CHAPTER 1

EXPOSING THE CORPORATE CRIMINAL
AN EXERCISE IN CORPORATE TRANSPARENCY

I. Understanding the Reasons Why: It Matters to the Jury

The apparent ease by which corporations manage to engage in undetected criminality is a function of the regulatory framework of government-sanctioned self-regulation. After corporations emerged in the 20th century as the dominant form of economic organization, the debate about how to regulate closely followed. The creation of the Securities and Exchange Commission (SEC) in 1934, in response to the uncontrolled corporate debacles of the 1920s, provided not only a regulatory organization to supervise the conduct of issuers, but a policy organization as well. One of the most significant policies promulgated by the SEC and Congress is the belief that corporations are best regulated through the model of self-regulation and minimal regulatory interference.

Simply, self-regulation is the manner in which all firms self-police their own activities to ensure that they are meeting all fiduciary and other duties to their clients. In fact, the old "shingle theory" was based on the principle that if you hold yourself out to the public as offering to do business, you are implicitly representing that you will do so in a fair and honest manner. As such, self-regulation became the cornerstone of most businesses, including the securities industry, beginning in the early part of the 20th century.[1]

As then SEC Chairman, and later Supreme Court Justice, William O. Douglas observed, "self-discipline is always more welcome than discipline imposed from above." He summarized the benefits of self-regulation in an address before the Bond Club of Hartford in 1938 as follows: "From the broad public viewpoint, such regulation can be far more effective [than direct regulation] . . . self-regulation . . . can be persuasive and subtle in its conditioning influence over business practices and business morality. By and large, government can operate satisfactorily only by proscription. That leaves untouched large areas of conduct and activity; some of it susceptible of government regulation but in fact too minute for satisfactory control, some of it lying beyond the periphery of the law in the realm of ethics and morality. Into these large areas, self-government and self-government alone, can effectively reach. For these reasons, self-regulation is by far the preferable course from all viewpoints."[2]

Corporate regulation is, therefore, dependent for the most part on self-restraint and ethical corporate governance within the regulatory environment mandated by Congress. The role of regulators and law enforcement is proscriptive in nature as opposed to proactive. This means that the government is not in a meaningful position to prevent misconduct. Instead, its role is largely reactive, punishing and/or prosecuting once the misconduct is uncovered. Often, the conduct is so severe that it requires Congress to respond with legislation, such as the Sarbanes-Oxley Act of 2002 (SOX),[3] in an effort to restore customer confidence in the marketplace and attract investors back into the market economy. With the recent collapse of the

1. Prior to congressional passage of the securities laws, firms organized to create another layer of organization—stock exchanges. By 1934, each of the stock exchanges had a constitution and bylaws that prescribed collective rules for the admission, discipline, and expulsion of stock exchange members. These rules were regarded as a contract between the organization and the member. For example, the New York Stock Exchange implemented a system of self-regulation through a governance committee that appointed other committees to carry out the business of regulating the activities of its members. The exchanges are now referred to as SROs, or self-regulatory organizations. The Securities Exchange Act of 1934 also codified the existing self-regulatory system for broker-dealers. The SROs retained primary authority to regulate their members, but the SEC was given the power to suspend or revoke an exchange's registration if the exchange failed to enforce compliance by its members with the Exchange Act.

2. Joel Seligman, *Cautious Evolution or Perennial Irresolution: Self-Regulation and Market Structure During the First 70 Years of the Securities and Exchange Commission*, 59 Bus. Law. 1347, 1361–1362 (2004) (quoting Supreme Court Justice William O. Douglas, Address at Bond Club of Hartford (1938)).

3. Pub. L. No. 107-204, 116 Stat. 745 (2002).

unregulated derivatives and hedge fund markets, the heady exuberance of the SOX initiatives quickly evaporated, leaving consumer suspicion of the markets at an all-time high. Congress went back to the drawing board.

In enacting the Wall Street Reform and Consumer Protection Act of 2010 (Reform Act),[4] Congress recognized that the existing regulatory oversight structure narrowly focused regulators on individual institutions and markets, which allowed supervisory gaps to grow and regulatory inconsistencies to emerge—in turn, allowing arbitrage and weakened standards. No single entity had responsibility for monitoring and addressing risks to financial stability posed by different types of financial firms operating in and across multiple markets. As a result, important parts of the system were left unregulated.

As Federal Reserve Board Chairman Ben Bernanke explained,[5] the purpose of the newly created Financial Stability Oversight Committee (FSOC), a central feature of the new Reform Act, is to provide a forum for agencies with differing responsibilities and perspectives to share information and approaches, and facilitate identification and mitigation of emerging threats to financial stability. [6] It is intended "that the lines of accountability for systemic oversight be clearly drawn, [but that] the council should not be directly involved in rule-writing and supervision. Rather, those functions should remain with the relevant supervisors, with the council in a coordinating role." In short, the current system of regulatory oversight will remain relatively intact, operating in tandem with the self-regulatory model in the private sector.

The current benchmark for self-regulated corporate behavior is "corporate transparency." Alan Greenspan, former chairman of the Federal Reserve Board, explains the meaning and importance of corporate transparency: "Transparency implies that [disclosure of] information allows an understanding of a firm's exposures and risks without distortion. The goal of improved transparency thus represents a higher bar than the goal of improved disclosures. Transparency challenges market participants not only to provide information but also to place that information in a context that makes it meaningful. Transparency challenges market participants to present information in ways that accurately reflect risks."[7] Disclosure and transparency are clearly not one and the same thing.

4. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 (July 21, 2010), *available at* http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/contentdetail.html.

5. Remarks of Chairman Ben Bernanke on the Squam Lake Report: Fixing the Financial System (2010) at http://www.federalreserve.gov/newsevents/speech/bernanke20100616a.htm.

6. Reform Act, 2010, Title I, Subtitle B, Section 1107.

7. Alan Greenspan, Chairman, Fed. Reserve Bd., Corporate Governance, Remarks at the 2003 Conference on Bank Structure and Competition (May 8, 2003), http://www.federalreserve.gov/boarddocs/speeches/2003/20030508/default.htm.

With the standard of self-regulation combined with the goal of full, fair, and meaningful disclosure as the preferred model for corporate governance, the obvious problem is that not all companies manage to follow the principles of corporate self-restraint. One major lesson from Enron, WorldCom, HealthSouth, and Refco, to name only a few, has been that tying executive compensation to measures of performance breeds conflict of interest and fraud. The mantra becomes growth at any cost and a "wink and a nod" with respect to corporate compliance programs that mandate self-restraint. Contemporary corporate culture, built on the foundation of cult personalities displacing the checks and balances of internal corporate management, explains in large measure the psychology that propels otherwise highly educated, law-abiding citizens into the mire of corporate crime. The timing of economic downturns and unrealistic earnings goals explain the motivation to cheat.

When asked what conditions brought us to this point of corporate failure, William McDonough, then chairman of the Public Company Accounting Oversight Board (PCAOB), accurately summed up the crisis:

> They could be summed up as mass confusion. We saw confusion about the role of the CEO. We saw the advent of the CEO superstar and an explosion in compensation that made those superstar CEOs actually believe that they were worth more than 400 times the pay of their average workers, an increase in the multiple by 10 times in 20 years—thoroughly unjustified, economically and morally. We saw confusion about the importance of earnings reports. When the private sector pinned its success to a report and not to actual earnings, the end was in sight. It became fashionable for public companies to encourage allegedly independent investment analysts to reach a consensus on the company's quarterly and annual earnings, a consensus that was closely guided by the financial management of the company. Then the market decided that the genius CEO was truly a genius if the company met or beat the estimate by a penny, but was a failure or a fool if the estimate was missed by a penny. Now anybody with a memory knows that there is a business cycle, a product cycle and the law of gravity. However, if quarter after quarter you have to match or beat the last quarter's results to stay in favor, there is an immense incentive to cook the books.
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> And the books got cooked by company managements, all too often with the collaboration or collusion of bankers, investment bankers, lawyers, and, yes, even accountants, irrespective of the true cost to the nation, not to mention to the participants themselves. It was a sickness, a kind of moral blindness and lack of courage to do what is right, that threatened to strike at the very soul of our national confidence.
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> The shock wave started with Enron, then rolled through Adelphia, WorldCom, HealthSouth and others. The American people looked at the wreckage of our vaunted private sector, and they got angry. The people got angry with the CEOs, with the boards, with the accounting profession and even with those of us in the regulatory sector. In a democracy, when people get angry, they will insist on change. Congress and the President responded, and the result was the Sarbanes-Oxley Act of 2002.[8]

These explanations of management psychology and stakeholder motivations are key theories exploited in the courtroom. The government has no obligation to prove either, but juries want to know "why." Evidence regarding the corporate culture, the personalities of key management officials, and the failure of the fiduciaries to follow internal guidelines become the framework in which proof of the charges contained in the indictment is presented to the jury. Concealment, false statements, misleading financial statements, document shredding, and other forms of obstruction are typical indicia of a scheme and artifice to defraud—not to mention the use of e-mail, which has become the most powerful evidence in some cases.[9]

Contemporary corporate crime adds a new dimension: the use of business networks to facilitate complicated financial crimes. Simply put, corporations get away with it when banks, financial analysts, underwriters, accounting firms, and law firms look the other way in order to collect enormous fees with respect to the prohibited transactions. This is another variant of the conflict of interest problem created by exorbitant fees paid for services rendered to the company. Arthur Andersen had no intention of giving up $52 million a year in fees to give Enron an answer it did not want to hear. Similarly, the current subprime mortgage crisis generated handsome fees paid to Wall Street firms like Bear Stearns, now defunct as a result, and banks like Washington Mutual (WaMu), also now defunct with the distinction of being the largest banking failure in U.S. history.[10]

The financial firms and banks, along with the analysts, were willing to close their eyes to "no-doc" portfolios—packages of loans sold in the secondary mortgage market without basic documentation establishing mortgage value and risk.[11] Open

8. Quoted in *The Editor Interviews William J. McDonough, Chairman, Public Company Accounting Oversight Board*, Metro. Corp. Couns., Sept. 2004, at 46, *available at* http://www.metrocorpcounsel.com/current.php?artType=view&EntryNo=1655.

9. For a description of the evidentiary use at trial of e-mail to establish fraud indicia and criminal intent, *see United States v. Arthur Andersen, LLP*, 374 F.3d 281 (5th Cir. 2004), *rev'd on other grounds*, 544 U.S. 696 (2005), where Enron's corporate counsel, Nancy Temple, suggested a deletion in a critical e-mail. One juror, Wanda McKay, said in an interview after the trial that it was not the document shredding that proved to be decisive but the evidence about Temple's efforts to revise a single e-mail memorandum. Jonathan Glater, *Enron's Many Strands: The Deliberations; Jurors Tell of Emotional Days in a Small Room*, N.Y. Times, June 17, 2002. *But see New York v. Microsoft*, 2002 WL 649951 (D.D.C. 2002) where the court excluded e-mail evidence on the grounds that there was insufficient foundation to establish that an e-mail satisfied the business-record exception under Federal Rules of Evidence 803(6).

10. WaMu lost $16.7 billion in deposits as of September 15, 2008, according to the Office of Thrift Supervision. John Letzing, *WaMu Seized, Sold to J.P. Morgan Chase*, Mkt. Watch, Wall St. J Digital Network, Sept. 26, 2008, http://www.marketwatch.com.

11. For an excellent and short explanation of how subprime mortgages caused the current financial disaster, see A.W. Bodine & C.J. Nagel, *Quants Gone Wild: The Subprime Crisis*, 24/7 WallSt.com, Mar. 27, 2008, http://www.247wallst.com/2008/03/quants-gone-wil.html.

and notorious financial behavior cannot generally succeed unless otherwise highly respected financial institutions and consultants are in on the caper. Thus, the issue of "who knew what and when" becomes another salient question in the prosecution and defense of entity-defendants that act only through their agents. Who was acting and with what authority?

As the Senate Enron hearings showed, there is usually enough blame to spread around. Yet, the more recent trend appears to be prosecutive restraint. For example, the Department of Justice (DOJ) has shown little interest, since the demise of Arthur Andersen, in prosecuting culpable banking institutions that also serve as the backbone of the financial industry. With indictment and conviction seen as a form of entity "capital punishment," the use of alternative prosecutive choices such as deferred prosecution agreements, corporate monitors, fines, restitution, and the like are on the rise. These alternatives are discussed in detail in Chapter 6.

II. Rational-Choice Theory: The Behavior of Corporate Criminals

Financial behavioralist literature explains that the central reason organizational actors engage in corporate crime is a simple one—they *choose* to do so. Crime-as-choice, also referred to as rational-choice theory, is not new.[12] Philosophers advanced the theory about two centuries ago. Over time, it has been adapted to the business context through the identification of the cost/benefit analysis as the primary paradigm of business judgment in reaching the choice to engage in otherwise unlawful behavior.

Why cost/benefit analysis? Profit maximization in capitalist society is the key organizational goal. One of the critical variables in calculating profitability is determining the time span over which profitability and return on investment can be expected by investors.[13] Logically, it follows that increased pressure to produce the best financial results over the shortest period of time becomes management's overarching business strategy. Corporate culture develops in a way designed to maximize profitability. Perhaps this strategy explains one of the primary characteristics of white collar crime: the steadfast denial of guilt, or, put another way, "This is just how business is done."

The cost/benefit analysis in its simplest form evaluates the benefit of the potential financial gain, achieved through unlawful means, against the risk or likelihood of getting caught and the expected consequences. Particularly in times of economic growth, when regulatory oversight is eased almost to the point of becoming noncredible oversight and the certainty of punishment is uncertain, rule-breaking becomes

12. Neal Shover & Andy Hochstetler, CHOOSING WHITE-COLLAR CRIME (2006).

13. Frank Pearce, *Crime and Capitalist Business Corporations*, in CRIMES OF PRIVILEGE: READINGS IN WHITE-COLLAR CRIME 35 (Neal Shover & John Paul Wright, eds., Oxford Univ. Press 2001).

more common. For example, after Enron and WorldCom, and the fleeting comfort provided investors by the passage of SOX, the Federal Reserve Board moved toward policies of loose money fostered by low interest rates to reinvigorate the markets. As a consequence, since 2002, banks, mortgage companies, institutional investors, and largely unregulated hedge funds were willing to take higher risks to manufacture higher investor returns. With the lure of higher spreads on subprime loans, investment banks sank billions into acquiring these mortgages.

When balanced against the new DOJ policy shift toward deferred prosecutions or even nonprosecution agreements after the postprosecution demise of Arthur Andersen (see Chapter 6), the organizational choice to engage in unlawful behavior, where increased personal compensation within the organization is tied to earnings performance, is a "no-brainer." Not to mention the fact that nobody was telling on anybody else in the organizational network of financial institutions, lawyers, accountants, and analysts.

In the same way, the timing of economic downturns provides motivation to cheat. Here, the lure is the need to continue growth at any cost. Unrealistic earnings expectations by shareholders and Wall Street analysts pressure organizations to engage in conduct aimed at satisfying investors.

In the absence of credible oversight, financial lure easily becomes criminal opportunity.[14] Lure has been likened to an unattended purse in a busy marketplace. It turns heads and makes one wonder if it can be taken without notice. It is a combination of opportunity and the absence of oversight. The strength of desire or predisposition to grab the proverbial purse is a function of the "G" word: greed. In the old days, when reputation and institutional longevity were prized business commodities, self-restraint and self-governance did shape organizational ethical preferences. Indeed, many theorists still suggest that reputational cost can shift ethical preferences.[15] In all fairness, the literature probably needs some time to catch up to the new business realities brought about by the demise in 2008 of such long-standing and reputable companies as Bear Stearns, Lehman Brothers, and Washington Mutual. The bailouts of Merrill Lynch, Fannie Mae, Freddie Mac, and AIG also undermine the real value of reputational cost as a determining factor in the cost/benefit analysis. Arthur Andersen, once viewed as the "Marines" of the accounting world, puts the analytical icing on the cake.

Rational-choice theory is not a mental exercise confined to academicians trying to discover how many angels can dance on the head of a pin. Understanding this theory is crucial for determining motive or defending against charges of willful

14. Shover & Hochstetler, *supra* note 12, at 107.

15. *Id.* at 169. Adam Smith, sometimes thought of as the "father" of capitalism, said: "The real and effectual discipline which is exercised over a workman is . . . that of his customers. It is the fear of losing their employment which restrains his frauds and corrects his negligence." THE WEALTH OF NATIONS 113 (Hayes Barton Press ed. 1956) (1776).

and unlawful organizational behavior. We are still at the point of talking about the motives and imbedded characteristics of any particular corporate culture. Juries want to know the reason that organizational actors engage in unlawful conduct. As the Enron juror interviews disclosed, at the close of the first round of deliberations only four members committed to a guilty verdict. That suggests the government was not very convincing in its case about the reasons for claiming a crime had been committed. The ultimate decision to convict, according to the interviewed jurors, had much to do with the jury instructions they received from the judge. (Parenthetically, the case was later reversed based on those faulty jury instructions.) Oversimplification of the process is always a danger, but there can be no question that any effective prosecution or defense must answer the most important question: Why did they do it?

III. Shifting Behavior by Punishment: Understanding the Federal Sentencing Guidelines Policy

The organizational federal sentencing guidelines, like the rest of the guidelines, are discretionary and not mandatory. The trend toward deflating the legal force of the guidelines and increasing judicial discretion in sentencing is underscored in the decisions *Gall v. United States*, 552 U.S. 38 (2007), and *Kimbrough v. United States*, 552 U.S. 85 (2007). The standard of review is abuse of discretion after the court takes into consideration, among other factors, the policies of the Federal Sentencing Commission in drafting the guidelines. That leaves open the very important question about the nature of the other information that judges tend to consider in adjudicating corporate sentences.

The current organizational sentencing guidelines focus on two factors: the seriousness of the offense and the organization's "culpability" factor. Culpability generally will be determined by the steps taken by the organization prior to the offense to prevent and detect criminal conduct, the level and extent of involvement in or tolerance of the offense by certain personnel, and the organization's action after an offense has been committed.[16] In a sense, the court considers, in punishing the company, whether the decision to engage in unlawful conduct was primarily an organizational choice prompted by management or the misfortune of failing to supervise a rogue employee. Choice dominates the sentencing landscape.

In any event, certainty of punishment, the key to reducing unlawful behavior in a rational-choice scheme, may be questionable under the current sentencing rules. For example, if the court finds that an organization will be unable to pay its restitution order, "no fine should be imposed."[17] Additionally, where the minimum guideline

16. U.S. Sentencing Guidelines Manual ch. 8, introductory cmt.
17. *Id.* § 8C2.2.

fine calculation is greater than the statutory maximum fine, the statutory fine controls, regardless of actual culpability.[18] The Offense Level Fine Table in the sentencing guidelines is hardly enforceable if the guideline calculation is inconsistent with the authorized statutory fines. This may explain in some measure the government policy in favor of resolving organizational disputes by plea agreement or deferred prosecution agreements. It also explains the willingness of organizations to seek informal resolution where possible. In the end, the real damage in the form of economic harm to the organization may be more closely aligned with the decision to prosecute by formal indictment as opposed to the judicial imposition of a fine or restitution after the case has been resolved through negotiated resolution. This is discussed in detail in Chapter 6.

In an effort to strengthen the impact of the guidelines, Congress enacted Sarbanes-Oxley in part to increase certain institutional penalties and required corporations to adopt a code of ethics, dubbed by the DOJ a "Corporate Compliance Plan," or explain publicly why they do not have one.[19] The absence of such a code or plan at the time of sentencing can be treated as an aggravating sentencing factor by the court. The New York Stock Exchange further requires listed companies to promptly publish a code of ethics and disclose any waiver of the code by officers or directors[20] in an apparent attempt to diminish the influence of cult-type management personalities who circumvent corporate ethics policies with impunity.

However, despite these efforts at shifting corporate behavior by law or even through punishment, the SEC is perhaps more realistic in its assessment that firms must create an internal "culture of compliance." "If you've been listening, you know it's not enough to have policies. It's not enough to have procedures. It's not enough to have good intentions. All of these can help. But to be successful, compliance must be an embedded part of [the] firm's culture."[21] In short, the company must create a culture that makes the choice to behave in accordance with the law. Again, that is certainly the philosophy adopted by the Sentencing Commission in drafting policy. In the commentary to the Chapter 8 revisions sent to Congress on May 1, 2004, the Commission stated: "[T]he promotion of desired organizational culture [is] indicated by the fulfillment of seven minimum requirements, which are the hallmarks of an effective program that encourages compliance with the law and ethical conduct."[22]

Revised Chapter 8 Guidelines were approved by the Federal Sentencing Commission in April 2010 and took effect November 1, 2010. The revised guidelines

18. *Id.* § 8C3.1(b).
19. Sarbanes-Oxley Act § 406(a).
20. N.Y. Stock Exch., Listed Company Manual § 303A.10 (2008).
21. Lori Richards, Dir., Office of Compliance Inspections and Examinations, U.S. Sec. & Exchange Comm'n, The Culture of Compliance, Address at the Spring Compliance Conference of National Regulatory Services (Apr. 23, 2003), http:// www.sec.gov/news/speech/spch042303lar.htm.
22. U.S. Sentencing Comm'n, Amendments to Sentencing Guidelines 74, 86 (2004).

expressly strengthen Guideline No. 7 regarding the appropriate response by an organization when criminal conduct or misconduct is detected. Guideline No. 7 now states that organizations should "remedy the harm resulting from the criminal conduct," including providing restitution to identifiable victims, self-reporting, and cooperation with authorities. The guidelines also now explicitly state that the organization should act to prevent further similar criminal conduct by assessing and making modifications to its compliance and ethics program to "ensure the program is effective," including the "use of an outside professional adviser to ensure adequate assessment and implementation of modifications."

Another change is that an organization can now gain credit in the culpability scoring process, even if a high-level executive is involved in the offense, if the organization meets four factors:

- The person or persons with operational responsibility for the compliance and ethics program have "direct reporting obligations to the governing authority or an appropriate sub-group," such as an audit committee;
- The compliance program must have detected the offense before anyone outside the organization or "before such discovery was reasonably likely;"
- The company "promptly reported the offense to appropriate governmental authorities;" and
- No one "with operational responsibility for the ethics and compliance program participated in, condoned, or was willfully ignorant to the offense."

The guidelines also describe the individuals deemed to have operational responsibility for the compliance program as having "express authority to communicate personally to the governing authority, or appropriate subgroup thereof, (a) promptly on any matter involving criminal conduct or potential criminal conduct; and (b) no less than annually on the implementation and effectiveness of the compliance and ethics program."

It is apparent that when answering the motive question, behavior and corporate culture ultimately play major roles in establishing guilt and, later, punishment. Because self-regulation is the prevailing business model for evaluating the true measure of internal corporate governance, the burden rests heavily on the organization to justify its choices. Case strategy, whether at the preindictment investigatory phase, at trial, or at sentencing, depends to some degree upon the portrayal of the organization as either a law-abiding citizen or a mastermind at the cost/benefit equation.

CHAPTER 2

THE FACTS BEHIND THE FICTION
THEORIES OF CORPORATE CRIMINAL LIABILITY

It was the sociologist Edwin Sutherland who first coined the term "white-collar" crime, in a 1939 address to the American Sociological Association. It was a new idea in American jurisprudence. This is not surprising given the legal development of entity liability in this country. Prior to the American industrial revolution in the early 20th century, the notion of entity criminal liability was unknown at common law. Corporate charters were granted as a privilege from the sovereign and limited to a particular financial transaction. The corporation was an extension or arm of the state.

With the onset of the industrial revolution, the entire notion of corporate identity changed from a government entity subject to external control to a private form of business operation with internal management. This dramatic change in entity formation and operation was at first not addressed by Congress because it was not a "federal" phenomenon as such; the corporation was an entity licensed by the state and under its jurisdiction.

The development of a body of law explaining organizational liability came from the Supreme Court and it remains the law today. As the impact of corporate conduct

on interstate commerce increased, Congress stepped in to legislate. White-collar crime is for the most part a creature of federal statute and prosecuted at the federal level. Licensure remains within the purview of state control, but criminal conduct is almost exclusively regulated by federal law.

I. Respondeat Superior

A. Imputing Acts of the Agent: Strict Liability in Criminal Law

In *Trustees of Dartmouth College v. Woodward*, 17 U.S. 518 (1918), the original founders of the college had obtained a charter from the Crown to operate prior to the American Revolution and independence. However, the state of New Hampshire, postrevolution, sought to pass a law abrogating the college's rights under the charter. The U.S. Supreme Court rejected New Hampshire's attempt to do so, holding that the creation of a corporation, even by royal charter, was a contract within the constitutional provision of Article 1, Section 10, prohibiting states from passing laws impairing contractual obligations. But the full significance of the case was the opportunity for the Court to delineate the contours of a separate corporate existence under the law. The legal fiction was now here to stay. Thus, the Court observed that "a corporation is an artificial being, invisible, intangible, and existing only in contemplation of the law." *Id.* at 636. A corporation therefore has no power except what is given by its incorporating act, either expressly or as incidental to its existence. As such, a corporation may sue and be sued and may enter into contracts.

In 1886, an Ohio citizen sued the Lake Shore & Michigan Southern Railway Co., an Illinois corporation, in federal district court, to recover damages in tort for the wrongful acts of its servants. On review, the Supreme Court held that it was well-established that, in actions for tort, the corporation may be held liable for damages for the acts of its agents within the scope of the agent's employment. *Lake Shore & Mich. S. Ry. Co. v. Prentice*, 147 U.S. 101 (1893). Citing state law precedent, the Court likewise observed that a corporation is "doubtless liable" for any tort committed by an agent in the course of his employment, even if the act is done wantonly, recklessly, or against the express orders of the principal. A corporation may be held liable for a libel, or a malicious prosecution, by its agent within the scope of his employment, and the malice necessary to prove to support either action, "if proved in the agent, may be imputed to the corporation." *Id.* at 110.

Of course, imputing the acts of the agent to the principal within the scope of his employment, under the venerable doctrine of *respondeat superior*, was merely a restatement of the common law: "Let the master answer."[1] Acts done by the agents of a corporation, in the course of its business and of their employment, are imputed to the corporation. Thus, the corporation is responsible in the same manner and to the same extent as an individual is responsible under similar circumstances.

1. Black's Law Dictionary 1179 (5th ed. 1979).

It was not until 1909 that the Supreme Court decided that a corporation could be held criminally responsible for an act done while an authorized agent is exercising authority conferred by the corporation. In *New York Central & Hudson River Railroad Co. v. United States*, 212 U.S. 481 (1909), a case involving kickbacks in the form of rebates paid by the company to the shipper in violation of the Elkins Act, the Court extended the civil tort concept of *respondeat superior* to criminal corporate liability: "If the act was . . . done [by a corporate employee] it will be imputed to the corporation. . . . There is no distinction any longer in essence between the civil and criminal liability of corporations, based upon the element of intent or wrongful purpose."

The Court rejected the policy argument that shareholders who did not authorize these acts would be unintended victims of the corporate prosecution. The Court could no longer "shut its eyes" to the fact that most business was being conducted through corporations and that "interstate commerce is almost entirely in their hands." To give corporations immunity from corporate prosecution would take away "the only effective means" of controlling corporate abuses. A corollary to this view is that criminal liability will heighten supervision of employee conduct.

One significant expansion of the doctrine is that even where the agent's acts are actually or potentially detrimental to the corporation, the agent's conduct may still be imputed to the corporation for purposes of imposing criminal liability if the agent's acts are motivated, at least in part, to benefit the principal. *United States v. Sun-Diamond Growers of Cal.*, 138 F.3d 961 (DC Cir. 1998) (citing the leading case, *United States v. Automated Med. Labs., Inc.*, 770 F.2d 399, 406–07 (4th Cir. 1985)), *aff'd*, 526 U.S. 398 (1999); *accord United States v. Singh*, 518 F. 3d 236 (4th Cir. 2008).

Likewise, imputation of criminal liability may apply even where the acts are expressly forbidden by the principal. *United States v. Potter*, 463 F.3d 9, 25–26 (1st Cir. 2006); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000 (9th Cir. 1972); *accord Halliburton Co. v. Dow Chem. Co.*, 514 F.2d 377 (10th Cir. 1975).

B. Collective Knowledge Doctrine

A corporation's vicarious liability also extends beyond simple vicarious liability for the criminal acts of a single employee. The courts have formulated a theory of collective liability to permit conviction of the corporation where no single employee could be found to have violated the law. This is known as the collective knowledge doctrine. In *United States v. Bank of New England, N.A.*, 821 F.2d 844 (1st Cir. 1987), the rule was stated: "A corporation cannot plead innocence by asserting that the information obtained by several employees was not acquired by any one individual who then would have comprehended its full import. Rather the corporation is considered to have acquired the collective knowledge of its employees and is held responsible for

their failure to act accordingly." *See also United States v. Arthur Andersen, LLP.*, 374 F.3d 281 (5th Cir. 2004), *rev'd on other grounds*, 544 U.S. 696 (2005). (The court concluded that direct evidence of pervasive knowledge of the same facts by numerous Andersen employees made it unnecessary to resolve whether the collective knowledge doctrine should be applied to impute knowledge to the entity).

The collective knowledge doctrine has been held to apply even where specific intent is imputed. *United States v. Phillip Morris USA, Inc.*, 449 F. Supp. 2d 1, 893–98 (D.D.C. 2006) (the opinion is reported in six parts, each with its own Westlaw number, due to length; citations here are to part 5, 2006 WL 2380650). The opinion is a little hazy in terms of the test to be applied. First, noting the circuit court's rejection of the requirement that a corporate state of mind can be established only by looking at each corporate agent at the time he acted, the opinion concedes that the courts have not clearly articulated "exactly what degree of proof is required." *Id.* at 896. Adopting the public policy arguments made in the *Bank of New England* decision, the court concluded that it is "both appropriate and equitable to conclude that a company's fraudulent intent may be inferred from all of the circumstantial evidence including the company's collective knowledge." *Id.* at 896–97.

More recently, the court explained the doctrine in the context of a civil suit filed under the False Claims Act (FCA). In *United States v. Science Applications International Corp. (SAIC)*, 555 F. Supp. 2d 40 (D.D.C. 2008), the court observed that the FCA requires a "knowing" submission of a material false claim for payment to the government. Relying on the *Phillip Morris* decision and *United States ex. rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908 (4th Cir. 2003), the court concluded that the "at least one" rule applied to establish liability. The knowledge of at least one employee raised a genuine dispute of fact regarding whether a corporation's certifications were knowingly false. In fact, a corporation could be held liable even if the certifying employee was unaware of the wrongful conduct of another employee. *Sci. Applications*, 555 F. Supp. 2d at 56.

The jury instruction upheld in *Westinghouse*, another FCA case, is highly instructive:

> [I]n order to find that [Westinghouse] took any action knowingly, you must find that at least one individual employee had all of the relevant factual information to satisfy that standard as to the fact or action at issue. In this particular case, that means that you would need to find that at least one individual employee of [Westinghouse] knew that GPC [General Physics Corporation] was submitting a bid on the subcontract, and knew of facts which would have required disclosure of an organizational conflict of interest by GPC. You do not need to consider whether this individual knew that a certification would be required or what information the GPC was actually disclosing on it.

Westinghouse, 352 F.3d at 918.

The *Westinghouse* court rejected the "single actor" standard requiring the same employee to know both the wrongful conduct and the certification requirement. The court concluded that acceptance of the rule would create an anomalous precedent. In the future, corporations could merely segregate certifying officers who did nothing more than sign government contracts and thereby immunize the company against liability.

C. Collective Entity Doctrine

The collective entity doctrine was a legal corollary to the inapplicability of the Fifth Amendment to business organizations other than sole proprietorships. After a long hiatus, the doctrine was revitalized by the Supreme Court in its decision in *Braswell v. United States*, 487 U.S. 99 (1988). Rejecting the prior rationale for the development of the doctrine, the Court applied a new rationale—the "agency rationale"—to the attempt by a corporate records custodian to assert a Fifth Amendment privilege in response to a subpoena requesting company documents. The Court held that a corporate record custodian's act of production "is not deemed a personal act" because unlike a sole proprietor, the corporate actor "holds . . . documents in a representative capacity rather than a personal capacity." The logic of the decision is coextensive with the law on corporate privilege in that "[a] claim of Fifth Amendment privilege asserted by the agent would be tantamount to a claim of privilege by the corporation—which of course possesses no such privilege." *Id.* at 110.

However, with the proliferation of new forms of business entities since *Braswell* was decided in 1988, some have argued that the doctrine's agency rationale has not withstood the test of time. For example, single-member LLCs (limited liability companies) differ in many important ways from the corporate operating structure like the one in *Braswell*. In many states, LLCs are permitted to operate less formally, without adherence to the same corporate formalities that even closely held corporations must follow. In many states they are not required to have officers, and management rights can be vested in individual LLC members.

Not surprisingly, LLCs have waged a frontal legal attack against the *Braswell* rationale, arguing that they do not conduct themselves as agents of a separate corporate collective entity. In other words, the agency rationale of *Braswell* does not fit either the legal or operational reality. Of course, the inapplicability of the Fifth Amendment to partnerships, *United States v. Fisher*, 425 U.S. 391 (1976), established long before *Braswell*, would seem to deflate the argument in the context of the noncorporate form. Nonetheless, the argument was recently tried in a proceeding by a sole-member LLC to quash a grand jury subpoena calling for the production of business records in the case *United States v. Feng Juan Lu*, 248 Fed. Appx. 806 (9th Cir. 2007). There, the court rejected the claim that the sole member was not acting in a representative capacity of a collective entity because state law required the

LLC to maintain a state-registered agent. That fact alone was enough to establish agency.

In short, the vitality of the legal characteristics of the principal-agent relationship in business organizations, other than sole proprietorships, remains fixed in the law, defining both rights and liabilities. The issue of corporate privilege is revisited in Chapter 4 at length. The purpose of mentioning the collective entity doctrine here is to complete the big-picture understanding about the principal-agent legal relationship and the expanse of its application.

II. The Corporate Fiduciary: Circumstantial Evidence of Guilt

Here is one place where the corporation, while treated as a legal person for some purposes, does not share the attributes of a human being, not even through agency principles. Fiduciary responsibility is owed to the owner of the corporation—the shareholder—and that responsibility is placed squarely upon the shoulders of the board of directors and managers. So, why talk about fiduciary duty in the context of a criminal case and potential corporate exposure? The breach of a fiduciary duty can be used as circumstantial evidence establishing guilt of corporate officials acting on behalf of the company in at least two ways. Breaking a rule and knowingly engaging in bad conduct can be used as circumstantial evidence to establish consciousness of guilt of the company, its directors, and management. *See Galaxy Computer Servs., Inc. v. Baker*, 325 B.R. 544 (E.D. Va. 2005). Breach of fiduciary duty has also served as a prosecutive theory supporting a finding of guilt under the mail fraud statute, 18 U.S.C. §1341, both pre- and post-*McNally*.[2] *United States v. Johns*, 742 F. Supp. 196 (E.D. Pa. 1990), *aff'd*, 972 F.2d 1333 (3d Cir. 1991).

The seminal case summarizing this duty is *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984). Simply put, directors of a solvent company owe fiduciary duties of care and loyalty to the shareholders with respect to decisions made on behalf of the corporation. The duties of care and loyalty are separate and have different legal attributes.

Pursuant to the duty of care, directors and managers are required to exercise the degree of care that an ordinarily prudent person would exercise under like circumstances. They have the obligation to make all reasonable efforts to be fully informed prior to making a business decision and may not engage in acts of gross negligence

2. McNally v. United States, 483 U.S. 350 (1987). In the now famous footnote 10 of his dissent in *McNally*, Justice Stevens observed: "When a person is being paid a salary for his loyal services, any breach of that loyalty would appear to carry with it some loss of money to the employer—who is not getting what he paid for. Additionally, '[i]f an agent receives anything as a result of his violation of his duty of loyalty to the principal, he is subject to a liability to deliver it, its value, or its proceeds, to the principal.' RESTATEMENT (SECOND) OF AGENCY § 403 (1958)." *Id.* at 377.

when acting on behalf of the corporation. The duty of care can be violated by nonfeasance (failing to act) or misfeasance (committing bad acts). The decisions of directors who are also corporate officers are subject to a higher level of scrutiny than those of outside directors because inside directors have superior knowledge of the day-to-day affairs of the corporation.

As the Sarbanes-Oxley Act has made clear, a director may no longer serve as a mere figurehead. Ignorance of the company's affairs is not a defense. Thus, the directors must hold, attend, and participate in regular meetings. Prior to voting, directors should obtain all reasonably available materials germane to the decision-making process. The law focuses almost exclusively on how the decision was made as opposed to the correctness of the final judgment as evidenced by the application of the business judgment rule in this context, discussed in the next section. Courts have no interest in second-guessing business decisions of directors and management.

The duty of loyalty addresses conflicts of interests. Here, second-guessing is the name of the game. Directors and managers must avoid any conflict of interest that would affect their ability to make decisions that are in the best interest of the company. The best interests of the company require the exercise of judgment without regard to outside or personal interests. Directors and managers cannot engage in conduct that would injure the corporation or deprive it of profit or advantage. Examples of typical violations include fraud, bad faith, self-dealing without full disclosure and approval, and favoring one group of shareholders over another.

Not every form of self-dealing is prohibited. Generally, a self-dealing transaction, otherwise viewed as a conflict of interest, can be legally acceptable if, after all material facts of the transaction and the director's interest are disclosed, the transaction is then approved by a majority vote of the disinterested directors. Otherwise, transactions that benefit an interested director create a rebuttable inference that the director acted adversely to the corporation. The director must rebut by demonstrating that the actions not disclosed or approved were fair and in the corporation's best interests. To avoid even the appearance of impropriety, the best practice is full and fair disclosure, and the interested member should abstain from voting.

Usurping corporate opportunities is one of the more serious and most frequently litigated areas under breach of the duty of loyalty. In short, corporate opportunities belong to the corporation, and a director cannot commandeer a corporate opportunity to the director's own use or benefit. Of course, once the corporation rejects the opportunity, after having all information fully and fairly presented, the director can pursue the opportunity in safety after notifying the company.

III. Business Judgment Rule: Not a Defense

The business judgment rule is one applied in the courtroom in determining whether a lawsuit, usually filed as derivative action by shareholders, should proceed against

the directors and/or management. While it applies in cases alleging breach of the duty of care, it has no application to suits alleging breach of the duty of loyalty or conflict of interest.

The business judgment rule is not a legal standard of conduct or a prescribed duty of care. Rather, it is a "rebuttable presumption" applied by the court in assessing the merits of a motion to dismiss an action. It is a rebuttable presumption that directors acted properly. Directors can assert protection under this rule if they have acted within the scope of their authority, in good faith, with reasonable care, and for a rational business purpose. In other words, they should not be subject to suit for an honest mistake in judgment, even where there are negative consequences to the corporation. Otherwise, a judge would become a super-director, second-guessing business judgments of corporate executives and directors involving business transactions that the judge may not understand or know little or nothing about.

The bottom line is that generally, directors are found to have breached their duty of care only if they act in a grossly negligent manner, exhibiting reckless indifference or deliberate disregard for the interests of the shareholders. Any actions outside the bounds of reason will suffice to impose liability.

Note that the shareholders of a solvent company can file a derivative action on behalf of the corporation, seeking redress for an alleged breach of fiduciary duty. However, in the event of corporate insolvency, it is the creditors who have standing to assert the action and seek redress for harm to the company. To meet the burden to plead insolvency, the creditor must show either: (1) a deficiency of assets below liabilities with no reasonable prospect that the business can be successfully continued or (2) an inability to meet maturing obligations as they fall due in the ordinary course of business. *Prod. Res. Group, L.L.C. v. NCT Group, Inc.*, 863 A.2d 772, 782 (Del. Ch. 2004).

IV. Chinese Walls

"Chinese Walls," or information barriers, do not provide an absolute defense to legal misconduct nor to defendants who engage in financial misconduct. Frequently, a Chinese Wall turns out to have been no "Great Wall" at all, "but more like a wall in a stage set, designed for show." *United States v. Helmsley*, 726 F. Supp. 929, 937 (S.D.N.Y. 1989). It is, as its name implies, a partition of sorts, which is recognized in varying degrees by the courts as a means to prevent some actual or potential form of taint.

The government frequently invokes the use of a Chinese Wall in *Kastigar* hearings,[3] in suppression hearings dealing with computer and/or electronic data

3. Kastigar v. United States, 406 U.S. 441 (1972), held that a grant of immunity prohibits the use in a subsequent prosecution of compelled incriminating evidence of the "fruits directly attributable thereto." The doctrine has been extended to nonevidentiary as well as evidentiary use. The burden, and it is a heavy one, is on the government to show that its evidence emanates from an independent source—hence the need for a Chinese Wall where evidence derives from immunized disclosures.

seizures,[4] and in other such evidence-gathering techniques where prosecutors handling the case must be careful to avoid any taint to the case by reviewing or utilizing immunized or other privacy-protected information. Government taint teams are frequently used to accomplish the goal of avoiding contamination of case prosecutors or evidence in a case. *See, e.g., United States v. Poindexter*, 698 F. Supp. 300 (D.D.C. 1998).

In a business context, there is no definitive case law finding that the use of a Chinese Wall constitutes a legal defense to charges of corporate liability. Regulators are more willing to accept its use. For example, the Securities and Exchange Commission (SEC) adopted rule 14e-3,[5] relating to securities firms engaged in a nonpublic tender offer where an employee executes a trade for a firm in the takeover target's securities. The firm is absolved if effective screening procedures were in place, that is, if the employee making the investment decision was "screened off" or partitioned from the persons with knowledge of the tender offer. The SEC indicated that Chinese Walls were an appropriate device under the rule to satisfy the screening requirement.[6]

The problem with Chinese Walls in business is that there are no guarantees against failure.[7] Nowhere is that more apparent than in the conclusions of the Senate investigation report of the Enron collapse.[8] For that reason, Sarbanes-Oxley has written Chinese Walls into law. Title V of Sarbanes-Oxley amends the Securities and Exchange Act of 1934 by inserting new Section 15D, entitled "Securities Analysts and Research Reports"[9] in an effort to:

> establish structural and institutional safeguards within registered brokers or dealers to assure that securities analysts are separated by appropriate informational professional partitions within the firm from the review, pressure, or oversight of those whose involvement in investment banking activities might potentially bias their judgment or supervision.

The bottom line is that a Chinese Wall may provide a mitigating factor to be considered by a court or a jury in assessing knowledge and/or blame. However, for highly

4. For a complete discussion of Department of Justice procedures, see Searching and Seizing Computers and Obtaining Electronic Evidence in Criminal Investigations (Computer Crime & Intellectual Prop. Section, Criminal Div., U.S.D.O.J., July 2002), http://www.usdoj.gov/criminal/cybercrime/s&smanual2002.htm.

5. 17 C.F.R. § 240.14e-3 (1988).

6. SEC Release No. 17,120, [1980 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶82,046 at 83,461 (Sept. 4, 1980).

7. Lynn Turner, former Chief Auditor of the SEC, Address at the International Monetary Fund Seminar on Current Developments in Monetary and Financial Law (June 4, 2004), http://www.imf.org/external/np/leg/sem/2004/cdmfl/eng/turner.pdf.

8. For a more complete discussion, see Miriam Miquelon-Weismann, *Selling Out Corporate Reform: Eliminating the "Disinterested Person" Requirement for Investment Bankers Advising Chapter 11 Debtors*, 2 N.Y.U.J.L. & Bus. 731, 749–53 (2006).

9. 15 U.S.C. § 78o-6(a)(3).

regulated businesses, the Chinese Wall may already be required by law and would provide indicia of wrongdoing where a breach of the legally mandated partition evidences a breach of fiduciary duty.

CHAPTER 3

CRIME AND PUNISHMENT
STATUTORY TOOLS

"White-collar criminality in business is expressed most frequently in the form of misrepresentation in financial statements of corporations, manipulation in the stock exchange, commercial bribery, bribery of public officials directly or indirectly in order to secure favorable contracts and legislation, misrepresentation in advertising and salesmanship, embezzlement and misapplication of funds, short weights and measures and misgrading of commodities, tax frauds, misapplication of funds in receiverships and bankruptcies. These are what Al Capone called 'the legitimate rackets.'"[1]

I. Fraud

Corporate crime is primarily financial crime. This chapter describes the most common forms of financial fraud in terms of various statutory criminal offenses, including: mail fraud and wire fraud, the proverbial scheme and artifice to deprive the victim of money or property using the mails or the wires; bank fraud, which is closely

1. Edwin H. Sutherland, *White-Collar Criminality, in* CRIMES OF PRIVILEGE: READINGS IN WHITE-COLLAR CRIME 4, 6 (Neal Shover & John Paul Wright, eds., Oxford Univ. Press 2001).

related to mail and wire fraud; money laundering, hiding the source or nature of cash generated in violation of some other provision of federal law; bribery of public officials; program fraud by theft; tax fraud, including illegal slush funds or false reporting; securities fraud and the application of Rule 10(b)(5); "process crimes" including obstruction, perjury, and false statements; and conspiracy. The discussion is aimed at identifying the most common forms of corporate and organizational misconduct as opposed to the nuanced aspects of any particular statute.

In terms of corporate prosecutions, these crimes are typified by discreet financial transactions or a pattern of transactions. The crimes are usually engineered by management and/or employees of the corporation. They are often not complex and do not involve much technical knowledge of finance or accounting. Most prosecutors and practitioners understand the targeted transactions in fairly short order. Often, the most complicating factor is the paper. Usually there is lots of it, and the crimes are pieced together by federal agents experienced in such matters from the Federal Bureau of Investigation (FBI), the Internal Revenue Service (IRS), the Postal Inspection Service, and other federal agencies. Because these cases are labor intensive, prosecutors routinely seek to simplify the charges, opting to prosecute the easiest case under the most straightforward statute. However, after 9/11, most of the available case agents were reassigned to antiterrorism task forces reducing the number of white collar criminal prosecutions. Despite Department of Justice (DOJ) attempts to put a positive spin on the statistics in its *2008 Corporate Fraud Task Force: Report to the President*,[2] an enforcement study covering the period 2002–2008, shows that from 2000 to 2007, prosecutions of frauds against financial institutions dropped 48 percent, insurance fraud cases dropped 75 percent, and securities fraud cases dropped 17 percent.[3] In the 2007 budget cycle, the FBI obtained money to fund the hiring of a single agent for criminal investigations.

The Transactional Records Access Clearinghouse (TRAC),[4] which compiles its statistics through Freedom of Information Act requests to the DOJ, provides further insight into national profile and enforcement trends on a monthly and annual basis. The fiscal year 2008 report of FBI convictions, including statistics through June 2008, shows that monthly convictions for current FY 2008 were down 1.3 percent from the same periods the year before, and down 9.8 percent from five years before.[5] According to the data for the month of June 2008, the government reported 943 convictions for cases referred by the FBI. Of the 934 convictions reported, only 2 percent accounted for "Fraud—Other Business" crimes.

2. Available at http://www.usdoj.gov/dag/cftf/corporate-fraud2008.pdf.

3. Eric Lichtblau, David Johnston, & Ron Nixon, *F.B.I. Struggles to Handle Wave of Financial Fraud Cases*, N.Y. Times, Oct. 19, 2008.

4. Based at Syracuse University, TRAC gathers, researches, and distributes information about staffing, spending, and enforcement activities of the federal government. http://trac.syr.edu/.

5. Transactional Access Clearinghouse, Convictions for June 2008, http://trac.syr.edu/tracreports/bulletins/ jfbi/monthlyjun08/gui/ (Oct. 2008).

The statistics remain much the same for FY 2011. The latest available data from the Justice Department shows that during the first nine months of FY 2011, the government reported 8,421 new convictions for cases referred by the FBI. If this activity continues at the same pace, the annual total of convictions is expected to increase 0.1 percent for FY 2011. However, compared to five years ago, the estimate of FY 2011 convictions is down 7.8 percent. Convictions over FY 2011 are lower than they were 10 years ago.

Overall, the data shows that FBI related convictions are down 17.3 percent from the level reported in 2001. Cases were classified by prosecutors into more specific types. The single largest number of convictions of FBI cases through June 2011 was for "Narcotics/Drugs," accounting for 24.1 percent of convictions. The second largest category was "White Collar Crime," accounting for 20.8 percent of total convictions. Within the "other" category, which includes a diverse group of programs, the largest specific program prosecutions include: "Weapons," 4.8 percent, "Official Corruption," 2.6 percent, and "Organized Crime," 2.5 percent.[6]

What about the IRS and white collar crime? The FY 2007 audit rate for the nation's largest corporations "plunged to its lowest level in the last 20 years, less than half what it was in FY 1988," according to TRAC figures.[7] The IRS has apparently changed its strategy to increase audits for smaller corporations with assets of $50 million or less because they take less time and cost less. The results of this strategy are dubious. The TRAC report reveals that in FY 2007, for each revenue-agent hour spent auditing the smallest corporations, the IRS gained $682 in additional tax revenues; midsized corporations produced only $474 in recommended additional taxes. However, for corporations with over $250 million in assets, the agents recommended additional taxes of $7,498 per revenue-agent hour. The internal IRS data further concludes that about one-third of all revenue-agent time spent auditing smaller and midsized corporations resulted in absolutely no changes in recommended taxes that were owed. These are termed "nonproductive" audits by the IRS.

According to the April 12, 2010 TRAC report, as of FY 2009, the audit activity of large corporations continued in a steady decline despite the growing federal deficit. Specifically, IRS audits of large corporations fell from 4,693 in FY 2005 to only 3,675 in FY 2009. Audit rates fell even faster.[8]

6. Transactional Access Clearinghouse, Convictions for June 2011, http://tracfed.syr.edu/results/9x704e87441419.html (Sept. 2011).

7. Transactional Access Clearinghouse, Audits of Largest Corporations Slide to All Time Low, http://trac.syr.edu/tracirs/newfindings/current/ (Oct. 2008).

8. Transactional Access Clearinghouse, Convictions for June 2011, http://trac.syr.edu/tracirs/newfindings/v15/ (Oct. 2011).

While the level of IRS convictions increased in 2008 by 19.3 percent from five years ago in FY 2003, the largest number of prosecutions, 45 percent, is for tax fraud. The second largest category is 20.7 percent for the Drugs Organized Crime Task Force. In business-related prosecutions, the category "Fraud—Other" accounts for 4.5 percent; "Fraud—Unspecified," 4.5 percent; "Money Laundering," 4.5 percent; and "Fraud—Health Care," 2.7 percent.

The statistics do not show whether the convictions for such crimes as fraud, money laundering, and health care fraud are being double-counted by law enforcement agencies such as the FBI, the Drug Enforcement Agency, or the Postal Inspection Service. Such double-counting, where two or more federal agencies report the same conviction as part of their annual prosecution statistics, is a common practice when more than one agency has a case agent assigned to a particular criminal case. Granted, statistics can be slippery; however, where audits of large corporations have diminished and about one-third of small to midsized company audits are nonproductive, it may be reasonable to infer that IRS statistics do not reflect a significant increase in the prosecution of white-collar crime.

II. Specific Crimes

A. General Principles: *Mens Rea* and *Actus Reus*

White collar offenses, like other criminal offenses, require a *mens rea, actus reus,* and causation. These elements are defined by the particular statutory provision proscribing the crime. In *Liparota v. United States,* 471 U.S. 419, 424 (1985) the Supreme Court stated: "The definition of the elements of a criminal offense is entrusted to the legislature, particularly in the case of federal crimes, which are solely creatures of statute." And in a later case, "[W]e have long recognized that determining the mental state required for the commission of a federal crime requires 'construction of the statute and . . . inference of the intent of Congress.'" *Staples v. United States,* 511 U.S. 600, 605 (1994).

The most direct approach to understanding the meaning of the *mens rea* and *actus reus* elements is to examine the jury instructions in the federal jurisdiction where the case is being prosecuted. It is not unusual for the same concepts to have different meanings, sometimes to the point of conflicting meanings, in application. Generally, however, the terms have agreed upon meanings as a result of Supreme Court cases resolving various legal disputes.

With the exception of public welfare statutes that impose strict liability and negate the *mens rea* requirement altogether, all federal statutes contain a defined *mens rea* requirement. Public welfare offenses that negate the *mens rea* requirement are statutes that regulate potentially harmful or injurious items. The courts have upheld these statutes, despite the common law construct requiring both a guilty

mind and a bad act in order to impose criminal liability, on the reasoning that as long as the defendant knows that he is dealing with a dangerous device of a character that places him "in responsible relation to a public danger," he must "ascertain at his peril whether [his conduct] comes within the inhibition of the statute." *Id.* at 607.

Most federal statutes, however, require that the defendant act "willfully" in the performance of the bad act. Sometimes the language states that the defendant must "willfully and knowingly" engage in the conduct. We consider "willfully" first. The Supreme Court observes that "willfully" is "a word of many meanings" whose construction often depends on the context in which it appears. *Bryan v. United States,* 524 U.S. 184, 191 (1998). In general, a willful act is one undertaken with a bad purpose. In other words, the government must prove that the defendant acted with knowledge that his conduct was unlawful. *Ratzlaf v. United States,* 510 U.S. 135, 137 (1994). The Supreme Court construction is incorporated in the federal pattern jury instructions as follows: "Willfully means to act with knowledge that one's conduct is unlawful and with the intent to do something the law forbids, that is to say with the bad purpose to disobey or disregard the law."[9]

As for the term "knowingly," the Supreme Court remarks that unless the text of the statute dictates a different result, "knowingly" merely requires "proof of knowledge of the facts that constitute the offense." *Bryan,* 524 U.S. at 193. Thus, the knowledge requisite to a knowing violation of the statute is factual knowledge as distinguished from knowledge of the law, based on the maxim that ignorance of the law is no excuse or defense to a crime. Although these two terms have been subject to different legal interpretation by the courts, it is not unusual for the terms "willfully" and "knowingly" to be used almost interchangeably in statutes and jury instructions.

One area that is an exception to these general rules is dealing with tax offenses. In *Cheek v. United States,* 498 U.S. 192 (1991), the Court distinguished this class of cases as one where Congress does require a specific intent to violate the law as an element of the offense. The theory underlying *Cheek* is that tax laws are more difficult to comprehend than other federal statutes and so require knowledge of the law that is intended to be broken.

Interestingly, the federal criminal code does not distinguish between specific intent and general intent crimes. The Supreme Court has likewise criticized the distinction in numerous cases. *See, e.g., Liparota v. United States,* 471 U.S. 419, 433 n.16 (1985); *United States v. Bailey,* 444 U.S. 394, 403–06 (1980). Jury instruction committees have sought to abandon the distinction as well.[10] As a practical matter, the

9. L. Sand, J. Seiffert, W. Loughlin, & S. Reiss, Modern Federal Jury Instructions ¶3A.01, at 3A-18 (1997).

10. "Each of the jury instruction committees of the circuit courts of appeal have followed suit and discouraged the use of jury instructions on specific intent." Kevin F. O'Malley et al., Federal Jury Practice and Instructions §17.03 (5th ed. 2000).

distinction nonetheless continues to exist at trial. It may best be explained in general terms: "a 'specific intent' offense is one in which the definition of the crime: (1) includes an intent to do some future act, or achieve some future consequence (i.e., a special motive for the conduct), *beyond the conduct or result that constitutes the actus reus of the offense;* or (2) provides that the actor must be aware of the statutory attendant circumstance. An offense that does not contain either of these offenses is termed 'general intent.'"[11] As a helpful rule of thumb, statutory language that includes doing some act using the terminology "with the intent to" achieve some goal or purpose is typically a specific intent statute.

Why does this make a difference? If the crime is a general intent crime, only reasonable mistakes of fact or law provide a defense; by contrast, even unreasonable mistakes may be introduced to defend against a prosecution for a specific intent crime. Of particular importance to business organizations at trial are the good faith defense and the reasonable reliance on counsel defense, both of which can be asserted only to defend against a specific intent crime.[12]

The *actus reus*—the bad act or the failure to act where there is a duty—is discussed next with an examination of the types of offense conduct statutorily proscribed under the federal system. These offenses include conspiracy, mail and wire fraud, bank fraud, bribery and illegal gratuities, program fraud, money laundering, securities fraud, corporate tax fraud, perjury, and so-called process crimes such as perjury and obstruction of justice.

B. Conspiracy: 18 U.S.C. § 371

Judge Learned Hand aptly described conspiracy as "that darling of the modern prosecutor's nursery." *Harrison v. United States*, 7 F.2d 259, 263 (2d Cir 1925). What makes it such a darling is the evidentiary and procedural benefits attendant to its use. As a threshold matter, conspiracy is an inchoate offense, an unlawful agreement between two or more persons to commit an unlawful objective and an overt act in furtherance of the agreement. Because the agreement is the gravamen of the offense, the unlawful objective need not be accomplished before the crime can be charged. In fact, the coconspirators can fail in the attempt to commit the unlawful objective. Even the impossibility of success is no defense. *United States v. Jimenez Recio*, 537 U.S. 270, 275 (2003).

However, assuming the coconspirators are successful in achieving the commission of the unlawful objective, the conspiracy charge does not merge with the completion of the unlawful, substantive criminal offense. Both are separate crimes and carry separate punishments.

11. Josh Dressler, UNDERSTANDING CRIMINAL LAW 102 (Matthew Bender & Co. 1995).
12. United States v. Stevens, 771 F.Supp.2d 556 (D.Md. 2011).

While not the only federal conspiracy statute—there are other special conspiracy statutes for narcotics, racketeering, and securities fraud, to name a few—18 U.S.C. § 371, Conspiracy to Defraud the United States, is the main one and perhaps the easiest to plead and prove. Section 371 requires proof of three elements: (1) an agreement to achieve an unlawful objective or objectives; (2) knowing and voluntary participation; and (3) the commission of an overt act in furtherance of the conspiracy.

The agreement must be between two or more persons. A corporation is a person under the statute. While all of the coconspirators must agree on the essential nature of the plan, it is not necessary to prove that all coconspirators had knowledge of all of the details of the agreement or even know of the existence or identity of all other coconspirators.

Under the Pinkerton doctrine, *Pinkerton v. United States*, 328 U.S. 640, 646–47 (1946), every coconspirator is liable for the foreseeable acts of coconspirators performed in furtherance of the conspiracy even where the identity of the coconspirator performing the act is unknown to every coconspirator and/or not all conspirators even had knowledge of the act or agreed to the performance of the act. A party must only have knowledge of the conspiracy and agree to participate. The existence of the conspiracy is a question for determination by the court under the preponderance of evidence standard. The statements of the coconspirators may be used as evidence to establish proof of the existence of the conspiracy.[13]

There are two types of unlawful objectives prohibited under § 371: (1) an agreement to commit any offense against the United States, such as any offense arising under Titles 8, 18, 21, 26, 31, and others; or (2) an agreement to defraud the United States or one of its agencies, often referred to as an agreement to impair, impede, and obstruct an agency from engaging in or performing its lawful functions. *Hammerschmidt v. United States*, 265 U.S. 182 (1924); *United States v. Arch Trading Co.*, 987 F.2d 1087 (4th Cir. 1992). The agreement may have as its objective the intent to commit an unlawful act or a lawful act by unlawful means. The indictment can identify multiple objectives but the prosecution need not prove all of the objectives, nor is a defendant typically entitled to a special verdict form identifying which objective was proved beyond a reasonable doubt to the jury.

An overt act can be a lawful act or an unlawful act. It must simply be one performed in furtherance of the unlawful agreement. The conspiracy arises with the formation of the agreement and is completed with the commission of the overt act. Thus, a coconspirator can withdraw only in the time between the agreement and the commission of the overt act.[14] Once the overt act is completed, with or without the knowledge and/or agreement of all coconspirators, there can be no further withdrawal;

13. Bourjaily v. United States, 483 U.S. 171 (1987).
14. The affirmative defense of abandonment from the conspiracy, which does not negate liability for the conspiracy but merely for future substantive crimes, is discussed in Chapter 5.

each coconspirator is guilty of the conspiracy and, under *Pinkerton*, guilty of any foreseeable crimes committed in furtherance of the conspiracy. It does not matter if one defendant is the leader and another is a bit player in the overall scheme. Each coconspirator is equally responsible for the offense.

From an evidentiary standpoint, conspiracy is very difficult to defend against because of the breadth of relevant evidence and the exception to the hearsay rules. As a procedural matter, all coconspirators can be joined and tried together regardless of relative culpability. Severance is not an option.[15] Evidence relative to one coconspirator is, therefore, admissible against all members. Without a conspiracy charge, defendants might be otherwise entitled to separate trials where relevant evidence would be limited to the participation of a single defendant. Damage control in the form of cautionary instructions to the jury is about as much as can be hoped for, and then only in a limited number of instances.

Additionally, hearsay statements of a coconspirator of a party, regardless of whether the declarant is formally charged, made during the course and in furtherance of the conspiracy are admissible as one of the hearsay exceptions.[16] This provision offers the prosecution the ability to throw in the proverbial "kitchen sink" when introducing evidence at trial. Here, conspiracy trumps the *Bruton* rule.[17] The *Bruton* rule protects the right to confront witnesses against the defendant thus preventing the admission of an unavailable codefendant's inculpatory statements or confessions implicating the defendant. However, the charge of conspiracy allows into evidence the statements of an indicted or unindicted, available or unavailable, coconspirator which implicates or incriminates the defendant without the right to confront the coconspirator. So, for example, an uncharged coconspirator cooperates with the police and incriminates the defendant but now asserts the Fifth Amendment and refuses to testify at the defendant's trial. The police officer may still testify at trial to the statement made by the unavailable coconspirator incriminating the defendant despite the defendant's inability to cross-examine the coconspirator about the statement.

Another evidentiary pitfall is the admissibility of the guilty pleas and allocution statements of coconspirators made prior to trial. Under Federal Rule of Evidence 803(3)(b), the statement may be admissible as a statement against penal interest where the coconspirator is now "unavailable" based upon the assertion of the Fifth Amendment privilege at the time of a subsequent trial. The courts have likewise held that the Confrontation Clause is not violated by the admission of such evidence. *See, e.g., United States v. Aguilar*, 295 F.3d 1018 (8th Cir. 2002); *United States v. Centracchio*, 265 F.3d 518 (7th Cir. 2001); *United States v. Gallego*, 191 F.3d 156 (2d Cir. 1999).

15. United States v. Novaton, 271 F.3d 968 (11th Cir. 2001); United States v. Triumph Capital Group, Inc., 260 F.Supp.2d 432 (D.C. Conn. 2002).

16. Fed. R. Evid. 801(d)(2)(E).

17. *Bruton v. United States*, 391 U.S. 123 (1968),

There is also a procedural advantage to the prosecution in terms of venue. The case can be prosecuted in the place where the conspiracy was formed or where any overt act took place. The prosecutor may pick and choose among the overt act or acts charged in the indictment.

1. Intracorporate Conspiracy

A seminal case in the field of corporate conspiracy law is *United States v. Stevens*, 909 F.2d 431 (11th Cir. 1990). There, the court held that in a criminal conspiracy case, a sole stockholder who completely controls a corporation and is the sole actor in the performance of corporate activities cannot be guilty of a criminal conspiracy with that corporation in the absence of another human actor. In other words, the court found that the "plurality" requirement of two or more persons had not been met.

The court distinguished the case from the factual situation where a corporation is charged with conspiring with its officers or employees. In its earlier opinion, *United States v. Hartley*, 678 F.2d 961, 972 (11th Cir. 1982), the court rejected the "single entity theory" that all agents of the corporation engaging in corporate conduct form a single, collective legal person; that is, the corporation and the acts of each agent shall constitute the acts of the corporation.

As the *Stevens* court observed, *Hartley* established two important principles in the area of intracorporate conspiracy. First, a group of people cannot defeat conspiratorial liability simply because they are acting on behalf of the same corporation. Second, the case reaffirms the imputation of criminal liability to the corporation based on the rule of *respondeat superior*.[18]

2. Intercorporate Conspiracy

Two corporations can form a conspiracy where two separate individuals are associated with each. However, where a single agent is acting for each corporation, the plurality requirement is not satisfied. *United States v. Santa Rita Shore Co.*, 16 N.M. 3, 113 P. 620 (N.M. 1911).

3. Impact of the Acquittal of Individual Coconspirators

In *United States v. Hughes Aircraft Co.*, 20 F.3d 974 (9th Cir. 1994), the company and one of its employees were charged with one count of conspiracy to defraud and two substantive counts of making false statements. The individual employee was acquitted on all counts; the company was convicted on the conspiracy charge but acquitted on the false statement counts. Hughes argued on appeal that its conspiracy conviction should be reversed because the same jury had acquitted the "indispensible

18. In a similar case, *Copperweld Corp. v. Independence Tube Corp.*, 467 U.S. 752, 768 (1984), the Supreme Court ruled that a parent corporation and its wholly owned subsidiary were incapable of conspiring with each other for purposes of Section 1 of the Sherman Antitrust Act, finding the conduct to be "wholly unilateral."

coconspirator" upon whose acts the corporate liability necessarily rested. Rejecting the company's argument on appeal, the court applied conventional conspiracy principles for the proposition that "the conviction of one coconspirator is valid even when all the other coconspirators are acquitted." *Id.* at 978.

C. Mail and Wire Fraud

After the collapse of Enron, the Sarbanes-Oxley Act of 2002 (SOX) quadrupled the maximum statutory sentences for mail and wire fraud, from five years to 20 years. Yet the net effect of post-Enron reform is dubious. First, between 2001 and 2006, the percentage of federal offenders charged with fraud as the primary offense fell from 11.4 percent to 9.7 percent. The increase in sentences for economic crimes amounted to less than one month in comparison with sentences pre-Enron.[19] Arguably, the potential for increased sentences does add real incentive to plea bargain cases. (This is addressed in detail in Chapter 6.) That, perhaps, is the hook for evaluating the effectiveness of post-Enron reforms in terms of corporate prosecutions.

Changes to the mail fraud statute in 2002 by SOX and in 2008[20] have increased financial penalties to $1 million if the violation occurs in relation to a major disaster or emergency declared by the President or affects a financial institution.[21] Because each mailing constitutes a separate and distinct crime and may be charged and sentenced as separate crimes subject to separate penalties, a fine could be crippling to a company engaged in such misconduct. The same statutory penalty language is included in the wire fraud statute.

Specifically, the mail fraud statute, 18 U.S.C. § 1341, prohibits any scheme or artifice to defraud another of money or property by fraudulent means and the use of a mailing, either through the postal service or by private carrier, in order to execute the scheme. The "scheme to defraud" element is as broad as the criminal's imagination. It is not limited by the common law definition of fraud. Conduct characterized by the deprivation of something of value by "trick, deceit, chicane, or overreaching" is encompassed within the terms of the statute. *Hammerschmidt v. United States*, 265 U.S. 182 (1924).

The scheme to defraud requires that defendant act with the intent to defraud. The intent to deceive does not always coincide with the intent to defraud requirement. For example, in *United States v. Regent Office Supply Co.*, 421 F.2d 1174 (2d Cir. 1970), the company used false pretenses to obtain access to customers but later delivered goods of the price and quality represented during the sales pitch. The Second Circuit concluded that where false pretenses are "not directed to the quality, adequacy or price of goods to be sold, or otherwise to the nature of the bargain," they do not support a finding of a scheme to defraud. *Id.* at 1183.

Although actual harm is not required for conviction, the government must still demonstrate that "some actual harm or injury was contemplated by the schemer." *Id.* at 1180. As a practical matter, prosecutors typically do not prosecute technical violations of the statute without the ability to demonstrate material harm to the victim. Jurors tend to view technical violations as a "so what?" or "no harm, no foul" exercise.

Finally, materiality is an essential element of mail, wire, and bank fraud. The Supreme Court observed that "the common law could not have conceived of 'fraud' without proof of materiality." *Neder v. United States*, 527 U.S. 1, 22 (1999).

The wire fraud statute, 18 U.S.C. § 1343, mirrors the mail fraud statute with the exception that the wires must be used in *interstate* or foreign commerce to effectuate the scheme. There is no requirement that the defendant must know or foresee that the transmission is going interstate. *United States v. Bryant*, 766 F. 2d 370 (8th Cir. 1985). A simple long-distance phone call will suffice. Notably, the case law precedent developed under the mail fraud statute and the wire fraud statute generally applies to interpreting both statutes.

A third related provision to the mail and wire fraud statutes is 18 U.S.C. § 1346, which provides a statutory definition for one type of scheme or artifice to defraud known as the "deprivation of honest services" offense. The reason that Congress had to single out this specific type of fraud resulted from the Supreme Court decision in *McNally v. United States*, 483 U.S. 350 (1987), which held that absent a statutory provision to the contrary, it was unconstitutional to charge a scheme or artifice to defraud that resulted in a mere deprivation to the company of an employee's honest and faithful services through a fraudulent course of self-dealing. An actual deprivation of money or property was required. In other words, deprivation of intangible rights, as opposed to the deprivation of tangible rights, was insufficient to charge a scheme or artifice to defraud the principal company under either statute.

In response, Congress passed Title 18 U.S.C. § 1346 to add the intangible rights theory of "honest-services fraud" to the definition of proscribed conduct. Section 1346 provides in pertinent part: "For purposes of [Title 18 that prohibits mail fraud § 1341, and wire fraud § 1343], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."

However, the Supreme Court once again narrowed the application of § 1346 honest-services fraud prosecutions to only bribery and/or kickback schemes arising under the mail fraud and wire fraud statutes. *Skilling v. United States*, 130 S. Ct. 1568 (2010). Defendant Jeffrey Skilling, the mastermind of the Enron collapse, was indicted with two other Enron executives and charged with multiple counts of securities fraud, wire fraud, making false representations to Enron's auditors, and insider trading.

Count 1 of the indictment charged Skilling with, among other things, conspiracy to commit honest services fraud under § 1346. The theory of the indictment was that

19. Lucian Dervan, *Plea Bargaining's Survival: Financial Crimes Plea Bargaining, a Continued Triumph in a Post-Enron World*, 60 OKLA. L. REV. 451 (2007).

20. Pub. L. No. 110-179, § 4, 121 Stat. 2557 (Jan. 7, 2008).

21. The increased penalty provisions apply to the wire fraud § 1343 and bank fraud § 1344 provisions as well.

Skilling "placed his interests in conflict with that of the [Enron] shareholders, when, for his own financial benefit, he engaged in an undisclosed scheme to artificially inflate the stock's price by deceiving the shareholders and others about the company's true financial condition." However, Skilling was not charged with soliciting or accepting any bribes or kickbacks in connection with the scheme. The Supreme Court, in reversing that count of conviction, held that conflict of interest cases are not qualified schemes under the honest services doctrine. Prosecution under the statute is thus limited to schemes involving bribery and/or kickbacks.

In practice, § 1346 may protect a corporation from the imputation of criminal liability for the criminal acts of its agents, under the theory of *respondeat superior*, when victimized by an agent acting for the agent's own benefit to the detriment of the company. The company is, thus, deprived of the agent's honest and faithful services. But the use of the statute to cut off agent imputation under the theory of *respondeat superior* has been narrowly circumscribed by the courts.

The ground rules were well-established in the seminal case *United States v. Sun-Diamond Growers of California*, 138 F. 3d 961, *aff'd on other grounds*, 526 U.S. 398 (1999). Sun-Diamond was a large agricultural cooperative owned by individual member cooperatives. Among other responsibilities, Sun-Diamond acted as a lobbyist on behalf of the cooperatives in Washington, D.C., in an effort to seek favorable agricultural policies. Then Secretary of Agriculture Mike Espy recruited Sun-Diamond to assist in retiring the political debt incurred by Espy's brother in a failed political campaign. Unfortunately, the law prohibited both corporate contributions for congressional campaigns and disguised contributions. To circumvent this, the company's vice president of corporate affairs and Espy came up with a scheme in which the company persuaded individual employees to make contributions, for which the employees received reimbursement using corporate funds. Sun-Diamond was later convicted of, among other crimes, wire fraud.

On appeal Sun-Diamond claimed that the scheme was designed to defraud Sun-Diamond and not to benefit the company and, therefore, it was a victim, deprived of the honest services of its employee, and not a perpetrator of the scheme. The court rejected the argument for several reasons: (1) the corporate agent need not be acting solely, or even predominantly, with the intent to benefit the corporate principal; and (2) the corporation need not actually receive the corporate benefit. The Supreme Court upheld the conviction on the theory that while the scheme came at a cost to Sun-Diamond, there was still the promise of a benefit in obtaining favorable regulatory treatment in the future.

One of the Enron cases led to a reaffirmation of the same principles but with the anomalous result of reversing the individual defendants' convictions. In *United States v. Brown*, 459 F.3d 509, 522, *cert. denied*, 127 S. Ct. 2249 (2007), the famous "Enron barge case," the court held that where there is *no* evidence that the agent was acting contrary to the principal's interest, there may be no breach of duty and, thus, no deprivation of honest services. Here, the government charged the defendants with a mail fraud scheme based on a sham transaction designed to help Enron meet its earnings projections. "This case, in which Enron employees breached a fiduciary duty in pursuit of what they understood to be a corporate goal, presents a situation in which the dishonest conduct is disassociated from bribery or self-dealing and ... concomitant to the employer's immediate interest."

D. Bank Fraud

The scheme to defraud as used under the bank fraud statute, 18 U.S.C. § 1344, mirrors the use of the terminology in the mail and wire fraud statutes. The bank fraud statute is broad and includes any scheme to defraud a federally insured financial institution. *United States v. Jimenez*, 513 F.3d 62 (3d Cir. 2008). Where the victim is not a bank and the fraud does not threaten the financial integrity of a federally insured institution, the statute does not apply. *United States v. Blackmon*, 839 F.2d 900 (2d Cir. 1988).

Bank fraud requires only that the defendant put the bank at the risk of loss, not that the bank actually suffer a loss. It is not a defense to the charge that a depositor colluded with a bank officer to commit bank fraud. It is the financial institution itself—not its officers or agents—that is the victim of the fraud protected under § 1344. *United States v. Waldroop*, 431 F.3d 736, 742 (10th Cir. 2005); *United States v. Saks*, 964 F.2d 1514 (5th Cir. 1992). Thus, even if a bank officer knew of the true nature of the fraudulent transactions, the banking institution could nonetheless be defrauded. *United States v. Rackley*, 986 F.2d 1357 (10th Cir.), *cert. denied*, 510 U.S. 860 (1993).

Likewise, repayment may not absolve the defendant of liability. A jury instruction that "[a]ctual repayment to the bank may negate an intent to defraud the bank only if coupled with other evidence that likewise negates an intent to defraud," was upheld on the basis that it appropriately focuses the jury's attention on the defendant's intent at the time of the charged conduct. *Jimenez*, 513 F.3d at 75 (citing *United States v. Abboud*, 438 F.3d 554, 594 (6th Cir.), *cert. denied*, 127 S. Ct. 446 (2006)).

For an instructive discussion of the most common types of fraudulent schemes engaged in by corporate commercial enterprises to defraud banks, see *United States v. RW Professional Leasing Services Corp.*, 452 F. Supp. 2d 159 (E.D.N.Y. 2006). The opinion provides a useful factual description of the multiple schemes engaged in by the corporate defendant. For example, one common scheme included disguising unsecured loans as loans secured by the sale and leaseback of new equipment. This was accomplished by submitting phony invoices to the bank purporting to show the borrower's purchase of new equipment from the company that could be used as collateral to secure the loans under the lease agreements. In fact, the purchased equipment was not new and the sale and leaseback agreements were phony and prepared without the knowledge or consent of the borrower.

As corporations such as Enron and WorldCom experienced corporate failures, chief corporate executives defended based on the consent and approval of their actions by the board of directors. In one case, the chief executive officers of a bank disclosed their actions to the bank's directors and obtained director approval. The Ninth Circuit in an unpublished decision, *United States v. Whitmore*, 35 Fed. Appx. 307 (9th Cir.), *cert. denied*, 123 U.S. 659 (2002), rejected the defense, citing well-established precedent that the "board's knowledge, ratification and consent are not per se defenses to the charge of [bank fraud] ... [r]eview by the board is a particularly dubious basis for exculpating the [defendant where] the evidence showed that [the defendant] was the moving force behind the board of directors." *United States v. Unruh*, 855 F.2d 1363, 1368 (9th Cir.) *cert. den.*, 488 U.S. 974 (1989).

E. Bribery and Illegal Gratuities

Prosecutors have a wide statutory arsenal to prosecute official corruption. Corruption is frequently charged under one of three statutes that have some overlap: Bribery of Public Officials and Witnesses, 18 U.S.C. § 201; the Hobbs Act, 18 U.S.C. § 1951; and the Travel Act, 18 U.S.C. § 1952. The most frequently used statute is § 201. This statute focuses on prohibiting conduct seeking preferential treatment from public officials and prohibiting public officials from using their office for private gain. Bribery under § 201(b) requires proof that something of value was given, offered, or promised to a federal public official corruptly to influence an official act. The crime requires a "quid pro quo," a payment in exchange for influence. The value of that influence is determined subjectively by the importance attached by the defendant. Bribery is always forward-looking, a thing of value being given in exchange for being influenced.

Illegal gratuities are punished under § 201(c). The gratuity statute does not require a quid pro quo. Unlike bribery, "it may constitute merely a reward for some future act that the public official will take, or for a past act he has already taken." *United States v. Sun-Diamond Growers of Cal.*, 526 U.S. 398, 405 (1999). The payment can be a mere "thank you" for a past act or to create a pool of "good will" for the future; there is no requirement that the public official be influenced in any way.

Perhaps one of the more colorful cases under the statute involved the guilty plea in 2005 of Congressman Randy "Duke" Cunningham. Cunningham was a member of the powerful House Appropriations Committee from 1998 to 2005. He used that position to solicit bribes from defense contractors in exchange for the award of lucrative defense contracts. Cunningham delivered a "bribe menu," written on congressional stationary, to the president of MZM, Inc., which delineated what each million dollars in contracts would require in terms of bribe payments. As the quid pro quo, in exchange for approximately $160 million in Pentagon contracts, MZM gave Cunningham more than $1 million in payments and gifts, including money to pay off his mortgage, free travel on a charter jet, a Rolls-Royce, antique furnishings, and the cost of his daughter's birthday party.

However, not every act of a public official constitutes an "official act" sufficient to create liability under the statute. In *United States v. Muntain*, 610 F.2d 964, 967-8 (D.C.Cir. 1979), the court found that the defendant Muntain, an Assistant to the Secretary for Labor Relations at the Department of Housing and Urban Development (HUD), had not accepted illegal gratuities for an official act when he was compensated by private persons for selling private auto insurance schemes to labor unions with whose leaders he also dealt on official HUD business.

The court rejected the government's argument that official acts "encompass any acts within the range of an official's public duties," which the government argued included Muntain's meetings with labor union officials. As the promotion of group auto insurance was not a matter that "could be brought before Muntain—or, for that matter, anyone else at HUD—in an official capacity," there was no danger that the gratuities received could have induced Muntain "to act improperly in deciding a HUD-related matter." Accord; *United States v. Valdes*, 437 F.3d 1276 (D.C.Cir. 2006).

However, the courts have applied the brakes to FBI seizures in congressional investigations. Congressman William Jefferson was charged with, among other crimes, soliciting bribes from companies seeking to benefit from his African connections in the telecommunications business. To prove his involvement with these companies, the FBI obtained search warrants to search his congressional office. In *United States v. Rayburn House Office Building*, 497 F.3d 654 (2d Cir.), *cert. denied*, 128 S. Ct. 1738 (2008), the court held that under the Speech and Debate Clause, the FBI is barred from searching a location containing legislative materials without the member's consent.[22] This limitation increases the pressure to search the premises and records of the companies doing business with corrupt politicians.

Apparently, Congress is concerned that the current legislative tools are not adequate. A new public corruption bill, the Public Corruption Prosecution Improvements Act of 2011, is currently pending approval. This recent legislative development, which also significantly affects mail and wire fraud, bribery, and illegal gratuities statutes, is discussed in greater detail in Chapter 10.

F. Program Fraud

The federal bribery statute, 18 U.S.C. § 666, prohibits defrauding organizations that "receive, in any one year period, benefits in excess of $10,000 under a federal program." § 666(b). Section 666 has become a very effective tool in prosecuting health care fraud. Because of the complexity of the criminal statutes under the Medicare and Medicaid statutes, § 666 offers a more direct route to conviction for prosecutors.

22. *See* David F. DuMouchel, George B. Donnini & Joseph E. Richotte, *Call the Question: Is Capitol Hill A Warrant-Free Zone Post-*Rayburn*?*, *in* WHITE COLLAR CRIME 2008, at G-1 (ABA Criminal Justice Section & the Ctr. for Cont. Legal Ed. 2008).

That route was further facilitated by the Supreme Court's decision in *Fisher v. United States*, 529 U.S. 667 (2000), finding that the statute applied to the role and regulated status of hospitals as health care providers and beneficiaries under the Medicare program within the meaning of the statute. The decision is immensely significant in expanding the potential criminal exposure of companies doing business with hospitals. A lesser charge of fraud or commercial bribery may be elevated to the more serious offense of federal program fraud even though the hospital is not a federal agency but merely a recipient of federal funds.

The decision has also become the eye of the storm in the new debate over whether the receipt of federal funding should legally result in the "federalization" of fraudulent criminal behavior. Corporate defendants argue that the prosecution is pushing the envelope in charging cases under this section. For a more detailed understanding of the debate, see Justice Thomas's dissent in the *Fisher* decision, *id.* at 682.

For a discussion of civil fraud causes of action and penalties under the False Claims Act and the Fraud Enforcement and Recovery Act, refer to Chapter 10.

G. Money Laundering

Sections 1956 and 1957 of Title 18, the money laundering statutes, target financial transactions involving the proceeds of unlawful activities. The statutes also cover currency-reporting violations involving proceeds of unlawful activity "knowing that the transaction is designed in whole or in part . . . to avoid a transaction reporting requirement under State or Federal law."[23] More specifically, § 1957(a) prohibits knowingly engaging or attempting to engage in monetary transactions involving "criminally derived property that is of a value greater than ten thousand dollars and is derived from specified unlawful activity [SUA]."

Section 1956 (a)(1) prohibits domestic money laundering. Section 1956(a)(2) prohibits international money laundering, and § 1956(a)(3) is designed for government sting operations using government property represented to be proceeds of a SUA.

The most common prosecution is under § 1956(a)(1), and the essential elements include (1) the defendant took part in the financial transaction; (2) the defendant knew that the property involved in the transaction involved the proceeds of an illegal activity; (3) the property involved was in fact the proceeds of a SUA; and (4) the defendant knew that the transaction was designed in whole or in part to conceal or disguise the nature, source, location, ownership, or control of the illegal proceeds.

A "specified unlawful activity" or SUA is defined as part of a list of offenses in § 1961(1) "racketeering activity" and certain Title 31 offenses. The list is broad, including everything from murder, kidnapping, and drug transactions to mail fraud and computer fraud. The same SUA definition is included in § 1957. However, the crime of money laundering must be a crime distinct from the SUA by which the money is

23. 18 U.S.C. § 1956(a)(1)(B).

obtained. The money laundering statute is not merely an additional criminal penalty for the same conduct. It is a separate prohibition of processing the fruits of the crime or a completed phase of an ongoing offense. *United States v. Abuhouran*, 162 F.3d 230 (3d Cir. 1998). This is known as the doctrine of merger under the money laundering statute, that is, the question whether the money laundering statute is being used to criminalize the very same conduct as the predicate unlawful activity.

In *United States v. Santos*, 553 U.S. 507 (2008), the Supreme Court, in a 5-4 decision, interpreted the meaning of the word "proceeds." To avoid mere criminalization of the underlying SUA, the Court held that "proceeds" under § 1956 includes only the profits, not the "total amount brought in" or gross receipts, from the SUA to "ensure that the severe money laundering penalties will be imposed only for the removal of profits from criminal activity, which permit the leveraging of one criminal activity to the next." Subsequently, Congress passed the Fraud Enforcement and Recovery Act of 2009 (FERA), rejecting the Court's decision and defining "proceeds" to now include the gross receipts of an unlawful activity, not just the profits garnered from such activity.[24]

In another decision aimed at clarifying statutory ambiguity, *Cuellar v. United States*, 553 U.S. 550 (2008), the Court addressed the complex *mens rea* requirement under § 1956. The case involved an attempt to transport illicit funds across an international border. In order to understand the potential significance of this decision, it is important to understand the dramatic increase of the incidences of money laundering in the global context.

According to the interagency *Money Laundering Threat Assessment Report* issued in 2005,[25] the use of international trade by corporations and organizations to disguise the transfer of funds has burgeoned. These new trade-based money laundering schemes are difficult to monitor because of technological advances. For example, "stored value cards," like prepaid cash or phone service cards, provide an easy means to store and access cash value without the use of an identifiable bank account. Card management firms use "pooled accounts" opened in the name of a company or organization without verification of cardholder identity.

These cases have now become even more difficult to prosecute in light of the Court's interpretation of the *mens rea* requirement under the statute in *Cuellar*. There, a jury convicted the defendant of attempting to transport illicit funds across the border, knowing that the transportation was "designed ... to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of [SUA]" under § 1956(a)(1)(B)(i).

24. According to Section 1956 (c)(9), the term "proceeds" means any property derived from or obtained or retained, directly or indirectly, through some form of unlawful activity, including the gross receipts of such activity.

25. Available at http://www.ustreas.gov/press/releases/reports/js3077_01112005_MLTA.pdf.

The Court reversed the conviction, finding that evidentiary proof of "design" requires that the defendant knows that the *purpose* of transporting the funds is to conceal or disguise the attributes of the funds described in the statute (nature, location, source, etc.). It is not enough that the secretive aspects of the transportation were employed to *facilitate* the transportation; the evidence must show that secrecy was the *purpose* of the transportation. In other words, moving "dirty money" across international borders in a secretive manner is not enough. The defendant must be moving the money with the intent of concealing source, location, ownership, or control of the funds.

H. Securities Fraud

There is an overlap between civil and criminal law in the area of securities fraud, subjecting a violator to civil and criminal penalties for the same conduct. Although there is an array of federal statutes to prosecute securities fraud, most prosecutions are brought under the Securities Act of 1933 and the Securities and Exchange Act of 1934.[26] Prosecutions for securities fraud have concentrated on violations of Section 17(a) under the 1933 Act and Sections 10(b) and 10(b)(5) under the 1934 Act. In recent years, the focus has been primarily on abuses occasioned by insider trading.

Insider trading generally refers to the purchase, sale, or transfer of securities using material, nonpublic information in breach of fiduciary duty or a similar duty of trust and confidence. While not specifically defined by any statute, there are two types of inside information that may serve as the basis for an insider trading prosecution.

One type is information that generally concerns the internal business affairs of the company whose stock is being traded, such as unreleased facts about earnings, dividends (e.g., *Dirks v. United States*, 463 U.S. 646 (1983) (liability of the "tippee")), or other factors affecting the stock value. Such was the stock trading scandal of ImClone and Martha Stewart, involving the knowledge that the Food and Drug Administration was unlikely to approve a new drug developed by the company. The other kind of inside information is "market" information, which relates to the existence of the market potential for the sale of company securities rather than to the intrinsic value of the securities themselves (e.g., *Chiarella v. United States*, 445 U.S. 222 (1980) (breach of corporate fiduciary duties by insiders)).

The seminal corporate insider trading case is *Securities and Exchange Commission v. Texas Gulf Sulphur Co.*, 401 F.2d 833 (2d Cir. 1968). That case reiterated that companies are required to behave according to certain fairness principles intrinsic in the capital market system. There is "an expectation of the securities marketplace that investors trading on impersonal exchanges have relatively equal access to material

26. For a discussion of the recent changes to the SEC Manual regarding disposition by plea agreement or other negotiating opportunities involving securities prosecutions, see Chapter 6.

information." The progeny of cases following *Texas Gulf Sulphur* address who is an insider, when it is necessary to disclose otherwise nonpublic information, and whether the failure to disclose was material. Materiality of information is a critical component.

Examples of individual insiders include officers, directors, and controlling shareholders. Historically, the direct consequences of criminal prosecution for securities fraud usually affect the accused individuals as opposed to the company. However, it is important to emphasize that the collateral consequences of prosecution, including the economic impact on corporate stock following the initiation of an investigation and following a conviction, may be substantial to the corporation. Depending on the facts and circumstances, the corporation may truly be characterized as a victim, giving rise to a cause of action against the offending officers, directors, employees, and other third parties.

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Reform Act) has expanded the definition of insider trading. Compared to the existing insider trading federal code provision, 7 U.S.C. § 13(e), the prohibitions of Section 746 under the Reform Act are broader and vaguer. The existing provision sets forth two types of insider trading. The first, 7 U.S.C. § 13(e)(1), is limited to those who are insiders and who "willfully and knowingly" trade upon or disclose "any material nonpublic information obtained through special access related to the performance of such duties." The second, 7 U.S.C. § 13(e)(2), applies to "any person" but is limited to "willfully and knowingly" trading upon the basis of any "material nonpublic information that such person knows was obtained in violation of paragraph (1) from [an insider]."

Section 746 broadens the criminal insider trading prohibition already in the U.S. Code. First, it expands the application of the insider trading prohibition to any employees or agents of the federal government and any individual who uses information imparted by such employees or agents. Second, it broadens the definition of insider information to include "information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information in a manner which makes it generally available to the trading public. . ." Third, it creates a "Theft of Nonpublic Information" offense, which makes it criminal to "steal, convert, or misappropriate" nonpublic information "where such person knows, or acts in reckless disregard of the fact, that such information" is nonpublic. This offense will also be enforced under 7 U.S.C. § 13(a)(5).

The issue of insider trading has received considerable attention in the courts over the last 30 years, *see, e.g.*, *Chiarella v. United States*, 445 U.S. 222 (1980) (breach of corporate fiduciary duties by insiders); *Dirks v. United States*, 463 U.S. 646 (1983) (liability of the "tippee"); *United States v. O'Hagan*, 521 U.S. 642 (1997) (the use of confidential information as a breach of fiduciary duty); and, more recently, *SEC v. Zandford*, 535 U.S. 813 (2002) (involving misappropriation of client property). The prosecutive trend,

seen by many as singularly unfair, is not to charge the insider trading offense but instead to prosecute the attempt to lie and cover it up. These crimes have been labeled "process crimes" and are discussed later in this chapter. The homemaker turned billionaire mogul, Martha Stewart, is the most recent example. The insider information she received one day before it was released publicly saved her approximately $51,000 in trading losses. Never actually charged with a securities offense, because few prosecutors would ever waste office resources in an effort to prosecute this kind of insider trading case, she was sentenced on charges of obstruction of justice and lying to investigators. The punishment included five months in jail, five months on home detention, and a fine. However, the out-of-court, or collateral, consequences to Stewart and her publicly traded company involved the loss of millions of dollars. Many believe that the resulting punishment in the marketplace in response to a criminal indictment, particularly where a civil resolution of the securities issue was considered more appropriate, simply was too onerous and did not fit the crime.

To further fortify the antifraud provisions, the Reform Act expanded the application of Section 10(b) and Rule 10b-5 to include extraterritorial misconduct. In 2010, the Supreme Court ruled in *Morrison v. National Bank Ltd.*, 130 S. Ct. 2869 (2010), that Section 10(b) and Rule 10b-5 applied "only in connection with a purchase or sale of a security listed on an American stock exchange, and the purchase or sale of any other security in the United States." In response to the court's decision, Congress added to the Reform Act Section 929O(b) which applies the antifraud provisions extraterritorially to: "(1) conduct within the United States that constitutes significant steps in furtherance of the violation, even if the securities transaction occurs outside the United States and involves only foreign investors; or (2) conduct occurring outside the United States that has a foreseeable substantial effect within the United States."

The Reform Act also expands the civil enforcement penalties under the securities laws for retaliation against whistleblowers passed as part of SOX, 18 U.S.C. § 1514A.[27] The new whistleblower provisions of the Act are addressed in greater detail in Chapter 10.

SOX also added a new section to the prosecutive arsenal in the specific area of securities fraud, 18 U.S.C. § 1348. This statute, in conformity with existing criminal statutes under the 1933 and 1934 securities acts, criminalizes a scheme or artifice to defraud anyone "in connection with any security" or a scheme to obtain by false or fraudulent pretenses "any money or property in connection with the purchase or sale of any security." In the past, most cases were simply charged under the mail and wire fraud statutes for obvious reasons of simplicity in prosecution. Section 1348, styled in the same statutory language as the mail and wire fraud statutes, is intended to offer the same ease of prosecution when compared with the more complex securities statutes.

Additionally, the Fraud Enforcement and Recovery Act of 2009 (FERA) amends the definition of securities fraud under 18 U.S.C. § 1348 to include fraud related to commodities futures and options in addition to the existing category of registered securities under the Securities Exchange Act of 1934.

27. Section 806 of the Sarbanes Oxley Act.

There are few reported cases under § 1348 and none relating to organizational conduct. In *United States v. Motz*, 652 F. Supp. 284 (E.D.N.Y. 2009) the corporate broker–dealer was defunct by the time of the indictment. In *United States v. Mahaffy*, 499 F. Supp. 2d 291 (E.D.N.Y. 2007), the defendants were all acquitted under the § 1348 charge. In another, the court dismissed the counts. Finally, in a third case, *United States v. Vought*, 2006 WL 1662882 (D. Conn. 2006), the court, in an unpublished opinion, noted the close similarity between § 1348 and the bank fraud statute under § 1344 in seeking guidance in construing the elements of proof. The case, however, failed to resolve the question of whether the government was required to prove under § 1348 that the scheme actually subjected a person to a risk of loss. In short, the extent to which newly enacted § 1348 will be utilized as the favored prosecutive tool in securities cases remains relatively untested.

Finally, it is significant that SOX imposes obligations on the chief executive officer and the chief financial officer to certify that the financial reports of the issuer report fairly, in all material respects, the financial condition and results of operations of the issuer under the recently enacted § 1350. The penalties are stiff. A knowing violation carries a maximum incarceratory penalty of 10 years and a $1 million fine and a willful violation carries a 20-year maximum penalty and a $5 million fine.

I. Corporate Tax Fraud

Section 9-28.400 of the U.S. Attorneys Manual (USAM), entitled "Principles of Federal Prosecution of Business Organizations," issued by the Department of Justice in 2008,[28] provides: "[The] Tax Division has a strong preference for prosecuting responsible individuals, rather than entities, for corporate tax offenses." There are many reasons for that policy decision. The most obvious, illustrated by the statistics at the beginning of this chapter, are the facts that IRS audits of big companies are practically nonexistent and almost one-third of the audits of small to midsized companies are deemed nonproductive. In short, there are not enough resources to take on criminal tax prosecutions of companies.

Second, it is easier to target and convict an individual. Third, most prosecutors avoid tax statutes either because of general unfamiliarity or because the "methods of proof" that must be employed to establish criminal liability are somewhat complicated and jurors tend to get lost in the jury instructions. Prosecutors generally take the path of least resistance to conviction, meaning that the most frequently used statutes in the prosecutive arsenal will be employed.

28. Appendix C. USAM at http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf. The prior memoranda, which are superseded by these provisions of the USAM, were issued by Deputy U.S. Attorneys General Mark Filip (August 2008), Paul J. McNulty (December 2006), Larry Thompson (January 2003), and Eric Holder (June 1999).

Tax offenses are located in Title 26 of the U.S. Code. Prosecutors must seek special permission from the Tax Division at the DOJ to initiate a separate "tax grand jury" to initiate a tax prosecution. Additionally, once a defendant is indicted for a tax offense, the U.S. Attorney's Office must seek permission to dispose of a tax count by plea agreement or by dismissal. The somewhat bureaucratic inflexibility is yet another reason that prosecutors tend to shy away from charging tax offenses.

On the other hand, tax offenses can be a very useful trial strategy when added as a count to the indictment. The practice is informally referred to as "stacking" counts. If a prosecutor is concerned about the strength of the evidence on certain counts, a tax count can be used to convince the jury that if the defendant lied about its taxes, it probably has lied or is lying about everything else.

One interesting case in this area deals with the liability of corporate tax preparation firms and the misconduct of tax accountants seeking to provide illegal tax benefits to clients in an effort to retain business. In *United States v. Shortt Accountancy Corp.*, 785 F.2d 1448 (9th Cir. 1986), the accounting corporation was convicted under 26 U.S.C. § 7206(1), which penalizes subscribing to a false and fraudulent tax return. In *Shortt*, the accounting corporation, through its chief operating officer, fraudulently structured certain investments to appear as if they were made before certain changes in the law, resulting in undeserved tax benefits for its clients. The corporation claimed that it could not be prosecuted under § 7206(1) because the clients were apparently unaware that they had subscribed to a false return.

In rejecting the argument, the court concluded that § 7206(1) was in the nature of a perjury statute, and therefore anyone who makes a false return could be prosecuted under this section. To hold otherwise would permit the accountant to escape liability "by arranging for an innocent employee to complete the proscribed act of subscribing a false return."

J. "Process Crimes"

Process crimes include perjury (18 U.S.C. §§ 1621 and 1623) and obstruction of justice (18 U.S.C. §§ 1501 *et seq.*). Newly enacted § 1519 was the congressional SOX response to the Arthur Andersen shredding episode in the Enron investigation. This obstruction statute is aimed directly at organizational attempts to destroy, alter, or falsify records and other evidence or otherwise cover up in an attempt to impair or impede an investigation. Section 1520 is another SOX follow-up aimed directly at auditors and organizations, requiring the maintenance of audit records in conformity with the requirements of the securities acts for a period of five years. Unlawful destruction of such records now is a criminal offense.

In terms of organizational or corporate prosecution, there is not much to report under the perjury statutes and that will not be a focus of this discussion. However, several important cases in the organizational context have been recently prosecuted under § 1519. In *United States v. Ionia Management S.A.*, 526 F. Supp. 2d 319, 323 (D. Conn. 2007), the court rejected the argument that the actions of its employee to obstruct a federal investigation could not be imputed to the employer-company. The court reaffirmed the principle that an agent need not have conferred any actual benefit to the employer; it is sufficient if there was an intent, at least in part, to benefit the employer. The following jury instruction was incorporated into the trial instructions:

> If you find that the agent was acting within the scope of the employment, the fact that the agent's act was illegal, contrary to his employer's instructions, or against the corporation's policies will not relieve the corporation of responsibility for it. However, you may consider the fact that the agent disobeyed or violated company policy in determining whether the agent intended to benefit the corporation, or was acting within his authority.[29]

A critical aspect of this decision distinguishes § 1519 from other obstruction statutes such as § 1505 and § 1512. The court observed that § 1519, referred to euphemistically as the "antishredding" provision, is meant to apply broadly to any acts to destroy or fabricate physical evidence so long as they are done with an "intent to obstruct" an investigation. However, unlike the other obstruction statutes, the terminology does not require the defendant to be aware of a federal proceeding, or even that a proceeding is actually pending. The decision signals a clear departure from the *Aguilar* nexus requirement between the act of obstruction and knowledge of the existence of a pending federal proceeding. To satisfy that requirement, the defendant's conduct must "have a relationship in time, causation, or logic with the judicial proceedings." In other words, "the endeavor must have the natural and probable effect of interfering with the due administration of justice." *United States v. Aguilar*, 515 U.S. 593 (1995).

The case law as applied to § 1512 and its various subsections is inconsistent. For example, the accounting firm Arthur Andersen was charged with obstruction under § 1512(b)(2), which required proof of the *Aguilar* nexus. However, some courts have been unwilling to extend the nexus requirement applicable to that section to other subsections within the same statutory provision, such as § 1512(b)(3). *See United States v. Rhonda*, 455 F.3d 1273 (11th Cir. 2006).

Section 1512(c) was added to the statute as part of the SOX revisions. Conviction under § 1512(c)(1) requires proof that evidence is destroyed "with the intent to impair the object's integrity or availability for use in an official proceeding." Interpreting this provision in *Arthur Andersen v. United States*, 544 U.S. 696, 707-08 (2005), which involved document shredding, the Supreme Court concluded that it is "one thing to say that a proceeding 'need not be pending or about to be instituted at the time of the offense,' and quite another to say a proceeding need not even be foreseen."

29. Leonard B. Sand, et al., MODERN FEDERAL JURY INSTRUCTIONS—CRIMINAL ¶2.01, Instr. 2-7 (2007).

This language requiring the element of foreseeability appears to be a departure from the stricter *Aguilar* standard. However, in *United States v. Reich*, 479 F.3d 179 (2d Cir. 2007), involving a prosecution under 18 U.S.C. § 1512(c)(2) which subjects to criminal liability one who corruptly obstructs, influences, or impedes any official proceeding or attempts to do so, the court held that the *Aguilar* nexus test does apply to the application of this subsection.