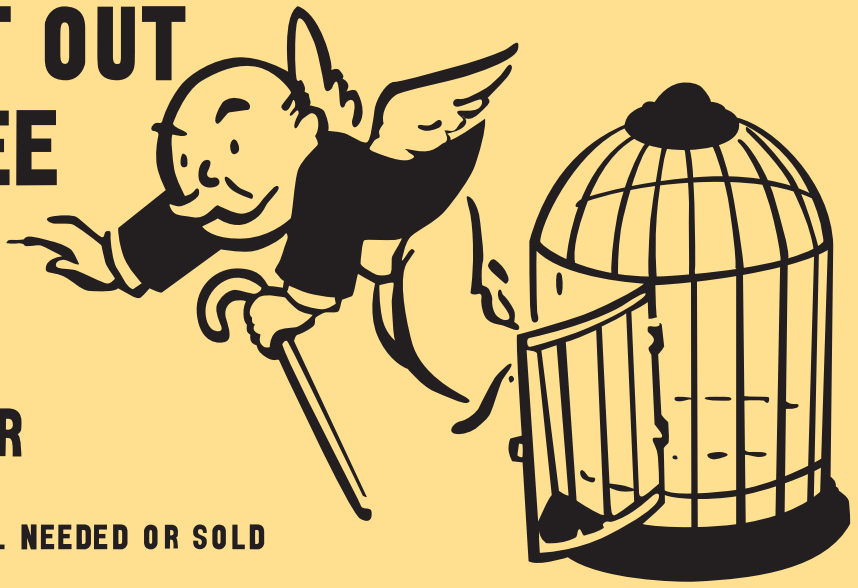
HOW WALL STREET CROOKS GET OUT OF JAIL FREE



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THIS CARD MAY BE KEPT UNTIL NEEDED OR SOLD

Over the past decade, the Justice Department has gone soft on corporate crime.

When Charles Ferguson received an Oscar for his documentary on the financial crisis, *Inside Job*, he reminded the audience that "not a single financial executive has gone to jail, and that's wrong." Given the abundant evidence of massive fraud, Americans everywhere have asked the same question: Why haven't any of those bankers gone to jail? If federal investigators could not establish criminal intent for any top-flight executives, didn't they have enough evidence to prosecute banks or financial houses as law-breaking corporations?

Evidently not. Except for occasional civil complaints by the Securities and Exchange Commission, the nation is left to face a disturbing spectacle: crime without punishment. Massive injuries were done to millions of people by reckless bankers, and vast wealth was destroyed by elaborate financial deceptions. Yet there are no culprits to be held responsible.

Former Senator Ted Kaufman was especially upset by this. Kaufman was appointed in 2008 to fill out the remaining two years of Vice President Biden's term as senator from Delaware. With no ambition to stay in politics, he was free to speak his mind. He made unpunished bankers his special cause.

"People know that if they rob a bank they will go to jail," Kaufman declared in an early speech. "Bankers should know that if they rob people, they will go to jail too." Serving on the Senate Judiciary Committee, he helped get expanded funding and manpower for investigative agencies. In hearings, he politely prodded the Justice Department, the SEC and the FBI to be more aggressive.

"At the end of the day," Senator Kaufman warned, "this is a test of whether we have one justice system in this country or two. If we do not treat a Wall Street firm that defrauded investors of millions of dollars the same way we treat someone who stole $500 from a cash register, then how can we expect our citizens to have any faith in the rule of law?"

Kaufman, now retired, sounded slightly embarrassed when I reminded him of his question. "When you look at what we got, it ain't very much," he conceded. "I'm genuinely concerned there are a lot of guys walking around Wall Street, the bad apples, saying, 'Hey, man, we got away with it. We're going to do it again.'"

If the legal system cannot locate the villains in this story, then "the law is a ass—a idiot," as Charles Dickens put it. The technical difficulties in making a case for criminal prosecutions are real enough, given the complexities of modern finance. But the government's lack of response to enormous wrongdoing reflects a deeper conflict of values. Will society's sense of right and wrong prevail, or will corporate capitalism's amoral need to maximize profit? So far, the marketplace appears to be winning.

The government's ambivalence about prosecuting the largest corporate interests could be heard in the president's comments. "Nothing will be gained by spending our time and energy laying blame for the past," Barack Obama said in a different context (crimes of torture and unlawful detention committed under the Bush administration). Treasury Secretary Timothy Geithner bluntly dismissed the "public desire for Old Testament justice." That might be morally satisfying, he said, but it would be "dramatically damaging" to economic recovery.

No one had to tell federal prosecutors to go easy. They can read the newspapers. The Treasury's inspector general called the financial system "a target-rich environment" for financial

fraud. But the government at the same time expended a vast fortune in public funds to rescue and restore the biggest banks and brokerages. Criminal indictments would not be good for investor confidence.

The economic argument dilutes, even checks, law enforcement. This occurred in government policy long before the financial crisis erupted, with its revelations of widespread fraud. During the past decade, the government demonstrated a similar reluctance to act aggressively against corporations. The Justice Department instead adopted a softer, more forgiving approach, at least for major companies. The intention was to limit the economic damage that can result from vigorous prosecution.

Instead of "Old Testament justice," federal prosecutors seek "authentic cooperation" from corporations in trouble, urging them to come forward voluntarily and reveal their illegalities. In exchange, prosecutors will offer a deal. If companies pay the fine set by the prosecutor and submit to probationary terms for good behavior, perhaps an outside monitor, then government will defer prosecution indefinitely or even drop it entirely. The corporation thus avoids the stigma of a criminal trial and the bad headlines that depress stock prices. More to the point, the "deferred prosecution agreement," as it's called, allows the company to escape the more severe consequences of criminal conviction—the loss of banking and professional licenses, charters, deposit insurance or other government benefits, including eligibility for federal contracts and healthcare programs. In other words, the punishment prescribed in numerous laws.

'Deferred prosecution agreements,' now standard, allow companies to escape the more severe consequences of criminal conviction.

"With cooperation by the corporation, the government may be able to reduce tangible losses, limit damage to reputation, and preserve assets for restitution," the Justice Department's authorizing memorandum explained in 2003. "A deferred prosecution or non-prosecution agreement can help restore the integrity of a company's operations and preserve the financial viability of a corporation that has engaged in criminal conduct."

The favored argument for the more conciliatory approach was that criminal indictment may amount to a death sentence for a corporation. The fallout will destroy it, and the economy will lose valuable productive capacity. The collateral consequences are unfair to employees who lose jobs and stockholders who lose wealth. Corporate defenders cited Arthur Andersen, the giant accounting firm that imploded after it was convicted in 2002 of multiple offenses in Enron's collapse. But was it the firm's indictment or its criminal behavior that caused clients, accountants and investors to abandon it?

A better name for the Justice Department's softened policy might be "too big to prosecute." Just as the Federal Reserve used the "too big to fail" doctrine to rescue big financial institutions from their mistakes, Justice has created an express lane for businesses and banks to avoid the uglier consequences of their illegal behavior. As a practical matter, the option is reserved for the larger companies represented by the leading law firms. They have the skill and clout to negotiate a tolerable settlement.

Russell Mokhiber, longtime editor of the *Corporate Crime Reporter*, describes deferred prosecutions as another chapter in the long-running degradation of corporate law. "Over the past twenty-five years," Mokhiber says, "the corporate lobbies have watered down the corporate criminal justice system and starved the prosecutorial agencies. Young prosecutors dare not overstep their bounds for fear of jeopardizing the cash prize at the end of the rainbow—partnership in the big corporate defense law firms after they leave public service. The result—if there are criminal prosecutions, they now end in deferred or nonprosecution agreements—instead of guilty pleas. If executives are criminally prosecuted, they tend to be low-level executives."

Deferring prosecution was made standard practice by George W. Bush's Justice Department, which over eight years deferred or canceled some 108 prosecutions. The Los Angeles law firm Gibson, Dunn & Crutcher took the lead in promoting the new policy and has negotiated numerous agreements. A lawyer in a rival firm wisecracked that Gibson, Dunn had become "the West Coast branch of the Bush Justice Department."

During Obama's first two years, Justice deferred action on fifty-three corporate defendants. None of those cases stemmed from the financial crisis. In a recent article Gibson, Dunn's leading lawyers dubbed deferred prosecution "the new normal for handling corporate misconduct." The Justice Department does still indict hundreds of business entities every year for crimes ranging from routine price-fixing to environmental destruction. Some major corporations still plead guilty as charged, especially drug companies, but prosecutions are overwhelmingly aimed at garden-variety fraud and crimes of smaller enterprises. As Gibson, Dunn lawyers put it, negotiated settlements "are now the primary tool in DoJ's efforts to combat corporate crime." The statistics in this account are unofficial, drawn from Gibson, Dunn's periodic reports to clients on deferred prosecutions.

Important corporations that have settled without a public trial include Boeing, AIG, AOL, Halliburton, BP, Health South, Daimler Chrysler, Wachovia, Merrill Lynch, Pfizer, UBS and Barclays Bank. The crimes ranged from healthcare fraud to cheating the government on military contracts, bribing foreign governments, money laundering, tax evasion and violating trade sanctions.

"Too big to prosecute" has generated controversy in legal circles but very little in politics. William Lerach, the notorious trial lawyer who has won huge investor lawsuits against Enron and many other corporations, describes deferred prosecutions as "sham guilt. They create a thin veneer of responsibility, but nothing really happens." (Lerach is not a neutral or untarnished expert, having gone to prison himself for illegally recruiting plaintiffs.) "I call them headline fines—they make for good reading, but that's all," Lerach says. "The companies can pay them in a heartbeat. You know what it is to them? A cost of

doing business, that's all. The profitability of the illegal activity far exceeds the cost of the penalty."

Lerach argues that negotiated settlements of corporate cases serve a different purpose: they shield the company's top officers and directors, who could be held personally liable for crimes. "It shifts the blame to the corporate entity—the fictional person—rather than the individuals who engaged in the misconduct and really gained financially from it," Lerach charges.

"The actual law says you are not allowed to indemnify a corporate officer or board member from prosecution for deliberate dishonest acts, i.e., criminal behavior," he explains. "The way they get around this is a misuse of these agreements. They settle with the government on what is a criminal charge, and the shareholders end up paying. They use corporate guilt to pay off the prosecutor."

Some of the penalties are huge—Pfizer paid $2.3 billion for marketing drugs in violation of labeling restrictions—but many fines seem trivial alongside a company's ill-gotten gains.

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A series of federal judges have accused Justice and SEC lawyers of letting defendants off too easy. "A facade of enforcement," New York Judge Jed Rakoff complained when he objected to a $33 million SEC settlement with Bank of America. The bank subsequently agreed to pay $150 million.

Judge Emmet Sullivan in Washington, DC, hammered Justice Department lawyers for giving "a free ride" to Barclays, which was accused of evading US sanctions on Iran and Cuba. Evidence made clear that its officers knew they were breaking the law, but none of them were indicted. "You know what?" Judge Sullivan told the government lawyers. "If other banks saw that the government was being rough and tough with banks and requiring banking officials to stand before federal judges and enter pleas of guilty, that might be a powerful deterrent to this type of conduct."

In fact, federal judges have no authority to block or alter such agreements. The discretion belongs solely to Justice Department prosecutors and US Attorneys—in effect, a semi-private system with virtually no external checks. When New Jersey Governor Chris Christie was a US Attorney, he approved a series of deferred prosecution agreements and handed out sinecures to political pals—the lucrative lawyer's job of monitoring the corporations. In one settlement Christie ordered Bristol-Myers-Squibb to finance an endowed chair in business ethics at Seton Hall law school, Christie's alma mater. This became a minor issue in his gubernatorial campaign but not enough to defeat him.

Professor Kent Greenfield of Boston College, author of *The Failure of Corporate Law*, views all this as an ominous trend. "It has become the increasing normalization of law-breaking by corporations," he says. When epic crimes go unpunished by the legal system, the wrongful behavior seems less shocking when it is repeated in the future, tolerated by discouraged citizens or regarded as an acceptable option by corporate managers.

"Crime is defined as price rather than punishment," Greenfield notes. In the new normal, "corporations can say, 'Well, is the crime worth the price, discounted by the probability of getting caught?' Because you can't make a corporation go to prison. They have no morality, no human personality or sense of morals, other than the morality of the market that reduces everything to money. If the only way to punish companies is with money, then the fine sets the price for crime."

This amoral economic logic epitomizes the deep conflict over values our society is gradually losing. Corporate leaders may protest my characterization of business values, but Greenfield points out that during the past generation this bloodless market logic has become mainstream thinking among legal scholars. A rough version of the same thinking has crept into law enforcement. Oft-cited legal scholars Frank Easterbrook and Daniel Fischel argue, as Greenfield summarizes, that "corporations should, with some exceptions, seek to maximize profits even when they must break the law to do so.… As long as the expected penalties from illegality are less than the expected profits, the corporation should act illegally." As Easterbrook and Fischel write: "Managers have no general obligation to avoid violating regulatory laws, when violations are profitable to the firm." They even argue that "managers not only may but also should violate the rules when it is profitable to do so."

The confusion of values starts with the fictitious premise that the corporation is a person, for purposes of law. The Supreme Court has awarded it many of the constitutional rights that a person possesses—free speech, the right to due process. But corporations are not mortal beings, of course, and unlike people, they can live forever. The language of "corporate personhood" is really a slick way of saying property rights come before people's rights.

Government says it is acceptable to execute people for their crimes, then turns around and tries to eliminate the death penalty for corporations. When an actual person is sentenced to prison, the court does not pause to weigh the unfortunate collateral consequences for his children. "How many individuals do you know who get a deferred prosecution agreement?" Lerach asks. "They get marched into court and put in the clink."

Lerach is sympathetic to the "death penalty" argument, because he has seen the negative consequences for people whose firms collapsed. "But you can't have it both ways," he says. "You can't say you won't indict the corporation because it will injure a lot of innocent people and have catastrophic impact. OK, but then you don't indict the individuals who were responsible. And you let them use corporate money to pay the fine. That's just a big game. There's no accountability there."

Restoring justice thus has two parts—establishing individual responsibility within the company and redefining criminal

liability for the corporation in ways that have real impact on corporate behavior. Both require reforms that are fiendishly difficult to achieve, given the corporate dominance of politics. Prosecuting individuals is complicated, as Greenfield says, because responsibility is diffused within the corporation.

"It is hard to find the one individual who had a proper mental state that satisfies criminal intent, because everyone has a part of it," Greenfield says. "The purpose of limited liability is to protect people from being responsible. If we put the assumptions about how we organize business in other areas of our lives and politics, people would be aghast."

In other words, restoring individual responsibility requires big changes in the corporation itself—anti-trust legislation to make the big boys get smaller, and internal governance reforms that give voice and influence to other stakeholders, like employees and small shareholders, who now suffer most from recklessness at the top. People throughout the firm need incentives to take responsibility for its acts.

Corporations do not experience human guilt, since they exist only as artificial entities constructed from law. It is intolerable that these organizations wield so much power over society, but for many years people have been led to believe that corporate good fortune is synonymous with general prosperity. As broadly shared prosperity is steadily withdrawn, people may rise up and demand serious reforms.

Lerach thinks any reform is hopeless for now, but he nonetheless has lots of ideas about what it might look like. "Corporations are too big, too powerful," he says. "The prosecutors are completely outgunned by the law firms, setting aside the fact that a young prosecutor is probably thinking about a job someday in a private firm. Corporate executives are not only greedy; they tend to be pretty smart. They surround themselves with professionals who tell them what they're doing is reasonable. That creates a structural shield against prosecution."

Yet Lerach thinks criminal penalties "can be created for corporations that wouldn't amount to the death penalty for them but are still painful. So you wouldn't put the prosecutor in that terrible bind where indictment might cost innocent people their jobs but would still put pressure on the company."

If a company is convicted, law could prescribe a rising scale of mandatory measures depending on the severity of the crime: forcing the company to sell off subsidiaries, drop lines of business, surrender government licenses and contracts. This would be the equivalent of "three strikes, you're out" for the mammoth corporations. The courts could also punish executives past and present, break up the company or put the entire enterprise up for sale at depressed prices. These actions are harsh—in some cases, fatal—but not really worse than what happens routinely to smaller businesses in the marketplace. Business failure gets punished unsentimentally. Criminal behavior should be clearly defined as business failure.

What will give political momentum to these ideas? Continuation of the status quo. Nobody went to jail, so eventually the corporate crooks will do it again. Next time, the rebellion won't be aimed at government. ■