

# Corporate settlements in the United States

## The criminalisation of American business

**Companies must be punished when they do wrong, but the legal system has become an extortion racket**

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WHO runs the world's most lucrative shakedown operation? The Sicilian mafia? The People's Liberation Army in China? The kleptocracy in the Kremlin? If you are a big business, all these are less grasping than America's regulatory system. The formula is simple: find a large company that may (or may not) have done something wrong; threaten its managers with commercial ruin, preferably with criminal charges; force them to use their shareholders' money to pay an enormous fine to drop the charges in a secret settlement (so nobody can check the

details). Then repeat with another large company.

The amounts are mind-boggling. So far this year, Bank of America, JPMorgan Chase, Citigroup, Goldman Sachs and other banks have coughed up close to \$50 billion for supposedly misleading investors in mortgage-backed bonds. BNP Paribas is paying \$9 billion over breaches of American sanctions against Sudan and Iran. Credit Suisse, UBS, Barclays and others have settled for billions more, over various accusations. And that is just the financial institutions. Add BP's \$13 billion in settlements since the Deepwater Horizon oil spill, Toyota's \$1.2 billion settlement over alleged faults in some cars, and many more.

In many cases, the companies deserved some form of punishment: BNP Paribas disgustingly abetted genocide, American banks fleeced customers with toxic investments and BP despoiled the Gulf of Mexico. But justice should not be based on extortion behind closed doors. The increasing criminalisation of corporate behaviour in America is bad for the rule of law and for capitalism (see [article](#)).

No soul, no body? No problem

Until just over a century ago, the idea that a company could be a criminal was alien to American law. The prevailing assumption was, as Edward Thurlow, an 18th-century Lord Chancellor of England, had put it, that corporations had neither bodies to be punished nor souls to be condemned, and thus were incapable of being "guilty". But a case against a railway in 1909, for disobeying price controls, established the principle that companies were responsible for their employees' actions, and America now has several hundred thousand rules that carry some form of criminal penalty. Meanwhile, ever since the 1960s, civil "class-action suits" have taught managers the wisdom of seeking rapid, discreet settlements to avoid long, expensive and embarrassing trials.

The drawbacks of America's civil tort system are well known. What is new is the way that regulators and prosecutors are in effect conducting closed-door trials. For all the talk of public-spiritedness, the agencies that pocket the fines have become profit centres: Rhode Island's bureaucrats have been on a spending spree courtesy of a \$500m payout by Google, while New

York's governor and attorney-general have squabbled over a \$613m settlement from JPMorgan. And their power far exceeds that of trial lawyers. Not only are regulators in effect judge and jury as well as plaintiff in the cases they bring; they can also use the threat of the criminal law.

Financial firms rarely survive being indicted on criminal charges. Few want to go the way of Drexel Burnham Lambert or E.F. Hutton. For their managers, the threat of personal criminal charges is career-ending ruin. Unsurprisingly, it is easier to empty their shareholders' wallets. To anyone who asks, "Surely these big firms wouldn't pay out if they knew they were innocent?", the answer is: oddly enough, they might.

Perhaps the most destructive part of it all is the secrecy and opacity. The public never finds out the full facts of the case, nor discovers which specific people—with souls and bodies—were to blame. Since the cases never go to court, precedent is not established, so it is unclear what exactly is illegal. That enables future shakedowns, but hurts the rule of law and imposes enormous costs. Nor is it clear how the regulatory booty is being carved up. Andrew Cuomo, the governor of New York, who is up for re-election, reportedly intervened to increase the state coffers' share of BNP's settlement by \$1 billion, threatening to wield his powers to withdraw the French bank's licence to operate on Wall Street. Why a state government should get any share at all of a French firm's fine for defying the federal government's foreign policy is not clear.

I'll see you in court—in another life

The best thing would be for at least some of these cases to go to proper trial: then a few of the facts would spill out. That is hardly in the interests of the regulators or their managerial prey, but shareholders at least should push for that. Two senators, Elizabeth Warren and Tom Coburn, have put forward a bill to make the terms of such settlements public, which would be a start. Prosecutors and regulators should also be required to publish the reasons why, given the gravity of their initial accusations, they did not take the matter all the way to court.

In the longer term, two changes are needed to the legal system. The first is a much clearer division between the civil and criminal law when it comes to companies. Most cases of corporate malfeasance are to do with money and belong in civil courts. If in the course of those cases it emerges that individual managers have broken the criminal law, they can be charged.

The second is a severe pruning of the legal system. When America was founded, there were only three specified federal crimes—treason, counterfeiting and piracy. Now there are too many to count. In the most recent estimate, in the early 1990s, a law professor reckoned there were perhaps 300,000 regulatory statutes carrying criminal penalties—a number that can only have grown since then. For financial firms especially, there are now so many laws, and they are so complex (witness the thousands of pages of new rules resulting from the Dodd-Frank reforms), that enforcing them is becoming discretionary.

This undermines the predictability and clarity that serve as the foundations for the rule of law, and risks the prospect of a selective—and potentially corrupt—system of justice in which everybody is guilty of something and punishment is determined by political deals. America can hardly tut-tut at the way China's justice system applies the law to companies in such an arbitrary manner when at times it seems almost as bad itself.

From the print edition: Leaders