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WHITE-COLLAR CRIME

Expert Analysis

The 'Civil-izing' of White-Collar Criminal Enforcement

In recent congressional testimony, Attorney General Eric Holder made waves by acknowledging that "it becomes difficult for [the Department of Justice] to prosecute [large financial institutions] when…a criminal charge… will have a negative impact on the national economy, perhaps even the world economy."[1] His remarks were promptly reduced by the media to a sound bite—that many banks were "too big to jail"—and attacked by politicians on the left and the right.

The criticism was of two sorts. One concerned broader questions as to whether post-financial crisis legislative actions have sufficiently reined in large banks. Senator Elizabeth Warren remarked that "[b]ig banks are getting a terrific break, and little banks are just getting smashed."[2] A second criticism focused more narrowly on whether the Justice Department has been sufficiently aggressive in going after financial wrongdoing. Senator Charles Grassley commented that the Justice Department's failure to "enforc[e] federal laws against corporate criminals with enough vigor" would result in "perverse incentives and ultimately undermine the integrity of the U.S. financial system and economy."[3]

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In the parlance of Washington, D.C., the Attorney General committed a "gaffe," as defined by journalist Michael Kinsley: "a politician tells…some obvious truth he isn't supposed to say."[4] Because large financial institutions are vital to the economy, prosecutors will naturally hesitate to file criminal charges because of the ramifications for individuals and companies that rely on such institutions, ranging from employees to borrowers and counter-parties. The Attorney General's statement can be understood as an application of well-established Justice Department policy toward charging organizations, as expressed in the most recent pronouncement on the issue, the Filip Memorandum.[5] That document provides guidelines for prosecutors considering whether to file criminal charges against a company and expressly allows prosecutors to consider the collateral consequences of charges on third parties, such as a corporation's employees, investors and pensioners.[6]

In this article, we suggest that the Attorney General's comments go beyond financial institutions and reflect a broad trend in the prosecution of corporate misconduct following the demise of Arthur Andersen. Although only a handful of firm employees in Houston were implicated, Andersen was convicted in 2002 of obstructing a regulatory investigation and collapsed a short time thereafter.[7] By the time of the Supreme Court's unanimous reversal of the conviction in 2005, the firm was practically defunct.[8]

Since the Andersen prosecution, the Justice Department has employed different techniques either to avoid criminal convictions of companies or, if a conviction is deemed necessary, to mitigate its impact, thereby rendering the Justice Department enforcement actions against companies to a large extent civil in effect. Most prominent of these techniques are deferred and non-prosecution agreements, DPAs and NPAs, which require admissions of wrongdoing but avoid all or some of the effects of a guilty plea. Beyond these agreements, the Justice Department has brought civil fraud actions in addition to, and even in lieu of, criminal charges. If the Justice Department insists on criminal charges, it has allowed guilty pleas to be entered by subsidiaries rather than parent companies, or dormant shell companies rather than operating businesses, thereby sparing the business from debarment and other possible adverse effects of a conviction.

What we sketch out below is obviously not the whole picture. Some companies are still required to plead guilty to criminal offenses or agree to onerous terms in order to avoid a conviction. Likewise, criminal investigations of individuals for white-collar offenses remain widespread, with severe consequences for those under investigation or indictment. But the persistence of these practices should not obscure the related but separate development noted here—the "civil-izing" of white-collar criminal enforcement.

Agreements

Following Arthur Andersen's collapse, corporate convictions fell by almost half, while the number of DPAs and NPAs increased from fewer than 10 per year before 2004 to an average of approximately 30 per year thereafter.[9] "[T]he near-record pace of DOJ DPAs and NPAs [35 in total]" continued in 2012, resulting in $9 billion paid to the government "related to settlements involving a DPA or NPA."[10] A leading Justice Department official has acknowledged that DPAs "have become the mainstay of white collar criminal law enforcement."[11]

Though resulting from a criminal investigation, NPAs and DPAs resemble civil agreements under which companies pay money to the government and adopt various reform measures in return for the government forgoing prosecution.[12] What sets these agreements apart from a civil settlement is chiefly the requirement that a company admit wrongdoing. DPAs and NPAs hold companies "accountab[le]" by requiring them to accept a statement of facts constituting unlawful activity.[13] Nevertheless, DPAs and NPAs have enormous advantages over indictment and trial by allowing a corporation to avoid the collateral consequences of a guilty plea, for example, mandatory debarment from contracting with the government under various laws.[14]

The government has entered into DPAs and NPAs as an alternative to criminal prosecution in investigations involving, among others, banks, pharmaceutical companies and military contractors.[15] One of the more prominent recent DPAs involved global bank HSBC, which in December 2012 entered into an agreement under which it paid the government $1.92 billion.[16] The DPA went ahead notwithstanding criticism that the bank should have been prosecuted for laundering the proceeds of Mexican drug trafficking and conducting, and concealing, financial transactions with sanctioned countries.[17]

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Civil Fraud Charges

In recent years, the Justice Department has increasingly looked to civil fraud lawsuits to sanction alleged corporate misconduct. Often these charges are brought together with a criminal prosecution, though in many instances the Justice Department has pursued civil fraud instead of criminal charges.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), passed in response to the savings and loan crisis, authorizes the Justice Department to seek substantial financial penalties for violations of various provisions of the federal criminal law, including mail, wire and bank fraud, that affect a federally insured financial institution. The Justice Department has relied on FIRREA to bring civil rather than criminal charges against financial institutions for a range of alleged wrongdoing associated with the financial crisis, including fraud connected to federally insured mortgage lending.[18] Though premised on violations of the mail and wire fraud statutes, several of these lawsuits have resulted in civil settlements imposing hundreds of millions of dollars in civil penalties.

The Justice Department has also brought a very high-profile FIRREA case against the nation's largest credit-ratings agency, Standard & Poor's Ratings Services, accusing the firm of fraudulently rating collateralized debt obligations (CDOs) in 2007, which is being litigated vigorously and may ultimately shed light on the reach of the statute and merits of the Justice Department's civil litigation strategy.[19]

The False Claims Act (FCA) prohibits false statements to the federal government and authorizes filing suit against a wide range of businesses that benefit from government funding, including defense contractors, health care businesses that receive Medicare and Medicaid payments and mortgage loan originators whose loans come with federal guarantees. Cases premised on the FCA have been fueled in part by qui tam suits initiated by whistleblowers in which the government may intervene. In 2012, the government had a record recovery of $4.9 billion from FCA cases, $3.3 billion of which derived from qui tam actions.[20]

Recent examples of cases in which the Justice Department has pursued civil in lieu of criminal charges include lawsuits against Wells Fargo and Novartis Pharmaceuticals. The Justice Department's complaint against Wells Fargo in October 2012, though replete with allegations of knowing and reckless false statements to the Federal Housing Administration, was brought as a civil action under FIRREA and the FCA.[21] In a complaint against Novartis in April 2013, the Justice Department brought civil claims under the FCA alleging the payment of kickbacks to health care providers to induce them to prescribe Novartis pharmaceutical products that were reimbursed by federal health care programs.[22] In other cases, pharmaceutical companies have faced criminal charges for such alleged misconduct. The absence of criminal charges in this case may be an extension of the pattern of the Justice Department bringing strictly civil FIRREA cases against financial institutions.

The decision to pursue civil in lieu of criminal charges no doubt flows from many considerations, including the complexity of the underlying transactions, a dense regulatory context that may provide defenses to criminal liability, and ultimately the difficulty of meeting the higher proof requirements of a criminal prosecution. Beyond these important factors, the Justice Department's decision-making may also reflect a strategy to achieve the sort of sanction—financial penalties—and opprobrium commonly associated with criminal charges against companies, while reducing the danger of destroying a business.

Charging Subsidiaries

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.[23]

The 'civil-izing' trend may reflect a growing realization by prosecutors that the prosecution of organizations, often having severe effects on employees and others, should be reserved for only the most exceptional situations.

Recent examples of this practice include agreements between the Justice Department and international financial institutions growing out of widely publicized LIBOR investigations, pursuant to which a parent company with global operations entered into an NPA, agreeing to pay large sums in penalties and disgorgement, while smaller foreign subsidiaries, with substantially narrower business activities, pleaded guilty to felony wire fraud.[24] Another example is the government's investigation of Swiss-based Tyco International Ltd. In 2012, Tyco entered into an NPA, admitting violations of the Foreign Corrupt Practices Act, while a subsidiary pleaded guilty to conspiring to violate the FCPA and agreed along with Tyco to pay more than $26 million total to resolve the Securities and Exchange Commission and Justice Department investigations.[25] The same pattern has been seen in the health care industry.[26]

The practice of allowing subsidiaries to enter guilty pleas is not without controversy. One view is that such a guilty plea "is often a sham because the manufacturer is able to transfer assets and operations from the subsidiary to the parent company prior to the exclusion."[27] But this concern appears to have given way to the practical reality that the Justice Department can meaningfully sanction corporate misconduct through civil charges—without jeopardizing the viability of companies and the well-being of employees and communities.[28]

Conclusion

Much of white-collar criminal enforcement is unchanged. Individuals are investigated and prosecuted as before. Companies are investigated and are sometimes required to plead guilty to criminal offenses. The risk of indictment continues to limit a company's options in the context of a criminal investigation. But alongside this continuity exists the "civil-izing" trend described here. It may reflect a growing realization by prosecutors that the prosecution of organizations, often having severe effects on employees and others, should be reserved for only the most exceptional situations. Whatever the cause, the trend warrants close attention by white-collar practitioners.

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2. Mollie Reilly, "Elizabeth Warren Takes on Eric Holder's 'Too Big to Jail' Statement," The Huffington Post (March 6, 2013).
3. Letter to Eric H. Holder, Jr. from Senator Charles E. Grassley (Dec. 13, 2012).
4. Michael Kinsley, "Commentary: The gaffer speaks," The Times of London (April 23, 1988).
5. United States Attorneys' Manual, §9-28.000 (Principles of Federal Prosecution of Business Organizations (Aug. 28, 2008)).
6. Id. at §9-28.1000(B).
7. Kathleen F. Brickey, "Andersen's Fall from Grace," 81 Wash. Univ. L. Q. 917 (Winter 2003); Jonathan D. Glater, "Last Task at Andersen: Turning Out the Lights," The New York Times (Aug. 30, 2002).
8. *Andersen v. United States*, 544 U.S. 696 (2005).
9. Brandon L. Garrett, "Globalized Corporate Prosecution," 97 Va. L. Rev. 1775, 1870-71 (December 2011) (tables reviewing Sentencing Commission data on sentencing and depicting rise in deferred and non-prosecution agreements). See also Lisa Kern Griffin, "Compelled Cooperation and the New Corporate Criminal Procedure," 82 N.Y.U. L. Rev. 311, 321-22 (noting rise in use of deferred prosecution agreements since Andersen).
10. Gibson Dunn, "2012 Year-End Update on Corporate Deferred Prosecution Agreements (DPAs) and Non-Prosecution Agreements (NPAs)" (Jan. 3, 2012). See also, Peter J. Henning, "Deferred Prosecution Agreements and Cookie-Cutter Justice," The New York Times (Sept. 17, 2012).
11. Lanny A. Breuer, Speech at New York City Bar Association (Sept. 13, 2012). See also Max Stendahl, "Ralph Lauren FCPA Deal Puts NPAs in Fashion," Law360 (April 22, 2013) (SEC entered into its first NPA in an FCPA case; practitioners believe more will follow).
12. Jonathan S. Sack and Elizabeth Haines, "Be Careful What You Wish For: How Deferred and Non-Prosecution Agreements Can Be Used in Civil Litigation," Bloomberg Federal Securities Law Report (Jan. 10, 2012) (detailing provisions typically included in DPAs and NPAs).
13. Lanny A. Breuer, Speech at New York City Bar Association.
14. See, e.g. 42 U.S.C. §§1320a-7(a-b), 1320c-5; 42 C.F.R. §§1001.101, 1001.201-1001.1701 (providing for exclusion from participation in federal health care programs).
15. Michael S. Schmidt and Edward Wyatt, "Corporate Fraud Cases Often Spare Individuals," The New York Times (Aug. 7, 2012).
16. Press Release, Department of Justice, "HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit $1.256 Billion in Deferred Prosecution Agreement" (Dec. 11, 2012).
17. Ben Protess and Jessica Silver-Greenberg, "HSBC to Pay $1.92 Billion to Settle Charges of Money Laundering," The New York Times (Dec. 10, 2012).
18. See, e.g., *United States v. Wells Fargo Bank*, No. 12 Civ. 7527 (S.D.N.Y.); *United States v. Citigroup*, 1:11-cv-05473-VM (S.D.N.Y.).
19. Press Release, "Department of Justice Sues Standard & Poor's for Fraud in Rating Mortgage-Backed Securities in the Years Leading Up to the Financial Crisis" (Feb. 5, 2013).
20. Press Release, Department of Justice, "Justice Department Recovers Nearly $5 Billion in False Claims Act Cases in Fiscal Year 2012" (Dec. 4, 2012).
21. Complaint, *United States v. Wells Fargo Bank*, 12Civ.7527 (S.D.N.Y. Oct. 9, 2012).
22. Press Release, Department of Justice, "United States Files Complaint Against Novartis Pharmaceuticals Corp. for Allegedly Paying Kickbacks to Doctors in Exchange for Prescribing Its Drugs" (April 26, 2013). The press release notes that this is the second FCA complaint filed against Novartis. The first, filed on April 23, 2013, alleges that the company gave kickbacks to pharmacies in exchange for the pharmacies' agreement to switch patients from competitor drugs to Novartis product.
23. See Ben Protess, "Prosecutors, Shifting Strategy, Build New Wall Street Cases," The New York Times (Feb. 18, 2013).
24. Peter J. Henning, "UBS Settlement Minimizes Impact of Guilty Plea," The New York Times (Dec. 20, 2012); Ben Protess and Mark Scott, "Guilty Plea and Big Fine for Bank in Rate Case," The New York Times (Feb. 6, 2013).
25. Press Release, Department of Justice, "Subsidiary of Tyco International Ltd. Pleads Guilty, Is Sentenced for Conspiracy to Violate Foreign Corrupt Practices Act" (Sept. 24, 2012).
26. See Press Release, U.S. Dep't of Justice, "Schering to Pay $435 Million for the Improper Marketing of Drugs and Medicaid Fraud" (Aug. 29, 2006).
27. See, e.g., Katrice Bridges Copeland, "Enforcing Integrity," 87 Ind. L.J. 1033, 1054 (Summer 2012).
28. Henning, "UBS Settlement Minimizes Impact of Guilty Plea."