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Sentences Get Harsher in White-Collar Cases

Peter J. Henning follows issues involving securities law and white-collar crime for DealBook's White Collar Watch.

The 50-year prison term given to a one-time business mogul, Thomas J. Petters, is the latest in a string of harsh punishments imposed on defendants convicted of orchestrating frauds. Twenty years ago, a sentence of more than five years for a white-collar offender was rare, and most sentences were measured in months, not years.

The sentence meted out to Mr. Petters last week is similar in severity to the 150 years given to Bernard L. Madoff for defrauding investors of tens of billions of dollars in his vast Ponzi scheme, and it is the latest signal that many defendants, at least in high-profile cases, are looking at prison terms that will amount to life behind bars.

Even in less notorious cases, the prison terms for financial crimes have been moving higher, raising questions whether sentences once reserved for violent criminals are appropriate for white-collar defendants.

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Mr. Petters was convicted of 20 counts of fraud, money-laundering and conspiracy for a scheme that cost investors approximately $3.7 billion through the **Petters Companies**, which owned several legitimate business that were pushed into bankruptcy when the fraud came to light. Victims ranged from large hedge funds that loaned millions of dollars to his company to individual investors, including pastors and charities.

The government recommended the maximum sentence for the various offenses, totaling 335 years in prison. Mr. Petters sought a much shorter sentence, in the range of four years, arguing in a sentencing memorandum that "the victims' conduct contributed to the loss" and that he was "a pawn of the hedge fund industry." It is unlikely that either side thought the judge would accept its recommendation in full, so each took an extreme position in the hope of influencing a more favorable outcome in the end.

Mr. Petters is 52, so it is unlikely he will live long enough to serve out his term, which calls for his release in a little over 40 years once credit is given for the time he has already served in jail before trial and credit for participation in a drug abuse program while in prison.

These types of long sentences that are effectively life prison terms have become more common even as federal judges regained their authority to decide the punishment for a conviction without having to follow the Federal Sentencing Guidelines strictly. In addition to Mr. Petters and Mr. Madoff, tough sentences were handed out in other significant fraud cases in the past few years:

• Richard M. Harkless received a 100-year prison term for a Ponzi scheme that caused $39 million in losses to over 600 victims.

• Marc Dreier received a 20-year prison term for defrauding hedge funds with bogus investments that caused approximately $400 million in losses.

• Samuel Israel received a 20-year prison term for defrauding investors in the hedge fund the **Bayou Group**, which resulted in more than $400 million in losses.

None of these sentences compare with the 845-year prison term imposed on Sholam Weiss in 2000 for his role in the collapse of an insurance company that caused more than 25,000 policyholders to lose their investments. The Federal Bureau of Prisons dryly lists his projected release date as Nov. 23, 2754. His lawyer recently asked the United States Court of Appeals for the 11th Circuit to send the case back for resentencing so the judge can consider whether to reduce the term to more realistic time period.

One reason for the upward trend in fraud sentences was a change in the Federal Sentencing Guidelines in 2001 that substantially increased the impact of losses on the calculation of the prison term to be imposed. While almost unthinkable at that time, a loss of $400 million or more would set off an increase in the “offense level” that resulted in a term of at least 15 years, and with other enhancements, it could easily reach the 25- to 30-year range, if not a recommended life sentence.

The Supreme Court changed the role of the Federal Sentencing Guidelines in 2005 from mandatory to only providing important guidance to judges in deciding the ultimate sentence. With discretion restored, there has been greater variance in sentences, in particular for white-collar defendants. While sentences have dropped in some cases, the virtual life sentence has also occurred with much greater regularity, so increased discretion can be seen as cutting both ways.

It is hard to justify sentences like the 50 years imposed on white-collar defendants on the need to protect society from future harm. It is unlikely that someone like Mr. Petters would ever be in a position to defraud investors again, and he presented no physical threat. Whether other potential offenders will be deterred because of the sentence is also open to question, because many white-collar defendants often do not start out planning to defraud investors or customers, but pursue the fraud to avoid disclosing losses from poor business decisions. What can start out as a small lie can burgeon into a huge Ponzi scheme, as Mr. Madoff demonstrated.

The tough sentences may be more of a reflection of the conduct of the individual defendants and their hubris in taking advantage of investors. Courts often express a desire to send a message to the community that financial crimes are deserving of the same significant punishment more commonly given to drug dealers and violent offenders because the harm is just as great.

For example, Judge Denny Chin said in sentencing Mr. Madoff in federal court last year that "the message must be sent that ... this kind of manipulation of the system is not just a bloodless crime that takes place on paper, but one instead that takes a staggering toll."

Whether harsh sentencing is a good thing is open to debate, especially when the cost to society from increased incarceration of criminals strains budgets at every level of government.

Unlike drug or organized crime defendants, white-collar offenders often claim innocence because they were unaware of any wrongdoing, a position that can infuriate a judge. Mr. Petters testified at trial that he was misled by other executives as his company, an assertion that the sentencing judge found was "unbelievable — let's leave it at that."

Faced with a distinct lack of contrition, coupled with evidence that the defendant abused a position of authority to mislead investors, judges often feel they need to impose long sentences to let those in the upper reaches of society know that they will suffer the consequences of their conduct.

As more financial frauds come to the surface, do not be surprised to see more white-collar defendants receive long prison sentences. This does not appear to be a trend that will abate any time soon.

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