

Government Regulation as a Defense in Criminal and Civil Cases

Chevron to the Defense

by Howard M. Hoffmann

For financial movers and shakers, the now more than two-year-long financial crisis has been a civil liability, publicity and indictment crisis. Yet, regulators share a large measure of the blame for the national and global financial crisis. However, since the private sector and private enterprise do not oversee, investigate, or indict government agencies and agents, the playing field is not even and it is far easier for government to deflect blame onto the private sector than vice versa. Yet, regulators regularly give and are given enforcement messages during audits, and investigations that set the tone and tenor from which financial markets take their behavioral and performance cues. These may not track earlier field enforcement action, or even written regulations or statutes. In contrast, to state or federal legislation or administrative regulations they may be a harbinger of an agency policy shift or the idiosyncratic view of a field agent. Either is important.

The formal changing of executive branch policy is filtered through regulations and formal rule making. However, as often occurs, these sometimes not-so-subtle policy sea changes are implemented *informally* by field auditors without the benefit of either formal notice or formal amendment. These shifts in enforcement can be toward relaxation or tightening of enforcement policies, and come without alerts or warnings. In regulated industries, these unannounced new enforcement activities can serve as a defense to criminal charges or even as defenses in civil or regulatory adverse actions. This is all especially applicable in criminal cases, because if field enforcement or regional regulators set a tone and message and the regulatee follows that message, it becomes impossible to establish *scienter* (i.e., criminal intent).

Not all federal administrators dismiss or are indifferent to government's role in the collapse. In the March 21, 2010, *New York Times*, former Federal Reserve chairman Alan Greenspan admitted that, "regrettably, we did little to address the prob-

lem." Imbedded in Greenspan's statement is that it could have timely addressed the problem. The problems he referenced were earlier megabank mergers that created universally and unacceptably large systemic risks should the newly created megabanks fail. The risks were no longer containable. The point is that it is not possible to defend, in any forum, those charged with misconduct without putting the regulators on trial, as it was they who fostered the climate in which large risks became acceptable. The syllogism is an easy one—large risks are the things large returns are made of, and large returns, if realized, both feed public coffers and make regulators and administrators look and feel good.

Regulatory agencies, including those regulating securities, mortgage bases securities, and banking, while a part of the executive branch, are the offspring of legislation. Not only do Congress and state legislatures create state and federal regulatory agencies, but they also vest them with the power and authority they want them to exercise. To this end, legislatures grant *and* withhold authority. Consequently, lawyers for regulatees who disagree with agency action or believe clients have been victimized by an agency will scour enabling statutes to determine whether the undesirable, unwanted or unpopular agency action is permitted under the authority conferred on it by the legislature.

It is frequently argued that restrictions sought to be imposed by government agencies are premised on an ambiguous enabling statute—that the enabling legislation either did not authorize that agency's particular action, or that it is unclear whether the legislature intended to authorize that agency's particular actions. In these cases, the legal issue redounds down to how broad is the authority the legislature bestowed upon the agency, and has the agency exceeded its limited grant of authority? Also, if the regulation exceeds the authority given by Congress, it cannot serve as the basis for an indictment, because the basis for the criminal charge is *void ab*

initio. Therefore, the astute practitioner will bring this and ambiguous or indif-ferent field enforcement to the atten-tion of prosecutors to *prevent* criminal charges.

Federal courts increasingly have decided that legislative grants of author-ity and agency discretion are broad. After the United State's Supreme Court's 1984 decision in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*,¹ federal courts became reluctant to inter-vene in or second guess broad policy-setting discretion, which the Supreme Court held Congress intended to leave to regulatory agencies.

As Justice Anton Scalia points out on the speaking circuit, federal courts should presume that ambiguity and vagueness in acts of Congress are not the result of bad draftsmanship, but intentional in order to give regulatory agencies broad authority to implement regulations as times, national threats and interests, the economy, and regula-tory needs change. He views ambiguity in statutes as intentional and necessary, on the rationale that Congress cannot be expected to anticipate or legislate for every event that, in the future, might come before the agency (*i.e.*, that an agency's portfolio is to set and change broad policy within its expertise).

Unlike legislatures, agencies are pre-sumed to have a developed body of expertise to determine what is the soundest course of policy and regula-tion, whether in food and drugs, avia-tion, or commerce and finance. Inher-ent in this view is that agencies must be allowed to regulate with flexibility that can be instituted one of two ways (*i.e.*, formally, by actual rule changes, a fairly laborious process with its own rules; or informally, by relaxing or tightening field enforcement).

However, this does not mean enforcement or punitive action by regu-lators can be taken as a change of policy for which there was no notice. In *United*

States v. Farinella,² the court held: "The idea of secret laws is repugnant. People cannot comply with laws the existence of which is concealed." Similarly, gov-ernment may not spring on persons or entities new interpretations without adequate warning. Put another way, the government cannot 'fake left, go right.' It may work on the basketball court, but not *in court*. Government may not sig-nal one set of policies through enforce-ment activity and then ignore those sig-nals and sue or charge regulatees under another standard.

Until now, this broad authority has been a bane to industries. First, often with great justification, businesses feel they are pawns to the ever-changing whims of agencies accountable to no one except the courts, which, via *Chevron*, have largely washed their hands of providing judicial oversight and protection. Second, it is difficult to forecast what is required and make busi-ness plans in conformity with unstable parameters.

However, what was a curse can also be viewed as a salvation, because once agencies set a regulatory tone, no matter how unwanted it may have been at the time, it would be unconscionable for agencies to later renege on the messages they previously telegraphed via their enforcement practices, the informal method to temper regulations to adjust to changing circumstances. When agen-cies relax enforcement of regulations, regulatory agencies send messages that are, in good faith, relied upon by the regulated community, and they become valid defenses in a criminal, regulatory, or civil case.

What differentiates crimes from civil causes of action is criminal intent and a law that makes the underlying activity criminal. Therefore, if a banker, broker, dealer, trader or accountant took the cue from what he or she observed regulators were permitting, and then did the same, there cannot have been the *intent* to

commit a crime. The banker, broker, dealer, or accountant felt he or she was following the law as it was being enforced and interpreted by the agency. Regulators give messages, cues, hints, directions and instructions not only by what they say or do, but by what they do not say or do, which regulatees must be permitted to reasonably interpret and rely on.

Once agencies set a regulatory tone, it is unconscionable for government to walk away from the messages with which they littered the regulatory landscape.³ Therefore, for example, having encour-aged creative financial products, their attendant risks and relaxation of collater-al requirements, government may not later come back, after the bubble bursts, and retroactively brand them as now suddenly sham. Government may not deny the effect and influence of its earli-er regulations, actions or inactions.

For example, in boom times (*i.e.*, when the Dow Jones Industrial Average was over 14,000 and the subprime mort-gage market had not imploded) govern-ment felt its monetary and regulatory policies were part of the reason, and it did not want to undertake enforcement activity that could stifle the good times. In retrospect, those policies encouraged less than stellar industry practices. Where that occurred, industry practices that were honestly and reasonably premised on those regulatory messages cannot now be reinterpreted or restruc-tured as criminal.

By way of illustration, *The Wall Street Journal* reported that John Dugan, comptroller of the currency, in response to a report issued by the Treasury Department's inspector general, wrote:

We agree that, in the case of ANB, there were *shortcomings* in our execu-tion of our supervisory process and that it is appropriate to take addition-al measures to reinforce these princi-ples to our examination staff.

One man's "shortcomings" is another man's marching orders and defense. What this meant was that, *sans* new laws, regulation or notice, the comptroller was conceding agency messages were triggered, which banks acted on. The practitioner should not only search for defenses to cases in the black and white of statutes and regulations, but the conduct of field agents as well, and what they say and do.

Therefore, what are clients and their lawyers to do? Keep detailed records of materials, ledgers, and computer data provided, and maintain detailed notes of questions asked, answers given and remarks made, because in those interactions are the nuggets of future, potential defenses, if needed. ♪

Endnotes

1. 467 U.S. 837, 81 L. Ed. 2d 694, 104 S. Ct. 2778 (1984).
2. 558 F.3d 695 (7th Cir. 2009).
3. *See Farinella*.

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