Testimony of

Mr. Paul Rosenzweig

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Good morning Mr. Chairman and Members of the Subcommittee. Thank you for the opportunity to testify before you today on the topic of white-collar crime enforcement and sentencing.

For the record, I am a Senior Legal Research Fellow in the Center for Legal and Judicial Studies at The Heritage Foundation, a nonpartisan research and educational organization. I am also an Adjunct Professor of Law at George Mason University where I teach Criminal Procedure and an advanced seminar on White Collar and Corporate Crime. I am a graduate of the University of Chicago Law School and a former law clerk to Chief Judge Anderson of the U.S. Court of Appeals for the Eleventh Circuit. For much of the past 15 years I have served as a prosecutor in the Department of Justice and elsewhere, prosecuting white-collar offenses. During the two years immediately prior to joining The Heritage Foundation, I was in private practice representing principally white-collar criminal defendants.

The title of this hearing "Penalties for White Collar Offenses: Are We Really Getting Tough On Crime?" poses an empirical question. But before addressing it directly allow me a few preliminary observations.

Though couched as merely an empirical question, the issues to be addressed in today's hearing are of vital importance to the American judicial system. At its core, the legal system and the rule of law are one of the unifying principles in a heterogeneous, multicultural society like the United States (and, indeed, perhaps the only one). If citizens lose faith in and have disregard for the legal system, we do significant damage to the fabric of society.

There are troubling signs of just such a loss of faith today. If public reports are to be credited, it increasingly appears that neither the victims of crime nor those whose conduct is addressed by the judicial system have confidence in the ability of the courts to do justice. As we have heard so eloquently today, victims often feel that their own injuries are not sufficiently accounted for by the punishment meted out. Conversely, with the perceived disparities between punishments for white-collar and so-called "street" crimes, we run the risk that some defendants may come to view the judicial system as biased along either racial or class lines. Similarly, as we broaden and expand our definitions of criminal offenses to include trivial matters more suitably treated as civil wrongs, those who act in good faith yet get caught by the arbitrary exercise of governmental authority perceive themselves as victims of an over-zealous regulatory state that trivializes crime (equating serious personal offenses and technical, regulatory ones), and erodes its moral footing. The perceptions of all three groups are, in many senses, accurate.

In some ways (if you will forgive the irreverence of the analogy), the judicial system is a bit like Peter Pan's ability to fly - it only works if everyone believes it will. When citizens start to believe that the system is no longer just and fair, it risks crashing to the ground in an unseemly mess. The

perceived disparities and arbitrariness in white-collar enforcement and sentencing are just one piece of a larger puzzle reflecting the possibility of disillusionment with the judicial system. The Subcommittee is wise to address this question in the thoughtful manner it has chosen: First, determine first whether white-collar crimes are indeed being adequately punished and then determine (if they are not) what the causes of that might be. For, as Sir Winston Churchill said, "[t]he mood and temper of the public with regard to the treatment of crime and criminals is one of the most unfailing tests of the civilization of any country."

As with so many empirical questions, the answer to the one posed in today's hearing is indefinite. The answer is, in part, "no" and in part "yes." More importantly, rather than ask whether we are getting sufficiently "tough" on white-collar crime, the proper question to ask is, are we being "effective" in addressing white-collar crime. And the answer to that question is incapable of trite and ready articulation. It is, for example, far too easy an answer to say simply that we need to increase statutory maximum sentences for white-collar crime. That, alone, will achieve little, if any reform. What is needed is a close examination of the allocation of law enforcement resources and a better understanding of their effectiveness.

The Scope of White Collar Crime

To begin with we should carefully define what white-collar crime is.

As relevant to the topic of today's hearing it is important to distinguish between two distinct forms of white-collar offense. The first type of offense is, classically, fraud by any other name. Business frauds certainly differ in the details of how they are executed, in the sophistication of those who execute them and, candidly, in the difficulty that prosecutors have in unraveling them. But at their core, business frauds are no different in kind from any common law fraud occurring on the street. The Enron allegations, if they are proven true, will fit comfortably into this classical conception of crime. They are called white-collar offenses simply because of the socio-economic status of the actors and the means they have chosen for committing their criminal offenses - not because of anything unique or inherently different in the nature of their conduct.

This sort of white-collar crime has been around for a long while. Ponzi schemes were rampant in the Depression era. And, many would argue that, viewed through the prism of today, the "robber barons" of the turn of the century were white-collar criminals. As A.B. Stickney said to 16 other railroad presidents in the home of J.P. Morgan in 1890, "I have the utmost respect for you gentlemen individually, but as railroad presidents, I wouldn't trust you with my watch out of my sight."

Fraudulent white-collar crime is no less serious today. In 1999, for example, conservative estimates suggested that losses caused by mail fraud were approximately $36 billion annually, including phony sweepstakes, overvalued merchandise, chain letters and other pyramid schemes. The Association of Certified Fraud Examiners reported a "very conservative" estimate of more than $20 billion lost annually to fraudulent property and casualty claims. The same organization also reported occupational fraud - that is the use of one's occupation for personal enrichment through deliberate misconduct, such as asset misappropriation, fraudulent statements, bribery, and corruption - as roughly $200 billion per year. By contrast, in the same year the National Crime Victimization Survey estimates for personal theft ($3.9 billion), household burglary ($4.5

billion) and household larceny ($2 billion) were substantially lower. This kind of blatant fraudulent white-collar crime is a drain on the economy and a significant concern. When it goes unpunished, respect for the rule of law is diminished.

The second type of white-collar offense is, however, quite different. It involves prosecutions for violations of rules and regulations that are part of a larger statutory structure. In modern America, as the regulatory state has grown, the number of such criminal offenses has grown apace. They involve violations of the regulations of the Health Care Finance Administration, the Occupational Health and Safety Administration, the Consumer Products Safety Commission and a host of other Federal "alphabet agencies."

Three doctrinal developments define this second type of white-collar offense and differentiate it from the classic frauds that are the focus of this hearing. First, this type of white-collar offenses involves the criminalization of conduct that, in most instances, is not inherently wrongful in the same way that fraud and bribery are. Rather, we have seen a growth in the category of "public welfare offenses" - a category first created with modest penalties and now increasingly felonized. Second, and of special significance in weighing moral culpability, the statutes involve offenses where the mental element (or mens rea requirement) is substantially diminished, if not eliminated. For example, we now punish as strict liability offenses the taking of migratory birds - even if done utterly by accident. Third, this type of white-collar offense increasingly involves criminal prosecutions of managerial officers for, in effect, vicarious liability. The growth in this form of white-collar criminal offenses is what Professor John Coffee has called the "technicalization" of crime. As a result, for this category of white-collar offenses, the criminal law is increasingly being used interchangeably with civil remedies.

Consider: In 1999, the ABA Task Force on the Federalization of Criminal Law noted that there were now more than 3,500 federal criminal offenses. Those offenses incorporate either directly or by reference prohibitions contained in more than 10,000 separate regulations. Remarkably, nobody knows the exact number either of criminal statutes or criminal regulations. They are so diverse and so widely scattered throughout the federal code that they are literally uncollectable. I am told that, when it was recently asked to undertake the project, the Congressional Research Service said that the task was virtually impossible. This, too, breeds disrespect for the law and disaffection from the judicial system: When those who make the laws cannot themselves identify all the laws they have made, it borders on the arbitrary and capricious to allow prosecutors to select from among those laws and to criminalize conduct that, in the eyes of other prosecutors, might warrant only civil sanctions.

Is There A Disparity and Where Does It Come From?

With this distinction in mind, we turn then to the question posed by this Subcommittee: Is there a disparity in enforcement and sentencing for white-collar crimes (of both types) and "street" or blue-collar crimes in the federal system? As with so many things the statistics are susceptible of varying interpretations. I present the statistics first and then provide some rough interpretations.

In Fiscal Year 2000, the most recent year for which we have statistics, according to the United States Sentencing Commission, federal courts entered convictions for 58,636 individuals. An overwhelming percentage of those who were sentenced for traditional crimes received sentences

requiring terms of imprisonment. For example, 94.2% of those convicted of drug trafficking were sentenced to prison. 97% of those convicted of robbery were imprisoned, as were 93% of those convicted of arson, and 97.4% of those convicted of murder. By contrast only 53.5% of those convicted of fraud and 48.1% of those convicted of embezzlement were sentenced to prison. And, using a blended rate, those convicted of technical regulatory offenses (the second type of white-collar crime) were incarcerated only 30% of the time. At first blush it looks like a disparity does exist.

But if we look deeper into the statistics we see some oddities that challenge this initial perception. In truth the data quoted are skewed because of the mandatory sentencing nature of many of our drug and other street crime statutes. If we change the question and ask, what percentage of those who are eligible under law for non-prison sentences wind up getting jail terms, we see a different picture. In other words, the data tell a different story if we examine sentencing rates but eliminate those cases where Congress has removed the discretion from the district court judge and look only at those cases where a district judge has a legal choice to make between incarceration and some non-jail alternative (community service, probation, home detention, or some other form of punishment not involving a jail term) available. Here the data are much more equivocal. According to the Sentencing Commission, the following were the national rates of incarceration for federal cases in which there were non-jail alternatives (some 11,137 individuals):

Crime Type Rate of Imprisonment (%)

Fraud 35.6
Larceny 19.9
Immigration 84.3
Embezzlement 39.3
Drugs - Trafficking 48.5
Drugs - Simple Possession 31.2
Firearms 30.0
Forgery/Counterfeiting 29.2
Other Miscellaneous Offenses 26.3

As you can see, if we exclude the immigration category (for which there are probably some exogenous explanations), when courts have discretion much of the disparity in sentencing rates disappears. White-collar frauds, for example, are incarcerated at rates greater than those for defendants who possess drugs or firearms.

The final prism through which to attempt to assess the question of disparity lies, of course, not in imprisonment rates but in the length of imprisonment. Here the mandatory nature of certain drug offenses again is reflected in the data:

Crime Type Mean Sentence
(in months) Median Sentence
(in months)

Robbery 110.6 77.0
Drugs -- Trafficking 75.3 57.0
Drugs - Possession 18.5 6.0
Manslaughter 26.1 18.0
Larceny 15.6 12.0
Fraud 18.0 12.0
Embezzlement 9.9 5.0
Bribery 16.2 12.0
Tax Offenses 16.6 12.0
Money Laundering 46.3 33.0
Environmental/Wildlife 14.5 9.5
Antitrust 12.7 6.5
Food & Drug 23.1 12.0

But this, of course, does not tell the whole story. As we have seen already in connection with incarceration rates, the courts are often constrained by statutory requirements. So too with the length of terms of imprisonment imposed.

As a general rule, the length of a sentence is determined either by statute or, of course, by the operation of the sentencing guidelines. [The guidelines themselves are statutorily mandated, yet substantively developed through regulation; they are, thus, ultimately derived from statute]. It is useful therefore to ask whether the sentences reflected in the data are of the lengths they are because they are required to be that long by the sentencing guidelines or if they are the product of disparate departures from those guidelines by the courts. In other words, do judges ignore the guidelines and reduce the sentences in white-collar offenses or are the guidelines sentences for white-collar crimes regularly imposed? The answer is that the courts do not appear to depart from the guidelines with any greater frequency in white-collar cases than in street-crime cases. Consider the following data (which exclude departures for substantial assistance to the authorities):

Crime Type Rate of Departure (%)

Robbery 12.7
Drug Trafficking 4.9
Firearms 10.4
Larceny 6.3
Fraud 9.2
Embezzlement 6.2
Immigration 18.8
Other Miscellaneous 9.8

Once again, immigration offenses are unusual. Beyond that, the rates of departure from the guidelines are roughly consistent for all offenses and there is even some suggestion that serious offenses such as robbery and firearms are more likely to have judges depart from the guidelines than white-collar crimes. Again, the drug trafficking offenses are a possible exception to the general rule.

There are several tentative conclusions that can be drawn from this data. First and foremost, whatever disparities exist are principally the product of the actions of Congress. Median and mean sentences vary by type of crime, but insofar as we can tell, when offered a discretionary choice among offenders the courts do not impose incarceration in a disparate manner. Even drug trafficking offenders are, in the midst of the war on drugs, incarcerated less than 50% of the time when the courts are given the opportunity to choose whether to impose a sentence of imprisonment or not.

Moreover, the lengths of sentences flow almost exclusively and directly from either statutory requirements (mandatory minimums, and the like) or indirectly from statutes through the sentencing guidelines adopted by the U.S. Sentencing Commission. With the possible exception of drug trafficking charges there appears to be little difference, generally, in the way judges treat offenders before them. They get sentences less than what the guidelines would call for with the same approximate frequency.

Finally, insofar as the data are susceptible to analysis, other than serious personal offenses (such as robbery) and offenses relating to drug trafficking (including money laundering) most offenses are treated relatively similarly, with typical sentences falling in a fairly narrow range of from 1-2 years. Even manslaughter sentences do not vary appreciably from this seeming norm. One might almost suspect that we have reached a general consensus on the subject as a society and identified 1 2 years as the appropriate just punishment for most criminal offenses.

This is not terribly surprising. Recall, if you will, how it is that the Sentencing Guidelines were initially developed. The Commission chose to take the tack of historical analysis, looking to past practice around the nation, and attempting to carry that historical practice forward into the guidelines, while evening out disparities between regions and districts. In doing this, the Commission collected data on more than 40,000 cases.

Interestingly, the one area where the Commission chose to depart from this historical base was in the area of economic or regulatory crime. There, the historical data reflected that "economic crime[s] [were punished] less severely than other apparently equivalent behavior." Consequently, the guidelines as initially proposed in 1987 and as in use today make an effort to upgrade the penalties for regulatory and economic, white-collar offenses. I think the success of that effort is reflected in the data presented. With the exception of drug offenses - a sui generis topic on which Congress has often legislated - we have reached a fairly consistent point of equilibrium.

The question then is whether that equilibrium is the right place to be.

What To Do?

Our goal in punishing criminals is two-fold. We have the utilitarian goal of deterring criminal conduct. As Horace Mann said, "The object of punishment is the prevention of evil." We also have the equally significant goal of doing justice by imposing punishment on those who have acted wrongfully - the "just deserts" aspect of criminal law.

As to the appropriate quantum of punishment for true white-collar fraud, I have no crystal ball, nor any independent moral authority to advise you. It appears, however, that the sentencing

guidelines, as I have noted, reflect equivalence between white-collar fraud, tax evasion, and simple drug possession. Whether this equivalence is appropriate is not an easy question to answer, particularly for an academic happily ensconced in the ivory tower of a think tank.

I can, however, say that with respect to frauds of the nature alleged against Enron - real frauds with real victims - I share the sentiments expressed last week by Treasury Secretary Paul O'Neill, in typically colorful fashion. He said "I think people who abuse our trust, we ought to hang them from the very highest branch." I also agree with him, however, that truly large scale, significant corporate abuses are "relatively infrequent, but [that] even a few cases can poison confidence in our system which depends on entrusting public company managers with investors' capital."

To the extent that we think that justice requires harsher sentences for white-collar frauds, the answer must lie principally in revision of the sentencing guidelines. Presently, they measure the "harm" from a fraud by the dollar amount of the loss caused. Such a measurement does not differentiate between frauds of different sorts. Two frauds of the exact same scale may have vastly different impacts in the number of victims and the effect on their lives. To the guidelines, it does not matter whether the loss is incurred by a single pension fund that may be insured against the loss (thereby distributing the loss broadly throughout the economy), or the loss is incurred by hundreds of small investors whose life savings are wiped out. I cannot say how the law can adequately capture the distinction, but I do know that it exists and is inadequately addressed in the current guidelines structure.

More importantly, when we consider increasing the deterrence of white-collar frauds we need to consider both sides of the deterrence equation. Deterrence is accomplished by increasing the risks perceived by a wrongful actor of being punished. That involves both a consideration of the likely sentence of incarceration and an estimation (for the rational actor) of the chance of being caught.

It is not enough then, merely to look at the punishment side of deterrence. Increasing maximum sentences and revising the sentencing guidelines only go part way towards addressing the problem and are much the less important aspect where change is needed. What really drives the equation is the fraud that goes undetected. By definition we cannot, of course, know how much undetected fraud there is - but we can know that the more a fraudulent actor perceives that he is not likely to get caught the more likely he is to act in a wrongful manner.

In the context of white-collar crime this means that it is imperative to distinguish between the two types of crimes within the general category - the true frauds and the technicalized, regulatory offenses. We live in a world of limited resources - one where, increasingly, federal attention will rightly be devoted to matters of national security. Beyond that important area, all the remaining law enforcement priorities must compete for scarce attention and every technical, regulatory offense to which resources are devoted is one less instance where resources that might be devoted to truly deserving fraud investigations.

Thus, as the Judicial Conference of the United States put it in its Long Range Plan, criminal activity is appropriately the focus of federal concern only when federal interests are paramount. When federal resources are devoted to non-violent criminal conduct or regulatory offenses that are localized and with only an attenuated impact on interstate commerce those efforts are

misdirected and contribute to an under-deterrence of fraud through the diversion of resources to other areas.

The use of law enforcement resources for "technicalized" crime also contributes to disaffection from the legal system. As the reach of the regulatory state increases, we are seeing a broadening of the category of criminal offenses beyond those that one might consider appropriate. Do we really need, for example, to create a white-collar crime enforcing the ban on honeybee importation? And are federal resources really well invested in police extortion cases where the only connection to interstate commerce is that the motorist paid the police officer with cash from an ATM?

Concomitant with the growth in the scope of criminal law we are also seeing a related diminution in the mental state requirements for criminal conviction - again, resulting in a frittering away of scarce time and energy. If deterrence is our goal, there is no reason to make simple negligence the subject of criminal sanction when civil tort laws provide sufficient redress for wrongs done through accident, mistake, or neglect. Yet Congress has seen fit to create negligence crimes (not to mention crimes of strict liability, which ought to be anathema in any civil society) and the Federal government prosecutes them.

Put most succinctly, government properly imposes criminal liability only on those who commit acts of misconduct with bad intent, and not on those merely accused of negligence or mistake. This is the fundamental moral component of the criminal law - the "just deserts" aspect of punishment - and it is trivialized when the criminal law is used to address conduct that is not intentionally wrongful. The criminal law in a free society must be carefully crafted to target wrongful conduct, and not be used simply to ameliorate adverse consequences attributable to non-criminal conduct. The public interest is vindicated not based on successful prosecutions, but on successful administration of justice. Criminal sentencing should reflect society's collective judgment about the kind of conduct that warrants the most severe condemnation, seizure of property, and loss of liberty and life.

In the technicalization of criminal law, we have gotten away from these principles. The trends I have identified permit an arbitrary use of prosecutorial power in a way that erodes respect for the law and contributes to the misallocation of scarce prosecutorial resources. At the same time that we are under-deterring white-collar fraud, we are over deterring productive economic conduct.

Though it is nearly impossible to gather comprehensive data in this area of the misapplication of criminal law to technical offenses, anecdotal evidence suggests that the use of criminal law as a substitute for civil sanctions is growing. And the costs of such criminalization are very real - both for the individuals targeted and for society. Consider, for example, the case of doctors - many of whom are leaving the profession rather than face the specter of criminal prosecution.

There are now over 110,00 pages of Medicare rules, policies, and regulations. Complex federal regulations equate to countless hours of paperwork -- not patient work -- for physicians. And failure of a physician to follow Medicare's needlessly complex rules -- or even just a perception of such failure -- can result in an audit of a physician's billing records, withholding of payments and a complete crippling of a physician's practice. One doctor, oncologist John Kiraly of

California, spent over 2 ½ years and $10,000 in legal fees fighting an audit mistakenly assessing more than $58,000 in overpayments.

"The sense of intimidation and fear of HCFA among physicians is widespread and troubling...HCFA regulations are so excessively complicated, voluminous, and changeable that full compliance even among the most motivated is difficult. My office, for instance, receives about 35 pounds by weight of HCFA regulations every year," said Dr. Joe Sam Robinson, a neurosurgeon from Georgia.

Instead of trying to educate physicians about these complex regulations, physicians are treated as criminals that are trying to rip off their patients and the Medicare Trust Funds. To cite but one more of many possible examples:

Dr. Carol Vargo, a family physician in rural Montana, fought federal Medicare charges for over five years. The expert called in to review the criminal case for the government was instead willing to testify on behalf of Dr. Vargo, claiming that the prosecutors didn't have a good grasp of coding and didn't understand what standard physicians were being held to at the time that the billings occurred. The prosecutors soon dismissed the case. The government then pursued a civil suit for the sum of $37 million - - a figure calculated using a provision in the False Claims Act that allows the government to recover $10,000 per false claim, plus triple damages. The entire ordeal cost Dr. Vargo more than $300,000 in legal bills and a pulmonary embolism that doctors attributed to stress.

Nor is health care the only area where arbitrary prosecutions are possible. When a 70-year old owner of a family business is indicted for a technical violation of the Clean Water Act, something is amiss. After it was discovered that EPA agents had altered some of the evidence, the case was dropped. I yield to no one in my concern for the environment, but this was a case that at least one federal judge found to be "clearly vexatious." Whatever the merits of the matter, one may justly ask whether this form of criminal enforcement produces any results or merely erodes our confidence in law enforcement.

Thus, if there were one recommendation I can make to the Subcommittee for its consideration it would be to bear in mind the distinction between the two types of white collar offenses. The misallocation of resources reflects a lack of focus on true white-collar fraud - fixing that is at least as important as is the enhancing the length of the penalties imposed.

The analysis presented here is based upon a fairly extensive empirical evidence data set. Nonetheless, our understanding of the issues can be broadened and deepened through more research. Perhaps the most important thing this Subcommittee can do, then, is help answer these questions about the comparative effectiveness of criminal enforcement in the white-collar arena. Remarkably, there is virtually no data on whether or not criminal enforcement programs actually have a deterrent effect, much less assessments of the quantum of that effect. Instead, agencies prosecuting white-collar crime routinely report only the number of cases they have brought, without any attempt to determine the effectiveness of their activity. This "bean counting" mentality is the wrong way to evaluate criminal programs - it would be as if the D.C. Metropolitan Police Department reported only the gross number of murder prosecutions each

year without reporting its clearance rates for unsolved murders or changes in the murder rate in the city.

Regulatory agencies report their prosecutions, without ever tying those prosecutions to increased regulatory compliance. But after enactment of measures like the Government Performance and Results Act we ought to be asking questions about the effectiveness of enforcement programs - i.e. the results they achieve. If we knew the answers to those questions we might better know where to direct our law enforcement resources - we could balance the comparative benefits of different enforcement methods and make conscious decisions about what does and does not work. Knowing something about the answer to that question is truly a worthy goal for this Subcommittee.

Thus, in the end, the answer to the question "Are we getting tough enough" on white-collar crime is, "maybe." The answer depends on which white-collar crimes you are talking about and how you define tough. If you define it as greater sentences, we plainly can increase the penalties to an infinite level. If, however, you define "tough" as "effective" then the best answer is a mix - greater penalties for significant frauds and greater law enforcement focus on non-technical, "true" frauds.

Mr. Chairman, thank you for the opportunity to testify before the Subcommittee. I look forward to answering any questions you might have.