Overcriminalization of Corporate Acts

By David L. Douglass and Winifred M. Weitsen

What Is a General Counsel to Do?

Public perception that corporations deliberately, routinely, and cavalierly break the law, fleece the public coffers, and disregard public welfare regulations have long created pressures on the government to punish offending corporations and corporate officials. By the 1960s, "white collar crime" had become a matter of major attention in the law enforcement community. By the 1980s, it had become a topic of concern and fascination for the general public, largely in response to high-profile securities fraud prosecutions. Subsequent waves of government spending—on national defense in the 1980s, health care in the 1990s, the financial crisis of 2001, wars, Katrina, and the recent mortgage-driven financial collapse of 2008—have fueled these concerns. Administrative agencies were seen, rightly, as inadequate to enforcing the law. The public and politicians demanded accountability and action. Enforcement agencies responded, vowing to enforce accountability by aggressively investigating and prosecuting corporate crime.

Congress responded to public pressure by giving the enforcement community new statutory and regulatory tools, including most notably a revitalized False Claims Act, 31 U.S.C. §3929 *et seq.*, new compliance and disclosure obligations in the Sarbanes-Oxley legislation, Pub. L. 107-204 (2002), and most recently, the Dodd-Frank Act, Pub. L. 111-203 (2010), which includes over two dozen criminal offenses, some new while others expand existing criminal statutes.

For its part, the executive branch responded by announcing new enforcement initiatives and promising tougher punishment. This cycle repeats during each perceived, new corporate scheme. For example, in response to alleged government contractor profiteering in the wake of the Iraq and Afghanistan wars, the U.S. Department of Justice (DOJ) announced forming a National Procurement Fraud Task Force "to promote the early detection, prevention and prosecution of procurement fraud associated with increased contracting activity for national security and other programs." *See* Press Release, U.S. Department of Justice, Deputy Attorney General Paul J. McNulty Announces Formation of National Procurement Fraud Task Force (Oct. 10, 2006), http://www.justice.gov/opa/pr/2006/October/06_odag_688.html (last visited Nov. 13, 2012). Later, in response to the 2008 financial collapse the government created the "Financial Fraud Enforcement Task Force," comprised of several constituent entities.

While few would argue that corporations and their executives should not be prosecuted for violating the law, endangering the public welfare, or misappropriating public funds, at least not publicly, it is fair to argue, publicly, that this phenomenon has gone too far. Someone can accept the legitimacy and even the necessity of criminalizing corporate misconduct and yet argue that excessive criminalization, "overcriminalization," in fact undermines society's enforcement goals and imposes other disproportionate social and economic costs. While overcriminalization is a real problem for corporations and their executives, corporate counsel can take action to reduce these risks and costs.

What Is Overcriminalization?

The use of punitive statutes to regulate corporate behavior is known as "regulation by enforcement" and is firmly entrenched in criminal jurisprudence. In 1943, the U.S. Supreme Court endorsed

> legislation whereby penalties serve as an effective means of regulation. Such legislation dispenses with the conventional requirement for criminal conduct—awareness of some wrongdoing. In the interest of the larger good, it puts the burden of acting at hazard upon a

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> person otherwise innocent but standing in responsible relation to a public danger.

United States v. Dotterweich, 320 U.S. 277, 280–81 (1943).

The seminal case on this point is *United States v. Park*, 421 U.S. 658 (1975), in which the CEO of a national retail food chain was charged with a misdemeanor violation of the Food, Drug and Cosmetic Act due to adulteration of products in one of the chain's 16 warehouses even though he was not directly responsible for conditions at the warehouse. Imposing strict misdemeanor liability on corporate officers for corporate transgressions is known as the responsible corporate officer doctrine. *Id.* at 672. Although this doctrine has been applied only to certain statutory misdemeanors, most notably associated with the Food, Drug, and Cosmetic Act and the Clean Water Act, the doctrine validates the policy of using criminal laws and sanctions to regulate corporate conduct. Political pressure to punish corporations and corporate management for misconduct, real or perceived, has caused both the legislature and the executive to magnify this policy and create an ever-expanding network of statutes and regulations that form a broad web that prosecutors can use to snare and punish businesses and their personnel.

Overcriminalization refers to the government's *excessive* reliance on *punitive* statutes and regulations to punish and regulate disfavored business practices. The term inherently connotes excess. It refers not just to criminal statutes but also to a constantly growing list of civil statutes and administrative sanctions that are punitive in nature or effect. The False Claims Act, which provides for treble damages, monetary penalties, and fee-shifting, epitomizes a civil but punitive statute. The government's authority to bar companies or individuals from doing business with the government, known as debarment or exclusion, is ostensibly intended to protect the government from the threat of future harm; yet, in practice, debarment punishes the debarred and can give prosecutors tremendous leverage to force settlements or pleas. Criminal and civil statutes, as well as administrative sanctions, constitute a web of enforcement tools that affords the government a wide range of tools to use to regulate, that is, to punish, disfavored corporate conduct. Regulation by enforcement becomes overcriminalization when it unfairly empowers the government retrospectively to sanction corporate activity that tradition does not recognize as unlawful.

Overcriminalization is the product of numerous laws and regulations that exponentially expand the scope of potential criminal, punitive civil, and administrative sanctions, including (1) statutes establishing criminal liability for specific corporate offenses; (2) guilt by association statutes; (3) obstruction of justice statutes, including statutes criminalizing false statements and certifications; (4) punitive civil statutes; and (5) draconian administrative sanctions. For example, in addition to strict misdemeanor liability under the Food, Drug, and Cosmetic Act and Clean Water Act, Congress has passed numerous statutes specifically criminalizing certain forms of fraud, such as health care fraud, document falsification or false statement under the Sarbanes-Oxley Act, and certain forms of financial fraud under the Dodd-Frank Act. Certain provisions of the Dodd-Frank Act are enforced under Title 7, section 13 of the United States Code, which states that any willful violation is criminally punishable. 7 U.S.C. §13(a)(5). What it really means is that some elected representative, or more likely a staffer, thought that Congress needed to add some teeth to the legislation, to say, "We really mean it. You can go to jail." This provision exemplifies the problems with overcriminalization. It purports to criminalize a broad, undefined, and potentially limitless category of conduct that in the final analysis is unlikely to establish a new substantive offense. And, to the extent that it does purport to do so, it is unlikely that its vague language affords adequate notice of what it prohibits to satisfy due process safeguards.

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Guilt by Association Statutes

One aspect of overcriminalization is that it resorts to guilt by association through conspiracy, aiding and abetting, and vicarious liability, or "respondeat superior." The responsible corporate officer doctrine is a specific manifestation of vicarious liability that holds the responsible corporate officer criminally liable for the failures of a subordinate, not on the basis of his or her participation in the violation, but solely on the basis of the employment relationship between the two individuals. More broadly, however, the doctrine of respondeat superior embraces criminal as well as civil liability for organizations. In the criminal context, the respondeat superior doctrine greatly expands a corporation's risk of criminal prosecution by rendering it liable for the acts of any of its employees regardless of whether the conduct was authorized or condoned by the corporation.

Vicarious liability is particularly threatening to organizations when considered in the context of mail and wire fraud. The federal mail and wire fraud statutes, 18 U.S.C. §1341 and 18 U.S.C. §1343 respectively, make it a federal felony to engage in a "scheme or artifice" to deprive another of money or property. These statutes essentially criminalize the commission of an interstate civil fraud through use of the mails or electronic communications. Virtually any significant business transaction would satisfy the threshold jurisdictional elements for mail and wire fraud, including the recently announced DOJ civil mortgage fraud case against Bank of America Corporation and its predecessors, Countrywide Financial Corporation and Countrywide Home Loans, Inc.

The federal conspiracy statute makes it a felony to conspire to "commit any offense against the United States, or to defraud the United States, or any agency thereof in any manner or for any purpose…." 18 U.S.C. §371. Liability is not lim-

ited "to common-law fraud, but reaches any conspiracy for the purpose of impairing, obstructing or defeating the lawful function of any department of Government." *United States v. Touhy*, 867 F.2d 534 (9th Cir. 1989) (quoting in part *Dennis v. United States*, 384 U.S. 855, 861 (1966)). In *Tuohy*, the defendant conspired with others to acquire a controlling interest in a bank. He was charged with conspiring to defraud the United States "by interfering with and obstructing the FDIC's lawful government function of administering the provisions of the Change in Bank Control Act of 1978 to prevent serious adverse effects on the banking system." *Id.* at 535. On appeal, the Ninth Circuit rejected the defendant's argument that "conspiracy to violate a noncriminal statute is not a crime." *Id.* Quoting the Supreme Court, the Ninth Circuit stated, "the 'illegal' purpose need not involve a criminal violation. Thus, the 'defraud' part of section 371 criminalizes any willful impairment of a legitimate function of government, whether or not the improper acts or objective are criminal under another statute." *Id.* at 537. When this principle is combined with the ever-expanding network of regulatory oversight of economic activity, the result is to subject to potential criminal activity virtually every financial transaction in which two or more participants share a common objective.

The conspiracy statute is especially attractive to prosecutors and threatening to their targets because the threshold for proving the elements of conspiracy is low and broad: "Three elements establish a conspiracy under section 371: An agreement to achieve an unlawful objective, an overt act in furtherance of the illegal purpose, and the requisite intent to defraud the United States." *Id.*

As any experienced prosecutor or defense attorney will tell you, the factual foundation necessary to satisfy "agreement," "an overt act," and "intent" is thin at best. An agreement need not be in writing or even the result of a hand shake. An agreement can be inferred from evidence as scant "as a wink or a nod." An "overt act" may be any act in furtherance of the conspiracy. "Intent" may be inferred by a jury based on direct and circumstantial evidence. And, as a criminal defense attorney will tell you, a jury's finding of wrongful intent unfortunately tends to reflect not what the defendant thought, but what the jury thinks he or she must have thought. Thus, once the government establishes the underlying offense, lassoing in additional defendants through the conspiracy statute can be more a product of effort than skill. Moreover, because the conspiracy statute is intended to address the harm of criminal agreements apart from the underlying substantive offense, someone can be liable for conspiracy even though the underlying offense is never consummated or the jury acquits on the charges for the underlying offense.

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Aiding and abetting liability is another form of guilt by association. Whereas the conspiracy statute punishes criminal agreements, aiding and abetting liability attaches to accessories to a criminal act. *See* 18 U.S.C. §2 (accessory before the fact) and 18 U.S.C. §3 (accessory after the fact). Similar to conspiracy liability, the elements of aiding and abetting, as distinguished from the underlying substantive offense, are broad and accord jurors great latitude to infer guilt on few facts.

Obstruction of Justice Statutes

The now well-worn phrase "It's not the crime, it's the cover-up" captures the range of statutes used to punish efforts to obstruct, impede, or frustrate law enforcement investigations or agency functions. This category encompasses more than the traditional obstruction of justice statutes, such as 18 U.S.C. §1501 *et seq.*, and perjury, 18 U.S.C. §1621, but includes statutes that criminalize false statements, such as 18 U.S.C. §1001, and false certifications. The Medicare program and other government contracting programs have long required claimants to certify to the accuracy of claims submitted to the government. The Sarbanes-Oxley Act borrowed and significantly broadened this requirement, requiring the "principal officers" of public companies, typically the CEO and CFO, to certify personally the accuracy of their company's U.S. Securities and Exchange Commission filings. False certifications to the government can constitute a criminal false statement, a five-year felony, as well as a violation of civil False Claims Act statutes, which can lead to treble damages, civil money penalties, and if arising from a qui tam False Claims Act action, responsibility for the whistleblower's attorneys' fees. Additionally, a false certification could well form the predicate for prosecution under a deprivation of honest services theory of mail or wire fraud liability.

Certification obligations are an attractive enforcement tool for two reasons. First, as an evidentiary matter they can ease the government's burden of proof by freeing it of the need to prove a criminal violation of what can be complex and arcane accounting requirements and instead, allow it to prove that a defendant knew or should have known that the certification was false. This approach can effectively shift the burden of proof to the defendant who essentially will be under pressure to prove the truth of the certification. Second, as compliance policy, these requirements give corporate executives personal stakes in ensuring the accuracy of claims and statements on which the government or the public rely to avoid prosecution. These requirements, however, have proved to be expensive, burdensome, and arguably unnecessary.

Punitive Civil Statutes

As alluded to above, criminal statutes are not solely responsible for overcriminalization. In fact, a key aspect of the overcriminalization phenomenon is the government's resort to civil statutes and administrative sanctions that have punitive characteristics. The federal False Claims Act exemplifies a punitive civil statute, as do the state law counterparts. The False

Claims Act subjects violators to treble damages and potentially staggering civil penalties. The False Claims Act also contains qui tam provisions that authorize private citizens, commonly known as whistleblowers or relators, to file lawsuits on behalf of the government. The qui tam provisions also subject defendants to paying the relators' attorneys' fees. The False Claims Act has become an enforcement tool of choice for both federal and state governments, especially with respect to military contracting and the health care goods and services industry.

Administrative Sanctions

A powerful but purportedly non-punitive weapon in the government's enforcement arsenal is its power to bar companies and individuals from doing business with the government, which is known as debarment, or in the case of companies that contract with health care programs, exclusion, referred to here collectively as "debarment." The stated purpose of the debarment authority is not to punish a company for its past transgressions but instead to protect government programs from the threat of fraud or harm prospectively. Thus, the government may not debar a contractor solely on the basis of past actions but only on a showing of a risk of prospective harm. In practice, however, conviction of a crime, or in certain circumstances, a finding of civil liability, can lead to debarment. For companies for which the government is a major customer debarment can be a crippling, even fatal sanction. Indeed, for many companies debarment is tantamount to a corporate death penalty. Consequently, the debarment authority provides powerful leverage to enforcement agencies to force settlements in exchange for the government's agreement not to pursue debarment or to agree to a limited term of debarment.

These criminal and civil statutes and administrative sanctions combined give the government a wide choice of tools, or weapons, to shape or to attack corporate conduct. Even a modest financial transaction can trigger a cascade of potential charges. A company can face multiple damages and fines and debarment. Its employees—up to and including its C-suite occupants—can face imprisonment.

What Is a General Counsel to Do?

Overcriminalization will no doubt remain a part of the legal and political landscape for the foreseeable future. Whatever the costs, the political reality is that a "soft on corporate crime" platform will not have a significant constituency. So, what is a general counsel to do? A general counsel should advise his or her client to adopt steps to reduce the risks posed by overcriminalization involving (1) effective compliance, (2) advocacy, and (3) strategic litigation.

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Compliance

Now, more than two decades after *In Re Caremark International Inc. Derivative Litigation*, 698 A.2d 959 (Del. Ch. 1996), which established a director's duty of care in oversight, and the Organizational Sentencing Guidelines, which firmly established an organizations' responsibility to implement and maintain effective compliance programs, organizations can no longer debate the desirability and necessity of strong compliance programs. While quantifying the risk reduction benefit of these programs continues to prove challenging, ample evidence exists, even if anecdotal, that such programs do indeed promote compliance and detect noncompliance, often at a stage that can avoid significant liability risk and disruption. Suffice to say that responsible companies must have compliance systems adequate to prevent and detect the type of liability risks that they face. The companies that fail to do so are presumably culpable in their fate.

Advocacy

In the face of mobilized constituencies that continue to press for more and tougher criminal sanctions for corporate misconduct, surprisingly the business community has responded comparatively tepidly. The business community can do more to expose and to modify the statutes and regulations that have demonstrated that they undermine the purposes they were enacted to achieve, however well-intentioned. Years ago, the business community successfully mobilized to repeal the so-called "Thompson Memorandum," a DOJ policy that considered a company's refusal to waive the attorney-client privilege as indicia of reluctance to cooperate with an investigation. Likewise, recent efforts to modify the most anticompetitive aspects of the Foreign Corrupt Practices Act have found a receptive legislative audience. Efforts to prevent adoption of False Claims Act-type statutes by states or to modify some of the more onerous provisions of proposed legislation have also met some success.

Decades of experience with government prosecution of corporate crime has generated demonstrable evidence that some of the statutes do not accomplish their purpose or undermine other important societal priorities, such as job creation, promoting competitiveness and innovation, and the law enforcement goal of encouraging corporate self-policing through compliance programs. Whatever the purposes of the False Claims Act, to pick one example, disproportionate bounties to whistleblowers and their counsel have turned a statute intended to ferret out fraud into a lottery system that encourages novel and specious theories of liability, turns informants and their lawyers into millionaires, and makes the hard and soft costs of defending these cases unfairly high. Similarly, when potential debarment threatens a corporation's existence, the risk that the government may impose those sanctions deters corporations and individuals from exercising their individual and socially valuable rights to challenge the government's allegations and evidence. Only the most naïve or calculating would argue that an allegation is as good as a finding. If litigation is a truth-seeking process and the right to a jury trial reflects the founding fathers' wisdom

that impartial juries—not government officials—are best suited to judging the facts underlying a dispute, then advocates have strong arguments to support eliminating rather than enhancing disincentives to exercising the right to a jury trial, such as the threat of debarment.

Litigation

Having made the case for reducing disincentives to litigation, the fact remains that an allegation is not a finding. Litigation is the process for separating fact from fiction and rending judgments that reflect the values of a cross section of society, not the executive branch. As defense counsel say during trials, "It is one thing to proclaim, it is another thing to prove." This axiom has proved especially valid in complex criminal cases. When the government's liability theories are tethered to arcane or complex government contracting provisions or financial accounting standards, prosecutions have tended to fail. Instead, when conduct constitutes run-of-the-mill lying, cheating, and stealing, juries generally convict. But in that case, a defendant's problem is not *over*-criminalization but plain old criminalization of deceit and avarice.

Litigation, though admittedly costly, inefficient, and imperfect, has nevertheless proved to be a reliable and effective process for organizing and evaluating the validity of complex claims. It forces clarity, objectivity, and hard choices—for both sides. Often an indictment or False Claims Act complaint is the product of years of investigation. It should not be surprising that by the time the government files a formal charge, whether civil or criminal, it has convinced itself of the validity and strength of its claims. Litigation is a defendant's vehicle for reorienting the government's perspective, focusing its attention on facts that it may have overlooked or inadequately considered and offering alternative explanations for motive and intent. It is also not surprising that allegations of serious misconduct, crafted no doubt to shape the views of a court, a jury, and even the public, can cause anxiety, even panic, among shareholders, corporate officers, and employees. Yet, a well-formed, diligently executed litigation strategy can (1) refute, or at least, narrow the potential scope of liability; (2) allow the company to factor in the effects and potential consequences of the litigation into its business planning; (3) plan for potential outcomes; and (4) even restore the confidence of interested and affected constituencies. Finally, given the massive fines and multiple damages that enforcement actions can bring on, the litigation costs frequently simply amount to a fraction of the costs of settlement. To turn an old adage on its head: "Pennies for defense, not a billion in tribute."

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All too often it seems that corporate officers and sometimes even their general counsel unfamiliar with litigation generally, let alone criminal investigations and prosecutions, focus unduly on potential adverse outcomes, which at the inception of an investigation or litigation are often speculative, uncertain and inevitably distant, and overlook the long path from allegation to proof. In the years that regulation by enforcement has metastasized into overcriminalization, the corporate criminal defense bar has had years to develop and refine our tools for defending companies against unfounded or exaggerated charges. If investigations and litigation are now simply a cost of doing business, as they unfortunately are, then litigation must also become part of a company's risk management program. If the government expects companies to implement systems to prevent and detect noncompliance, then surely they must implement systems to defend their compliance. In an age of overcriminalization, having the capacity and adopting a willingness to defend a company's compliance in litigation is an indispensable part of its risk management program.

Given the real and present danger of overcriminalization, general counsel must anticipate enforcement investigations and litigation. Similar to any other identifiable risk, a company must adopt measures not only to prevent the risk but to manage it. Managing the risk of prolonged enforcement investigations and litigation requires litigation preparedness, capacity, and planning. Too many organizations consider investigations as not unlike acts of god—unforeseeable, random plagues that unfortunately can beset Job as easily as the Pharaoh. In reality, however, the better comparison is to a storm, which can range from a mild inconvenience to a substantial disruption to a crippling natural disaster. Investigations are neither wholly random nor entirely unforeseeable. They can appear as a simple subpoena for documents, as a complaint, or as the natural disaster of enforcement, a search warrant. Regardless, enforcement investigations and litigation are as foreseeable as storms and proper preparation can limit the disruption that they inflict.

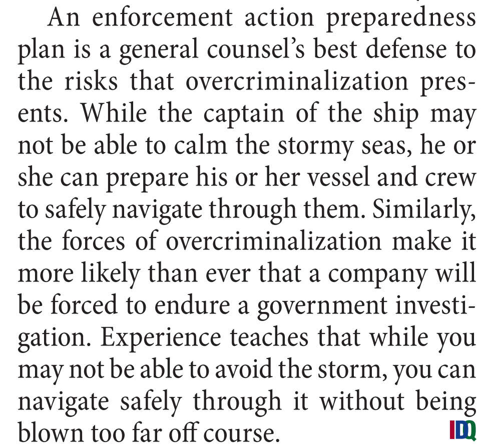
Enforcement action preparedness requires anticipating the forms in which investigations or litigation arise and adopting appropriate safeguards. Providing instructions to key personnel on how to respond to government requests for interviews, subpoenas, and even search warrants are some elements of an enforcement action preparedness plan. An enforcement action preparedness plan also should adopt procedures that ensure prompt, adequate, and accurate communication concerning an action to appropriate corporate personnel. The ability to communicate important information promptly to those with a need to know promotes confidence that a matter is being handled appropriately, minimizes business disruption, and allays fears. Creating lines of communication from affected or concerned personnel to the legal department is also essential to creating a channel for reporting information concerning an investigation that they pick up in the field

or at the water cooler, as well as preventing or limiting the spread of unfounded rumors or speculation.

Responding to a government enforcement action of even modest scope or duration requires an effective partnership between in-house counsel and retained defense counsel. The time to identify outside counsel is before the subpoena is served or the search warrant is executed. Candidly, a lawyer that brings knowledge of his or her client to an enforcement action is better equipped to represent a client than a lawyer who will learn about his or her client while simultaneously playing catch up to the government. Of course, defending a potentially significant government investigation is not an appropriate training ground for outside counsel. With respect to defending enforcement actions, experience counts. Many of the procedures, perspectives, and expectations in government enforcement actions arise not from statutes, case law, regulations, or formal rules but from practices that have evolved over time. Defense counsel must be familiar with the perspectives and expectations of prosecutors and agents. Counsel that knows a company can also tailor his or her advice to the company's specific needs, priorities, or culture in ways that less familiar counsel simply cannot.

Defending an enforcement investigation or litigation largely involves project management. The role of outside counsel is to advise a company respecting its rights, risks, and options, as well as to become its representative to the government. The role of in-house counsel is to evaluate the advice that he or she receives given the company's objectives, needs, priorities, and culture, to guide outside counsel regarding the company's legal objectives, and to select among the various strategic options that outside counsel may present. It is entirely fair and reasonable for in-house counsel to expect that outside counsel will conform his or her strategies, tactics, and efforts to the company's needs, such as providing ample notice of a need to collect documents and information, or adjusting litigation plans and schedules to accommodate the company's business needs and plans. A litigation priority should rarely trump a business priority. For even a sophisticated client and experienced in-house counsel government investigations and litigation are more often than not daunting, unfamiliar, and unsettling experiences. For experienced defense counsel, however, they are business as usual. Effective defense counsel will not simply defend a company but will strive to alleviate a client's fears, reduce its uncertainty, and minimize business disruption.

Among the greatest concerns for in-house counsel can be the potential expense of litigation. A new investigation invariably triggers unbudgeted expenditures. The days in which defense costs were unaffected by corporate budgetary constraints are an increasingly distant memory. Yet, the same experience that enables defense counsel to anticipate the course of an investigation should also enable him or her to forecast to a reasonable degree of certainty the cost of defending the investigation. Establishing a budget that is reasonable relative to the nature and scope of the investigation and the company's resources can greatly strengthen a company's litigation posture. Simply put, to the extent that defending government investigations and litigation is a cost of doing business, forecasting and managing those costs becomes a business imperative. Outside counsel should embrace rather than resist this reality.



An enforcement action preparedness plan is a general counsel's best defense to the risks that overcriminalization presents. While the captain of the ship may not be able to calm the stormy seas, he or she can prepare his or her vessel and crew to safely navigate through them. Similarly, the forces of overcriminalization make it more likely than ever that a company will be forced to endure a government investigation. Experience teaches that while you may not be able to avoid the storm, you can navigate safely through it without being blown too far off course.