might equally be treated civilly or do the prosecutions involve defendants who committed large-scale fraud and are deserving of criminal punishment? What evidence is there that the increased prosecution of health care fraud has had any effect on crime rates? And, thinking more broadly is health care fraud of such significance that we should devote substantial resources to it to the detriment of prosecuting other significant criminal activity?

By all accounts the answer to these questions is, at best, indefinite. There is, for example, no way of knowing whether in response to Congressional demands the FBI has, in effect, "cherry picked" easy cases against individual doctors for technical violations rather than focusing their efforts on larger (and more difficult) investigations of significant fraud. In reviewing the reported literature it is hard, indeed, to identify a large number of substantial health care fraud prosecutions against large HMOs or their officers.

Moreover, there is some evidence that the sustained effort has not been effective in reducing criminal fraud. At a gross level, as Senator Biden notes, in 1999 the estimate of fraud losses in the health care industry was 10%. While I am skeptical of the accuracy of this number,[1] the broader issue is: If the number is accurate why, after several years of effort required by HIPAA, does it remain so high?

More fundamentally, there is some substantial basis for questioning the necessity for so sustained an effort. As Dr. Robert Walker, has said: "The public has been led to believe that the Medicare program is ridded with fraud, when, in reality, complexity is the root of the problem. . . . We must have zero tolerance for real fraud, but difference in interpretation and honest mistakes are not fraud."[2]

Thus, there is some suggestion in the data that the reductions in mistaken Medicare payments that we do see are not attributable to increased criminal enforcement. According to HHS, Medicare's erroneous claims were reduced to $12.6 billion in 1998 from $20.3 billion in 1997. An audit conducted by the Office of Inspector General at HHS in 1999 demonstrated that these reductions in the amount of fraud resulted primarily from a big drop in "documentation errors." Such errors were 44 percent of Medicare overpayments in 1996 but only 16.8 percent in 1997. The "documentation error" decline contributed to $8.7 billion of the $10.6 billion reduction in "improper" Part A and B payments.[3] Moreover, as former AMA President Nancy Dickey observed at the time, the government estimate of "improper payments" of $12.6 billion was based upon a review of claims that were filed for

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[1] According to the GAO the portion of improper Medicare payments "attributable to fraud" is unknown. *See* GAO, *Federal Health Programs: Comparison of Medicare, the Federal Employees Health Benefits Program, Medicaid, Veterans' Health Services, Department of Defense Health Services, and Indian Health Services,* GAO/HEHS-98-231R, Aug. 7, 1998, at 23.

[2] Testimony before the National Bipartisan Commission on the Future of Medicare, Aug. 10, 1998.

[3] June Gibbs Brown, HHS Inspector General, *Improper Fiscal Year 1998 Medicare Fee for Service Payments,* Office of Inspector General, Department of Health and Human Services, February 1999 (A-17-99-00099), p. 7.

600 Medicare patients, or 0.0015 percent of Medicare's 39 million beneficiaries.[4] Thus, we should be skeptical of the efficacy of criminal enforcement -- it may, as I testified, that criminal enforcement is best used as a tool for truly egregious fraud and that our resources are better directed to regulatory reform as well as counseling and compliance assistance programs that would produce greater gains in protecting Medicare.

In short, in light of the data just cited, it appears that increased prosecution has yet to have a significant effect. This may reflect either inadequate resources or, more likely in my view, resources not well directed at deterrable crime.

Finally, in addressing crime in this manner – *i.e.* through Congressional directive – we must consider the substitution effects. The resources to be devoted to criminal prosecution are not infinite. Any new directive to maximize the prosecution of investor or pension fraud necessarily implies a reduction in some other effort. In the present circumstances, it is unlikely that such a reduction will be seen in counter-terrorism efforts. Where then, will the reduction occur? In prosecution of violent crime? Plainly it is not for me to say what the appropriate trade-offs are – that is Congress's prerogative. I would urge, however, that Congress expressly consider the question so that its judgment is an informed one.

2) Citing National Institute of Justice statistics regarding the non-economic harms suffered by victims of fraud, Senator Biden asked whether the penalty structure for white-collar crimes adequately addresses non-economic costs.

To a substantial degree, existing fraud sentencing guidelines already take into account some victim related effects. Thus, the guidelines enhance penalties if the victim is "vulnerable," U.S.S.G. § 3A1.1(b)(1), or if the victim is an official victim, *id.* § 3A1.2. Moreover, the current fraud guidelines, which tie the penalty directly to the dollar value of the fraud, are already explicitly tied to the harm caused. Though the dollar values are only a portion of the harm caused – as Senator Biden notes there are often other non-economic harms involved – they are, generally, a useful, readily measurable proxy for the non-economic aspects of the harm. It is, for example, unlikely that a small value fraud will cause health or emotional problems or lost time from work. Thus, as I see the fraud sentencing guidelines, they already implicitly incorporate non-economic harms into the consideration of fraud sentencing through the substitute of monetized harm.

In general, of course, there is no constitutional barrier to consideration of victim impact in sentencing. Thus, if the Committee wanted to go beyond the current monetized sentencing schema it would be free to do so.

We should, however, be cautious in expanding the use of victim impact in imposing sentence along these lines for two reasons: First, such secondary impacts will be exceedingly difficult to measure and therefore very burdensome on the courts and the probation office

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[4] Nancy Dickey, M.D., "Government to Grandpa: Rat on Your Doctor," *The Wall Street Journal*, Feb. 24, 1999.

to implement. How, for example, is the probation officer to judge whether a fraud had a "substantial emotional impact" on a victim? When we impose such burdens on the court we should do so in a manner that does not impose too significant a cost on the administration of justice.

Second, the criminal law generally limits punishment to those results that are reasonably foreseeable consequences of particular criminal actions. Monetary loss is plainly a foreseeable (indeed, intended) consequence of fraud in every case. Non-economic injuries will not always be so readily foreseeable or intended – obviously they will be in some instances but not in others. To the extent we expand consideration of these impacts in sentencing we will be diverging from the classic model of criminal law – a step not to be taken lightly.

Thus, while I am certainly exceedingly sympathetic to the plight of victims injured by the wrongdoing of corporate officers, it seems to me that to a large degree they are adequately compensated through the tort system that provides damages for intentional torts. We should be cautious about further systematic rules blurring the line between tort and criminal law.

Senator Grassley's Question

Why has there been an increase in the use of criminal law as a substitute for what I believe should be governed by civil law?

Social behavior in a free society is governed by norms that broadly distinguish three kinds of wrongful acts: 1) Crimes, which require such elements as malicious intent and harm, and which are treated as offenses against the state rather than merely against an individual; 2) Civil wrongs, which are torts against persons or property, are more loosely defined, typically carry lesser penalties or no penalties, and are adjudicated under less-rigorous procedural rules; and 3) Moral wrongs that are neither crimes nor civil wrongs and are usually redressed informally through peer pressure, social ostracism, and so on.

These categories can be used to characterize two parallel trends in American law that run contrary to the principles of freedom and personal responsibility. Both trends are a kind of "bracket creep" of wrongful acts from one category into another.

The first trend transfers mere moral wrongs into the realm of civil law. This accounts in large part for the well-known explosion in civil litigation. The schoolyard cut-up who was traditionally hauled before principal and parents is now sued for some arcane variety of "harassment." This litigious trend has spawned a nationwide movement for tort reform.

The second trend, identified in my testimony, elevates civil wrongs and even mere moral wrongs to the status of crimes. This trend is often driven by the political popularity of causes, by the need for elected officials to appear responsive to their constituents, and by government bureaucrats interested in increasing their own power.

In recent years, this trend of criminalizing relatively ordinary conduct has accelerated at an alarming rate. It's causes are several: (1) Politicians want to prove they are "doing something" about the perceived problem du jour; (2) agency officials are looking for new authority and expanding their bureaucratic power; (3) prosecutors seek publicity, and (4) public interest groups see the criminal arena as an area of alternative enforcement to be used when civil suits are unavailing. All these factors have joined together to create and support criminal sanctions for an expanding list of regulatory wrongs and socially undesirable acts. Although state legislatures and administrative bodies have contributed to this trend, the federal government has increased the scope of its criminal reach at an even greater rate.

A recent report by the ABA Task Force on Federalization of Criminal Law lists approximately 3,000 statutory crimes at the federal level.[5] The great majority of these criminal statutes have been enacted since the Civil War, and of these, more than 1,200 were passed since 1970. Only a fraction of the 3,000+ statutory federal crimes are traditional crimes such as bribery, theft, and counterfeiting. Under federal law, it is now a crime to fraudulently use the 4-H club emblem, use the flag for advertising purposes, and wrongfully disclose certain health care information,[6] just to list a few examples.

This list of federal statutory crimes also underestimates the number of distinct offences because Congress sometimes makes criminal the violation of future agency regulations that include numerous possible acts or omissions. This type of legislation is the most troubling because it delegates to the regulatory agencies the power to define for themselves – either by regulation or on an ad hoc basis – what is and is not criminal, including the violation of an individual permit. *See, e.g.*, 33 U.S.C. § 1481 (punishes violations of any regulations issued under the maritime pollution statute); 33 U.S.C. § 1415 (makes criminal any violation of a condition or limitation in a permit to dredge or fill a waterway).

James Madison quoted Montesquieu in *Federalist No. 47* that "There can be no liberty where the legislative and executive powers are united in the same person." This fear is greatest when the state invokes its power under the criminal law to imprison citizens and mark them as felons for life. Yet, this is precisely the situation when a legislature delegates a broad regulatory goal to an agency and gives it both the power to define regulatory crimes (through formal regulations, vague wetlands guidelines, or permitting decisions) and the power to enforce its own criminal prohibitions.

The expansion of criminal law to regulatory areas is exacerbated by the parallel trend in the legislature and the courts of making it easier for prosecutors to obtain convictions. In the case of many regulatory crimes, the essential proof of criminal intent has been fictionalized, and a defendant need only be shown to have intended to act as he did without any reason to know that his conduct was wrongful. Thus, even the traditional requirement of criminal intent is eliminated. As a retreat from the traditional distinction between crimes and other civil wrongs, many of the newer regulatory crimes do not require proof that anyone or

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[5] See "The Federalization of Criminal Law," Task Force on Federalization of Criminal Law, ABA Criminal Justice Section, Appendix C (1998).

[6] 18 U.S.C. § 707; 4 U.S.C. § 3; and 42 U.S.C. § 1320, respectively

anything was harmed. Even if it is unlikely that a jury would convict an individual where there was no harm, few people can endure the cost, stress, harm to reputation, and even remote risk of conviction of a criminal trial.

The result is that ordinary citizens and business managers are subjected to criminal investigations and potential criminal sanctions for conduct they could not have reasonably known was criminal and for which no one was conceivably harmed.

* * * * *

Thank you very much for the opportunity to testify and for the opportunity to respond to these additional written questions. If I may be of any further assistance to the Committee, please do not hesitate to contact me.

Sincerely yours,

Paul Rosenzweig
Senior Legal Research Fellow

cc: Sen. Joseph Biden
Sen. Charles Grassley

Commissioner Bradley Skolnik's Responses
Senate Judiciary Subcommittee on Crime and Drugs
Hearing on "Penalties for White Collar Offenses:
Are We Really Getting Touch on Crime?"
June 19, 2002

Question #1

1-1. The difficulty of investigating white collar crimes is best exemplified by the recent Baptist Foundation of America case in Arizona. The investigation began in the fall of 1998, and portions of the case continue today. The case involved numerous off-balance sheet transactions that were pieced together from documents numbering over one million. All the documents were catalogued on a database, a process that took four clerical employees several years and is still ongoing. The Arizona Securities Division dedicated one attorney, one CPA, and a paralegal full time for four years to unravel this 600 million dollar fraud that affected over 11,000 investors. In addition, the Arizona attorney general's office devoted attorney and investigator time to a related civil case against Arthur Andersen LLP, and criminal actions against eight individuals. The difficulty in a case such as this is that key evidence might be found in one memo, or one letter, stashed among the hundreds of thousands of documents. Also, a murder may have one victim, whereas a white collar crime usually involves many victims, often necessitating numerous interviews, communication, and further collection of documents.

1-2. One of the most striking impediments in large white collar cases is that there may be several defendants, each with attorneys, opposing the state, all with a talent for filing motions or other actions, frivolous or otherwise. In contrast, the resources of the state are more limited and one attorney may encounter the overwhelming effect of several large law firms with the ability to paper the state to death, thereby delaying the prosecution. Lack of resources is the most serious impediment to effective investigation of white collar crime.

1-3. On a state level, having more investigators tends to lead to better enforcement. But more prosecutors would also be needed, so that there were no bottlenecks for getting indictments and results.

Question #2

2-1. Investors tend to still live under the *caveat emptor* era. They do not know the right they have to full disclosure of information. They blame themselves for not asking the right questions. Quality investor education programs, coupled with strong and visible enforcement, are the best deterrent to white collar crime. Investors also tend to be embarrassed when an investment goes bad, especially if the hook used to sell the investment involved a higher than usual return. They feel foolish about looking greedy or stupid, and as a result, may not report their loss. Senior citizens, who frequently fall prey to white collar crime, are especially hesitant to report such crimes out of concern that family members will regard the incident as evidence of mental incompetence.

Other factors also play a part. In some cases, the perpetrator is a friend or fellow church member and victims do not want to report them to authorities. Victims also may fear that reporting the crime will do no good, or worse, will even deprive them of any chance of recovering at least a portion of their losses. Generally speaking, the problem does not appear to be one of victims' not understanding that they have been defrauded.

2-2. I am only aware of financial institutions having reporting requirements. Requiring other institutions to report fraud may help in the fight against white collar crime, but the approach also raises questions. What institutions would be subject to the requirement and to what degree would they comply? At a minimum, serious consideration should be given to requiring accountants and tax preparers to report fraud. Here too, though, questions arise, such as the tension between a reporting requirement and the obligation of these professionals to maintain client confidentiality. However, some reporting standards in the securities industry might prevent widespread damage if information is given to regulators at an earlier date than it is typically discovered.

2-3. Failure to report fraud is a problem. For example, as the question suggests, there does seem to be a growing trend among corporate employers not to disclose information about employees that are terminated for misconduct. To address these situations, the problem of liability for defamation may have to be addressed.

Question #3

3-1. Yes. The key is strong criminal remedies for financial crimes. Outside of investor education, it appears to be the only effective way to stop the activity.

3-2. Criminals are not threatened by loss of assets. Fines are often imposed but not collected. White collar criminals have learned to hide assets in other peoples' names, or off-shore. Even if they are collected, they are the cost of doing business for many financial operations. They are confident about their ability to begin anew and con people all over again. A long prison sentence is the most effective deterrent, both in terms of preventing violations in the first instance and in terms of preventing a recurrence.

3-3. Business and financial crimes have *not* been over criminalized. The highly publicized instances of alleged fraud by companies, accountants, and brokerage firms, which have come to light over the last year, suggest just the opposite – more than just fines are necessary to deter white collar crime.

Question #4

4-1. The alternative forms of punishment noted in the question are not by themselves sufficient to address the problem of white collar crime. The traditional criminal sanctions are a critical element. In combination, all available sanctions do provide the necessary tools to combat this form of crime. The key is making sure that all sanctions are applied vigorously and in the right combination according to the facts of each case.

Simply taking licenses away or shutting down a brokerage, will not deter a person who is bent on making a fortune through fraud. It will just drive them to sell off-market products -- partnerships, promissory notes, viaticals, etc. Many of these products are currently sold by insurance agents, financial planners, or the guy next door.

4-2. It's unclear whether self-regulation is the predominant regime for policing fraud, but it certainly remains a significant component. Self-regulation poses several limitations. First, there can be conflicts between internal compliance officers and the departments of a firm they are supposed to oversee: business agendas do not always coincide with compliance agendas in corporate culture. Second, there is a perception problem: many members of the public undoubtedly harbor doubts about the effectiveness of self-regulation. And recent headlines about scandal on Wall Street only reinforce this public skepticism. Other problems include the fact that there is no subpoena power for the SROs; they are too reliant on funds to operate from their membership; and their jurisdiction only extends to their membership, not other participants, such as aiders and abettors.

Question #5

5-1. With respect to the emotional and other non-economic costs of crime, the federal sentencing guidelines may shed some light on the issue. In general, criminal penalties are assessed after sentencing hearings in which the victims have an opportunity to talk about the emotional and psychological harm that has been done. The resulting sentences reflect that information.

5-2. These types of harm should certainly be considered by courts when sentence is imposed.

Question #6

6-1. The relationship between local, state, and federal officials can generally be characterized as cooperative. The states have worked with the FBI, the Postal Service, the IRS, the SEC, U.S. Attorneys Offices, and the CFTC in bringing joint cases on white collar crime. Their jurisdictions and priorities differ to some degree. State regulators have served on federal/state task forces to address particular problems, such as fraudulent boiler rooms. Sharing of information is one form of state/federal cooperation. Much of the relationship is based on having the right people on board who are dedicated to the issue and willing to put energy into a joint effort.

6-2. A problem that stands out is that the information flow tends to be more from the state and local authorities to the federal authorities, and less so in the other direction. For example, the IRS' inability to share any information with state law enforcement is a problem. It produces a one-way street of information, but doesn't necessarily assist the state in obtaining indictments. There is also no centralized communication system between state and federal authorities. The result is that a state may be investigating something that a federal agency is also investigating, with neither party aware of the other's activity.

6-3. The states have historically handled matters that are more localized such as point-of-sale fraud, unregistered securities, unlicensed sellers and a host of fraudulent scams. Federal regulators tend to focus more on corporate finance accounting crimes, exchange-related violations, market manipulation, and insider trading. These delineations are largely the result of the historical evolution of the law, differing statutory jurisdictions, and resource limitations. States have generally left prosecution of reporting companies to the federal authorities. However, many state administrators, will take on cases of national scope when their state is seriously impacted. Or states will band together to address issues impacting investors in every state (such as the Lloyds of London fraud.) There is no specific division of responsibility.

6-4. Federal enforcement actions are most effective and helpful when conducted in cooperation and consultation with local officials.

Grassley Question

1. State prosecutors can be assisted through training, sharing of information, additional state/federal task forces, and federal funding for state law enforcement initiatives. In some years, the states have brought far more criminal cases against white collar criminals than the federal authorities. Many state securities agencies have built strong relationships with their prosecuting authority and have brought criminal charges resulting in sentences that far exceed those that are handed down even under more stringent federal sentencing guidelines.

SUBMISSIONS FOR THE RECORD

Senate Committee on the Judiciary

Hearing before the Subcommittee on Crime and Drugs
June 19, 2002

Penalties for White-Collar Offenses: Are We Really Tough On Crime?

Statement of Frank O. Bowman, III
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Frank Bowman is Associate Professor of Law at Indiana University School of Law – Indianapolis. He is a graduate of Colorado College and Harvard Law School. He served as a Trial Attorney for the Criminal Division of the U.S. Department of Justice (1979-82), a Deputy District Attorney in Denver, Colorado (1983-87), and an Assistant U.S. Attorney in Miami, Florida (1989-96). While a Deputy District Attorney in Denver, he was in charge of criminal prosecutions in the Consumer Fraud Division. While an Assistant U.S. Attorney in Miami, he specialized in white-collar crime. Professor Bowman was Special Counsel to the U.S. Sentencing Commission in 1995-96. Since entering teaching, he has co-authored a treatise on federal sentencing law, written extensively on federal economic crime sentencing, and was intimately involved in drafting the extensive revisions of the Federal Sentencing Guidelines relating to economic crime which took effect on November 1, 2001.

Are the penalties imposed on white-collar offenders by federal criminal law tough enough? Although the question sounds simple, it is extraordinarily difficult to answer because a truly full answer would require resolution of some of the most intractable problems in criminal law and public administration: What are the purposes of punishment, and which are the most important? Should the objective of punishment be crime control? Or should punishment be meted out according to the defendant's deserts, regardless of how it affects his future behavior or that of other prospective criminals? How do we know if punishment has achieved its stated purpose? How should we rank the severity of different crimes and the deserts of different offenders? And given the scarcity of federal criminal justice resources, on which sorts of offenses and offenders should we concentrate our investigative, prosecutorial, judicial, and penological

resources?

I can't answer these big questions, but I hope the remarks that follow will give the Subcommittee some useful information on the history and current state of federal economic crime sentencing. I have also ventured some tentative opinions about whether Congress should enhance current white-collar crime penalties, and perhaps more importantly, whether Congress should augment federal law enforcement resources devoted to detecting and prosecuting white-collar crime.

I. On Average, Federal Economic Crime Defendants Receive Much Lower Sentences Than Defendants in Any Other Major Crime Category

If we consider federal economic crime defendants as a group, they unquestionably receive lower sentences than defendants in any other major crime category. As indicated in Table 1, in FY 2000, defendants convicted of larceny, embezzlement, fraud, and counterfeiting who were sentenced to federal prison received average (mean) sentences of 15.6 months, 9.9 months, 18 months, and 17 months respectively. By contrast, robbery defendants received 110.6 months, drug defendants 75.3 months, and firearms offenders 64.1 months. Even the average immigration sentence was 27.8 months, ten months longer than the average fraud penalty. Moreover, federal economic crime defendants receive sentences of probation at dramatically higher rates than virtually any other class of defendant. More than one-half of all larceny defendants and one-third of all fraud defendants receive probation.