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WHITE-COLLAR CRIME

BY ELKAN ABRAMOWITZ AND BARRY A. BOHRER

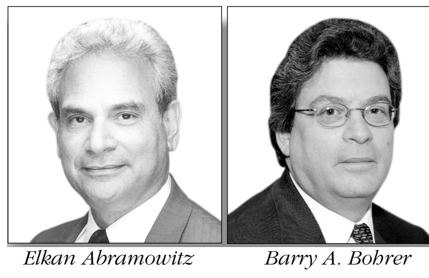
Throwing the Book (The Guidelines) at Corporate Criminals

TIMES ARE getting tougher for corporate executives who may have strayed from the straight and narrow. In the past, officers and directors could count on a certain leniency from the criminal justice system, as they were infrequently prosecuted and seldom subject to harsh sentences.

Times changed and they found themselves treated just like other alleged criminals — arrested, handcuffed, paraded on a perp-walk and facing the more certain prospect of incarceration.

Now, it seems, they have been targeted for especially severe treatment, as evidenced by amendments to the Sentencing Guidelines recently proposed by the United States Sentencing Commission. Those amendments are in response to the directive in the Sarbanes-Oxley Act to review and amend the guidelines to ensure that they sufficiently punish and deter the offenses targeted by the act: fraud and related offenses committed by corporate officers or directors; offenses that endanger the solvency or financial security of a large number of victims; and obstruction of justice, particularly where it is extensive in scope or planning, or targeted at especially probative evidence.

Elkan Abramowitz *is a member of Morvillo, Abramowitz, Grand, Iason & Silberberg. He is a former chief of the criminal division in the U.S. Attorney's Office for the Southern District of New York.* **Barry A. Bohrer** *is also a member of Morvillo, Abramowitz and was formerly chief appellate attorney and chief of the major crimes unit in the U.S. Attorney's Office for the Southern District of New York.* **Judith L. Mogul** *assisted in the preparation of this article.*



Elkan Abramowitz *Barry A. Bohrer*

The proposed amendments will be considered as emergency amendments at the commission's January 2003 meeting, after which the commission will consider re-promulgating them as permanent amendments following a period of public comment ending on Feb. 18, 2003.[1]

Qualitative Nature

Predictably, the amendments would impose stiffer penalties on corporate fraud offenders, linked not only to the scale of the fraud (measured in terms of the number of victims and the amounts involved) but also to the qualitative nature of the crime, distinct from its quantitative impact. Where once white-collar defendants, particularly those who occupied executive suites and boardrooms, could previously rely on under-enforcement and relative leniency, they can expect to have the book thrown at them if these proposals become law — as they almost certainly will.

The commission's current proposals chart a middle course between the positions of the Department of Justice, which advocates harsher punishments for fraud and tax offenders across the board, and defense groups that have called for narrow tailoring of any amendments to address only those white-collar criminals who committed their crimes at the highest corporate levels.

Quantitative Factors

Fraud Offenses: Number of Victims. The proposed amendments contain several provisions that would impose more severe sentences on defendants whose frauds affect a large number of victims. The commission is considering two different options for amending the victim table in §2B1.1(b)(2), which currently provides a two-level enhancement for frauds affecting more than 10 but less than 50 victims, and a four-level enhancement where 50 or more victims are involved. The first option would add another layer to that table, providing for a six-level enhancement if the offense involved 250 victims or more. The second option would leave the victim table undisturbed, but would amend to the application notes to add offenses containing substantially more than 50 victims to the list of factors militating in favor of an upward departure.

While the Department of Justice and

the Criminal Law Committee of the Judicial Conference of the United States have both expressed support of the first option, the Practitioners' Advisory Group (PAG) has expressed concern that the proposed six-level adjustment — which is likely to be coupled with other enhancements for use of sophisticated means, role in the offense and abuse of position of trust — would lead to overly harsh sentences. The PAG notes that under existing guidelines, a loss of $30,000 would yield a sentence of more than five years, a loss of $200,000 would allow for the imposition of a 10-year sentence, and losses in excess of $7 million would permit a sentence of over 20 years. Under the proposed amendments, a defendant responsible for a $30,000 loss could be sentenced to 10 years, and a 20-year sentence could be imposed for less than a half-million-dollar loss. On the assumption that cases of the sort contemplated by the Sarbanes-Oxley Act will almost certainly involve losses exceeding $2.5 million, the PAG notes that the proposed six-level enchantment would "virtually mandate" a sentence of 30 years to life for every defendant — a sentence of unprecedented severity for first-time, nonviolent offenders.[2]

Another proposed amendment is based on the presumption that where an offense endangers the financial solvency of a publicly traded company, or any business with a large number of employees, a large number of victims will be affected.[3] That amendment would impose a four-level enhancement and a minimum offense level of 24 for any offense endangering the solvency or financial security of a publicly traded company, with options to expand that enhancement to other businesses with a large number of employees,[4] on the theory that offenses that compromise large organizations affect the financial security of a large number of victims in much the same way as do offenses affecting publicly traded companies.

This enhancement is similar to the current enhancement in §2B1.1(b)(12) for offenses that jeopardize the safety and soundness of a financial institution. The application note for the proposed amendment, modeled after the analogous note for the financial institutions prong of the enhancement, lists as circumstances that will trigger the enhancement offenses that cause or threaten to cause the organization to: become insolvent; file for bankruptcy protection; suffer a substantial reduction in the value of its stock or the value of its employee retirement accounts; substantially reduce its workforce or its employee benefits; or merge with another company in order to continue active operations because its assets were so depleted by the fraudulent conduct. The commission has flagged as a specific issue for comment whether this list should be non-exhaustive and whether there are any other factors that, if present, should require application of the enhancement.

Whatever the ultimate particulars of the list, application of this enhancement is certain to engender considerable ancillary litigation over issues of causation, inasmuch as many corporate frauds occur precisely because a corporation is already experiencing significant financial difficulty. Defendants will argue that even without their malfeasance, the corporation would have experienced the setbacks enumerated in the application note and the prosecution will seek to lay the entire blame for a company's economic reversal at the defendant's feet.

Extent of Loss

In recognition that loss calculation is also rife with litigation potential, the commission is seeking comment on whether the definition of loss should be amended to provide further guidance in complex cases. It asks whether losses should be calculated based on change of market capitalization, a change in value of the corporate assets or some other economic effect. Resolution of the method to be employed may eliminate one potential bone of contention, but loss causation will remain subject to varying interpretations and is likely to remain highly contentious given the extent to which sentences are determined based on precise measurements of loss.

The proposed amendments expand the loss table in §2B1.1, which currently provides for 13 two-level enhancements, with the maximum increase of 26 levels imposed for losses in excess of $100 million. The proposed amendment would add two additional increments: a 28-level increase for losses over $200 million and a 30-level increase where the loss exceeds $400 million. These increases are intended to reflect congressional concern regarding particularly extensive and serious fraud, and to effectuate the increase in statutory maximum penalties for fraud from five to 20 years. The commission seeks comments on whether the loss table should be amended to provide for higher penalties for frauds involving lower amounts, particularly because two-thirds of all frauds involved less than $120,000.

Significantly, the commission has also inquired whether it should make corresponding changes to the tax loss tables "in order to maintain the long-standing relationship between the two loss tables." The answer to this question will determine whether the new focus on corporate fraud will have the effect of singling out corporate wrong-doers for particular approbation or whether it marks the beginning of a general enhancement of the penalties for white collar crime.

The Department of Justice urges a broader approach, noting that small-scale frauds, while less newsworthy, "constitute heart-rending calamities for their victims. … [and that] Congress did not intend to ignore such cases and reserve severe punishment only for those whose illegal deeds make the front page."[5] Counseling a more restrained approach, Professor Frank Bowman notes that nothing in the Sarbanes-Oxley Act or its legislative

history suggests congressional concern that economic crime penalties in general are too low. He notes that the objective of Sarbanes-Oxley was to restore confidence in American capital markets, concluding that "the evil Congress thought it was addressing was systemic fraud, mismanagement, and phony accounting by executives, accountants, and board members of large, publicly traded corporations — offenses on a scale that threatened the financial soundness of these huge corporations and therefore the health of the entire economy."

Defendant's Position/Identity

The Sarbanes-Oxley Act contained a specific directive that the sentencing commission "expeditiously consider the promulgation of new sentencing guidelines ... to provide an enhancement for officers or directors of publicly traded corporations who commit fraud and related offenses."[6] The commission's response consists of a new two-level enhancement at §2B1.1(b)(13), that would apply if an officer or director of a publicly traded corporation committed any offense involving a violation of the securities laws, regardless of whether the offense of conviction was under a specific securities fraud statute or under a general fraud statute. The commission also included a second option under which this enhancement would also apply to brokers and dealers and requested comment on whether it should apply to officers and directors of other large organizations that are not publicly traded. Other issues on which the commission has solicited comments include:

- whether there should be a minimum offense level for this proposed enhancement and
- whether, as an alternative to this enhancement, the guidelines should establish a series of enhancements that could be applied cumulatively and would apply if a defendant used a position of trust in furtherance of fraud or another corporate crime, worked to defeat or compromise internal corporate controls, independent audits or oversight by a governing board or derived more than $1 million in personal gain.

Destruction of Audit Records

Sarbanes-Oxley created a new offense — destruction of corporate audit records — codified at 18 USC §1520. Section 2E5.3 governs sentencing for this offense, but provides that the fraud or perjury guidelines should be applied as appropriate where that the offense was committed to facilitate or conceal theft, fraud or embezzlement, or involved an obstruction of justice.

Because loss calculation is rife with litigation potential, the commission seeks comment on whether definition of loss should provide guidance in complex cases.

Obstruction of Justice

The other major category of offenses addressed in the proposed amendments is obstruction of justice. Taking its cue from the Sarbanes-Oxley Act, in which Congress directed the commission to ensure that the guidelines were sufficient to deter and punish obstruction of justice generally and, more specifically, when obstruction was extensive or aimed at particularly probative evidence, the commission has proposed a two-tiered approach to obstruction. Under the amendment, § 2J1.2 would require a two-level enhancement if the offense (1) involved the destruction, alteration or fabrication of a substantial amount of evidence; (2) involved the selection of especially probative evidence to destroy or alter; or (3) was otherwise extensive in scope, planning or preparation. As yet unresolved is whether the enhancement should be triggered merely by the number of participants involved in the scheme — a concern raised by the commission but not at this point incorporated into the proposed amendment. (Presumably, if large numbers of people are involved in the obstruction, it would qualify as extensive in scope). The commission has also requested comment on whether the base offense level for obstruction of justice should be increased from 12 to 14, in order to reflect congressional concern over the seriousness of the offense. Finally, reflecting its own concern regarding parallel treatment of offenses previously treated as similar, the commission seeks comment on whether the guideline governing sentencing for per-jury and subornation of perjury should be similarly amended to maintain proportionate sentencing between the perjury and obstruction guidelines.

Given the nature and extent of the proposed amendments, the comments sought by the commission should be forthcoming in earnest.

(1) The public comment period for the emergency amendments closed on Dec. 18, 2002.

(2) Practitioners Advisory Group, Letter to Hon. Diana E. Murphy, Chair, United States Sentencing Commission, Dec. 12, 2002.

(3) One commentator has noted that this proposal, made in response to the congressional directive to ensure that the guidelines address frauds that endanger the solvency or security of a substantial number of victims does not adequately fulfill that directive, at least in part because it is underinclusive. See Letter from Frank O. Bowman, III, Professor of Law, Indiana Univ. School of Law to Hon. Diana E. Murphy, Dec. 13, 2002.

(4) The commission is considering whether this option should apply at all and, if so, whether it should apply to companies with more than 200, 1,000, or 5,000 employees.

(5) Letter from Eric H. Jaso, Counselor to the Attorney General, to Hon. Diana E. Murphy, Dec. 18, 2002.

(6) Pub. L. 107-204, §1104.

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