



## **White Collar Prosecutions in the Wake of Financial Crisis**

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**CRIMINAL JUSTICE**

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***WHITE COLLAR PROSECUTIONS IN THE WAKE OF FINANCIAL CRISIS***

***INTRODUCTION***

The Attorney General of the United States first announced new FBI investigations relating to the failed companies at the heart of the Wall Street economic crisis and then announced that he did not expect that the companies would actually be prosecuted. By the time you read this article we will know who the next President will be. Perhaps the Attorney General - and the economy - will have taken yet new unexpected turns. Are the CEO's and decision makers of the big firms facing prosecution, even if the corporations are not? Time will tell.

However, it is a certainty that major waves of white collar prosecutions will proceed at other levels throughout American business including locally. These will not be for causing the demise of Wall Street but for ordinary business transactions. Whenever there is an economic turndown, let alone a crisis, allegations of fraud follow. Just as we saw in other times of economic stress, when people lose money, they look for blood. This certainly occurred in the late 80's and early 1990's and we can anticipate it here.

### ***WHITE COLLAR CRIME AND ECONOMICS***

Federal economic white collar crime can be reduced to a handful of offenses which are popular with federal prosecutors: Fraud against the public (including, wire fraud, mail fraud and securities fraud) and, fraud against banks. There are other statutes, such as money laundering, conspiracy, false statements and RICO, which come into play in prosecuting the underlying allegations of fraud. And, there are other offenses which are tangentially related to these economic crimes, such as threats to public officials, bribery, conflicts of interest and tax fraud. But, at the bottom, there is the concept that the business practices of companies or individuals, where money was lost, are responsible for someone losing the money.

The rate of economic white collar crimes is not measurable except to the extent that prosecutions ensue. While there are reporting problems with all sorts of crime, there is some basis for knowing whether there are more homicides or bank robberies in a community. It does not matter whether or not the crimes are solved, let alone someone prosecuted, you can keep track. Economic white collar crimes are often not identifiable unless there is an actual prosecution. Having said that, why do we expect more *prosecutions* for white collar offenses?

First, there is a great deal of prosecutorial discretion at the law enforcement level and within the United States Attorney's Office. These offenses are not defined in clear terms. They usually involve an after-the-fact evaluation of what went wrong. An element of the various fraud offenses, false statements and tax fraud is materiality. Materiality must be proven beyond a reasonable doubt but it is subject to pre-indictment discretionary analysis.

Second, what may be considered material to an investor when he or she loses his or her life savings is different than what would be considered material if the same investor had made high returns. In other words, the same business conduct may go entirely unreported if the investors are making money but may give rise to prosecution if there is a loss. Even in relatively stable economic times, the evaluation of materiality is often a back extrapolation from loss.

Third, economic crisis - even a mild recession - can trigger losses and, therefore, the scrutiny of ordinary business transactions. For instance, in the late 80's the corporate raiding and junk bonds caused a crisis. Law firms specializing in mergers and acquisitions gave way to law firms specializing in criminal defense. The Milken and Boesky prosecutions got headlines at the top but there were countless others who were prosecuted in much more ordinary business circumstances as a result of the downturn.

Again in the early 1990's we saw prosecutions for fraud among major real estate developers. While property values increased in the 1970's and 80's, investors could buy up land cheaply, be fairly undisciplined in their development strategy and still sell their projects for a substantial profit. Inflation in property values was the friend of many a real estate developer. When the value of both residential and commercial real property stopped inflating and a recession ensued, these same developers came under scrutiny for the same business practices they had employed during the "boom." The materiality of misrepresentations or omissions became more significant (or, perhaps, significant for the first time) when investors lost money.

As we all know, there has been criticism for sometime of the obscene profit taking, giant CEO salaries and golden parachutes on Wall Street and elsewhere, as well as subprime lending and irresponsible credit practices that led to the crisis this fall. In fact, during the last two years, there has been more criticism than action. However,

it is safe to predict, that the Wall Street crisis of September and its aftermath will kick fraud prosecutions into high gear at both the federal and state levels. In fact, the prediction is that, other than a few national “show trials,” the brunt of prosecutions will fall on local and regional businesses and their CEO’s and decision makers. In that regard, corporate, transactional and white collar defense counsel have to be prepared.

### ***CORPORATE BOOKS AND RECORDS AND CORPORATE INTERNAL INVESTIGATIONS***

Corporate counsel cannot go back and falsify books and records. However, they can make sure that everything is up to date, in good order and properly preserved. It is critical that all corporate records, including minutes of shareholders meetings, correspondence, e-mails and other corporate records be maintained properly. We all have been shocked at how lax some operations are. This is true in national corporations as well as more local ones. In this particular economic crisis, our clients should be ready for civil litigation and the possibility of a criminal investigation.

In addition, remember, as discussed in this Column many times, that corporate internal investigations can be critical to continuing in business and avoiding indictment. If there is an indictment, a proper corporate internal investigation can limit who will be prosecuted. It can also avoid charges of obstruction of justice (either as a substantive charge or a sentencing enhancement) and can mitigate punishment including disgorgement and monetary penalties. Of course, as also suggested in this *Column*, the government has made excessive demands of corporations and only recently backed off of some of them. For instance, until recently, the Attorney General had been discouraging the compensation of counsel for officers and employees by the corporation and had also been requiring attorney client privilege waivers. These practices are not dead and, for the purpose of this month’s *Column*, suffice it to say that corporate internal investigations constitute an art form which continues to evolve.

### ***THE RESPONSE OF CORPORATIONS, CEO’S AND DECISION MAKERS WHO COME UNDER INVESTIGATION***

All counsel - business, transactional, in-house and outside corporate counsel - involved with corporations and businesses have to be ready to respond to the first indication of a criminal investigation. It bears repeating in this *Column* that pre-indictment intervention can be all important. The investigation can be limited, losses checked, an indictment avoided entirely or, at the least, a defense begun before the Speedy Trial Act kicks in. The strategy of getting in early and talking with the Agent and the AUSA can be particularly important in the fraud investigations where the conduct is susceptible to various interpretations.

Prosecutors often learn more about their case and decline to prosecute when it appears that there may be a valid defense. Sometimes additional information about the true nature of the disclosures or about self-dealing of alleged victims can have the result of avoiding indictment. Prosecutors are also interested in defenses, such as reliance on the advice of counsel, before making a final decision. Ultimately, of course, defense counsel has to determine how much information to disclose pre-indictment, when to do so and how to do it. Often, however, contextualizing the alleged conduct can have a salutary effect.

Nevertheless, I would expect that quite a number of people and companies, on and off Wall Street, will be getting target letters from the government. Alan Dershowitz, in a cynical article in *Forbes Magazine*,<sup>14</sup> predicts a boom in business for Wall Street firms which handle white collar cases. He also says that firms with former AUSA's on board will attract more clients (probably true but not necessarily warranted) and that firms will be running in and pleading their clients guilty in exchange for cooperation agreements. Unfortunately he is probably right that this will happen, whether or not it is proper. As alluded to above, the government wants to encourage corporations to roll over on officers and employees. Similarly, individuals are encouraged to roll over on each other. This is not always in the interests of justice.

The fact is that many cases can be defended successfully if handled properly. Lawyers who handle white collar criminal defense seriously have all been appalled to see a subject/target agree to plead guilty to something in exchange for cooperation only to find that no one else in the case ever got convicted. Prosecutors sometimes complain, internally to be sure, that they "bought the wrong person's testimony." It is not a result that they want and justice is certainly not served by

perpetuating a prosecution against others who ultimately should not have been prosecuted. In some of these cases, if everyone took their time, evaluated the evidence and availed themselves of time and opportunities pre-indictment, the entire case might have been avoided.

Of course, prosecutors do appreciate people coming forward, whether falling on their swords or not, to help them prosecute crime. There are also cases where an individual may find it in her or his best interest to agree to cooperate. But a rush to plead guilty in white collar cases, even if in exchange for consideration, is often not be the best course of action. White collar defense requires time to understand the case. Transactions are often quite complicated and there are often multiple factors leading to the failure of an enterprise. There is investigation to be done. And, of course, interaction with the AUSA and the agents can be invaluable.

Based on prior experience in times of recession, I suspect that a big part of what criminal defense lawyers will be doing in many of these cases is trying to help the AUSA or agents understand how the business practices were not to blame. The economy caused the rug to be pulled out from under many of these transactions. We will have to scrutinize the alleged misrepresentations or omissions in light of what was material in a functioning economy and try to avoid a more simplistic conclusion that where money was lost, there must be fraud.

## ***CONCLUSION***

Time will tell. Hopefully, the economic woes will pass quickly and criminal prosecutions will be reserved for the most serious cases. Meanwhile, we will continue to keep track of developments in future columns.

