Cato Handbook *for* Policymakers

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CATO INSTITUTE

18. White-Collar Prosecution

Congress and state lawmakers (and where appropriate, the president and executive branch law enforcement officials) should

- review existing law with an eye toward rolling back overcriminalization and replacing criminal penalties with civil sanctions where feasible;
- enact reforms such as the model Criminal Intent Protection Act to bolster recognition of *mens rea* (punishment should ordinarily require a guilty state of mind, not inadvertent noncompliance) as well as the related *mistake of law defense* in criminal law;
- codify the common law rule of lenity (ambiguity in law should be resolved against finding guilt), as Texas joined other states in doing in 2015;
- devise safe harbor provisions that enable economic actors to avoid criminal liability by behaving reasonably and in intended compliance with the law;
- limit agency discretion to create new crimes without an act of the legislature;
- enact guidelines to strengthen judicial oversight of deferred prosecution agreements and nonprosecution agreements (explicit court approval, not the unilateral say-so of government prosecutors, should be required for appointment of corporate monitors or the extension of time under supervision);
- enact asset forfeiture reforms such as Rep. Jim Sensenbrenner's (R-WI) Due Process Act, including requiring that conviction be a prerequisite for forfeiture;

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- review and, where appropriate, reduce or coordinate per-offense fines and sanctions to avoid levying penalties disproportionate to the gravity of misconduct;
- prohibit, as a proposed New Mexico law would do, the allocation of settlement moneys (cy pres) to charities, nonprofits, or advocacy groups not themselves injured;
- assign penalties, forfeitures, and settlement proceeds to the public treasury or, where appropriate in certain cases, to private parties who can show specific individual injury from the offense (penalties should not fund particular government agencies in ways that incentivize zealous enforcement or insulate the agencies from appropriations oversight);
- prohibit the payment of public lawyers and forensics experts on contingency, that is, in ways dependent on case outcome or the magnitude of penalties (this principle should apply alike to career prosecutors, other staff public lawyers, experts, and outside law firms); existing contingency arrangements should be terminated;) and
- impose transparent principles of selection and payment on outside contracting for legal services.

Prosecution: A Climate of Abuse

"The increasing criminalization of corporate behavior in America," noted *The Economist* in 2014, "is bad for the rule of law and for capitalism." In fact, the British weekly noted, prosecution as a means of regulating business in the United States has become "an extortion racket. . . . The formula is simple: find a large company that may (or may not) have done something wrong; threaten its managers with commercial ruin, preferably with criminal charges; force them to use their shareholders' money to pay an enormous fine to drop the charges in a secret settlement (so nobody can check the details). Then repeat with another large company. . . .

"Perhaps the most destructive part of it all is the secrecy and opacity. The public never finds out the full facts of the case, nor discovers which specific people—with souls and bodies—were to blame. Since the cases never go to court, precedent is not established, so it is unclear what exactly is illegal. That enables future shakedowns, but hurts the rule of law and imposes enormous costs."

Many abuses arise from prosecutors' search for publicity and glory. These include splashy raids on offices and "perp walks" for executives, in situations where a simple request to cooperate would have sufficed, and manipulation of the media through leaks and prejudicial publicity.

The most natural way to address prosecutorial abuse might seem to be disciplinary sanctions based on traditional standards of legal ethics and applied by judges or bar panels. The trouble with relying on that solution is that few prosecutions of large businesses eventuate in trial before a judge. When a business does put up a fight, it sometimes wins big. In 2016, after the Department of Justice (DoJ) indicted the FedEx Corporation on charges that it had knowingly done business with illegal pharmacies, FedEx refused to settle; once before a judge, DoJ's case collapsed in spectacular fashion and it dropped the charges midtrial. Much more often, however, businesses faced with a doubtful or overreaching prosecution take their lawyers' advice and fold their hands and try to get the best possible settlement. For businesses based on trust or regulatory permission, the costs and risks of defying federal law enforcement—legal, reputational, and otherwise—are just too high. The government has the upper hand. That is one reason lawmakers need to step in.

Overcriminalization and the Need for Clear and Compliable Law

There are now more than 4,000 federal criminal offenses, up from approximately 165 in 1900, 2,000 in 1970, and 3,000 in 1982, along with hundreds of thousands of regulations backed up by criminal sanction.

Under the rule of law, citizens should be able to arrange their actions so as to avoid the commission of crimes. Yet the proliferation of highly technical laws, many going beyond the prohibition of intrinsically wrongful acts, makes it more likely that even a careful business with thousands of employees will commit some violations—especially if criminal infraction of regulations can be assessed without reference to *mens rea* (i.e., guilty intent).

As Sen. Ted Cruz (R-TX) has written, "Congress should enact legislation that requires the government to prove the defendant knowingly violated the law—or that, at least, allows a 'mistake of law' defense—for certain classes of crimes that have no analog in the common law or that no reasonable person would understand to be inherently wrong. Where the government has criminalized non-blameworthy conduct for regulatory purposes, ignorance of the law should be a valid defense to criminal liability."

Four Outrageous Business Prosecutions

- "When I got there, there were people in SWAT attire that evacuated our entire factory." Thirty federal agents raided the headquarters of Nashville's legendary Gibson Guitar, carting away a fortune in wood and instruments and interrogating staff without benefit of a lawyer. The charge was that the company had used small quantities of imported wood without doing enough to ascertain suppliers' compliance with a federal law called the Lacey Act. Gibson's chief executive officer—who "had not received so much as a postcard telling the company it might be doing something wrong"—got a letter the next day warning him that if he so much as touched any guitar left in the plant he could be charged with a separate federal offense, with possible jail time, for each "violation." After much press coverage sympathetic to the company, the feds settled for a relatively low $300,000, a sum far below what Gibson would have been likely to pay in legal defense, and returned the seized instruments.
- The federal government extracted more than a billion dollars from Toyota in a settlement, even though its own engineers at the National Highway Traffic Safety Administration cleared the Japanese automaker of charges that its cars were subject to runaway acceleration. The penalties were mostly premised on minor regulatory infractions unrelated to any injuries or accidents. The Department of Justice's press announcement employed language suggesting that the problem of mechanical acceleration had been real, though Washington had good reason to know better.
- The federal government and various states, notably New York, launched enforcement actions against major banks whose actions, it was alleged, had helped propel the mortgage bubble and crash of 2008. No one really knew, and no court ever decided, whether the charges were true or what a suitable penalty level might be. When the dust settled, major banks had agreed to pay record settlements, some going to investors and consumers, but with hundreds of

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millions also going to nonprofit organizations that the various law enforcement officials saw as worthy causes—which, in the case of the Obama administration and the attorney general of New York, happened also to be close political allies.

- Several small family-owned retailers, including a Maryland dairy farm, a Detroit-area grocery, and a North Carolina convenience store, violated the little-known federal "structuring" law, which prohibits depositing money into banks in sums under $10,000 so as not to trigger a paperwork filing to the government, even when no tax or other laws are being evaded in the process. Federal agents seized the families' bank accounts. With volunteer legal help, and amid public outcry, all three businesses managed to get their money back. But many other small businesses swept up by the same law, sometimes unable to pay lawyers because of the freeze on their assets, had by that time capitulated to large forfeitures.

The situation is even worse when laws are so vague that even reading them does not give fair notice of what they prohibit. Courts are inconsistent about applying the "rule of lenity" (ambiguities should be resolved against finding guilt) and the "void for vagueness doctrine" (laws can fail constitutional muster if they leave too much doubt about what they prohibit). As a result, certain areas—including federal mail and wire fraud, "honest services" fraud, antitrust law, and securities law—have proved particularly resistant to clarification.

In recent years, the U.S. Department of Justice has also sought to expand something called the "responsible corporate officer doctrine." That doctrine allows the government to hold executives criminally liable for the sins of the corporation generally, even when those executives have not been shown to personally hold a guilty state of mind. Although the doctrine somehow passed muster at the U.S. Supreme Court in the cases of *United States v. Dotterweich* (1943) and *United States v. Park* (1975), it is ripe with potential for injustice.

Settlements and Slush Funds

Deferred prosecution agreements (DPAs) and their close relatives, nonprosecution agreements (NPAs), have become a major tool of white-collar prosecution in recent years. Typically, in exchange for avoiding trial, a business defendant agrees to some combination of cash payment, agreement to change behavior, and submission to future oversight by DoJ. Often, DoJ assigns "monitors" with broad, vaguely defined powers to oversee the affairs of defendant companies and report back to Washington on an ongoing basis.

NPAs at the federal level date back only to 1992. But they have multiplied rapidly, from 1 or 2 a year in the nineties to more than 30 a year during the Obama administration. Since 2010, 16 of the largest U.S. businesses have come under Department of Justice supervision, with tens of billions of dollars extracted in settlements.

Notably, in these agreements, a business defendant may pledge to alter its future course of action in ways that a court would never have ordered had the case gone to trial but that the government is interested in extracting as concessions. These deals may have the effect, or even the aim, of helping or hurting third parties who have the ear of the government, such as customers or competitors of the targeted defendant.

"Without any adjudication to establish wrongdoing and without any judicial oversight, businesses have agreed through these settlements to remove or replace key officers and directors; to change sales, marketing, or compensation plans; and to appoint new officers or independent 'monitors' reporting to prosecutors but paid by the companies," write James Copland and Isaac Gorodetski. The two argue that this process adds up to a "shadow regulatory state" lacking many of the administrative law protections of the visible regulatory state. Appointed monitors, in particular, can wield ill-defined but wide-ranging power with little accountability if it is put to heavy-handed use.

What to do? The United Kingdom took an early lead with its 2013 Crime and Courts Act, which, among other provisions, directs judges to determine that the provisions of DPA equivalents are "fair, reasonable, and proportionate." In the U.S. Congress, a proposal called the Accountability in Deferred Prosecution Act of 2014 attempted to pursue similar principles. Much more is needed if U.S. law is to catch up with the institutional reality of a Department of Justice that has become the nation's most powerful business regulator without anyone's having designed it that way.

At base, the case for civil liberties in the business world is much the same as the case for civil liberties generally. Businesses deserve impartial prosecution in the interests of justice, not merely scoring wins for the government; speedy trial and clear exposition of charges; determination of guilt on an individualized, not group, basis; no excessive punishment; protections against baseless search and seizure; and, in general, the full range of due process protections. The marketplace, like the rest of American society, deserves the full protections of the U.S. Constitution.

Suggested Readings

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