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Corporate Guilt And Individual Innocence in Financial Fraud

Part One of a Two-Part Article

By Robert J. Anello and Kostya Lantsman

Robert J. Anello **Kostya Lantsman**

Throughout the past decade, politicians, the press and the public have clamored to have individuals, particularly senior executives, held criminally accountable for missteps leading to the financial crisis as well as for more recent banking scandals, including the recent Wells Fargo fake account scandal, which has garnered Congressional attention. In apparent response to criticism of its handling of cases related to the nation's financial crisis, the Department of Justice (DOJ) announced a year ago in the Yates Memorandum that its prosecutors would focus on holding individuals accountable through criminal prosecutions.

Today, entities embroiled in criminal investigations continue to pay massive fines and plead guilty to criminal charges, but these investigations have led to few individual prosecutions and convictions. The reason for this paucity of individual prosecutions is something that may be hard for politicians, the press and public to accept: Despite bad decisions and bad policies, few senior-level individuals may actually bear criminal responsibility for these misdeeds, despite our assumptions to the contrary. Establishing individual criminal liability, therefore, has proven difficult for prosecutors.

The Outcry over Criminal Charges or The Lack Thereof

Politicians and commentators continue to maintain that supposedly lax prosecutors too often settle with companies and fail to pursue criminal charges against individuals. For example, in the aftermath of the financial crisis, Sen. Elizabeth Warren (D-MA) forlornly recounted in her book, "A Fighting Chance," her surprise that after the 2008 financial collapse she witnessed "[n]o perp walks" and "[n]o mass indictments." Although she decried the lack of wholesale indictments against individuals, on the other hand she acknowledged, "I don't know for sure if anyone at the giant banks engaged in criminal activity in the months and years leading up to the financial meltdown." Thankfully for our criminal justice system — and for executives such as those at Wells Fargo who have been the latest focus of Senator Warren's ire — prosecutors and the courts require more before indicting masses of individuals to satisfy politicians' and the public's calls for heads to roll.

Others had criticized what they saw as prosecutors allowing corporations to protect individuals. In a *Huffington Post* blog back in 2013, former District of New Jersey and U.S. Court of Appeals for the Third Circuit Judge H. Lee Sarokin derided the government's settlement with Halliburton over that company's destruction of evidence related to the Deepwater Horizon oil spill. He lambasted what he saw as the absurdity of a corporate guilty plea and fine that came with an agreement that the government would not

Robert J. Anello, a member of this newsletter's Board of Editors, is a partner in the firm of Morvillo, Abramowitz, Grand, Iason & Anello P.C. specializing in the defense of white-collar criminal cases, securities litigation, other civil litigation, and the representation of attorneys and accountants. He is a Fellow of the American College of Trial Lawyers, a Fellow of the American Bar Foundation and the President Emeritus of the Federal Bar Council. **Kostya Lantsman** is an associate with the firm.

pursue any further criminal prosecutions. He concluded by pointing out what he thought was obvious: "Corporations don't commit crimes. People commit crimes." He, of course, was incorrect: both can and do.

The Conundrum over Individual Charges

The lack of individual indictments likely reflects neither a failure to investigate nor corporations shielding individuals, but rather the considered conclusion that individuals should not be criminally charged — because they simply lacked the requisite criminal intent or because a conviction, for other reasons, would be unlikely. The investigations into mortgage lending and securitization practices have lasted for years, consumed tremendous government resources and manpower and resulted in settlements that included massive fines and no provisions that shielded individuals from criminal liability.

In the case of JP Morgan Chase, the bank paid a $13 billion civil fine in 2013 as the result of an extensive investigation into the mortgage and securitization practices at JP Morgan, Washington Mutual, and Bear Stearns. During settlement talks, the government explicitly rejected the bank's request of a provision to shield individuals. Moreover, according to press reports, the DOJ is still considering bringing criminal charges against some individuals pursuant to the extended 10-year limitations period applicable to frauds affecting financial institutions found in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. The JP Morgan case disproves critics' assertions that prosecutors have not fully investigated the financial crisis and that individuals get an uncritical free pass when corporations settle.

The Disparity: Corporate v. Individual Guilt

So, the question remains: If corporations are pleading guilty, why are their executives not being held accountable?

Guilty pleas by corporations do not, by themselves, demonstrate that individuals deserve to be indicted. Corporations settle investigations of corporate malfeasance — including by pleading guilty — for a number of reasons that do not apply to individuals. First, corporations, acting through their risk-averse boards of directors and other fiduciaries, almost never risk a criminal indictment and trial. Second, a corporation may be guilty by virtue of the collective knowledge and the intent and acts of various officers and employees, though no single individual had sufficient knowledge of wrongdoing, harbored the necessary criminal intent or committed the required acts.

Not only may corporations plead guilty in cases where no single individual committed a crime, but they may also do so in cases where the corporation itself did not commit a provable crime. Corporations, of course, do not go to jail, so the typical criminal ramifications — a fine and perhaps the imposition of a monitor — are not conceptually different from what the corporation would suffer in a rigorous civil or regulatory settlement. Indeed, oftentimes companies settle simultaneously with criminal and regulatory authorities which divvy up the loot — whether denominated as fines, penalties, restitution or disgorgement — and may jointly agree to accept the same monitor.

Although the collateral consequences of a criminal conviction, such as loss of business licenses or certain regulatory exemptions (absent a waiver) or debarment can be severe, similar consequences may follow certain government civil or regulatory sanctions. In the end then, a corporation's guilty plea simply does not present a material difference to a civil or regulatory resolution and certainly does not carry the same stigma that a criminal conviction carries for a real, live person.

Thus, corporations plead guilty for a number of reasons that have nothing to do with their actual guilt. They may want to avoid distraction of the business-generating C suite or to bring an investigation and prosecution that has been weighing down the stock price to an end. In highly regulated industries, corporations may conclude that a guilty plea is the best way to maintain good relations with regulators and the government as a whole. Moreover, large corporations often cannot risk the uncertainty of a criminal trial and potential criminal conviction. Instead, corporations and their top-notch counsel often decide fairly early on that they are not seeking to vindicate themselves at trial; rather, their goal is to resolve the matter as quickly, as cheaply, and as fully as possible. The collapse of the ultimately vindicated — on appeal — Arthur Andersen likely cemented the view that corporations should not risk a pitched battle with the DOJ.

An interesting case in point may be UPS, which entered into a Non-Prosecution Agreement with the DOJ and forfeited $40 million to settle charges that it knowingly helped distribute controlled substances for illegal online pharmacies rather than litigate those rather novel charges. Another shipper, FedEx, on the other hand, took an unusual posture and refused to settle similar charges, arguing that it lacked the requisite knowledge. FedEx attained victory during an abruptly-ended trial earlier this year when the government's proof of even corporate guilty knowledge failed. FedEx's trial may embolden companies facing potential criminal charges to reevaluate whether to risk trial where the case against them is uncertain.

Part of prosecutors' reluctance in charging individuals — even when the company for which they worked has capitulated — is because, like FedEx, individuals have been willing to hold the government to its proof.

After all, a criminal conviction for an individual not only forever brands the person as a criminal in the eyes of family and the community, but also exposes him or her to the real possibility of serving time in prison. Thus, white collar targets of criminal investigations — particularly sophisticated executives — are generally quite reluctant to accept a criminal conviction when the evidence against them may be ambiguous, thin or lacking. Rather, these individuals, through their attorneys, will argue strongly against indictment and make clear to prosecutors that they will not accept a plea, thus putting prosecutors in a position of either declining a prosecution or indicting a case that may be far from a slam dunk.

When a defense attorney pitches the prosecutor about the target's lack of knowledge or intent, reasonable prosecutors listen and decline to pursue uncertain cases. Individuals commit crimes and are indicted. Often prosecutors' failure to indict, however, is the result of a reasonable prosecutor concluding that the individuals they investigated should not or cannot be held criminally responsible.

Part Two of a Two-Part Article

Comparing the success of the Department of Justice (DOJ) in extracting guilty pleas from companies for violations of the Foreign Corrupt Practices Act (FCPA) with the DOJ's notable trial failures in FCPA matters brought against individuals is particularly instructive when we are discussing individual versus corporate criminal accountability, as we did in the first part of this article.

Dozens of companies have pleaded guilty to FCPA-related charges while only two — Harris Corporation in 1990 and Lindsey Manufacturing Company in 2011 — put the government to the test by going to trial. Charges against Harris Corporation were dismissed before it put on its defense. Lindsey Manufacturing Company was convicted at trial, but the trial judge vacated the conviction and dismissed the indictment for prosecutorial misconduct. *See* Robert J. Anello & Kostya Lantsman, Law v. Lore: The Lack of Judicial Precedent in FCPA Cases, 22 *Business Crimes Bulletin* 11 (2015), available at http://bit.ly/2h6I2g5.

Similarly, prosecutors' failure to evaluate fairly the strength of cases against individuals or choosing to ignore their weaknesses has led to significant failures at trial, including the now infamous African sting cases, which involved charges against individuals under the FCPA.

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In that failed prosecution, the government arrested and charged 22 individuals after a two and a half-year undercover investigation. That investigation involved FBI agents posing as Gabonese government officials willing to accept bribes from defense companies seeking contracts to sell body armor, weapons and other military gear to Gabon. Although three individuals pleaded guilty, 19 defendants refused to do so. The initial trial of four defendants ended in a mistrial due to a hung jury. The second trial, involving six more defendants, concluded with three acquittals, and the jury hung as to the other three defendants. Having failed to secure any convictions across two trials, the DOJ not only decided against retrying any of the counts where the juries failed to reach a verdict, but also dismissed all remaining charges and defendants.

The government's case had significant holes from the start, including credibility problems for its chief witness and evidence showing that most of the defendants — the alleged conspirators — had never met or spoken to each other. Such public failures sensibly make prosecutors loathe to indict others unless their cases are airtight.

Recent Case Study FX Manipulation

This past spring, the United Kingdom's Serious Fraud Office (SFO) announced that it was closing its investigation into fraudulent conduct related to the manipulation of FX rates without indicting any individuals. The SFO has not shied away from prosecuting individuals in the past — with mixed results. The SFO secured a guilty verdict against Tom Hayes of UBS and Citigroup for his attempts at rigging the London Interbank Offered Rate (LIBOR), while six brokers who had been accused of conspiring to help him were acquitted in a subsequent trial. It also secured guilty verdicts against three former Barclays employees for their roles in the LIBOR scandal, but the jury hung regarding the guilt of two other Barclays traders.

The SFO's decision not to prosecute any FX traders in the later FX manipulation scandal — coming on the heels of the acquittal of the six brokers in their LIBOR rigging trial and before the mixed results of the Barclays LIBOR trial — is instructive. Financial institutions have not only paid over $10 billion in fines and penalties, including over $2 billion to the UK regulator, to settle various charges related to FX manipulation, but Citicorp, JPMorgan, Barclays, and Royal Bank of Scotland pleaded guilty to U.S. criminal charges for conspiring to manipulate the FX market. Yet, the SFO announced its conclusion that "there is insufficient evidence for a realistic prospect of conviction" of any individuals. Although the DOJ has made no such announcement, and may yet bring charges, no such charges for FX manipulation have been filed well over a year after guilty pleas by the various banks.

Although the SFO has pointed to "insufficient evidence" — a common justification for failing to bring individual prosecutions — the circumstances reveal that the SFO has evidence to show exactly what happened. According to the DOJ press release, traders from various banks "used an exclusive electronic chat room and coded language to manipulate benchmark exchange rates." The information was not exchanged in dark alleys, the actions did not take place behind locked doors and the agreements were not hatched using hushed tones at the local pub. Instead, traders carried out their communications and made their agreements in imprudently named chat rooms such as "The Cartel," "The Bandits' Club" and "The Mafia." The financial institutions captured and turned over these communications, revealing the precise words and actions of the traders involved. Thus, the SFO concluded not that it failed to gather evidence for sufficient proof of what happened, but that the evidence did not show that individuals were criminally liable.

Moreover, the fact that the banks pleaded guilty to criminal charges supposedly based on the evidence gathered suggests either: 1) that the banks' guilt was a result of the collective knowledge, intent, and acts of its officers rather than criminal wrongdoing by any particular individual or individuals; or 2) that the banks pleaded guilty simply to put the FX manipulation matter behind them.

What Will Be the Impact of the Yates Memorandum?

Responding to repeated calls to prosecute more individuals, the DOJ, through the Yates Memorandum, has attempted to leverage the corporation and its lawyers to help it pursue individuals. Experienced prosecutors and defense attorneys can attest that prior to the Yates Memorandum, individuals were not ignored — rather, prosecutors have always asked, and defense attorneys have answered, the hard questions as to whether or not to bring such cases against individuals.

The Yates Memorandum may not materially alter the landscape.

For a corporation that knows that it must settle a criminal investigation, the goal is to minimize the penalty of that settlement by cooperating with prosecutors. The purpose of the Yates Memorandum was to enlist the corporate counsel to focus on individuals when performing investigative work in order to help the DOJ achieve individual convictions. The first, and arguably most important, guidance in the Yates Memorandum is that "[t]o be eligible for any cooperation credit, corporations must provide to the [DOJ] all relevant facts about the individuals involved in corporate misconduct." The corporation "must identify all individuals involved in or responsible for the misconduct."

Furthermore, the Yates Memorandum instructed DOJ prosecutors "not [to] resolve matters with a corporation without a clear plan to resolve related individual cases," and that "absent extraordinary circumstances or approved [DOJ] policy, the [DOJ] will not release culpable individuals from civil or criminal liability when resolving a matter with a corporation." Thus, corporate defense attorneys know that the fastest way to resolve an investigation is not only to cooperate by providing evidence against the corporation, but also to provide the evidence and assistance necessary for DOJ investigators to formulate a plan on resolving individual cases through civil or criminal charges or settlements.

The Yates Memorandum may not materially alter the landscape. For the last several decades, corporate cooperation has been the norm, not the exception. Because of the high hurdles involved in successfully prosecuting individuals, the Yates Memorandum's renewed focus on holding individuals accountable may make little difference in achieving convictions of individuals in white collar cases. Although the Yates Memorandum ostensibly will further incentivize companies to help prosecutors to investigate and understand the roles of individuals, it does not change the requisite elements of individual criminal liability nor alter the motives for real people to doggedly fight being labeled a criminal. Nor should it affect a sensible prosecutor's careful weighing of the evidence and evaluating the government's chances of developing a case beyond a reasonable doubt.

Thus, despite this greater focus on holding individuals accountable, innocent executives, represented by capable counsel, are no more likely to be prosecuted successfully or convicted today than in the past.

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