

From the “Perp Walk” to the Plea Deal:

FIGHTING AND DETERRING CORPORATE CRIME IN A NEW ENFORCEMENT ENVIRONMENT

by Daniel Abrams, JD/MBA Candidate

ONLY DAYS INTO 2004, THE ENTIRE LANDSCAPE of the current campaign against corporate crime changed dramatically. On January 15, 2004, two years to the day since Enron was de-listed from the NYSE, Andrew Fastow, the former CFO and architect of Enron's infamous "special purpose entities,"¹ pled guilty to two charges of securities fraud. Not only was this a reversal of his earlier not guilty plea, but it was a landmark prosecutorial event that exposes a forever-changed legal landscape. With a new vigor, the Securities and Exchange Commission (SEC) and Department of Justice (DOJ) have embarked on a campaign to clean up the corporate world and, as a result, have changed the way corporate crime is prosecuted, perhaps forever.

Marred by slow progress and an increasing level of sophistication among corporate criminals, the government has been forced to find creative ways to maintain an appearance of toughness. With this new era of crime, a new method of crime fighting has emerged: winning the battle one headline at a time. In a society forever changed by the Internet, one which demands answers almost instantaneously, crime-fighting strategies have shifted from the courtroom to the living room. Cases are now tried on the 11 o'clock news and the sight of [*substitute your favorite corporate crook here*] being led into the courthouse in handcuffs is the opening and closing arguments for a jury comprised of the American public. After roughly 21,000 Enron employees lost the equivalent of \$1 billion and most, if not all, of their retirement plans, there is no question that we are all tuned-in.

Age-old crime fighting dogmas of punishment and deterrence have a new companion: embarrassment - by way of the perp walk. The government can no longer afford a shocking allegation followed by a lengthy and drawn-out investigation. With a growing awareness of society's notoriously short attention span, the government is now forced to feed us, the future jurors of America, a constant stream of white-collar headlines, lest we forget their efforts, or even worse, cease to care. With this breakthrough, prosecutors may finally get inside access to Enron's boardroom and the long-awaited convictions of Enron superiors appear just over the horizon. Yet we are still hungry. Therefore, the government must tide us over, again and again. What's on the menu this week? The Martha Stewart special.

To understand the current status of this unprecedented era of

corporate malfeasance, its background and development must first be explored. This new breed of corporate criminals did not arise extemporaneously. Like the financial missteps of every generation, these emerged in a series of largely unnoticed and sometimes innocuous events. During what has become known as the "dot-com bubble," unprecedented prosperity and corporate compensation revolutionized the business world. Stories began to appear of CEOs throwing lavish parties and jet setting across the country. Corporate officers developed a sort of movie-star persona, with the pay to match. With tax and accounting incentives that emphasized

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pay-for-performance and de-emphasized disclosure, much of this new compensation took the form of stock options and share packages. Senior executives and board members soon became the largest owners of their corporations' stock. This trend was supported not only by the directors, but also by pundits who believed that stock ownership theoretically aligned the interests of management with those of the shareholders. However, it was not long before directors realized that their personal wealth was intimately tied to stock performance - outright manipulation was not far behind. Soon, the only acceptable news was good news. Financial statement reporting started to resemble story telling, with P/E ratios going through the roof and investors, largely unaware or perhaps uninterested, rode the wave of "irrational exuberance" through the late 1990s until the bubble burst.

Corporations, however, were not the only ones to blame. The integration of large financial services companies, exemplified by Arthur Anderson, compounded the situation. Analysts performed disservices by urging investors to buy stock in companies

that their banking colleagues underwrote. The same companies also had their auditors certify highly-manipulated financial statements while their lawyers justified what were often questionable practices in order to retain big clients and the generous legal fees they provided. CEOs could practically buy the influence they needed between big campaign contributors (i.e. Enron directors) helping to write Bush Administration policy² and widespread behind-the-scenes IPO trading.³

In what has been two years of unprecedented corporate corruption and white-collar crime, beginning with Enron's bankruptcy, the largest in US history until WorldCom, a chain of events set in motion a new era of enforcement not seen since the Roosevelt era.⁴ When Enron's stock was de-listed at \$0.67 (off its high of \$81.39 only 12 months earlier) mounting public pressure forced the government into action. It was not long before President Bush responded by announcing his Ten-Point Plan to Improve Corporate Responsibility and Protect America's Shareholders⁵ and an executive order establishing a Corporate Fraud Tax Force with the Deputy Attorney General serving as chair.⁶ Meanwhile, not to be outdone by the President, Congress threw its legislative hat into the corporate accountability fray. Senator Patrick Leahy, a former prosecutor, and Chairman of the Senate Judiciary Committee, proposed Senate Bill 2010: the Corporate and Criminal Fraud Accountability Act of 2002. Addressing the Committee on the Judiciary, Sen. Leahy stated, "The inadequacy of current statutes and sentences available in white-collar cases is one of the most important issues facing our country ... The integrity of our judicial system depends on accountability."⁷ The reforms were groundbreaking and the Act passed unanimously in Congress as Section VIII of the Sarbanes-Oxley Act of 2002.⁸

Walk This Way

TO MATCH THE LEGAL DEVELOPMENTS, the government adopted a new and more attention-grabbing enforcement response to stop corporate crime before it starts. One effective and surefire way to make investors and the public pay attention is to lead a handcuffed CEO of a major public company past a slew of reporters into the courthouse. The effectiveness of the perp walk is unquestionable. The government has even taken to providing the media with advance notice of the sensational scenes. For example, when enforcement officials showed up at former Adelphia CEO John Rigas' house to arrest him for allegedly looting the company of over \$2.5 billion, they had already notified the New York media. It apparently mattered little that the 77-year old Rigas met both of the requirements needed to turn oneself in (not a threat to yourself or others; and not posing a flight risk).⁹ Prosecutors still rejected his request to arrange surrender. The government's decision to deter future crime in this manner trumps all complaints regardless of any possible embarrassment. Try as they may, there is no avoiding the perp walk.

Therefore, it comes as no surprise that significant legal challenges have been waged against the perp walk as a crime-enforcement method. Objections have come in several forms, yet courts have consistently upheld perp walks as legal. Arguing that the perp walk is an illegal invasion of privacy, several former New York City police officers recently sued Westchester County after their handcuffed-walk was videotaped and shown on TV and in newspapers. In *Caldarola v. County of Westchester*,¹⁰ the US Court of Appeals for the Second Circuit held that the perp walk did implicate the 4th Amendment rights of the officers, yet the county's legitimate crime-fighting purpose outweighed the finding of a violation. Remarking that "[a] recent surge in executive 'perp walks' [featuring] accused white-collar criminals in designer suits and handcuffs"¹¹ was probably broadcast and printed for their entertainment value, the court asserted that perp walks, more importantly, serve

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the serious purpose of educating the public about law enforcement efforts.¹² Furthermore, the court concluded, "The image of the accused being led away to contend with the justice system powerfully communicates government efforts to thwart the criminal element, and it may deter others from attempting similar crimes."¹³

In another legal challenge, Lea Fastow, the wife of the Enron CFO, and herself the former assistant treasurer of Enron, also complained of her perp walk in *US v Fastow*.¹⁴ She also recently secured a plea deal with the government, this time on charges of filing a false tax return. She argued that when the government insisted on a perp walk instead of allowing her to surrender, her rights to a fair trial were violated. Rejecting her contention, the federal district court upheld the privacy implications of *Caldarola*, adding that "it will not second guess a decision that is entirely within the province of the law enforcement agency."¹⁵ The perp walk has clearly developed into an important tool in the government's new crime-fighting arsenal - and one it is not afraid to use.

There is no doubt that it takes a significant amount of time

to assemble strong cases against corporate giants. For that reason, the SEC must piece together smaller cases against lower-level executives (like Fastow) in order to get them to turn on their former bosses. This also consumes a great deal of time and resources, making for quite an arduous process. As Professor Alan Dershowitz stated, "These rarely are cases that can be made with paper... you need someone to flip."¹⁶ This lack of discernable progress is not, however, from a lack of effort. As of the summer of 2003, the Corporate Fraud Task Force, only a year and a half old, had over 500 people working on more than 320 investigations, with more than 20 working on Enron and 15 on WorldCom full-time. Compared to past assignments of only three investigators per case, the SEC has notably stepped-up their efforts as well.¹⁷ What's more, the government's power of deterrence has not been restricted to just encounters with the media. As the *Wall Street Journal* reported, "In the post-Enron era, even the whiff of an SEC investigation will send a company's stock plummeting."¹⁸ The SEC even has a policy of encouraging US Attorneys to open cases against white-collar criminals by backing them with manpower, expertise, and analysis.¹⁹

Sign on the Dotted Line

THE ONLY ISSUE THAT REMAINS IS which enforcement path the government will choose. Moreover, while simultaneous top-down and bottom-up strategies haven't proved sufficient, a new strategy has emerged in a result-driven and headline-seeking enforcement climate that takes nothing for granted and no perpetrator is too large or too small.

Having CEOs on the Most Wanted List allows the government to enforce the law, thereby performing the duties it was entrusted to do, while also continuing to deter future criminal conduct. This "shot across the bow" to other CEOs is intended to remind potential criminals of the price of malfeasance. This, of course, is the ideal strategy. However, in government, as in life, the ideal is often unattainable. Going after corporate leaders requires access to information, which the government so desperately needs. Therefore, the government is driven to plea bargaining with lower profile corporate criminals who become the rungs on a corporate crime ladder that prosecutors can then climb, albeit slowly but surely. Yet these deals lack the same deterrent effect as that of a jury conviction or a stiff sentence, and are often not as newsworthy. In response, what has developed is a phenomenon that now shapes the prosecutorial era of this generation: the prosecution of higher profile, yet less malevolent, corporate leaders on ostensibly "lighter" crimes in order to support a tough-on-crime image and keep alive a momentum that will ultimately deliver jury convictions and win elections.²⁰ In this strategy of deterrence through media exposure, plea deals and "smaller" convictions allow the government to publicly, albeit laboriously, fulfill its purpose. The effect is a complex enforcement environment, driven by results, and yet because of its

own ambitions, one that often must substitute bark for bite.

The wildfire touched off by Enron resulted in investigations of more than twenty behemoth public companies and their leaders and yet, two years later, the government had not charged former Enron chief executive Kenneth Lay, or former WorldCom CEO, Bernard Ebbers. With only a small number of cases making any determinable progress, state prosecutors were forced to step in. For example, hoping to assuage the rising public outcry the Attorney General of Oklahoma, W.A. Drew Edmondson, filed felony charges against Ebbers on August 27, 2003. Edmondson stated that he resorted to taking the matter into his own hands because of his "disappointment with the sanctions that have been leveled to date at the federal level."²¹ New York Attorney General Eliot Spitzer has almost left the federal government in the dust by leading an impressive campaign against corruption, specifically against the \$7 trillion mutual fund industry. Of course, as significant progress is illusive, any plea bargain comes as a welcomed reprieve for a federal government that is anxious for results. Even the plea bargain well seemed dry on January 14, 2004. Enter Andrew Fastow, whose plea agreement in January 2004 for an "eye-popping 10-year prison term and forfeiture of over \$29 million is among the harshest ever handed down for a white-collar crime."²² Yet, this means much more than just an executive crook doing hard time. It signals that the government's new campaign may not, in fact, be entirely headlines and no convictions. Additionally, in a telling move, Mr. Fastow agreed to the long sentence in exchange for tossing his 98-count indictment, rather than leave his fate to a jury he probably believed had been watching a lot of television.

In the Spotlight

WHAT HAPPENS IN AN ERA THAT IS CAPTIVATED by sensational headlines and instantaneous results, when the really big fish are nowhere to be found? More little fish are caught. The Frank Quattrone obstruction of justice case, while serious, is a prime example of the Manhattan U.S. Attorney's office proceeding with limited evidence on a weaker and unrelated charge to the alleged crimes under investigation. As a star investment banker who came to exemplify the excesses of the late '90s in an environment (Silicon Valley) that he built, Quattrone is another high profile and celebrity-like corporate perp. In what has been described as a prosecutorial "overreach" that almost backfired, the highly circumstantial evidence almost produced a mistrial.²³ Quattrone was nearly acquitted, but a last-minute reversal among jurors forced a deadlock, largely due to a flip in Quattrone's own testimony.²⁴ Furthermore, in choosing to bring obstruction charges,²⁵ it is possible that the government was unable to produce sufficient evidence of another crime.²⁶ These tactics are an example of what has been called a "prosecutorial Al Capone strategy,"²⁷ where the government pursues "the lesser, seemingly simpler charge, if the big one looks too

tricky to try before a jury.¹²⁸ The resulting mistrial demonstrated a crack in what appeared to be an otherwise-sturdy campaign against corporate malfeasance.

The case against Martha Stewart is perhaps a better example. For the roughly \$50,000 she saved by trading on what was allegedly insider information, she faces charges of obstruction of justice, making false statements, and conspiracy, amounting to a possible ten years in jail and \$1 million in fines. Yet, interestingly, like Quattrone, she was not charged with the crime for which she was investigated, namely, insider trading. Instead, prosecutors brought a rare application of securities fraud in which they charged that by making public statements regarding her innocence, Stewart was in



Former Enron CEO Jeff Skilling's "Perp-Walk" (Feb. 2004).

fact attempting to boost the stock price and thereby defrauding investors in her public company, Martha Stewart Omnimedia.²⁹ To the government's chagrin, that charge was dismissed and never reached the jury. Now, after Martha's conviction, the government's strategy to charge obstruction in lieu of the underlying crime may gain some momentum even after the failed attempt to obtain a conviction in the first Quattrone trial. Yet, while her actions appear

shocking and disappointing, especially for a former NYSE director and stockbroker, they must be viewed relative to the gravity of the crimes perpetrated at Enron and WorldCom. With Stewart, the government gets an incredibly visible and successful executive who arguably believed that she did not have to play by the rules.³⁰ By securing a conviction, the government fulfills its goal of deterrence, gains a high profile victory, and tides over a hungry public while still making criminals pay for their crimes.

Adapting to a New Environment

CLEARLY, THE SEC AND THE US ATTORNEY'S OFFICE are meeting the challenges of investigating and penetrating the boardroom with a tougher tone. Since Enron, the SEC in particular has set out on a new path of enforcement with new practices and goals that have redefined the securities enforcement landscape. The SEC has undertaken a "real-time" enforcement program that is said to provide faster and more effective oversight of the securities markets.³¹ By putting an immediate stop to unlawful conduct through a "fast track" for prosecutions, the US Attorney's office, in conjunction with, the SEC, is now seeking greater civil penalties.³² With the help of Sarbanes-Oxley, the SEC can now hope to deter future misconduct effectively and completely. The SEC has also stepped in to put the focus on corporate governance by highlighting the importance of officer and director fiduciary responsibility. In fact, after asking the NYSE and NASDAQ to review their corporate governance and listing standards, several high-profile changes have been made, including the resignation of the NYSE's chairman Richard Grasso due to his \$140 million pay package.³³

In this new enforcement environment an interesting and complicated dynamic has developed: a public that demands immediate results coexists with a government that must weigh the challenges of prosecuting complicated white-collar crime cases against the necessity of securing convictions. Even though it implements many new tools and resources, it is clear that the government has chosen to pursue a number of smaller cases, both in order to secure larger trophy cases, and also because of a sense that if they don't, we, as potential jurors, might forget our anger,³⁴ or worse yet, believe the government is feeble in its efforts. What was once a glorifying and appealing title, CEO has turned into a symbol of greed and a political punchline. Yet, despite the government's mixed results, the threat that cynicism and distrust in our corporations may run rampant in our financial markets still remains. From perp walks to plea deals, it is a threat met by a new arsenal of tools and in a new enforcement environment with its results beamed to living rooms across America.

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Daniel Abrams is a second-year JD/MBA candidate at American University Washington College of Law and the American University, Kogod School of Business focusing on entrepreneurial studies and corporate law. Mr. Abrams received his BA in Psychology from Tufts University. Mr. Abrams is currently on the executive board of the Sports & Entertainment Law Society.

ENDNOTES: Daniel Abrams

¹ These fictional accounting entries are used to shift assets and debt off of a company's balance sheet to make it look more favorable; a practice that forced Enron to restate \$1.2 billion of earnings as losses, ultimately resulting in the company's implosion.

² Dick Cheney admitted that he met former Enron CEO Kenneth Lay regarding Bush Energy policy before Cheney's Energy Task Force issued sweeping recommendations. Enron had been one of George W. Bush's largest campaign contributors, with estimates reaching \$500,000, including his gubernatorial races. See e.g., Peter Dizikes, *Cheney: We Met with Enron Execs*, ABC News, Jan. 9, 2002 available at http://abcnews.go.com/sections/business/DailyNews/enron_cheneyletter020109.html

³ Frank Quattrone's "Friends of Frank" program, where as many as 300 corporate directors and executives were given shares of hot IPOs in 1999 and 2000. This became the basis of NASD disciplinary charges in March of 2003, and his later fine and suspension in Jan. of 2004. One such exchange was chronicled in a series of emails with Michael Dell, CEO of Dell, Inc. where Dell agreed to be the keynote speaker at a CSFB technology conference in return for 250,000 shares of Corvis. See Randall Smith and Kara Scannell, *Under Cross-Examination, Tech Financier Concedes a Role in IPO Allocations*, Wall St. J., Oct. 13, 2003, at A1.

⁴ From Teddy Roosevelt's trust-busting of the early 1900s to the 1932 election between FDR and Herbert Hoover. In that election, the major issue debated was so-called "state's rights" with governmental control of financial markets in the depression era called into question. With FDR's victory, the enactment of the Securities Act of 1933 came within his first 100 days in office.

⁵ Ten-Point Plan available at <http://www.whitehouse.gov/infocus/corporatereponsibility/index2.html>

⁶ See Corporate Responsibility at <http://www.whitehouse.gov/news/releases/2002/07/20020709-2.html>. This position is now occupied by James Comey, the Manhattan US Attorney responsible for many of the early prosecutions against corporate officers. The task force is charged with directing and instituting investigations and charges into white-collar criminal offenses.

⁷ *Penalties for White Collar Crime: Are we Really Getting Tough on Crime?*, 107th Cong. (2002) (statement of Sen. Patrick Leahy, Member, Senate Subcommittee on Crime and Drugs).

⁸ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

⁹ Douglas Harbrecht, Editor, *Less Fanfare for Bush's Fraud Fighters*, Bus. Wk., Nov. 1, 2002, available at http://www.businessweek.com/bwdaily/dnflash/nov2002/nf2002111_9035.htm.

¹⁰ *Caldarola v. County of Westchester*, 343 F.3d 570 (2nd Cir. 2003).

¹¹ *Id.* at 572-73.

¹² See *id.*

¹³ *Id.*

¹⁴ 292 F. Supp. 2d 914 (S.D. Texas 2003).

¹⁵ *Id.* at 12.

¹⁶ Nanette Byrnes et al., *Angling for the Really Big Fish*, BusinessWeek, Sept. 15, 2003, at 42.

¹⁷ *Id.* at 42.

¹⁸ Michael Schroeder, *SEC Welcomes Prosecutions: Jail Threat is Considered Best Way to Deter White-Collar Crime*, Wall St. J., June 11, 2002, at A2. For Example, Martha Stewart Omnimedia went from a high near \$20/share to a low of roughly \$5/share with the news of Martha's insider trading scandal.

¹⁹ See *id.* at A2. (Stating that, for example, in 2000, the SEC provided 20 enforcement attorneys to various US Attorneys offices as aid).

²⁰ The prosecution of criminals has always been a politically charged phenomenon. Often Attorneys General and other executives are elected for their "tough-on-crime" attitude or reputation. For example, Rudy Giuliani's success as mayor of New York was largely attributed to his reputation for cleaning up the city, a record he built as a former prosecutor.

²¹ See Byrnes *supra* note 15, at 42.

²² *Enron Justice*. Wall St. J., Jan. 15, 2004, at A4.

²³ See *id.*

²⁴ See Randall Smith and Kara Scannell, *Under Cross-Examination, Tech Financier Concedes a Role in IPO Allegations*, Wall St. J. Online, Oct. 13, 2003, at A1; see also Randall Smith and Kara Scannell, *Inside Quattrone Jury Room: Discord Culminates in Mistrial*, Wall St. J., Oct. 27, 2003, at A1. After steadfastly denying that a

company-wide email to "clean-up your files" was in response to a pending grand jury investigation into IPO allocations (see Smith and Scannell, *supra*, note 3, at A1), the prosecution displayed dozens of Quattrone's own emails which forced his confidence to falter and caused him to backtrack on his earlier testimony. Jurors then questioned the main tenet of his defense that he had no interest in seeing documents destroyed and what was 7-4 majority for acquittal turned into an 8-3 deadlock.

²⁵ See *id.* at A1 (Quoting Jan L. Handzlik, former federal prosecutor: "[These cases] are theoretically easier to prove than the underlying allegations of fraud ... and that helps to explain why we see prosecutions of Martha Stewart, Arthur Anderson and Frank Quattrone on obstruction charges, while federal cases like those against Ken Lay, Jeffrey Skilling and Bernard Ebbers remain in the starting gate.")

²⁶ See *The Quattrone Mistrial*, Wall St. J., Oct. 27, 2003, at A20. "They did not indict the former investment banker for crimes associated with investment banking. Presumably, they never found enough evidence on those matters to indict him with."

²⁷ See *id.* at A20.

²⁸ Kara Scannell and Randall Smith, *Quattrone Mistrial May Give Prosecutors Reason to Hesitate*, Wall St. J., Oct. 27, 2003, at C1.

²⁹ See Kara Scannell, *Stewart Trial: White Collar, White Heat*, Wall St. J., Jan. 16, 2004, at C1 (explaining the government's assertion that by publicly proclaiming her innocence and repeating an allegedly false story about the reason for her sale, she was fraudulently trying to boost the price of her own company's stock). See also, David Mills & Robert Weisberg, Editorial, *Flunking the Martha Test*, Wall St. J. Commentary, Jan. 16, 2004, at A10 (commenting on the misgivings of making a new securities fraud charge for public statements about one's company).

³⁰ See Thomas S. Mulligan and Walter Hamilton *Martha Stewart Found Guilty: Prison Likely*, Los Angeles Times, March 6, 2004, at A1. U.S. Atty. David N. Kelley said he hoped the case would "send an important message that we will not and, frankly, cannot tolerate dishonesty and corruption."

³¹ See John F.X. Peloso and Ben A. Indek, *Securities Litigation and Enforcement: The Current SEC Enforcement Landscape*, 227 N.Y. L.J., p. 1 (2002).

³² *Id.*

³³ See Kate Kelly & Susanne Craig, SEC, *Spitzer Plan Probes of Grasso's Pay*, Wall St. J., Jan. 15, 2004, at C3.

³⁴ See Lee Walczack et al., *Let the Reforms Begin: As America's Anger Grows, the Time for Talk is Long Past*, Business Week, July 22, 2002, at 26 (citing a June 2002 Gallup poll finding that 77% of respondents called business scandals either a crisis or a major problem leading politicians to turn up the heat on both rhetoric and action).