TOO BIG TO JAIL

HOW PROSECUTORS COMPROMISE WITH CORPORATIONS

BRANDON L. GARRETT

TOO BIG TO JAIL

How Prosecutors Compromise with Corporations

BRANDON L. GARRETT

The Belknap Press of
Harvard University Press
Cambridge, Massachusetts
London, England
2014

Printed in the United States of America

First Printing

Library of Congress Cataloging-in-Publication Data

Garrett, Brandon, author.
Too big to jail : how prosecutors compromise with corporations / Brandon L. Garrett.
pages cm
Includes bibliographical references and index.
ISBN 978-0-674-36831-6 (hardcover : alk. paper)
1. Corporation law—United States—Criminal provisions. 2. Tort liability of corporations—United States. 3. Corporate governance—Law and legislation—United States. 4. Corporations—Corrupt practices—United States. 5. Criminal liability of juristic persons—United States. 6. Prosecution—United States. I. Title.
KF1301.A2G37 2014
345.73'0268—dc23 2014013351

TOO BIG TO JAIL

To Kerry

ABBREVIATIONS

ABA	American Bar Association
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CFTC	Commodities Futures Trading Commission
DOJ	Department of Justice
DPA	Deferred prosecution agreement
ENRD	Environment and Natural Resources Division
EPA	Environmental Protection Agency
FBI	Federal Bureau of Investigation
FCPA	Foreign Corrupt Practices Act
FDA	Food and Drug Administration
FDCA	Food, Drug, and Cosmetics Act
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
GAO	General Accountability Office
HHS-OIG	Department of Health and Human Services Office of Inspector General
IRS	Internal Revenue Service
LIBOR	London InterBank Offered Rate
NPA	Non-prosecution agreement
OCC	Office of the Comptroller of the Currency
OSHA	Occupational Safety and Health Administration
SEC	Securities and Exchange Commission

TOO BIG TO JAIL

CONTENTS

1

United States vs. Goliath

"I know what this is about. I have been expecting you."[1]

It was not until 2006 that The Banker finally got the knock on his door. Six police officers and a prosecutor were standing there with an arrest warrant.

He later recalled, "I was a true Siemens man, for sure. I was known as the keeper of the slush fund. We all knew what we were doing was illegal." The Banker was in charge of just some of the multinational bribery operations at Siemens Aktiengesellschaft, a German multinational firm, ranked in the top 50 of the Fortune Global 500 list of the world's largest corporations. It has more than 400,000 employees in 190 countries and makes everything from trains to electrical power plants to home coffeemakers. Among its many activities was paying more than a billion dollars in bribes around the world to secure lucrative business from foreign governments. Now Siemens would be prosecuted, and not just in Germany but also in the United States.

This book is the first to take a close look at what happens when a company is prosecuted in the United States. A corporate prosecution is like a battle between David and Goliath. One would normally assume that federal prosecutors play the role of Goliath. They wield incredible power, with the ability to hold a corporation liable for a crime by even a single employee and the benefit of expansive federal criminal laws. It is hard to think of federal prosecutors as the little guy in any fight. Yet they may play the role of David when up against the largest and most powerful corporations in the world.

Some companies are not just "too big to fail" but also "too big to jail": they are considered to be so valuable to the economy that prosecutors may not hold them accountable for their crimes. The expression "too big to jail" has mostly been used to refer to failures to prosecute Wall Street banks. A dismayed reaction to the lack of prosecutions after the last financial crisis is understandable, but to see why corporations may escape prosecution, it is important to understand exactly how a company can be prosecuted for a crime and the many practical challenges involved. The very idea that a corporation can be prosecuted for an employee's crime seems odd on its face, and even among criminal lawyers, the topic of corporate crime had long been obscure. Over the past decade, corporate crime exploded in importance—not only because of greater public interest in accountability but also because prosecutors transformed their approach to targeting corporations.

In this book, I present data collected from more than a decade of cases to show what really happens when prosecutors pursue corporate criminals. I examine the terms of the deals that prosecutors now negotiate with companies, how prosecutors fine companies to punish them, the changes companies must make to prevent future crimes, and whether prosecutors pursue individual employees. The current approach to corporate prosecutions raises "too big to jail" concerns that extend beyond Wall Street banks to the cases brought against a wide range of companies. I argue that prosecutors fail to effectively punish the most serious corporate crimes. Still more troubling is that not enough is known about how to hold complex organizations accountable; prosecutors exacerbate that problem by settling corporate prosecutions without much transparency. My main goal in exploring the hidden world of corporate prosecutions is to encourage more public attention to the problem of punishing corporate crime. To go deeper inside the decision making of prosecutors and companies, in each chapter not only do I present data describing the larger patterns in corporate prosecutions and non-prosecutions, but I also tell the stories of how particular companies such as Siemens fared. The Siemens story is an important one to begin with: the case broke all records for the biggest prosecution for foreign bribery.

How were the Siemens bribes paid? The Banker did not pay them himself. True to his nickname, he instead "organized the cash" by transferring funds from anonymous bank accounts in Switzerland and Lichtenstein or using dummy corporations to hide where the money was coming from and where it was going. He explained how he carried the cash undetected: "For a million euros, you don't need a big suitcase because the bills aren't very big. A briefcase is enough—200,000 euros isn't so much that you couldn't carry it in your coat pocket."[2] In the countries where Siemens was pursuing lucrative government contracts—whether it was Greece, Nigeria, Argentina, or Bangladesh—executives hired "consultants" to help them "win" the government contracts. The consultants received a fee and personally delivered the bribes to government officials.

Siemens paid bribes around the world—more than a billion dollars from 2002 to 2007. The Banker's division dealt with telecommunications and had a bribery budget of $40–50 million a year. He recalled how the telecom unit was kept "alive" by bribes and how other major divisions at Siemens operated this way. Bribery was pervasive and "common knowledge."

Bribing foreign government officials is a crime in Germany, the United States, and many other countries. In 2008, prosecutors in Germany charged The Banker with corruption, leading to a conviction, two years' probation, and a $170,000 fine.[3] He received leniency on account of his cooperation with the authorities. When he later spoke to journalists, he expressed disappointment that Siemens treated him like an "outsider" and gave him a "kick in the pants" while people at the top were not held accountable. "I would never have thought I'd go to jail for my company," he later said. "Sure, we joked about it, but we thought if our actions ever came to light, we'd all go together and there would be enough people to play a game of cards."[4]

The controversy surrounding this global bribery scheme would eventually bring in prosecutors around the world, notably those in the United States. They would wield a powerful new approach to targeting corporations, one I explore throughout this book. In the Siemens case, was The Banker right that underlings would be the only ones held accountable, or would the storm reach the summit—the top executives or the company itself?

No Soul to Be Damned, No Body to Kick

How exactly are corporations convicted of a crime? The word *corporation* comes from *corpus*, the Latin word for "body." A corporation may be a body, but it is a collective body that can act only through its employees. As the British lord chancellor Edward Thurlow reportedly remarked in the late eighteenth century, corporations have "no soul to be damned, no body to kick."[5] Corporate persons obviously cannot be imprisoned. However, companies can face potentially severe and even lethal consequences, even if in theory they can be "immortal." They can be forced to pay debilitating fines or suffer harm to their reputation. When convicted they can lose the government licenses that make doing business possible; for example, a company can be suspended or even barred from entering into contracts with the federal government.

The federal rule for corporate criminal liability is powerful and long-standing. In its 1909 decision in *New York Central & Hudson River Railroad v. United States*, the Supreme Court held that a corporation could be constitutionally prosecuted for a federal crime under a broad rule.[6] The rule is simple: an organization can be convicted based on the criminal conduct of a single employee. That standard comes from a rule called the master-servant rule or respondeat superior—"let the master answer" in Latin—which makes the master responsible for the servant's acts. Under that rule, an employer was responsible for an employee's wrongs if those wrongs were committed in the scope of employment and at least in part to benefit the employer. As the Court suggested in *New York Central*, the master or corporation may be in the best position to make sure employees are properly supervised to prevent lawbreaking. The Court emphasized "the interest of public policy," since giving companies "immunity" from criminal prosecution would make it hard to "effectually" prevent "abuses."[7] Rather than spend time on theoretical questions about when and whether corporations should constitute legal persons, I focus on whether corporate prosecutions are actually effective in preventing crime. Many have debated corporate personhood, including in response to the Court's ruling in *Citizens United v. Federal Election Commission* (2010) that the First Amendment protects corporations against regulation of election spending.[8] To understand corporate prosecutions, though, what matters is not *Citizens United* but rather the strict master-servant rule from the less well-known *New York Central* case.

Today, a corporation is a "person" under federal law, as are other types of business organizations. The very first section of the U.S. Code, with definitions that apply to all federal laws, including those dealing with crimes, defines a person to include "corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals."[9] As a result, federal prosecutions may be brought against any type of organization. The *U.S. Sentencing Commission Guidelines Manual* uses the word *organization* because the guidelines cover criminal sentences for all kinds of companies, including partnerships not formally incorporated by a state. Prosecutors convict giant multinational corporations such as Siemens, large domestic public corporations with millions of shareholders, and mom-and-pop companies with just a few owners or only one owner.

In theory, a corporation can be prosecuted for just about any crime that an individual can be prosecuted for (except for crimes with heightened intent, such as homicide). In practice, corporations are prosecuted for crimes likely to take place in a business setting, such as accounting fraud, banking fraud, environmental violations, foreign bribery, money laundering, price fixing, securities fraud, and wire fraud. Important corporate prosecutions are chiefly brought by federal prosecutors, in contrast to prosecutions of smaller-scale corporate crimes or prosecutions of individuals, which are overwhelmingly brought at the local level.[10]

Data on Corporate Prosecutions

Over the past decade, there has been an increase in the size and importance of federal prosecutions of corporations, though not in the number of cases brought. One of my goals in writing this book was to uncover and present data explaining how corporations are actually prosecuted. As Figure 1.1 illustrates, the data that I have gathered show a large spike in corporate criminal fines over the past few years.

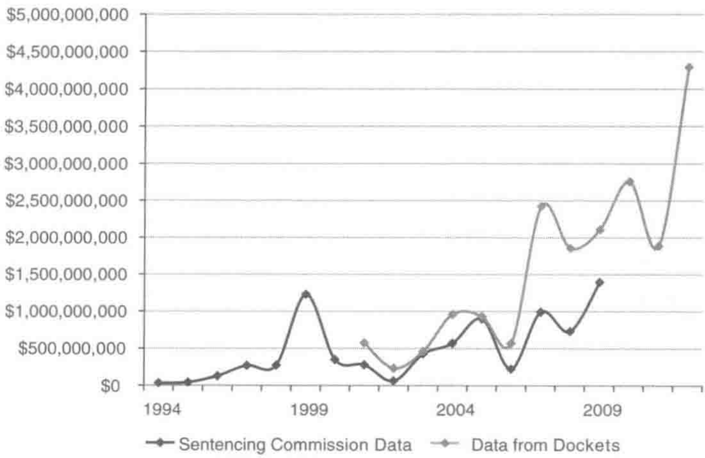

Figure 1.1 Total Criminal Fines for Organizations, 1994–2012

In the past, given the modest sentences for companies, it was often not worth the effort to prosecute them.[11] Corporate fines grew after 1991, when the U.S. Sentencing Commission, a group convened by Congress to write rules for sentencing federal criminals, adopted the first sentencing guidelines specifically designed for corporations. More resources were also devoted to corporate prosecutions in response to Enron and other corporate scandals that shook the United States in the early 2000s, prompting the Department of Justice to form an Enron Task Force and later a Corporate Fraud Task Force (now called the Financial Fraud Enforcement Task Force).[12] Figure 1.1 shows total fines for the approximately 3,500 companies convicted from 1994 to 2009. It includes data from the Sentencing Commission for the earlier period, but from 2001 to 2012 the more dramatic rise in fines is shown in the data that I collected by hand from more than 2,250 court dockets and corporate prosecution agreements.

To understand what has really changed, we need to look behind the aggregate data displayed in Figure 1.1. The bulk of those corporate fines were actually paid in a small number of blockbuster cases, such as the Siemens case. For example, the large spike in 2009 is because the pharmaceutical giant Pfizer paid a then-record fine of nearly $1.2 billion. That single fine made up about half of the total for that year. Other massive antitrust cases, foreign bribery cases, and illegal pharmaceutical sales cases involve fines in the hundreds of millions. There is still more about corporate prosecutions that those totals do not capture. The criminal fines are only a fraction of the costs imposed on companies. For example, as part of criminal settlements, companies were required to pay billions more to victims of fraud. Also not reflected in the fines are structural reforms that prosecutors require companies to adopt to prevent future crimes.

What is clear from the reported activity of prosecutors is that over the past decade they have embraced a new approach: deferred prosecution agreements. Prosecutors enter agreements that allow the company to avoid a conviction but which impose fines, aim to reshape corporate governance, and bring independent monitors into the boardroom. The rise of such deferred prosecution agreements, and non-prosecution agreements, in which no criminal case is even filed, means that the official Sentencing Commission statistics on corporate convictions, as shown in Figure 1.1, fail to capture many of the most important cases. Corporate fines are up, but the big story of the twenty-first century is not corporate fines or convictions but prosecutors changing the ways that corporations are managed. Prosecutors now try to rehabilitate a company by helping it to put systems in place to detect and prevent crime among its employees and, more broadly, to foster a culture of ethics and integrity inside the company. This represents an ambitious new approach to governance in which federal prosecutors help reshape the policies and culture of entire institutions, much as federal judges oversaw school desegregation and prison reform in the heyday of the civil rights era in the 1960s and 1970s.

What initially attracted me to studying these corporate agreements with prosecutors was that, as a former civil rights lawyer, I was surprised to see prosecutors taking on for themselves the hard work of changing institutions. I have spent years researching wrongful convictions and DNA exonerations in individual criminal cases, in which errors may implicate larger problems in our criminal justice system. I turned my attention to the very different world of corporate prosecutions because a single prosecution of a company such as Siemens can have enormous repercussions in the U.S. and the global economy, particularly since other industry actors will be watching and nervous about whether they might be next. I quickly learned, however, that there is not much information out there about when or how corporations are prosecuted.

There is no official registry for corporate offenders, nor is there an official list of deferred prosecution and non-prosecution agreements by federal prosecutors. I decided to create these resources. Over the years, with invaluable help from the UVA Law Library, I created a database with information on every federal deferred prosecution or non-prosecution agreement with a company. In one place or another, this information was publicly available, but I wanted to put it together in order to learn who these firms were, what they did, what they were convicted of, and how they were punished.

There have been more than 250 such prosecution agreements entered over the past decade. I made this database available online as a public resource, and it remains the most authoritative and complete source.[13] I then amassed a second and much larger archive of more than 2,000 federal corporate convictions, mostly guilty pleas by corporations, and placed these data online as well.[14] These data have real limitations; although prosecutors pound their chests when bringing the largest corporations to justice, in many other cases no charges are brought. We have no way to know how often prosecutors decline to pursue charges against corporations—they do not usually make those decisions public—except when they enter non-prosecution agreements. We do not know how often corporations commit crimes, as the government does not keep data on corporate crime, which is hard to detect and to define.

More than 250 federal prosecutions since 2001 have involved large public corporations. These are the biggest criminal defendants imaginable. Prosecutors have taken on the likes of AIG, Bristol-Myers Squibb, BP, Google, HealthSouth, JPMorgan, KPMG, Merrill Lynch, Monsanto, and Pfizer. Such Fortune 500 firms can and do mobilize astonishing resources in their defense. The Siemens case illustrates the titanic scale of the power plays at work in federal corporate prosecutions, making them unlike anything else in criminal justice.

Convicting Siemens

The story of the prosecution of one of the world's biggest corporations began in one of the world's smallest countries—the principality of Lichtenstein. In early 2003, a bank in Lichtenstein owned by the royal family was having auditors review its records. The bank auditors noticed something strange: millions of euros were bouncing around between Panama, Lichtenstein, and the British Virgin Islands. The bank secrecy laws in Lichtenstein, like those in Switzerland, make banks an attractive place for some people to keep money. Auditors were on the lookout for unusual transactions that might be the work of terrorists or other criminals trying to take advantage of this secrecy to engage in money laundering. They noticed odd transactions between offshore companies, including large sums going into an account of an offshore firm called Martha Overseas Corp. That company was incorporated in Panama, but it was controlled by an executive of Siemens working in Greece—and the money going into the account was coming from another offshore company, one based in the British Virgin Islands and controlled by another executive of Siemens.

The bank informed Siemens of this problem in 2004 and began to block these money transfers. They also notified bank regulators in Germany and Switzerland, who in turn contacted regulators in Austria and Italy. Two years later, German police appeared on The Banker's doorstep in Munich and seized documents from more than thirty Siemens offices.[15]

The case of Siemens (and three of its subsidiaries in Argentina, Venezuela, and Bangladesh) became a truly global prosecution. Siemens had paid more than $1.4 billion in bribes between 2002 and 2007 to government officials in sixty-five countries in Asia, Africa, Europe, the Middle East, and South America. All sorts of major public works projects were implicated. The focus of the U.S. case against Siemens was kickbacks paid under the U.N. oil-for-food program in Iraq, in which Siemens paid $1.7 million in return for forty-two contracts with $80 million in revenue and over $38 million in profits.[16]

At first glance, the Siemens scandal might seem to be a problem for German prosecutors, not American ones. After all, why would bribes paid to foreign officials by a German company, already under investigation in Germany, trouble U.S. prosecutors? But many companies, Siemens included, do business in the United States. Bribe transactions may pass through U.S. wires. Even more important, Siemens is a public corporation with stock listed on the New York Stock Exchange (NYSE), giving U.S. prosecutors jurisdiction. The U.S. Department of Justice (DOJ) and the U.S. Securities and Exchange Commission (SEC), which regulates companies with publicly listed stock, both have authority over a firm such as Siemens.

It would be U.S. prosecutors who seized the lead in this multinational case and collected the lion's share of the fines. The DOJ and the SEC began to investigate upon hearing of the raids; both handle matters related to foreign bribery. When a company such as Siemens has ties in the United States, it falls under a law called the Foreign Corrupt Practices Act (FCPA). The FCPA makes it a violation to bribe foreign officials, to keep inaccurate books and records, or to have inadequate internal procedures to prevent bribe payments. This criminal law was enacted in 1977 in the wake of the Watergate scandal and revelations that corporations regularly bribed government officials. The SEC discovered in the mid-1970s that hundreds of U.S. companies had spent millions of dollars from slush funds for illegal bribery overseas.[17] The head of enforcement at the SEC at the time recalled wondering, "How does Gulf Oil record a transaction of a $50,000 cash payment? I wanted to know, what account did they charge? Do they have an account called 'Bribery'?"

The idea of a bribery account was not far off the mark in the Siemens case. Prosecutors discovered that Siemens kept "cash desks" in its offices—literally desks filled with cash—where employees could withdraw large sums to write