

# PROSECUTING CORPORATE CRIMES

Christopher Wray

*The U.S. Department of Justice is moving decisively to address corporate criminal behavior, using the tools provided by the Sarbanes-Oxley Act of 2002 to crack down on corporate officials and other professionals who abuse their positions to enrich themselves at the expense of all other stakeholders.*

*Strategies and policies for combating corporate crime are set by the Corporate Fraud Task Force, created by President Bush in 2002 following a wave of corporate scandals in the United States. The task force comprises both a Justice Department group that focuses on enhancing the criminal enforcement activities within the department, and an interagency group that works to maximize cooperation and enforcement throughout the federal law enforcement community. Recent prosecutions illustrate the department's new and aggressive approaches to fighting business-related crime.*

Christopher Wray was confirmed on September 11, 2003, as the assistant attorney general of the Criminal Division of the U.S. Department of Justice. He has been with the department since 2001, handling a variety of federal cases and investigations, including for securities fraud, public corruption, racketeering, counterfeiting, and immigration.

Corporate crimes injure investors, employees, and the capital markets that fund the needs of existing firms and promote new businesses. Recent revelations of corporate fraud and other crimes have increased the need to investigate and prosecute criminal activity conducted by corporate officials—and associated professionals—who have abused their positions to enrich themselves while breaching the trust of investors, employees, financial institutions, and the capital marketplace.

The prosecutions for corporate fraud and related misconduct have demonstrated that criminal activity has permeated the highest levels of several major publicly held corporations, brokerage firms, accounting and auditing firms, and others. A few dishonest individuals have damaged the reputations of many honest companies and executives. These wrongdoers injured workers who dedicated their lives to building the companies that hired them. They hurt investors and retirees who had entrusted their financial futures when they placed their faith in the promises of the companies' growth and integrity.

These revelations of a corporate culture of corruption and deception in a number of very prominent corporations have threatened to undermine the public's confidence in corporations, the financial markets, and the economy. They also have magnified the need for a renewed emphasis on effective corporate governance.

## ENFORCEMENT ACTIVITIES

To address these and other abuses revealed by recent corporate fraud scandals, such as those related to Enron, WorldCom, HealthSouth, and Adelphia, President George Bush created the Corporate Fraud Task Force in July 2002. The task force, chaired by the deputy attorney general of the Department of Justice, comprises members of the department assigned to enhance criminal enforcement activities within the department, and an interagency group of investigative and regulatory agencies that concentrates on maximizing cooperation and joint regulatory, investigative, and enforcement activities throughout the federal law enforcement community in matters of federal corporate fraud.

The current wave of corporate fraud prosecutions focuses on a variety of criminal conduct, including falsification of corporate books and records, distribution of fraudulent financial statements to the public and to regulatory authorities, creation of “off-the-books” accounts and relationships to conceal fraudulent activity, abuse of high corporate positions for personal benefit at the expense of the corporation, and insider trading. Often, related charges are brought for obstructing and compromising audits and investigations related to fraudulent misconduct, destruction or alteration of corporate records, perjury before grand juries and investigative authorities, and related criminal activity.

On the legislative front, the U.S. Congress passed the Sarbanes-Oxley Act in July 2002. The act constitutes the most comprehensive reform of U.S. business practices in 60 years. It gives prosecutors and regulators new means to strengthen corporate governance, to improve corporate responsibility and disclosure, and to protect corporate employees and shareholders.

The act requires, upon pain of imprisonment, that the most senior officers of a corporation certify that the firm’s financial statements truly and accurately reflect its financial condition and result of operations; that auditors exercise their responsibilities to provide an independent examination and certification of the accuracy and reliability of a corporation’s financial statements; that employees are protected from retaliation for disclosing improprieties of corporate officials; and that the corporate information available to investors is true and accurate, and free from deception.

### INNOVATIVE TOOLS

Recent investigations and prosecutions of corporate fraud cases have been expedited by the use of some of the new tools provided to prosecutors by the Sarbanes-Oxley Act and by strategies and policies developed by the Corporate Fraud Task Force. These innovations include the following:

- **Bringing the collective resources and expertise of federal agencies to bear earlier in an investigation in order to complete the investigation and initiate prosecution more expeditiously.** This frequently means using the resources of regulatory agencies, such as the Securities and Exchange Commission (SEC), to conduct a joint investigation of corporate misconduct from the inception of an investigation, instead of awaiting completion of the SEC proceedings before commencing a criminal investigation.
- **Segmenting complex investigations into smaller, more manageable portions that can be investigated and prosecuted promptly and are more understandable to investigators, prosecutors, and juries.** A more narrowly defined criminal investigation often encourages corporate officers and others who are involved in fraudulent conduct to enter plea agreements. A plea agreement is a formal agreement for the disposition of criminal charges between the prosecutor and the defendant pursuant to which the defendant agrees to plead guilty to one or more charges of an indictment or information and the prosecutor agrees to do certain things, such as not to



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bring or move to dismiss other charges or recommend to the court that a particular sentencing disposition is appropriate under the circumstances. Consequently, instead of spending years investigating a complex scheme of corporate fraud—as would have been the case only a few years ago—cases are now more often investigated and prosecuted in months.

- **Using aggressive and innovative means to obtain corporate cooperation before criminal charges are instituted.** Usually, the issue of corporate cooperation is intertwined with the criminal liability of the corporation itself. Increasingly, corporations are held accountable through full prosecutions or negotiated resolutions. A corporation or other organization may be fined, placed on probation and ordered to make restitution, and ordered to notify the public and their

## CORPORATE FRAUD PROSECUTIONS

**Recent corporate fraud prosecutions illustrate the Department of Justice's new approaches to investigating and prosecuting corporate fraud.**

### **ENRON CORPORATION**

The Department of Justice's Enron Task Force has brought charges against 33 defendants, including 24 former employees of the energy company, among them, the chairman of the board, two chief executive officers (CEOs), the chief financial officer (CFO), a treasurer, three CEOs of prominent business units within Enron, the executive vice president for Enron's investor relations, and a corporate secretary. Of those defendants, 22 have pleaded guilty or been found guilty after trial, including the former CFO, and more than \$161 million in ill-gotten gains have been seized. Most recently, in November 2004, a jury convicted five executives of Enron Corporation and Merrill Lynch & Co., Inc., a financial management firm, of fraud, perjury and obstruction of justice charges arising out of a sophisticated and complex financial fraud scheme.

As in all aspects of the overall Enron investigation, there was close coordination between the Department of Justice and the Securities and Exchange Commission (SEC). Merrill Lynch settled civil charges with the SEC and entered into a deferred prosecution agreement with the Department of Justice that provides for Merrill Lynch to adopt a number of sweeping reforms and to appoint a monitor to assure the department and the court that the company is abiding by its agreement to institute and comply with the agreed-upon reforms.

### **HEALTHSOUTH CORPORATION**

The former CEO and chairman of the board of HealthSouth, a health care services provider, was indicted on numerous charges of fraud arising out of a scheme to artificially inflate HealthSouth's publicly reported earnings and value of its assets and to falsify reports of the company's financial condition. The defendants allegedly added \$2.7 billion in fictitious income to the company's books and records and induced the company to pay themselves salaries, bonuses, stock options, and other benefits based upon the fraudulently inflated figures.

Seventeen former officers of HealthSouth, including five former CFOs, have pleaded guilty to felony charges in connection with the scheme and have agreed to cooperate in the investigation and trial. This case developed in coordination with SEC enforcement actions.

### **ADELPHIA COMMUNICATIONS CORPORATION**

The former CEO and CFO of Adelphia Communications, a cable television company, were convicted by a jury of conspiracy, securities fraud, and bank fraud arising from a complex financial and accounting fraud scheme and of embezzlement of corporate property that defrauded Adelphia's shareholders and creditors. The investigation and prosecution of this case were closely coordinated with the SEC, which also instituted a parallel enforcement action.

### **PNC FINANCIAL SERVICES GROUP/AMERICAN INTERNATIONAL GROUP (AIG)**

These related cases, involving the fraudulent use of special-purpose entities, exemplify the use by the Department of Justice of deferred prosecution agreements to address corporate wrongdoing. In these cases, the financial companies engaged in a scheme to utilize the special-purpose entities to offload more than \$750 million in problem loans and investments from PNC's books to the special-purpose entities. Under the deferred prosecution agreements, the Department of Justice defers prosecution, essentially providing for a term of corporate probation requiring complete cooperation, prospective internal reforms, retrospective review of particular financial transactions, and punitive measures, including penalties and restitution.

victims about their criminal wrongdoing. A condition of probation may require the corporation to take actions to remedy the harm caused by the offense and to eliminate or reduce the risk that the harm will occur in the future.

The Department of Justice is also increasingly using *deferred prosecution agreements*, a less punitive option with reduced collateral harm. These agreements typically provide for the filing of criminal charges with an agreement that those charges will be dismissed after a period of time if the company lives up to its obligations. The agreements usually provide for the company to accept responsibility by acknowledging the acts of its employees, make restitution and surrender ill-gotten financial gains, install effective compliance programs, employ an independent monitor to review future activities, and commit to fully cooperating with the government in its investigation of culpable individuals. A court may add to the fine any gain to the corporation from the offense that has not and will not be paid as restitution or by way of other remedial measures. Any breach of the agreement by the company would subject it to a full prosecution.

On other occasions, the Department of Justice has entered into *cooperation agreements* with companies. These agreements can encompass most of the attributes of a deferred prosecution, but they do not involve an actual legal action in court. The cooperation agreements allow the company to avoid any potential collateral consequences associated with the mere fact that the

company has been charged with a crime, but they still require acceptance of responsibility, restitution and surrender of ill-gotten gains, full cooperation, and implementation of remedial measures.

- **Prosecuting those who facilitate fraud and obstruct investigations, either in separate criminal proceedings or in the underlying corporate fraud prosecution.**
- **Aggressively pursuing civil and regulatory enforcement action, often in proceedings parallel to criminal prosecutions and investigations.** This ensures that enforcement actions will be promptly initiated and actively pursued to protect investors and consumers from corporate fraud.

### **RESTORING PUBLIC CONFIDENCE**

Much has been accomplished in the Department of Justice's ongoing campaign against corporate fraud; however, much remains to be done. In order to restore full public confidence in the financial markets, continued strong enforcement will be necessary to increase the level of transparency of corporate conduct and of financial reporting and to strengthen the accountability of corporate officials. ■