

Five Years Later, No Criminals?

Federal Judge Jed S. Rakoff suggests that prosecutors' shift in focus toward seeking corporate, rather than individual, responsibility is a primary reason for a lack of prosecutions.

Judge Jed S. Rakoff recently delivered a powerful speech at the New York City Bar Association addressing corporate accountability after the 2008 financial crisis. The number of high-level executives criminally prosecuted for fraud related to the crisis is zero. Even though the U.S. federal government has widely attributed the crisis to fraudulent activity at big banks, the lack of criminal charges suggests that not a single Wall Street CEO will go to jail over the biggest economic catastrophe since the Great Depression. A federal investigation into Angelo Mozilo, the chief executive of Countrywide Financial, was dropped without any criminal charges being filed. Similarly, no criminal charges were ever brought against CEOs such as Hank Greenberg of AIG, Charles Prince of Citigroup, or Dick Fuld of Lehman Brothers.

What explains the lack of criminal prosecutions in response to the financial crisis?

Judge Rakoff, a highly respected New York federal judge and the former Chief of the Securities Fraud Prosecutions Unit of the U.S. Attorneys' Office for the Southern District of New York, offers

some insightful thoughts. He has received national attention — and a host of followers on the federal bench — for criticizing the SEC's standard practice of settling civil enforcement actions in exchange for "pocket change" financial penalties without requiring any admission of wrongdoing.

The Advocate is pleased to present an excerpt from Judge Rakoff's speech. In this excerpt, Judge Rakoff highlights a primary factor why high-level executives have not been prosecuted in the aftermath of the financial crisis:

“ The final factor I would mention is both the most subtle...and arguably the most important. It is the shift that has occurred, over the past thirty years or more, from focusing on prosecuting high-level individuals to focusing on prosecuting companies and other institutions. It is true that prosecutors have brought criminal charges against companies for well over a hundred years, but until relatively recently, such prosecutions were the exception, and prosecutions of companies without simultaneous prosecutions of their managerial agents were even rarer.

Judge Rakoff Speaks On The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?

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If you are a prosecutor attempting to discover the individuals responsible for an apparent financial fraud, you go about your business in much the same way you go after mobsters or drug kingpins.

In recent decades, prosecutors have been increasingly attracted to prosecuting companies, often even without indicting a single person. This shift has often been rationalized as part of an attempt to transform 'corporate cultures,' so as to prevent future such crimes.

The reasons were obvious. Companies do not commit crimes; only their agents do. And while a company might get the benefit of some such crimes, prosecuting the company would inevitably punish, directly or indirectly, the many employees and shareholders who were totally innocent. Moreover, under the law of most U.S. jurisdictions, a company cannot be criminally liable unless at least one managerial agent has committed the crime in question; so why not prosecute the agent who actually committed the crime?

In recent decades, however, prosecutors have been increasingly attracted to prosecuting companies, often even without indicting a single person. This shift has often been rationalized as part of an attempt to transform 'corporate cultures,' so as to prevent future such crimes; and as a result, government policy has taken the form of 'deferred prosecution agreements' or even 'nonprosecution agreements,' in which the company, under threat of criminal prosecution, agrees to take various prophylactic measures to prevent future wrongdoing. Such agreements have become, in the words of Lanny Breuer, the former head of the Department of Justice's Criminal Division, 'a mainstay of white-collar criminal law enforcement,' with the department entering into 233 such agreements over the last decade. But in practice, I suggest, this approach has led to some lax and dubious behavior on the part of prosecutors, with deleterious results.

If you are a prosecutor attempting to discover the individuals responsible for an apparent financial fraud, you go about your business in much the same way you go after mobsters or drug kingpins: you

start at the bottom and, over many months or years, slowly work your way up. Specifically, you start by 'flipping' some lower- or mid-level participant in the fraud who you can show was directly responsible for making one or more false material misrepresentations but who is willing to cooperate, and maybe even 'wear a wire'—i.e., secretly record his colleagues—in order to reduce his sentence. With his help, and aided by the substantial prison penalties now available in white-collar cases, you go up the ladder.

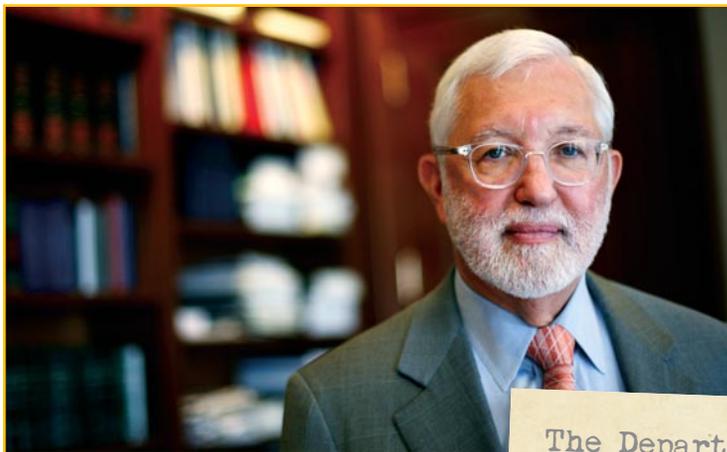
But if your priority is prosecuting the company, a different scenario takes place. Early in the investigation, you invite in counsel to the company and explain to him or her why you suspect fraud. He or she responds by assuring you that the company wants to cooperate and do the right thing, and to that end the company has hired a former assistant U.S. attorney, now a partner at a respected law firm, to do an internal investigation. The company's counsel asks you to defer your investigation until the company's own internal investigation is completed, on the condition that the company will share its results with you. In order to save time and resources, you agree.

Six months later the company's counsel returns, with a detailed report showing that mistakes were made but that the company is now intent on correcting them. You and the company then agree that the company will enter into a deferred prosecution agreement that couples some immediate fines with the imposition of expensive but internal prophylactic measures. For all practical purposes the case is now over. You are happy because you believe that you have helped prevent future

crimes; the company is happy because it has avoided a devastating indictment; and perhaps the happiest of all are the executives, or former executives, who actually committed the underlying misconduct, for they are left untouched.

I suggest that this is not the best way to proceed. Although it is supposedly justified because it prevents future crimes, I suggest that the future deterrent value of successfully prosecuting individuals far outweighs the prophylactic benefits of imposing internal compliance measures that are often little more than window-dressing. Just going after the company is also both technically and morally suspect. It is technically suspect because, under the law, you should not indict or threaten to indict a company unless you can prove beyond a reasonable doubt that some managerial agent of the company committed the alleged crime; and if you can prove that, why not indict the manager? And from a moral standpoint, punishing a company and its many innocent employees and shareholders for the crimes committed by some unprosecuted individuals seems contrary to elementary notions of moral responsibility.

These criticisms take on special relevance, however, in the instance of investigations growing out of the financial crisis, because, as noted, the Department of Justice's position, until at least recently, is that going after the suspect institutions poses too great a risk to the nation's economic recovery. So you don't go after the companies, at least not criminally, because they are too big to jail; and you don't go after the individuals, because that would involve the kind of years-long investigations that you



Judge Jed Rakoff, U.S. District Court
Southern District of New York

no longer have the experience or the resources to pursue.

In conclusion, I want to stress again that I do not claim that the financial crisis that is still causing so many of us so much pain and despondency was the product, in whole or in part, of fraudulent misconduct. But if it was—as various governmental authorities have asserted it was—then the failure of the government to bring to justice those responsible for such colossal fraud bespeaks weaknesses in our prosecutorial system that need to be addressed.



Judge Rakoff's speech reinforces the fact that investors will have to wait until the next major Wall Street scandal to see whether federal prosecutors can buck the trend and successfully marshal the resources to prosecute culpable high-level individuals for complex financial fraud. In the meantime, investors should consider the issues raised in Judge Rakoff's speech and take action to demand greater accountability.

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