JOHN C. COFFEE, JR.

CORPORATE CRIME AND PUNISHMENT

The Crisis of Underenforcement

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This book is dedicated

to the love of my life (and wife of fifty years):

Dr. Jane Purcell Coffee, professor of mathematics

at the City University of New York.

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Preface

This is *not* an "academic" book. If it were (and I have written several such books), it would have three times the footnotes and much more jargon. Instead the footnotes have been trimmed (reluctantly) and the jargon avoided (hopefully) to reach a broader audience. At least by design, this book is intended to be accessible to anyone interested in (1) white collar crime, (2) criminal justice administration in the real world, (3) why high-ranking executives seldom seem to be prosecuted, and (4) why certain aspects of contemporary corporate governance tend to be criminogenic. Thus, this book's focus is on both corporate and criminal law, and this book is the product of the author's work in the field of white collar crime for over forty years and in the field of corporate law and governance for even longer.

This combination produces a special perspective. For example, others have explained the persistent phenomenon that high-ranking executives are seldom prosecuted using primarily political explanations—for example, the enforcers were "captured" or the prosecutors were too risk averse. Without rejecting these explanations (which could sometimes be true), the more fundamental problem is that prosecutors function within understaffed, overworked bureaucracies that cannot normally undertake intensive investigations. Those who rise to managerial positions in such a bureaucracy are those who have learned how to stay within budget and achieve early settlements that allow their agency to claim a victory. This need to claim a victory (and quickly) is part of the unending struggle for credit in which agencies engage in order to justify a greater budget, and this need explains much about the behavior of enforcement agencies, including the recent popularity of deferred prosecution and nonprosecution agreements, the tendency for internal corporate investigations to be run by defense counsel (and not the prosecutor), and the desire of enforcement agencies to avoid protracted litigation. Bureaucracies, including U.S. Attorneys and the Securities and Exchange Commission (SEC), need to celebrate claimed victories, while staying within budget, if they are to convince legislatures to allocate them greater funds. This is a difficult balancing act and sometimes an impossible one when a major new crisis arises.

Although this diagnosis that prosecutors are too logistically constrained to undertake intensive investigations applies easily to such cases as Lehman Brothers and the other major firms that failed in 2008, the same pattern is also evident in more recent cases, such as the Boeing 737 MAX crisis, the behavior of major opioid manufacturers in selling on a wholesale basis to drug mills, the Volkswagen emissions scandal, and the failures of Pacific Gas and Electric Company (PG&E), where the organization knew at all levels that its equipment was aged and its forests were overgrown and vulnerable to major forest fires. In none of these cases were prosecutors in a position to take on lengthy investigations that necessarily would have occupied a large staff for many months. Instead, they were under pressure to reach a quick settlement—and they did. In large part, this was because experienced defense counsel understood the prosecution's logistical limitations and exploited them. The result is what this book calls "underenforcement."

If this is the problem, what is the answer? This book explores alternative arrangements and strategies that could be used to redress the logistical imbalance that cripples white collar law enforcement. In this regard, this book is ultimately as much about corporate law as criminal law. What forces within the modern public corporation are criminogenic? What causes corporate executives to take high risk? A principal answer of this book is that high levels of incentive compensation induce managers to accept high risk—both operationally and legally. That is not an answer that an academic versed only in criminal law would give. In turn, it follows that a logical way to reduce excessive risk taking at a convicted corporation may be to restrict incentive compensation, and this is most feasibly done by imposing restrictive conditions of probation on the convicted corporation. This is a corporate solution to a criminal law problem, and this is the type of solution that this book will repeatedly offer.

Similarly, much of this book will be about procedure, but not traditional criminal procedure. For example, it will ask: How can we economize on the costs of investigation and prosecution? How can we induce or compel the corporate defendant to conduct an adequate investigation on which the prosecution can rely? Again, these are not the standard problems that traditional criminal procedure addresses. Current internal investigations, this book argues, tend to discover who was responsible only down at the base of the corporate pyramid, rarely going much higher. Although many recent commentators have justly criticized deferred prosecution and nonprosecution agreements, the better policy goal should not be to prohibit such agreements but rather to use them as the carrot that induces much greater cooperation by the corporation against its own executives. This "divide and conquer" strategy requires several steps that have not yet been taken and on which this book focuses.

Consistent with many other recent critics, this book argues that the corporation itself should not be the principal target of law enforcement. This is true for three entirely different reasons: First, corporations are hard to deter; they can (and do) absorb enormous penalties as a cost of doing business. In contrast, individuals tend to be more risk averse, and empirical evidence shows they are easier to deter. Indeed, senior executives may be happy to use the corporate entity as a buffer and shield. Second, the corporation has an enormous comparative advantage over prosecutors: it can investigate internal corporate misconduct much more quickly and efficiently than the government, which is restrained by a variety of constitutional protections. This advantage needs to be harnessed and put to the service of prosecutors much more effectively than it is today. But there are subtle problems here. Third, the moral failures underlying corporate crime are those of individuals, not artificial entities (such as the corporation), and currently these individuals usually escape exposure. Convicting the corporation should not be the end goal, but it can be a principal means by which the goal of identifying and convicting responsible individuals is achieved.

Much of this book addresses the question of how regulators and prosecutors can obtain adequate resources to contest corporate misbehavior, given the reality that public bureaucracies are always constrained by budgetary limitations. It advocates two controversial strategies.

First, civil regulators (such as the SEC, the Federal Trade Commission [FTC], and other consumer-oriented agencies) should employ private law firms as their counsel, on a contingent fee basis, to handle the largest cases that these agencies cannot afford to staff or conduct themselves. Empirically, private law firms are able to undertake two to five-year campaigns to prosecute corporate misconduct (and regularly to do so in class action litigation today). Compared to public agencies, such firms are superior risk bearers because they can face the risk of defeat and come back undeterred (and have done so many times). Also, because they eat only what they kill (meaning that their fees are contingent on the outcome and they understand that there is no fee if they lose), they impose low costs on taxpayers. The counterargument to this approach is that use of private counsel would require a sacrifice of prosecutorial discretion. If such a loss were truly necessary, that would be a strong reason for public agencies not to employ private counsel on a contingent fee basis. But this is a makeweight argument. As will be seen, many public agencies already employ such counsel and do very well. The insistence of civil service attorneys in federal agencies that private counsel not be employed is sadly self-interested.

Second, the one new law enforcement tactic that appears to work in white collar cases is paying bounties to whistle-blowers for information. Law enforcement agencies could make far greater use of the whistle-blower as a means of economizing on investigation costs than they do today. Although no one denies that whistle-blowers provide valuable information, few federal agencies make serious use of them, and those agencies that do use them seem equivocal and inclined to compensate these agents only parsimoniously.

Realistically, some of the reforms proposed in this book may never be adopted (although they are beginning to be discussed). The premise to this book is not that their adoption is imminent but that we need a new way of thinking about corporate crime and misconduct. Both prosecutors and defense counsel (including those who later enter academia) tend to view these problems through the narrow prisms of their professional roles and experience. Although that is understandable, the intent of this book is to develop new strategies and a broader inventory of tools. Even if these tools are not adopted, they can give us a fuller sense of what is possible.

Finally, a preface should acknowledge those who have helped the author to formulate his ideas. For over thirty years, I have taught a seminar on white collar crime with Senior U.S. District Judge Jed Rakoff. We agree more than we disagree, but we dispute much, and his cogent thinking and strong focus on the underlying moral values in criminal law have helped me crystalize my thinking. The work of several contemporary legal scholars has also influenced me, including, most notably, Professor Brandon Garrett, whose book, *Too Big to Jail: How Prosecutors Compromise with Corporations*, set a new standard for scholarship in this field. Others who helped me shape my ideas (or at least refine them) include my colleagues Reynolds Holding, the editor of the *CLS Blue Sky Blog*; Professor Henry P. Monaghan, the Harlan Fiske Stone Professor of Constitutional Law; Professor Harold Edgar, the Julius Silver Professor of Law, Science and Technology Emeritus; and Professor Joshua Mitts. Lastly, my research assistants, Roy Cohen and Amy Burr Hutchings, deserve special credit for diligent research, thoughtful criticism, and putting up with me.

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PART 1

The Factual Story

Introduction to Part 1

ONCE UPON A TIME, corporate criminal liability was very simple: the corporation was liable for any act, committed by an employee or agent, intended at least in part to benefit it. This rule—known to lawyers as *repondeat superior*—meant that if the employee or agent was guilty, so was the corporation.

That rule is still the formal law, but over the past twenty years, it has been overwhelmed by a new practice: the corporation can escape liability for its employees' acts and instead receive a *deferred prosecution agreement* under which it may pay a fine but is not convicted or formally sanctioned. The price for this disposition is that the corpoation may have to cooperate with the prosectuion to some degree and typically conduct an internal investigaiton, which could result in prosecutors instead indicting corporate employees.

Such dispositions have now become presumptive, but they are rarely accompanied by the prosecution of higher-level corporate officers or executives. Part 1 of this book describes how this practice developed and why it has become controversial. It principally focuses on events preceding and following the 2008 financial crisis, including the complete failure of the federal government to prosecute, either civilly or criminally, anyone at Lehman (or any other senior executive at any Wall Street investment bank). Then, it turns to subsequent scandals at Volkswagen, General Motors, and the pharmaceutical firms that produced or distributed opioids and finds that the same pattern prevails.

Part 1 examines each of these cases briefly and analyzes what has caused this pattern. Was it corruption, political cowardice, risk aversion, or logistical inability to take these cases on? Tentative answers are offered. Part 1 then moves on to the Trump administration and finds that corporate prosecutions are rapidly declining. In short, American law faces a problem of underenforcement, as corporations now receive leniency as a matter of course.

ONE

The Regulatory Shortfall

SINCE THE 2008 CRASH, one question has dominated the public debate over it: Why were no senior executives on Wall Street prosecuted? How did those guys escape prison? Politicians, scholars, television commentators, and participants in nearly every cocktail party at which the 2008 crash was discussed have asked this question—usually in tones suggesting outrage, suspicion, or, at the least, pure puzzlement.[1]

Indeed, this suspicion is understandable because earlier financial debacles did produce high-profile and sometimes massive prosecutions. When Enron and WorldCom collapsed in 2001–2002, their chief executives (among others) were indicted, convicted, and sentenced to lengthy prison terms.[2] Similarly, the collapse of savings banks in the 1980s elicited wholesale prosecutions with (by some estimates) over one thousand savings bank employees and executives being convicted of felonies in federal court (with most going to prison).[3] Yet the failure of Lehman not only produced no federal prosecutions of the executives at that firm, but the SEC similarly brought no civil actions against its senior executives. Although it is an overstatement to say that no one was prosecuted as a result of the crash (as a host of lower-echelon persons were), no senior executive on Wall Street or at a major financial firm was convicted (or even prosecuted).[4]

Given the public's strong desire for retribution and the personal interest of many federal prosecutors in conducting high-profile criminal prosecutions (upon which one can build a career), this absence seems anomalous. Many have offered plausible explanations to account for this joint failure of prosecutors and regulators. The most popular theory has been that the federal government was either "captured" by the financial industry or that prosecutors were too risk averse to take on major cases that might have been lost. Jesse Eisinger, an able and respected journalist, has been the most outspoken proponent of this view, arguing in his 2017 book a thesis that is largely conveyed by that book's title: *The Chickenshit Club: Why the Justice Department Fails to Prosecute Executives*. As he sees it, the "revolving door" practices at the Justice Department and the cautious attitudes of its leaders (who were soon to rotate back to "establishment" law firms) explain this failure. Unquestionably, he makes a cogent and plausible case for his position. Even if one doubts his view that the Justice Department's leadership was cowardly or conflicted, one can still understand why the Federal Reserve and other banking agencies might have wanted more to calm troubled waters than to impose retribution. Having poured trillions into these banks pursuant to a variety of bailouts, the federal banking agencies likely saw little point in imposing massive fines on these same banks that ultimately would be paid from the funds they had advanced; the net result would only have been circular.

Of course, this does not explain why individuals were not also prosecuted. Financial regulators possibly feared that indicting senior bank officers might slow a return to normalcy and keep the banking system destabilized. Some foreign governments openly made this argument (in the case of their own banks), and some evidence suggests that federal officials also cautioned the Justice Department against a punitive pursuit of Wall Street.[5] But what does this mean? It can be read as a somewhat more polite and palatable reinterpretation of Eisinger's blunter thesis that prosecutors were simply "chicken." Still, this does not necessarily imply that federal prosecutors were "captured" but only that they proceeded more cautiously in the case of the nation's largest banks, recognizing that major banks presented a different and more problematic case for enforcement than did Enron and WorldCom.

At the other end of the spectrum from those who see the Justice Department as being overly constrained (whether by politics or innate caution) are those who deny that there was any enforcement failure at all. Within the banking industry and among economists, some believe that few prosecutions occurred because there were no true crimes committed.[6] They will argue: "It was a bubble, not a fraud." In their view 2008 was a "perfect storm"—a classic banking panic that arose outside the banking system because the "shadow banks" of Wall Street (including Lehman, Bear Stearns, and Merrill Lynch) were largely beyond the Federal Reserve's supervision. Some in this school will blame market forces; others, regulatory laxity. Clearly, these are at least colorable arguments, and one can buttress them with the observation that normally prosecutors would be eager to prosecute high-profile bank executives, either because they were "headline happy" or because they had careerist motives. Although this book believes that fraud was both present and pervasive, it recognizes that there are two sides to this argument, and neither the claim that prosecutors failed nor the counter-position that banking panics need not involve fraud can be dismissed or ignored. To date, there has yet to be a coolheaded, objective analysis that compares these rival explanations for why both prosecutors and regulatory enforcers were so equivocal (or worse) after 2008.

But the goal of this book is not to rehash a crisis that is already a decade in the past. Our starting point begins with the observation that this pattern of underenforcement that was so clear during the 2008 financial crisis has persisted, and recent crises (such as the opioid epidemic) have elicited only a few criminal prosecutions, notwithstanding deaths from prescription opioid overdoses in the range of 400,000 or more. Other disasters have produced even less of a response from public enforcers. Consider the record forest fires that swept California in 2018 and killed many. Was California's leading public utility responsible? Did it know and ignore the risks? Now in bankruptcy, Pacific Gas and Electric Company is beyond the reach of monetary sanctions, but should its executives have escaped liability? No one can answer this question without an objective investigation that probes deeply into a complex bureaucracy. In that light, the focus of this book is on the obstacles to effective investigation and enforcement, now and in the future, in the case of large-scale organizational misconduct. As we will see, the prosecutorial abdication that followed 2008 could easily happen again—and may have. In the arena of consumer safety, one may point to the cases of Boeing or General Motors where vehicles arguably known to have been unsafe were tolerated with consequent loss of life. In the case of the opioid crisis, the leading candidate would be Purdue Pharma Inc., which marketed a risky product broadly for a wide range of ailments, and overdoses potentially caused by it killed tens of thousands. In the case of environmental disasters, the examples of PG&E and British Petroleum (BP) stand out, as each recklessly caused epic destruction.

A recent popular movie—*Dark Waters*—alleges that DuPont for an extended period hid its chemical contamination of the water supply affecting at least 70,000 persons in an area of West Virginia. The movie, which grew out of a *New York Times Magazine* story,[7] asserts that DuPont long knew that the chemical was unsafe and was leaking into the water supply but concluded that the product involved was just too profitable. So it gave no warnings. Are these charges true? No judgment is here reached, because the more relevant point here is that only an extended investigation could uncover the true facts, and that is generally beyond the capacity of most prosecutorial offices. Even though a private civil settlement was reached, this is not a fully satisfactory resolution, as the settlement remains under seal and thus the goals of transparency and individual accountability are subordinated to that of victim compensation. Only public enforcement is likely to reveal the fuller truth.

Similarly, massive money laundering schemes have escaped federal prosecution (for example, HSBC), and we simply do not know how many foreign corrupt practices cases have not been pursued that should have been. The scope of these cases is simply too global for most prosecutors to pursue on