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## Preventing a Personal Indictment Crisis — Part II

Law360, New York (March 09, 2009) — In the first installment of this article, we reviewed some of the issues concerning white collar criminal indictment and prevention. We will continue here with a look at criminal intent, “theft of services,” bonuses and other issues.

The financial crisis has wrought troubling assaults on traditional standards of criminal intent, the bulwark of the determination of guilt and innocence. Conduct that would formerly have only been breaches of fiduciary duty and/or contract is becoming foundations upon which to charge crimes. The line between purely civil or administrative liability standards and crimes is becoming muddled.

Traditionally, a breach of a fiduciary duty or contract would rarely constitute a crime, while a crime is invariably a breach of fiduciary duty or contract.

The underlying conduct, to constitute a crime, must be willful as opposed to inadvertent or negligent; it must be the consequence of a desire or plan to obtain a benefit for self or someone else that is not revealed as opposed to an error in judgment or neglect and it must rise to the level of a fraud to steal or deprive someone of what is rightfully theirs or someone else’s.

Frauds are spawned in dark places. Therefore, corporate, professional, political and personal actions performed with complete transparency, no matter how they turn out, are difficult to convert into crimes.

A prime example is found in the criminal cause of action known as theft of “loyal and faithful” services. It is a favored prosecutorial tool against accused public employees and office holders. It is undoubtedly being readied for use against former Illinois Governor Blagojevich.

The underlying rationale is that the public did not get the faithful, honest loyal and disinterested services it deserved and bargained for. It has moved into the private sector.

Prosecutors are now expanding its application to high school coaches and elementary school gym teachers who sexually abuse students; university coaches who scheme to obtain academic credits and scholarships in violation of conference rules; and Los Angeles federal prosecutors are investigating the feasibility of charges against the Los Angeles archdiocese, if not Cardinal Mahoney himself, for transferring to other parishes priests who had sexually abused parishioners without warning the new parishioners.

There is no separate, distinct crime of defrauding a private constituency in the absence of an underlying, established offense.

Similarly, when an alderman or governor is not providing honest, loyal faithful services, his vehicle for services fraud is already an established crime such as bribery, extortion, mail or fraud, etc.

Also, the Baylor University basketball coaches had to have used the U.S. Mails or wire communications while committing their fraud against the conference, perpetrating a classic mail or wire fraud.

In my view, the victims' loss of honest, loyal services is, at best, a result or manifestation of the fraud, but not the fraud itself. It is inevitable this theory will be used against those involved in the financial crisis. If it can be invoked against the Los Angeles archdiocese and its revered Cardinal Mahoney, why not Wall Street?

In the financial sector, the theory will be that investors, both institutional and individual, were defrauded of implicit duties of care and due diligence when their brokers, dealers, managers and, when applicable, accountants, put them into investments without adequate due diligence or, worse, no due diligence whatsoever, or without regard to or even knowing about the risks, all the while collecting handsome fees and commissions.

An important factor in determining criminal liability will be the extent of the vetting of the investment product represented to have been done versus the due diligence actually performed.

I now turn to bonuses in financial industries in the present climate. While in the real marketplace this is not nearly always true, nonetheless, the perception of wages is for work performed, while the perception of a bonus is for results achieved. Hence, a very good bonus in a very bad year will look like robbery.

While rewarding and retaining key employees with bonuses is a necessary and valid exercise of business judgment, it must be tied to that individual's individual or team performance. If, as in banking, bonuses are not really bonuses, but part of an integrated salary structure, then it must be documented accordingly.

The gripe with bonuses is not with those paid to rank and file, but the mega discretionary bonuses paid to top tier executives responsible for total corporate performance in years the company performed abysmally.

Yet, a valid argument may exist that though the company did poorly, one or a group of employees had stellar years and helped the company from having an even worse year. Make sure the decision to award bonuses is transparent, documented, and has objective merit.

In the absence of objective merit, prosecutors have the argument that it was approved by a BOD acting in collusion with the recipient. Assuming the company is able and willing, employment contract provisions calling for bonuses under specified conditions are better yet.

All schemes, Ponzi or otherwise, present yet another often overlooked defense to individuals and entities under criminal investigation. Occasionally, not only were they not perpetrators of the fraud, but they were co-victims.

If a financial consultant charged with defrauding his client was himself fraudulently misled, he is as much a victim as his client. In such cases, the earlier fraud is an intervening event that may keep the investigatee from having criminal intent.

Companies are often faced with the decision whether to protect the company or individuals. Most individuals have a strong humanistic urge to be loyal to and protect colleagues. However, your legal duty of loyalty and honesty is to the company. Actions to protect co-workers from their follies are dangerous and ill-advised.

It is always in the company's best interest to uncover the full extent of and encapsulate the problem. It is also in the best interest of the company and employees at every level, to not aid and abet a cover-up or perpetuate the questionable or illegal scheme, because then, not only is there the original misconduct, but the number of potential felons has increased and the underlying illicit activity has become systemic within the company.

The indictment of corporate entities is common. It is also unfair since companies, being inanimate entities, are incapable of harboring criminal intent. Crimes are committed by individuals and, as in the case of Arthur Andersen in the Enron debacle, the acts of one or a few can threaten the careers of thousands of wholly innocent employees far removed from the core events.

Indicting the company is a decision wholly within the discretion of the prosecutor. However, there are measures the company can initiate to reduce the risk of indictment. However, having policies that only pay lip service is worse than having no policies at all.

The goal of such policies is to prevent systemic corruption, make someone with authority responsible and take immediate action to isolate corrupt practices and corrupt employees including nipping a cover up before it takes root including preventing the destruction of "evidence."

The idea is to be able to demonstrate the company's commitment to honest dealing, transparency and curative action as opposed to profits, selling overvalued, doubtful financial products, distribution of unsafe toys, cribs, food products, etc., or protecting a corrupt individual(s).

Your legal advisor will advise as to the desirability of further action including mandatory reporting requirements, sequestration of computer and hard copy records, samples, tests, etc., and termination of individuals, etc. Early detection is an opportunity to make an ally of your regulator.

You will not always know whether you are the target of an investigation. In fact, subpoenaed banks are required to not alert account holders and others are asked not to talk to targets either to protect the secrecy and sanctity of the grand jury, to not alert those under investigations or protect deep throats or moles.

Nonetheless, there are signs to watch out for. Is your industry generally under scrutiny? Are you in a securities, money management lending, health care, defense contracting, construction or construction lending industry? Do you derive revenue from any government payor?

Do you provide goods or services to a state or federal customer? Have you learned that a person or entity with which you have done business is being investigated or recently sued or indicted? Or pleaded guilty? Have partners, suppliers, customers or employees been approached by law enforcement?

Do not contact them! Assume that any conversation you might have under such circumstances is discoverable, if not actually being recorded, and words, no matter how innocently intended, can be reinterpreted and misinterpreted.

You do not want to give the impression that you are either impeding an investigation or threatening or retaliating against a prospective witness. Have your lawyer do the contacting.

The surest sign you or your company is "of interest" is an unexpected law enforcement visit. Your handling of this encounter will determine your future.

My unwavering advice is to unequivocally and politely ask them to leave; not engage in any discussions other than name, rank and serial number; and simply state "leave me your card and I will have my attorney contact you as soon as possible."

There is no reason or excuse to not follow this most sound of all advice you will ever receive. However, if you are beset by a death wish and reject this incredibly sound advice, do not lie. Not telling the truth is its own crime. If you do not believe me, ask Martha Stewart, who was convicted not for the underlying offense being investigated, but for lying to agents when they came calling.

A significant criminal spill-out from the plummet of markets is on its way. Everyone with a role is at risk. Like the universe itself, what constitutes criminal conduct is ever expanding.

Defense lawyers know there was a time before civil or criminal RICO and when giving a public job to a party loyalist under the aegis of a ward boss was not a crime.

Alas, as the proverbial worm, the earth turns and preconceptions are amended as thoughtful, creative prosecutors react to new conditions. Notions of what constitutes crimes are not static.

These episodes start small and balloon into infernos because of ignorance, failure to appreciate ultimate repercussions, fear and greed.

Coming clean in an intelligent, organized manner according to a prepared plan of action under the stewardship of a lawyer who knows how to approach prosecutors can stave off criminal charges, save the business and eliminate or reduce civil and administrative liability.

In conclusion, a few hallmarks bear repetition:

- Do not speak to agents;
- Do not lie to agents;
- Document;
- Consult counsel;
- Do not let problems fester;
- Fully disclose risks to clients;
- Do not misrepresent underlying values;
- Make no valuation representations if you have no basis for them; and
- Perform due diligence or, alternatively, make it clear you did no due diligence and that your involvement should be no barometer of the quality of the investment.

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