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Why Individuals Aren't Prosecuted For Conduct Companies Admit

By
Matthew E. Fishbein

On Dec. 11, 2012, HSBC entered into a deferred prosecution agreement (DPA) with the Department of Justice in which it admitted that it "moved illegally hundreds of millions of dollars through the U.S. financial system on behalf of banks located in Cuba, Iran, Libya, Sudan, and Burma," and hid the banks' identities by altering payment messages.[1] Under the terms of the DPA, HSBC was fined almost $2 billion, but despite the Justice Department's statement that "[t]he record of dysfunction that prevailed at HSBC for many years was astonishing," no individuals were charged—let alone convicted—in this scheme.

The HSBC matter is only one of several recent, well-publicized examples of companies entering into criminal settlements in which they admit to egregious conduct and accept massive penalties, but where no individuals are charged. The public has every right to wonder how it can be that the government brings no charges against individuals in the wake of settlements like these. Companies act only through the conduct of individuals—if the conduct is as egregious as portrayed in these settlements, and if the massive penalties are appropriate, how is it that so often the government charges no individuals?

The dearth of individual prosecutions after the financial crisis has caused significant populist outrage, from kitchen tables across the country to the pages of Rolling Stone. U.S. District Judge Jed S. Rakoff recently opined that the lack of individual prosecutions can be attributed in part to prosecutors devoting their resources to "other priorities" (such as terrorism, Ponzi schemes and insider trading), as well as to the government's own involvement in what led to the financial crisis.[2] Others have suggested that prosecutors were wary of launching investigations into teetering financial institutions. Still others note that certain crimes, like violations of the Bank Secrecy Act, are "legally institutional in nature" because individual responsibilities over the actions constituting the violation are discrete such that no one individual may be culpable.[3]

This article proposes a different explanation: Prosecutors' increasing appreciation of the leverage they enjoy over corporate entities, coupled with companies' determinations that a "bad" settlement is likely better than a "good" litigation, has resulted in a greater number of corporate settlements in cases where the government would be unlikely to prevail if forced to prove its case in court. The result, increasingly common over the last 20 years, is that prosecutors can obtain what appears to be a monumental victory without needing to develop a theory, supported by evidence, that could survive a legal challenge or prevail before a jury.

Prosecutors have far less leverage over individuals. People, unlike corporations, often face the prospect of incarceration and financial ruin in the event of a criminal conviction. As a result, individuals are more likely to test the government's legal theories and version of the facts. Of course, the government often does pursue complex cases against individuals where the legal theory is clear and the facts compelling (for example, the recent wave of insider trading cases). But in many of the recent settlements, prosecutors know from their interactions with lawyers for individuals that, unlike with the corporation, they are likely to have a fight on their hands if they bring charges. Prosecutors are under enormous pressure from Congress and the public to pursue cases against senior executives who are thought to have caused the financial crisis. If they thought they would prevail, is there any doubt that they would bring these cases?

Increase in DPAs/NPAs

The use of corporate pretrial diversion has increased substantially since 2002, largely as a result of the prosecution and conviction of Arthur Andersen, the former "Big Five" accounting firm convicted of obstruction of justice for destroying documents relating to the Enron scandal. The prosecution and collapse of Arthur Andersen had two consequences that, together, contributed to the modern practice of pretrial diversion. First, faced with the drastic potential collateral consequences of convicting a company, prosecu-

MATTHEW E. FISHBEIN *is a litigation partner with Debevoise & Plimpton.* DAVID GOPSTEIN *and* NOAM GREENSPAN, *associates with the firm, and summer associate* DUSTIN J. BROCKNER, *assisted in the preparation of this article.*

tors began turning to DPAs as less severe enforcement tools. This shift was reflected in the Thompson Memorandum, a 2003 set of guidelines for federal prosecutors on charging corporations and corporate pretrial diversion. The Thompson Memorandum emphasized corporate governance and compliance programs, and instructed prosecutors to consider pretrial diversion in exchange for cooperation. Second, the Arthur Andersen case provided companies with a stark warning of the tremendous risk of a criminal indictment and trial. Arthur Andersen was reportedly offered a DPA, but refused it.

After Arthur Andersen, the number of DPAs and NPAs entered into by the Justice Department increased from two in 2003 to an average of 32 per year from 2009 to 2013.[4] DPAs and NPAs also have dramatically increased in the size of their monetary penalties: In 2012, the total recovery through DPAs and NPAs reached $9 billion. In 2013, seven agreements included penalties of at least $100 million. To date, there have been four settlements in 2014 exceeding $100 million, two of which exceeded $1 billion.

Government Leverage

As NPAs and DPAs have become increasingly common, the government's leverage over corporations in negotiating these settlements has become more apparent. In addition to the tremendous risks associated with an indictment, prosecutors have several other powerful sources of negotiating leverage. These include: government suspension and debarment; the loss of key licenses, such as banking licenses; the drain on the time and energy of corporate executives and other witnesses; legal costs; and costs associated with the uncertainty of a criminal investigation and potential indictment.[5]

Corporations are also reluctant to go to trial because they are risk averse. Regardless of the strength of the government's case, the facts in corporate criminal cases are often complex or esoteric, and there is always a chance that a jury may not understand why a few problematic documents do not add up to criminal liability.

In light of these factors, companies often may view an admission of criminal conduct as preferable to a legal victory that clears the company's name but requires years of uncertainty. By entering into a settlement, a company often confines its exposure to a press conference followed by writing a large check, after which the incident may be relegated to a paragraph in a 10-Q filing. By contrast, a company that goes to trial may receive negative—and unpredictable—news coverage for years.

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From a business perspective, the preference to settle appears to be prudent: Even though DPAs often involve damaging admissions and massive fines, such negotiated resolutions tend to lead to an immediate increase in a company's stock price. In 2013 and 2014 (through July 20), the stock price of companies that entered into DPAs and NPAs increased by an average of .28 percent (28 basis points) on the day the settlement was announced. Stock prices increased by 0.42 percent one day after settlement, and by 0.76 percent after one week.[6] The increase of a company's stock price after it admits to often egregious criminal conduct and pays a multimillion dollar fine reflects the strong desire of shareholders and the market—and the consequent pressure on corporate executives—to resolve investigations by entering into settlements.[7] The market appears to value the certainty of a resolution more than it is concerned by admissions of criminal conduct.

The above factors all contribute to an environment in which the government can test the limits of its leverage in negotiating corporate settlements. In recent years, prosecutors have pushed those limits further, knowing that they often need not develop a theory of criminal liability that would likely survive a court challenge. A December 2013 NPA that Archer Daniels Midland (ADM) entered into to settle FCPA charges provides a telling example. Under the NPA, ADM agreed to pay $54 million in penalties for bribing foreign government officials. Although it was undisputed that officials of ADM indirect subsidiary ACTI Ukraine paid off foreign officials, they did so in order to receive tax refunds owed by the Ukrainian government.

According to FCPA expert and Southern Illinois University School of Law Professor Michael Koehler, "it is difficult to square [the elements of the FCPA] with the facts alleged in the [ACTI] Ukraine information, and anyone who values the rule of law should be alarmed by it."[8] The FCPA was designed to prevent companies from "corruptly" acquiring "business"—not receiving owed tax refunds. Moreover, the statute specifically exempts from its anti-bribery provisions "payments to a foreign official… the purpose of which is to expedite or to secure the performance of a routine government action by a foreign official."[9]

The ADM NPA appears to reflect what Mark Mendelsohn, former head of the Justice Department's FCPA Unit, has described as the "danger" of NPAs and DPAs: "it is tempting for the [Justice Department] or the SEC…to seek to resolve cases through DPAs or NPAs that don't actually constitute violations of the law."[10] But if a case turns out to be marginal, why would a prosecutor pursue it? My experience as a former prosecutor and current defense lawyer suggests that there are at least three reasons for this phenomenon.

First, competition between prosecutors' offices and public demands for immediate investigations in the wake of high-profile stories place substantial pressure on prosecutors to investigate companies quickly and to pursue cases without having necessarily vetted their appropriateness for criminal charges.

Second, many of the subjects of corporate investigations are complicated, esoteric, and place a substantial burden on the limited resources of prosecutors' offices. After a lengthy investigation, a prosecutors' office may not be inclined to simply close a case, especially if it can induce the company to enter into a settlement.

Third, as a result of the leverage discussed above, prosecutors can obtain settlements and massive payments in even marginal cases. Corporate prosecutions represent a low-risk, high-reward opportunity: The risk inherent in pursuing a marginal case is blunted by the high likelihood that a corporation will settle because of the prosecutor's superior leverage and the corporate defendant's rational risk aversion. And as settlements increase and monetary penalties skyrocket, the government accumulates and issues press releases reporting record amounts in fines and forfeitures.

Individual Prosecutions

One might think that the reason individuals are rarely prosecuted when companies enter into DPAs is because there is some unstated agreement that in exchange for the company's settlement the government agrees not to pursue individuals. But that is rarely the case. The Justice Department guidelines on "Federal Prosecution of Business Organizations" list nine factors for prosecutors to consider in determining whether to charge a company, including "the corporation's…willingness to cooperate in the investigation of its agents."[11] Under the guidelines, companies are rewarded with more favorable settlements if they can provide information that can be used against executives and employees. Indeed, agreements often explicitly state that investigations (of individuals) are continuing and that the company's settlement is contingent on its continued cooperation.

Despite such explicit provisions preserving the ability to investigate individuals, and public pressure on prosecutors to do so, few prosecutions of individuals actually occur. The reason is simple: Prosecutors do not possess the same kind of leverage over individuals that they do over companies. Because an admission of wrongdoing by an individual has far greater consequences, individuals are more likely to test the prosecution's case. In cases where the evidence of criminal conduct is weak, prosecutors may well succeed in inducing the corporation to settle, but fail to convince individuals to do the same. Consequently, we see DPAs, often accompanied by inflammatory statements of fact (drafted by prosecutors) documenting outrageous criminal conduct by the company through its employees, without any follow-up prosecution of individuals.

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Conclusion

Prosecutors have long been able to charge companies for the criminal conduct of their employees. And in the appropriate case, it makes sense that the corporation, which is created by the laws of the state, should be held accountable to ensure that its employees follow the law. But it follows that if criminal conduct has occurred, the individuals responsible should also be pursued.

The leverage the government can exercise over companies has tipped the scales to a troubling degree. By using their considerable leverage to induce companies to enter into settlements in increasingly marginal cases and forcing them to admit to egregious conduct to settle charges that likely would not survive a legal challenge or be proved to a jury, prosecutors have created a situation where the public is deceived into thinking that the individuals involved in corporate criminal conduct are receiving a free pass.

If these cases were exposed to the light of day by the adversarial system, the public would learn that they are often far murkier than they appear in the DPA's statement of facts. Instead, however, the public sees a fundamental disconnect between the prosecution of corporations and the prosecution of individuals – and is justifiably left to wonder why prosecutors do not pursue the individuals through whom all corporations must act.

1. DPAs and Non-Prosecution Agreements (NPAs) are settlements pursuant to which a prosecutor forgoes prosecution against a defendant who complies with the agreement. Unlike DPAs, NPAs are typically not filed in court or associated with court proceedings.
2. "The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?" New York Review of Books (Jan. 9, 2014).
3. Elkan Abramowitz and Jonathan Sack, "Bank Secrecy Act: Why Few Individuals Are Charged," N.Y.L.J. (Sept. 2, 2014).
4. "2013 Year-End Update on Corporate Non-Prosecution Agreements (NPAs) and Deferred Prosecution Agreements (DPAs)." Gibson Dunn & Crutcher LLP Publ'n, (Jan. 7, 2014).
5. Concerns about the collateral consequences of a lengthy prosecution and trial were a substantial factor in the recent guilty plea agreements the Justice Department entered into with BNP Paribas and Credit Suisse. As part of their settlements, the banks received critical assurances—based on prosecutors' coordination with regulators—that they would not lose their licenses to do business. Thus, although these settlements undermine the post-Arthur Andersen view that criminal conviction is a company's death sentence, they do not reflect a change in the landscape of prosecutorial negotiations with companies. That landscape remains one in which prosecutors can exercise extensive leverage to reach settlements—DPAs or pleas—with companies desperate to avoid the uncertainty of trial.
6. The change in stock price was determined by subtracting the opening stock price on the day the DPA/NPA was announced from the closing stock price on that day and then dividing the sum by the opening stock price. So, for example, if the stock opened at $2 and closed at $4 on the day of a DPA, the percentage change would be 100 percent. This calculation was then replicated using data for the day after the settlement announcement and seven days after.
7. Even guilty pleas do not appear to hurt stock price. Credit Suisse and BNP Paribas' stock price increased by an average of .17 percent on the day their pleas were announced; by 2.49 percent after one day; and by .66 percent after one week.
8. "Why You Should Be Alarmed By the ADM FCPA Enforcement Action," 09 White Collar Report 54, at 3 (Jan. 24, 2014).
9. 15 U.S.C. §78dd-3(b).
10. "Mark Mendelsohn on the Rise of FCPA Enforcement," 24 Corp. Crime Rep. 35, 35 (Sept. 10, 2010).
11. United States Attorneys' Manual §9-28.300(A)(4) (2008).

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