



United States of America
FEDERAL TRADE COMMISSION
Washington, D.C. 20580

Office of Commissioner
Rohit Chopra

MEMORANDUM 2018-01

TO: Commission Staff and Commissioners
FROM: Commissioner Rohit Chopra
DATE: May 14, 2018
SUBJECT: Repeat Offenders

I. Summary

Federal law enforcement and regulatory agencies should vigorously enforce their orders, which have the force of law. While the FTC has undertaken a number of initiatives to stop recidivism, such as Project Scofflaw in 1996, there have been instances where other agencies have been more equivocal about their commitment to keeping wrongdoers on the right side of the law.

When companies violate orders, this is usually the result of serious management dysfunction, a calculated risk that the payoff of skirting the law is worth the expected consequences, or both. Either of these explanations requires serious remedies that address the underlying issues.

Thus, in addition to changing incentives by seeking monetary remedies, the Commission should seek to correct both the miscalibrated incentives and the management deficiencies through structural remedies, including the dismissal of senior management and board directors, changes to executive compensation, outright bans on adjacent business practices, and closure of appropriate business lines.

II. Recent Incidents of Corporate Recidivism

In recent years, the credibility of law enforcement and regulatory agencies has been undermined by the real or perceived lax treatment of repeat offenders.¹

For example, in 2015, several large global financial institutions pleaded guilty to felony charges related to a criminal conspiracy to manipulate exchange rates in the foreign currency exchange

¹ Reasonable minds may differ on whether the resolutions in the matters discussed in this section were individually appropriate. However, I believe the marketplace interpreted these resolutions as guidance that large, well-connected companies can evade consequences of serious violations of law.

spot market.² The law requires that these companies be automatically disqualified from preferential access to capital markets. However, the Securities and Exchange Commission has issued waivers -- over and over again -- to these institutions, allowing them to continue their preferential access in spite of serial violations of the law.³

The automatic disqualifications were designed, in part, to serve as a strong deterrent to engaging in misconduct. But with these repeated waivers, institutions will not factor this consequence into their risk-reward calculations.

This is not the only recent example of a perception of lax enforcement. After HSBC admitted its involvement in a massive money laundering scheme involving Colombian and Mexican drug cartels, regulators opted to settle the case with a deferred prosecution agreement⁴ -- even though this was the third time in ten years that the bank had been cited for weak controls.⁵ No bank executives were prosecuted.

Demanding structural remedies is rare, and often comes too late. Over the last three years, for example, Wells Fargo has been accused of opening accounts without customer authorization,⁶ illegally repossessing service members' cars,⁷ charging customers for unneeded auto insurance,⁸

² Press Release, U.S. Dep't of Justice, Five Major Banks Agree to Parent-Level Guilty Pleas (May 20, 2018), <https://www.justice.gov/opa/pr/five-major-banks-agree-parent-level-guilty-pleas>. One of the financial institutions was also found to have violated a non-prosecution agreement related to LIBOR manipulation.

³ See Dissenting Statement of U.S. Sec. and Exch. Commissioner Kara M. Stein Concerning Certain Waivers Granted by the Commission for Certain Entities Pleading Guilty to Criminal Charges Involving Manipulation of Foreign Exchange Rates (May 21, 2015), <https://www.sec.gov/news/statement/stein-waivers-granted-dissenting-statement.html>.

⁴ Press Release, U.S. Dep't of Justice, HSBC Holdings Plc. and HSBC Bank USA N.A. Admit to Anti-Money Laundering and Sanctions Violations, Forfeit \$1.256 Billion in Deferred Prosecution Agreement (Dec. 11, 2012), <https://www.justice.gov/opa/pr/hsbc-holdings-plc-and-hsbc-bank-usa-na-admit-anti-money-laundering-and-sanctions-violations>.

⁵ HSBC Bank USA, Federal Reserve Bank of New York, and New York State Banking Department, Dkt. No. 03-012-WA/RB-SM, Written Agreement (Apr. 30, 2003), <https://www.dfs.ny.gov/about/ea/ea030430.htm>; Consent Order, U.S. Dept. of Treasury, Office of the Comptroller of the Currency, In the Matter of HSBC Bank USA, Dkt. No. AA-EC-10-98 (Oct. 6, 2010), <https://www.occ.gov/news-issuances/news-releases/2010/nr-occ-2010-121a.pdf>.

⁶ See Press Release, Office of the Comptroller of Currency, OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices (Sept. 8, 2016), <https://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html>.

⁷ See Press Release, Dept. of Justice, Justice Department Reaches \$4 Million Settlement with Wells Fargo Dealer Services for Illegally Repossessing Servicemembers' Cars (Sept. 29, 2016), <https://www.justice.gov/opa/pr/justice-department-reaches-4-million-settlement-wells-fargo-dealer-services-illegally>.

⁸ See Consent Order, U.S. Dept. of Treasury, Office of the Comptroller of the Currency, In the Matter of Wells Fargo Bank, Dkt. No. AA-EC-2018-15 (Apr. 20, 2018), <https://www.occ.gov/static/enforcement-actions/ea2018-025.pdf>.

and hitting homeowners with improper fees,⁹ among other charges. The breadth of the alleged misconduct may have been a problem of skewed incentives, or it may have been a symptom of the board's and management's inability to adequately oversee the megabank's sprawling businesses, or both.

Noting “pervasive and serious compliance and conduct failures[,]” the Federal Reserve Board of Governors eventually ordered the company to restrict its growth, and accused its lead independent director of “ineffective oversight.”¹⁰ The Office of the Comptroller of the Currency took action as well, vetting the appointment of new executives and directors, and reserving the right to seek dismissal of top leaders.¹¹ It is likely that if this type of relief had been pursued earlier, the company's pattern of misconduct could have been halted before more Americans were harmed.

These are not the only examples. Taken together, I am concerned that these incidents and others undermine the rule of law. The Commission must not take a similar path. We must continue to be unequivocal that violations of our orders will result in more than a slap on the wrist. Fortunately, we have a wealth of experience and a robust set of tools to do just that.

III. FTC Authorities and Efforts

FTC orders are not suggestions.¹² These orders result from lengthy investigations and often litigation, and they reflect the considered judgment of agency staff as to how defendants can be brought into compliance with the laws we enforce, while taking into account the relevant tradeoffs. In the overwhelming majority of cases, these orders -- backed by the FTC's enforcement regime -- keep parties on the right side of the law. But to deter violations and maintain our credibility as law enforcers, scofflaws who flout our orders must face severe consequences -- irrespective of whether they are small-time scammers or sophisticated corporations. The Commission should carefully consider ways to build on its existing enforcement regime to make clear to market participants that our orders are to be taken seriously.

Maintaining our credibility as public interest law enforcers requires that order violations be remedied and, when appropriate, penalized. For flagrant violators of district court orders, I believe the agency should consider contempt proceedings, referral to criminal authorities, and remedial injunctive relief. And companies that violate administrative orders should face not only stepped-up injunctive relief but also meaningful civil penalties that “vindicat[e] the authority of

⁹ *Id.*

¹⁰ Letter from Michael S. Gibson, Director, Division of Supervision and Regulation, Board of Governors of the Federal Reserve System, to Stephen Sanger, Chairman, Wells Fargo (Feb. 2, 2018), <https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180202a3.pdf>.

¹¹ Press Release, Office of the Comptroller of Currency, OCC Assesses \$500 Million Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Practices (Apr. 20, 2018), <https://www.occ.gov/news-issuances/news-releases/2018/nr-occ-2018-41.html>.

¹² We have strong tools to enforce compliance with our orders. Violations of district court orders can result in contempt proceedings, and violations of administrative orders can result in civil penalties of up to \$41,484 per violation. *See* 15 U.S.C. § 45(l); 16 CFR 1.98(c). Violations of either type of order can also lead to additional injunctive relief.

the FTC.” *US v. Danube Carpet Mills, Inc.*, 737 F.2d 988, 993 (11th Cir. 1984). While there is no precise formula for calculating civil penalties, these penalties should -- in the words of Chairman Simons when he led the Bureau of Competition -- “serve as a clear signal to all firms under FTC order that they must abide by those terms or face severe consequences.”¹³

Additionally, I believe the FTC should hold individual executives accountable for order violations in which they participated, even if these individuals were not named in the original orders. This relief is expressly contemplated by Fed. R. Civ. P. 65(d), which provides that an injunction against a corporation binds its officers.¹⁴ And this relief is important, because it ensures that individual executives who control the operation of the firm -- and not just shareholders -- bear the costs of noncompliance.¹⁵

Using many of these tools, the FTC has proven itself to be an aggressive and effective enforcer of its orders. As noted in a report on the FTC’s Project Scofflaw, agency efforts to prosecute serial offenders have resulted in civil and criminal contempt findings, millions of dollars in fines, and even incarceration.¹⁶ While that project was launched more than two decades ago, the FTC’s more recent efforts to pursue Kevin Trudeau¹⁷ show that we continue to vindicate our authority and protect the public interest when our orders are violated.

In addition to vigorously using these corrective tools, we must also consider how to prevent these parties from further recidivist behavior. Here, our existing approach to resolving fraud cases offers a useful model. In these cases, we routinely impose “fencing-in” requirements to prevent future harm to consumers, including bans on adjacent business practices, bond requirements, and compliance reporting. Frequently, we also seek fencing-in relief against individual defendants, including lifetime occupational bans for recidivists.

While these aggressive remedies are typically applied in fraud cases, we should not hesitate to apply them against repeat offender corporations and their executives. Regardless of their size and clout, these offenders, too, should be stopped cold. Indeed, as seen in the examples referenced

¹³ Press Release, Fed. Trade Comm’n, Federal Judge Issues Record \$7 Million Fine Against Boston Scientific Corporation (Mar. 31, 2003), <https://www.ftc.gov/news-events/press-releases/2003/03/federal-judge-issues-record-7-million-fine-against-boston>.

¹⁴ Courts have been clear that Rule 65(d) “is equally germane to orders enforcing decisions of administrative agencies.” *Reich v. Sea Sprite Boat Co., Inc.*, 50 F.3d 413, 417 (7th Cir. 1995).

¹⁵ While not common, there is precedent for the FTC obtaining civil penalties against individual officers and directors not named in the original orders. *See, e.g., United States v. Budget Marketing, Inc.*, No. 88-1698-E (S.D. Iowa, Mar. 17, 1997) and *United States v. SMI/USA, Inc.*, No. 3:94-CV-0058-T (N.D. Tex. June 30, 1995).

¹⁶ FED TRADE COMM’N, BUREAU OF CONSUMER PROTECTION, PROJECT SCOFFLAW’S FIRST FIVE YEARS (2002), <https://www.ftc.gov/sites/default/files/documents/reports/project-scofflaw-detection-and-prosecution-violators-district-court-orders-obtained-federal-trade/projectscofflawreport.pdf>.

¹⁷ Press Release, Fed. Trade Comm’n, FTC Returns More Than \$6 Million to Consumers Who Bought Infomercial Marketer Kevin Trudeau’s Weight-Loss Book (Jun. 22, 2016), <https://www.ftc.gov/news-events/press-releases/2016/06/ftc-returns-more-6-million-consumers-who-bought-infomercial>.

previously, the harm caused by major companies that swindle consumers can vastly exceed that caused by small-scale scammers.

There are many ways to address the underlying structural deficiencies that may result in companies running afoul of our orders.

IV. Addressing the Disease, Not Just the Symptoms: Structural Remedies Following Order Violations

Just as we seek business practice bans and individual accountability in fraud cases, the Commission should consider seeking from the Court or through consent agreements remedies that address the true causes of noncompliance. Diagnosing these causes requires examining companies' incentives and management.

Publicly held and private equity-owned corporations may engage in risky business practices to demonstrate to investors and capital markets that they are meeting or surpassing expectations for earnings and growth. Similarly, executive compensation practices might inadvertently create incentives for practices that might harm consumers or competition. A corporation operating with significant debt as part of its capital structure might also face pressures to adhere to creditor covenants requiring certain coverage ratios. Under these scenarios, the Commission might consider a number of remedies to address underlying structural deficiencies in companies' compliance efforts. Here are some examples:

- *Outright bans on certain business practices:* When the Commission orders corrective actions to safeguard against future noncompliance after the first instance of misconduct, and that misconduct is later repeated, we should then consider seeking to ban the firm from engaging in related business practices altogether. For example, if the Commission orders additional disclosures with respect to a specific type of transaction and the firm fails to comply, our investigation might question whether the firm can truly be trusted to ever conduct this transaction lawfully, making an outright ban appropriate. The FTC has a strong track record of obtaining business practice bans.¹⁸
- *Closure or divestiture of certain operating units:* Firms often assert the “few bad apples” defense, where problems are limited to a select group of individuals within a specific operating unit. However, when a firm under order continues to be plagued by problems within a specific operating unit, it is not clear that the firm is deserving of a *third* chance, making closure or divestiture to completely new ownership and management a more desirable outcome.

¹⁸ See, e.g., Press Release, Fed. Trade Comm'n, FTC Obtains Court Orders Banning Marketer from Negative-Option Sales (Apr. 16, 2018), <https://www.ftc.gov/news-events/press-releases/2018/04/ftc-obtains-court-orders-banning-marketer-negative-option-sales>; Press Release, Fed. Trade Comm'n, FTC Settlements Ban Chicago-area Phantom Debt Collector from the Debt Collection Business and from Selling Debt Portfolios (Nov. 1, 2017), <https://www.ftc.gov/news-events/press-releases/2017/11/ftc-settlements-ban-chicago-area-phantom-debt-collector-debt>.

- *Dismissal of senior executives and board directors:* Senior managers of firms are often quick to pin the blame on junior employees for repeated problems in the organization, but are less quick to acknowledge their own failures to remedy concerns. As noted above, orders not only bind a firm, but also its officers. When appropriate, the Commission should seek dismissals of executives and board members overseeing conduct that violates our orders.¹⁹
- *Dismissal of third-party compliance consultants:* Firms frequently hire third-party consultants and auditors to demonstrate that they are relying on independent judgment to ensure compliance with the law. However, the independence of these consultants can often be compromised.²⁰ The failure of a third-party compliance consultant to detect conduct that violated a Commission order may warrant their dismissal.
- *Clawbacks, forfeitures, and reforms to executive compensation agreements:* While equity owners should certainly incur costs when orders are violated, a fairer allocation of liability might include specific recoveries from executives. In those instances, it may be important for the violating company's board to exercise any rights it may have to claw back bonuses and order the forfeiture of certain unvested stock options and grants. In addition, the components of executive compensation arrangements may need to be amended to reflect a firm's commitment to compliance with the law.²¹
- *Requirements to raise equity capital:* A close investigation of a firm might determine that the underlying driver of misconduct stems from the need to generate cash to service unmanageable debt. High levels of corporate debt can amplify returns on equity, but when it creates risks to consumers and competition in the form of an order violation, it may be appropriate for the Commission to seek a recapitalization of the firm, even if this means that senior executives will find that their stock holdings are diluted.

Of course, this list is far from exhaustive. When orders are violated, a key question I will evaluate when reviewing matters for consideration by the Commission is whether the proposed remedies address the underlying causes of the noncompliance. To that end, I look forward to hearing from you about your ideas for ensuring that companies stay on the right side of our orders -- and face consequences when they do not.

¹⁹ As noted earlier, the Office of the Comptroller of the Currency recently reiterated its right to dismiss Wells Fargo executives and directors. *See* n. 11.

²⁰ *See, e.g.,* Agreement, NY State Dept. of Financial Services, In the Matter of Promontory Financial Group, LLC (Aug. 18, 2015), <https://www.dfs.ny.gov/about/ea/ea150818.pdf>; Agreement, NY State Dept. of Financial Services, In the Matter of Deloitte Financial Advisory Services LLP (Jun. 18, 2013), <https://www.dfs.ny.gov/about/ea/ea130618.pdf>.

²¹ For example, an agreement between the Office of Inspector General of the Department of Health and Human Services and GlaxoSmithKline required the company to change its executive compensation program, including by permitting bonus recoupment in the event of significant misconduct. *See* Corporate Integrity Agreement between the Office of Inspector General of the Dept. of Health and Human Services and GlaxoSmithKline LLC (Jun. 28, 2012), <https://www.justice.gov/sites/default/files/opa/legacy/2012/07/02/hhs-oig-corp-integrity-agreement.pdf>.