COMMERCE AND FEDERAL CRIMINAL LAW:

The Risks of Over-Criminalizing Commercial Regulation

Remarks of

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Good afternoon. We are here today to consider issues of corporate governance. Recent events have generated renewed interest in and highlighted the importance of one aspect of corporate governance, namely, dealing with government enforcement proceedings, including criminal investigations and prosecutions. My purpose today is to discuss a phenomenon that has been a quarter of a century or so in the making: the government's increased use of criminal law and other punitive enforcement mechanisms to regulate business activity. In so doing, federal criminal law as applied to business has strayed from its core purpose of protecting the means and instrumentalities of commerce to being used as a punitive regulatory tool.

I would like to address three considerations that I hope will be of practical use to you concerning this issue:

First, I think it would be useful to remind ourselves of the role federal criminal law has played in carrying out the core federal function of protecting the means and instrumentalities of, and thereby promoting, commerce.

Second, I would like to summarize the case for the proposition that federal criminal law has strayed far from that purpose.

Third, I would like to present a few ideas about what we can do to fix that, both in court and in discourse with the makers of public policy.

I am constrained to make a sidebar observation concerning September 11, 2001. Those events changed many things, but they also brought some things into sharper focus. One is that a strong economy should not be taken for granted. To have a strong economy, we need strong resourceful companies operating in an environment that recognizes commerce as beneficial to the human condition.

We should remember that prosperity is, in fact, a liberating factor in human affairs. Hamilton recognized this 225 years ago when he wrote:

> "The prosperity of commerce is now perceived and acknowledged by all enlightened statesmen to be the most useful as well as the most productive source of national wealth; and has accordingly become a primary object of their political cares."

Michael Novak, the 20th century theorist, has reiterated and reinforced that view:

> "The invention of the market economy in Great Britain and the United States more profoundly revolutionized the world between 1800 and the present than any other single force. After five millennia of blundering, human beings finally figured out how wealth may be produced in a sustained, systematic way … the gains in liberty of personal choice … increased accordingly."

What we also know from experience is that to prosper and grow, business needs an environment that fosters and encourages commerce. The Founders recognized this and made promoting commerce a core function of the fledgling federal establishment. But today, much of the use of criminal law in the commercial context seems to have lost sight of that basic principle and core federal function.

This is not the result of some deliberate, anti-commercial policy choice, or the result of some unsound or ill-advised seismic shift in government

posture towards business. Rather, it is the result of an accretion of events. We have quietly, perhaps imperceptibly, slipped our philosophical moorings**,** so that now government drifts from its role of protecting the commercial system toward an environment that criminalizes otherwise innocent behavior because it transgresses some regulation or other standard designed not to foster commerce, but to control or regulate how it is carried out.

Government regulation has become a tool of pursuing social goals and, with increasing regularity, government has resorted to criminal sanctions as a means of ensuring compliance with these regulatory norms. There is widespread support for many of these goals, such as clean air and water, safe medicines and food and an information infrastructure that has already exponentially increased our productivity. But should we make criminals out of those who fail to meet our expectations for achieving regulatory goals?

Let me be clear at the outset so that there is no mistake: I am not suggesting that we condone fraud or dishonesty in the marketplace. Far from it. A dishonest market is not a free market. But there is value in recognizing that a core function of the federal government, and therefore the core purpose of federal criminal law in the business context, is to promote commerce by protecting its means and instrumentalities.

The government and federal law enforcement have a critical role to play in policing the marketplace for fraud and corruption. It is clearly necessary to set and enforce standards that promote investor confidence in capital markets, provide transparency in credit transactions and to take such other steps, including the judicious use of criminal law, as are necessary to protect the integrity of commerce. Even though such measures present difficulties and expense for

business, one does not have to look very far for examples of how dishonesty, deceit and corruption can cripple a nation's economy and its commercial system. Indeed, businesses themselves have a vital interest in a level—that is, an honest—commercial playing field.

But much of the criminal law that applies to business today has strayed far from promoting these core values and, instead, punishes criminally what are, in essence, regulatory offenses. In the 20th century, Congress pursued many regulatory initiatives that set the stage for this new use of criminal enforcement authority. Most of these were enacted as part of a continued expansion of federal regulations and programs in general. These initiatives were the catalyst for an accelerated pace in the regulation of business activities by punitive mechanisms, which use seems far afield from the value of maintaining integrity in commercial affairs. Examples of this trend include:

1. Environmental laws which include steep civil and criminal enforcement penalties for failing to meet regulatory standards in conducting what is otherwise legitimate and innocent commercial behavior. Consider, for example, that polluting is legal in the United States; you can get a permit from the government to do it. Polluting too much, however, is a felony. The line is razor thin, often expressed in parts per million, and the stuff of great debate between experts and scientists.

2. Billing government health programs for medical services is obviously legitimate commercial activity.

Certain unbundling of the charges or otherwise sending a bill to the government that does not conform with a sheaf of federal regulatory dictates can be felonious conduct. Again, experts can and do disagree about minute aspects of coding medical services for reimbursement by public or private insurers.

3. Pumping oil and gas from federal lands is, of course, legitimate commercial activity. Failing to abide by complex government regulations when valuing crude oil or raw gas at the well for royalty purposes may not only lead to treble damages claims under the False Claims Act, but federal grand jury attention as well. And so on.

The core purpose of federal criminal law relating to commercial matters has traditionally been to foster commerce by protecting the means and instrumentalities necessary to it. It seems to me that now is a time to refocus on those fundamentals and to consider alternative mechanisms to achieve other goals sought through regulation.

To address the core federal function of promoting commerce, please allow me to trace briefly the evolution of the relationship between the federal authority and commercial activity.

The Constitution expressly gives Congress the power to "regulate" commerce. It also expressly gave Congress the power to "punish" treason, counterfeiting, piracies, felonies committed on the high seas and offenses against

the law of nations. These provisions seem to have been intended by the Founders to serve one common and fundamental purpose: to protect the country and its government and to empower it, in turn, to protect the channels and instrumentalities of commerce, as they were then known. The notion that criminal statutes could be used directly to "regulate" commerce is simply not envisioned in the Founders' work.

Early on, Congress followed the philosophical lead of the Founders, enacting criminal statutes limited to punishing treason, murder and bribery on federal property or the high seas, perjury in federal court, bribery of federal judges, forgery of federal certificates and securities and customs offenses. These and other statutes were clearly aimed at punishing threats to a well-ordered system of commerce and protecting the government charged with securing the benefits of commerce that would accrue to the people.

Two statutes passed in the 19th century, the mail fraud statute and the False Claims Act were designed to protect the mails, an important instrumentality of commerce, and the integrity of federal procurement, a matter of considerable value to the commercial participants therein. After the War, Congress soon saw the need to protect the newest instrumentality of commerce, the railroad, from criminal interference as well.

This same practice of enacting criminal statues to protect the means and instrumentalities of commerce continued through much of the 20th century. Banks were recognized as important instrumentalities of commerce and the federal bank robbery statutes were enacted to protect banks from the likes of John Dillinger and other robbers. Later, banks became the beneficiaries of numerous criminal statutes designed to protect them from white collar swindlers and thieves.

The Sherman Antitrust Act, enacted to remedy the predations of Standard Oil and to prevent their recurrence, was aimed at freeing interstate commerce from unnatural, anticompetitive impediments.

New Deal security acts and financial reporting laws were designed to preserve the integrity of commerce and increase investor and consumer confidence in publicly traded markets and the banking system generally.

Years later, RICO responded to the risk to legitimate commerce posed by the infiltration of organized crime.

When the Supreme Court decided in a 1909 watershed decision that corporations could be prosecuted for crimes, it is doubtful that it foresaw the minefield of regulatory offenses that the modern corporation would need to traverse on a daily basis. In New York Central and Hudson River Railroad v. United States, the Court reasoned simply that if a corporation could bind the shareholders to a contract, it should be held responsible for conduct on the corporation's behalf which is determined to be a crime. The Court also moved, rather casually, from the premise that corporations could be held liable for injuries to the conclusion that they also should be held liable for crimes. And lastly, the Court theorized that, if corporations could not be prosecuted, there were wrongs that could not be remedied and deterred. That last notion seems odd today, since the scope of civil remedies available to right corporate wrongs seems more than adequate and the keystone criminal remedy—jail—is not applicable to corporations.

But, indeed, the notion that corporations should be prosecuted criminally for their "wrongs" has proven to be a common refrain as the federal

government has migrated away from the core purpose of fostering commerce by protecting the means and instrumentalities necessary to it.

The lengths to which the government sometimes will go to turn a regulatory infraction into a criminal case would be humorous if it were not for the consequences to the corporate defendant. In 1982, in United States v. Hartley, the Eleventh Circuit upheld the conviction of a corporation and two of its employees for selling the military breaded shrimp that failed to meet certain specifications, including the amount of breading on each piece of shrimp. To be sure, the defendants in that case also had committed serious criminal acts. They deceived the government by altering inspection standards and changing the weights used to determine how much shrimp the government bought. The latter deserve criminal treatment because they involve the type of deception and dishonesty that characterize criminal intent. But one must question whether the under-breading of shrimp, the fundamental aspect of the case, justified 33 counts of conspiracy, mail fraud, violations of the National Stolen Property Act and RICO.

There are also two other principles of corporate responsibility that arise in connection with this breaded shrimp caper. First, the Eleventh Circuit held that it is possible for a corporation to conspire with its own officers, agents and employees under the federal conspiracy statute. In addition, the court of appeals held that a corporation may be simultaneously both a defendant and the "enterprise" under the RICO statute. The court was expressly non-sympathetic to the policy argument that this would make it far too easy to prosecute corporations under the RICO statute. Using language reminiscent of the Supreme Court's observations in the New York Central decision, the court of appeals said:

> "This is simply a reality to be faced by corporate entities. With the advantages of incorporation must come the attendant responsibilities."

One can easily acknowledge that corporations have a responsibility to abide by duly promulgated federal regulations. But enforcing those regulations through criminal prosecutions seems far from the traditional purpose of federal criminal law applied in the commercial setting. I do not advocate an 18th century view of the relationship between commercial activity and criminal law. It is clear though that, traditionally, commercial crimes were characterized by dishonest conduct in which the *mens rea* that delineates criminal acts was obviously present. Now federal criminal law applied to commerce seems to have lost that limitation. The result is something that may itself be as undesirable as polluted air and water:

An environment where the engine of commerce is starved for the fuel of entrepreneurial risk taking, and business decisions have far too much to do with avoiding the risk of oppressive federal inquiries into conduct controlled by the minutia of arcane federal regulations.

One of the ways this is brought about is the practice of Congress allowing regulatory agencies to define federal crimes, something that I think would be better left as a function of the politically accountable legislature itself.

This results when Congress enacts a statute with broad regulatory objectives, empowers an agency to promulgate regulations to accomplish those objectives and provides criminal penalties as part of the statute's general enforcement mechanisms. The result is that when agency bureaucrats write the regulations, they define the crimes. In addition, these regulations usually require regulated entities to provide information to the government, both formally and

informally. Such reporting often involves data that are something other than merely objective compilations of quantifiable information. As a result, reports and certification of compliance with regulatory requirements become fodder for prosecutors considering whether to prosecute a corporation for making false statements or concealing material information from the government.

A few factors that suggest this trend continues are worth noting. The first example is when Congress recently reacted to allegations of safety defects in tires and/or automobiles by considering a wide range of draconian criminal provisions and new regulatory requirements in the consumer product safety area.

A second example is the ascendancy of plaintiff's lawyers not only as sources of public policy created through the legal system, but also as private prosecutors. Under the federal False Claims Act, private plaintiff's lawyers can become prosecutors under the statute's *qui tam* provisions. This is a potent weapon in the hands of a creative plaintiff's counsel. As noted this past May by the Eleventh Circuit in United States ex rel Augustine v. Century Health Service Inc., "a number of courts have held that a false implied certification may constitute a false or fraudulent form even if the claim was not expressly false when it was filed." In other words, the claim may not be false, but nonetheless can be actionable if it is made without compliance with all attendant regulatory requirements of the program involved. Please note, however, that several circuits have at least limited the scope of this theory to those circumstances where there is an express certification of regulatory compliance required to accompany the claim. Cold comfort.

And then, of course, there is what has come to be called simply "Enron." Enron really epitomizes a phenomenon that began some time ago

regarding concern with false or misleading corporate financial statements. This issue had been bubbling up for a couple of years, attracting the interest of both securities enforcers and the Justice Department and, of course, private plaintiffs' counsel. Might we now be at a crossroads occasioned by consideration of how to deal with business regulation in the post-Enron environment? There clearly has been pressure yet again to "do something." Will that include passing new laws defining yet new crimes, not for dishonesty, but for what a regulator might consider overaggressive use of generally accepted accounting standards?

Are changes needed to insure that financial reporting of corporate performance is accurate and is designed to promote investor confidence in the market place? Absolutely, of course. But maybe we should pause to consider where we are in terms of criminal enforcement against businesses before defining new federal crimes arising from commercial activity.

And this brings me to the last of these three considerations and that is what we can do to fix this. I believe there are three elements to an effective response to this growing trend to regulate commercial activity by application of criminal law:

1. Address the issue at the policy level in both the legislative and executive branches, beating the drum regularly to sound the core purpose of federal criminal law as applied to commerce.

2. Press both the policy and the legal issues at the pre-indictment stage in all cases where prosecutors, and particularly responsible supervisory officials, might be persuaded that these core federalist considerations, among others, militate against a criminal prosecution based on a purported transgression of regulatory standards.

3. Where the opportunity presents itself, litigate the underlying policy issue by challenging prosecutions brought on unclear and ambiguous regulatory standards. As I will discuss in a moment, the courts have provided an opening to do just that.

The policy argument is obvious: focus on using federal criminal provisions to secure the core federal interest in promoting and protecting the means of commerce. A good first move would be to scrap the "Corporate Prosecution Guidelines" issued by the Justice Department during the last Administration. Not only are these benchmarks for the exercise of prosecutorial discretion unmindful of the core function of government to foster and protect commerce, but they are also simply bad policy. I think that the Justice Department could do much better. Rethinking these Guidelines is a good vehicle to move to a more well-reasoned and sound policy on corporate prosecutions. Another obvious policy option is to seek other means to achieve regulatory goals. Choices include the use of tax and other financial incentives for meeting regulatory objectives, real rewards for self-policing and, as necessary, civil damages and consent agreements to deter and change corporate behavior.

The second and third points are to be bold enough to argue and, if necessary, litigate some of the issues raised by egregious use of federal criminal law to regulate commercial activity. Two circuit courts of appeals recently rejected the overbroad application of general criminal statutes to ordinary commercial conduct. Those decisions by mainstream appellate courts, combined with a well-established principle of due process, can be used to craft persuasive arguments to establish limits on the untoward use of criminal enforcement mechanisms in the commercial context.

The Supreme Court has repeatedly held that "a penal statute must define a criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement." That particular quote is from Kolender v. Lawson, a 1983 decision, but its roots extend deeply into Supreme Court due process jurisprudence.

If one were to wade through the Medicare cost reimbursement rules and ask if this is sufficient notice of what is required and what is prohibited, so as to justify the use of criminal sanctions for regulatory transgressions, the value of this aspect of due process would be quite apparent.

In fact, that is precisely what the Eleventh Circuit did this past March and the conclusion it reached is well worth considering.

In United States v. Whiteside, the court reversed the convictions of two hospital officials who had been prosecuted for knowingly and willfully filing false statements in federal health program reports required to be submitted to the government. The case turned on whether the defendants knowingly and willfully made a false statement when they filed a single report classifying debt interest in terms of "how the debt was being used at the time of the filing of the cost report rather than how the funds were used at the time of a loan origination." The court of appeals found no legal authority clearly supporting the government's interpretation of the regulation upon which the prosecution charged criminal offenses. Experts had disagreed as to whether the government's position was correct. The court concluded that "competing interpretations of the applicable law are far too reasonable to justify these convictions."

The Second Circuit made a similar determination in United States v. Handakas, a case that ironically was also decided in March 2002, holding that the term "honest services" as used in connection with the mail fraud statute was unconstitutionally vague as applied to the prosecution of a construction company owner in New York. He had been convicted of mail fraud for conduct allegedly violating New York regulations requiring outside contractors to pay the prevailing rate of wages and to furnish accurate reports of work performed under a state contract. The court of appeals reviewed its own precedent defining "honest services" under the fraud statute and found the statute unconstitutionally vague as applied, because even a person fully informed about the federal statutes and the relevant Second Circuit case law "would lack any comprehensible notice that federal law has criminalized breaches of contract."

The court explained the implications of allowing the criminal conviction to stand on such a conceptually empty standard:

> "If the honest services clause can be used to punish a failure to honor New York's insistence on the payment of prevailing rate of wages, it could make a criminal out of anyone who breaches any contractual representation: that tuna was netted dolphin free, that stationery is made of recycled paper, that sneakers or tee shirts are not made by child workers, that grapes are picked by union labor, in sum, so-called consumer protection law and far more."
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> One might add, that shrimp is not properly breaded.

The same points and arguments that have currency in litigation can be used aggressively, and I will tell you from experience—effectively—in the pre-

indictment stages of a case to persuade prosecutors that alternative means to accomplish governmental objectives may be a far better policy choice than criminal prosecution. This is particularly so when the matter is presented to prosecutorial officials who have the responsibility to set policy in the exercise of prosecutorial discretion.

Quite rightfully, the Department of Justice and the FBI have continued to identify white collar crime as a priority. It is clear that the demands on federal law enforcement today are greater than ever before and we know that they cannot do everything. This seems a good time to address this issue and to refocus federal law enforcement on core federal functions. This means putting the emphasis back on protecting the means and instrumentalities of commerce rather than using criminal law to punish and control ordinary commercial activity governed by regulation. In mounting a defense to this trend, certain concepts are worth repeating. Corporations are not inherently evil. Wealth can serve good purposes. Commerce carries blessings to people far beyond the buyer and seller in a particular transaction.

Business leaders can contribute much by reminding our political leaders of these fundamentals. The adventurous, risk taking endeavors that lie at the heart of American commerce will thrive only so long as they are nourished in a hospitable environment. And the trend toward criminalizing the enforcement of regulated activities poses a threat to that environment. It would be a mistake for us not to consider these issues and take such corrective actions as consensus might allow.

Thank you.

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