \_\_, at \_\_\_\_\_.

<sup>54</sup> See, e.g., Gretchen Morgenson & Louise Story, *As Wall St. Polices Itself, Prosecutors Use Softer Approach*, N.Y. Times, July 7, 2011; David M. Uhlmann, *Prosecution Deferred, Justice Denied*, N.Y. Times, Dec. 13, 2013; David

means by which prosecutors unwilling or unable to prove up a case can nonetheless extract massive monetary settlements from risk-averse but “innocent” firms, and perhaps also impose structural (or cosmetic) reforms.<sup>55</sup> Each side may have a point, but figuring out which point applies to which case will always be a challenge. The agreed-upon fact statements that sometimes accompany these resolutions are artifacts of the negotiation process that preceded them. Admissions of culpability need to be taken in that context, as must claims of provability.<sup>56</sup> Caution should therefore be exercised – at least by outsiders -- before characterizing a resolution as “lenient” or “extortionate.” Moreover, as previously noted, we ought not to underestimate the extent to which the ex ante threat of corporate liability powers the internal investigations that may shake loose information about individual wrongdoing.

Nor should we underestimate the effects on corporate behavior of the burgeoning compliance industry that has been nurtured by, among other things, fears of corporate prosecution and legislative fiat.<sup>57</sup> Where a firm has grudgingly inserted a compliance function into its organization function, one should indeed worry that the change is merely “cosmetic.” One has only to look at the allegations so helpfully spelled out in the recent indictment of SAC Capital Advisors<sup>58</sup> to see how corporate managers can marginalize the personnel hired to look over their shoulders. Moreover, as Miriam Baer has noted, “even those firms that implement compliance programs in good faith will find themselves caught between market forces that demand better performance and the risk that employees may use noncompliance as a means of meeting increasingly tougher goals.”<sup>59</sup> Yet structures without organic roots still can develop competence,

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M. Uhlman, *Deferred Prosecution and Non-Prosecution Agreements and the Erosion of Corporate Criminal Liability*, 72 *Maryland L. Rev.* \_\_ (2013).

<sup>55</sup> See Brandon Garrett, *Structural Reform Prosecution*, 93 *Va. L. Rev.* 853 (2007); Jennifer Arlen, *Removing Prosecutors from the Boardroom: Deterring Crime Without Prosecutor Interference in Corporate Governance*, in *PROSECUTORS IN THE BOARDROOM: USING CRIMINAL LAW TO REGULATE CORPORATE CONDUCT* 76–81 (Anthony S. Barkow & Rachel E. Barkow eds., 2011); James R. Copeland, *The Shadow Regulatory State: The Rise of Deferred Prosecution Agreements*, Manhattan Institute Civil Justice Report, May 2012, available at [http://www.manhattan-institute.org/html/cjr\\_14.htm](http://www.manhattan-institute.org/html/cjr_14.htm)

<sup>56</sup> See Gerald E. Lynch, *Administrative System of Criminal Justice*, 66 *Fordham L. Rev.* 2117, \_\_ (1998).

<sup>57</sup> *Id.* at 995 (discussing growth of compliance industry)

<sup>58</sup> *Indictment, United States v. S.A.C. Capital Advisors, et al.* (2013), available at [http://www.justice.gov/usao/nys/pressreleases/November13/SACPleaDocs/SAC%20Indictment%20\(Stamped\).pdf](http://www.justice.gov/usao/nys/pressreleases/November13/SACPleaDocs/SAC%20Indictment%20(Stamped).pdf)

<sup>59</sup> Miriam Hechler Baer, *Governing Corporate Compliance*, 50 *B.C. L. Rev.* 949, 1015 (2009).

confidence, and esprit over time. It is thus far too early to grade the effectiveness – with respect to both legal compliance and long-term economic efficiency – of this relatively new industry.

My colleague Jerry Lynch has nicely stated the case for, under certain conditions, pursuing firms criminally:

Given the power of corporations, their reification as legal “persons” and (perhaps even more important) the desire of some large public companies to present themselves as social and economic personalities, the same concerns about fairness and public respect for law that dictate criminal punishment of individual white collar criminals argue against letting corporations escape the moral accounting that comes with a criminal prosecution, especially (though not exclusively) when the corporate form makes it difficult to establish culpability on the part of any particular individual.<sup>60</sup>

Corporation prosecutions are, in this sense, second-best -- a recourse when a situation merits a criminal response but there isn't a more satisfactory target. But we should not underestimate the range of cases – particularly where firm profit-maximizing behavior (as opposed to straightforward self-dealing) is involved – where corporate criminal charges will be the severest appropriate response to misconduct within a firm. This is not an argument for invariably targeting firms for criminal sanctions, but it is one for making those sanctions more of a realistic option, and for getting beyond the rhetoric of whether any firm is “too big to jail.”<sup>61</sup>

The devastating force of criminal charges and the prospect of conviction generally comes less from the criminal sanction itself than from the collateral consequences that a variety of regulatory frameworks have tied to criminal sanctions. As a general matter of legislative or regulatory policy, having contractual debarment, loss of licenses or other such consequences automatically follow a criminal conviction makes sense. Criminal convictions entail adjudicated findings of highly anti-social conduct, and those findings might appropriately have ramifications beyond the criminal process (just as they do for the individuals who lose any number of rights

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<sup>60</sup> Lynch, *supra* note \_\_, J. Law & Contemp. Probs. at 50-51; see also Sara Sun Beale, A Response to Critics of Corporate Criminal Liability, 47 Am. Crim. L. Rev. 1481 (

<sup>61</sup> See Brandon L. Garrett, *Too Big To Jail: How Prosecutors Compromise with Corporations* (2014); Court E. Golumbic & Albert D. Lichy, The “Too Big to Jail” Effect and the Impact on the Justice Department’s Corporate Charging Policy, \_\_ Hastings L.J. (2014) (forthcoming).

and regularly face deportation as an automatic consequence of criminal conviction).<sup>62</sup> When such automatic linkage between criminal and collateral sanctions leads public-regarding prosecutors – worrying about market effects or the preclusion of critical government contractors -- to think twice about charging a firm deserving of criminal stigmatization, however, it may be time to reconsider linkage, lest we make criminal charges too devastating to use.<sup>63</sup> In conjunction with the Justice Department’s recent targeting – in the LIBOR case<sup>64</sup> – of corporate subsidiaries (instead of parents),<sup>65</sup> this sort of experimentation with sanction decoupling seems worth developing.<sup>66</sup>

The foregoing pragmatic counsel raises the lurking issue – not whether criminal stigmatization of firms is ever appropriate, but how much it’s worth. Sometimes it might be worth a lot, and the fact that the similar fines, forfeitures and reforms (cosmetic or real) and public attention can be obtained via DPAs or civil suits ought not dissuade us from charging. Even as empirical scholars try to figure out the market and reputation hit a convicted firm takes,<sup>67</sup> we should also consider the way a criminal conviction provides a focal point for the development of public policy. When the criminal process is working right, a conviction entails the announcement that the politically accountable Executive Branch has deployed its discretionary enforcement power against conduct that has previously been legislatively condemned, and that a judge or jury has found the facts to support that deployment. Convictions won’t always jump-start productive

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<sup>62</sup> See Wayne A. Logan, *Informal Collateral Consequences*, 88 Wash. L. Rev. 1103 (2013);

<sup>63</sup> See Drury D. Stevenson & Nicholas J. Wagoner, *FCPA Sanctions: Too Big to Debar?*, 80 Ford. L. Rev. 775 (2011).

<sup>64</sup> See Peter J. Henning, *UBS Settlement Minimizes Impact of Guilty Plea*, N.Y. Times, Dec. 20, 2012; Ben Protes & Mark Scott, *Guilty Plea and Big Fine for Bank in Rate Case*, N.Y. Times, Feb. 6, 2013.

<sup>65</sup> See Golumbic & Lichy, *supra* note \_\_\_, at TAN 241-255

<sup>66</sup> See Elkan Abramowitz & Jonathan Sack, *The “Civil-izing” of White-Collar Enforcement*, N.Y.L.J., May 7, 2013 (When the Justice Department has required a company to plead guilty to a crime, it has sometimes allowed the plea to be entered by a corporate entity, such as a subsidiary of limited scope or a dormant shell company. The practical effect has been to preclude or limit the collateral consequences of a conviction, such as exclusion from federal programs, and thereby render the criminal disposition akin to a civil settlement in which the company chiefly pays money to end a litigation.”).

<sup>67</sup> See Jennifer Arlen, *Corporate Criminal Liability: Theory and Evidence*, 144, 149-151, in Alon Harel & Keith N. Hylton, eds., *Research Handbook on the Economics of Criminal Law* (2012).

conversations about institutional design and regulatory enforcement policy.<sup>68</sup> Indeed, they sometimes prevent such conversations from happening by allowing status quo defenders to dismiss the defendants as bad apple outliers. But these larger policy conversations are a worthy goal. That said, the difference between a corporate criminal resolution and a well-publicized and clear civil settlement with an enforcement agency may not be as great as often imagined.

### **III. Conclusion**

And so we return to headhunting. Elsewhere, I have written more generally about the odd political and institutional dynamics in the United States that all too often make criminal prosecutions a “sweet spot” in many policy spaces. Criminal sanctions will simply be the “second-best preference” of those who would really prefer a very different regulatory (or deregulated) regime.<sup>69</sup> This phenomenon seems at play today. I suspect (but cannot prove) that the loudest calls for corporate executive prosecutions come from those who would have preferred more regulatory controls on corporate behavior before 2008 and who aren’t satisfied with the regulatory response since then. (Count me as one of that group.) For their part, those who worry about the heavy hand of government may not be as keen to see heads roll. But if forced to choose, I suspect they would prefer a few show trials to sustained regulatory intervention.

In the face of the number of prosecutions under any realistic scenario and their cost, I call only for more managed expectations. Certainly there’s a place for individual prosecutions, even in those situations where the offenses were primarily or equally for the gain of the firm. But if simplistic clamoring for more heads keeps us from considering more systemic regulatory reforms that better handle dangerous market “innovation,” this will have been one expensive cathartic exercise.

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<sup>68</sup> For a critique of legislative measures sparked by the Enron and WorldCom cases, see Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 *Yale L.J.* 1521 (2005).

<sup>69</sup> See Richman, *Overcriminalization*, *supra* note \_\_\_, at 83.