

CNBC

October 22, 2008

Next in the Financial Crisis: Possible Criminal Charges

By Albert Bozzo

Investors and taxpayers angry about the government bailout of seemingly mismanaged financial firms can probably count on a wave of criminal indictments in the coming months, say white-collar crime experts.

"I think we're going to see some 'perp' walks," says Columbia Law School Professor John Coffee, referring to the law enforcement practice of having the accused appear in public wearing handcuffs.

"I think it's coming" says securities lawyer Jacob Zamansky, principal at Zamansky & Associates, predicting the "outcry for culprits and scapegoats" will be met.

Zamansky, Coffee and others say the government is now busy investigating likely wrongdoing that took place at dozens of firms and that it is just a matter of time before it yields results. But crisis management is taking precedence.

"The government and the private sector are focused on bailing out the ship right now, and rightly so," says former SEC enforcement official Marvin G. Pickholz, now a partner at the New York law firm Duane Morris.

"I think most resources are being channeled toward solving the current crisis," adds Harvey Pitt, who chaired the SEC during the government's crackdown on accounting fraud at the beginning of the decade. "I think it will be months before any prosecutions occur, if at all."

Investigations of this kind also take time. In the previous scandal, it took about two years from the time of the alleged wrongdoing to the first big indictments. WorldCom, for instance, was cooking the books in late 2000. Its CFO Scott Sullivan wasn't indicted in August 2002.

Pickholz adds that election year considerations may also be slowing down the process. US attorneys—who are political appointees—may be unwilling or reluctant to open a case without knowing who'll be the next president and whether they'll still be in their jobs.

Recent developments, however, show momentum is building. The government recently issued subpoenas to a dozen executives at Lehman Brothers, which CNBC learned, included CEO Richard Fuld, two CFOS and a COO.

As CNBC first reported Sept. 24, multiple federal investigations at Lehman

and at least 25 other firms are focusing primarily on asset values—that is, whether companies like Lehman were properly valuing things like mortgage-backed securities on their books, as well as the securities they sold to the public.

Thus far, there have been only two high-profile indictments. In June, two former hedge fund managers at Bear Stearns were charged with essentially concealing problems that eventually led to the collapse of the funds.

Experts say acts of concealment and/or misrepresentation will no doubt be an area of investigation and potential prosecution for authorities.

Zamansky, who's representing investors in the Bear Stearns hedge fund case, also sees possible wrongdoing in the way firms were marking assets and brokers pushing bank stocks with diminished prospects and quickly plummeted in value.

The government is going to use its "classic inventory of white collar weapons," says Coffee, citing securities fraud, mail fraud and racketeering laws.

In some cases, prosecutors will look to make the case that there was a "concerted effort by these firms to mislead the public," says Zamansky, which is essentially what executives at WorldCom, Enron, Adelphia and others did less than a decade ago.

Experts say prosecutors will comb through email records, looking for inconsistencies between private and public statements, to show that people acted willfully.

"You have CEOs who had conferences with securities analysts and others," says Coffee, adding that there are transcripts to such events.

Though most expect a wave of indictments, there's considerable debate about whether any big names will be snared, as was the case with WorldCom founder Bernie Ebbers and Enron CEOs Jeff Skilling and Ken Lay, all of whom were convicted, or savings-and loan kingpins such as Charles Keating two decades ago.

Pickholz and Zamansky expect CEOs to fall. "I would think so," says Pickholz, citing Congress' developing skepticism about top executives not knowing what was going on.

Coffee isn't so sure. He says though "prosecutors don't like to just focus on the little guy," some of the current big name CEOs were "brought in as reformers" and "will portray themselves as guys who came in to clean up the mess."

Nell Minnow, founder of the Corporate Library, which focuses on corporate governance and CEO pay, is altogether skeptical.

"In other cases, it was clear from the beginning people had broken the law," says Minnow. "I don't see executives going to jail over this. Most of what they did is perfectly legal. These people were clever enough to get the loopholes they wanted."

There's already been plenty of circumstances to beg the question effective legislation, regulation and oversight during a one-of-a-kind lending boom, which has resulted in extraordinary government involvement in the private sector -- after the fact.

Minnow says that's added insult to injury for both investors and taxpayers. "The sense of pervasive unfairness is greater in this scandal than any other," she says.