New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM
An ALM Publication
VOLUME 249—NO. 42
TUESDAY, MARCH 5, 2013

WHITE-COLLAR CRIME

Expert Analysis

Why So Few Individuals? Government's Prosecution of Corporate Misconduct

By **Elkan Abramowitz** And **Jonathan Sack**

A company pleads guilty or settles civil charges and makes a large payment to the government. The government condemns the egregious corporate misconduct and extols its prosecutors' hard work and tenacity. The media go into high gear, condemning the misdeeds of corporate America. The cry goes out to hold individuals accountable. But individuals end up not being charged.

This recent pattern—high-profile cases against companies, relatively few cases against individuals—has led courts and commentators to wonder why the government has not been more aggressive in prosecuting individuals.[1]

Lanny Breuer, assistant attorney general of the Department of Justice Criminal Division, recently addressed such criticism. In his view, the record reflects careful charging decisions, not timidity on the part of prosecutors. Despite what he sees as "[an abominable] level of greed [and]…excessive risk taking…," Breuer has emphasized that prosecutors have a "constitutional duty" not to bring cases that cannot be proven beyond a reasonable doubt.[2] As leader of the criminal division, Breuer said that he has "the same DNA in all of these cases. It's just not plausible that in one area we would be overly scared and in all the other areas we would be aggressive."[3]

While many factors may explain the seeming disparity between cases brought against companies and individuals, this article suggests two ways of thinking about the issue. First, in some cases the decision not to charge individuals may reflect important differences in the method of proving corporate and individual liability. The doctrine of "collective knowledge" makes it significantly easier to establish a corporation's guilt, especially in white-collar cases in which knowledge as well as intent are commonly the issues most sharply disputed.

Second, the seemingly small number of individual prosecutions may reflect a flawed and incomplete fact-finding process. Because the issues underlying a corporate settlement have not been litigated, the charges often reflect a one-sided view of the facts which downplays or ignores the weaknesses in the government's case. As a result, the wrongdoing at issue may not be nearly as severe or readily established as the government's charging document might suggest, thereby understating the difficulties the government would face in a prosecution of an individual.

In short, the common criticism of the government for not prosecuting individuals—that it lacks sufficient tenacity and toughness—may be misplaced. The reason for not charging individuals arguably lies, instead, in a realistic assessment of the difficulty of proving an individual's guilt—a difficulty that the government itself may be masking by overstating the strength of its case against companies which, for sound reasons, usually choose to settle enforcement actions.

Proof of Mental State

In his recent comments, Breuer specifically noted the difficulty of proving criminal intent in "Wall Street cases" against individuals. Whereas against an individual the government must

ELKAN ABRAMOWITZ *and* JONATHAN SACK *are members of Morvillo Abramowitz Grand Iason & Anello P.C. Abramowitz is a former chief of the criminal division in the Southern District U.S. Attorney's Office. Sack is a former chief of the criminal division in the Eastern District U.S. Attorney's Office.* GRETCHAN R. OHLIG, *an attorney, assisted in the preparation of this article.*

prove that a specific person had the requisite criminal mental state, the government's burden against a company is different. Under the "collective knowledge" doctrine, prosecutors do not have to prove that any particular individual in the company had the requisite knowledge. Instead, the doctrine permits a fact finder to aggregate and impute to a corporation the fragments of information known to any of its employees.

In *United States v. Bank of New England*, the U.S. Court of Appeals for the First Circuit gave what remains a leading articulation of the doctrine. The court affirmed a jury instruction that the bank's collective knowledge:

> is the totality of what all the employees know within the scope of their employment. So if Employee A knows one facet of the currency reporting requirement, B knows another facet of it, and C a third facet of it, the bank knows them all. So if you find that an employee within the scope of his employment knew that [Currency Transaction Reports] had to be filed…the bank is deemed to know it. The bank is also deemed to know it if each of several employees knew a part of that requirement and the sum of what the separate employees knew amounted to knowledge such that a requirement existed.[4]

The court explained that it would not be appropriate for a company to avoid criminal liability by "compartmentaliz[ing] knowledge, subdividing the elements of specific duties and operations into smaller components."[5]

The "collective knowledge" doctrine effectively reduces the burden on prosecutors in a case against a corporation.[6] Instead of having to wrestle with facts establishing one individual's knowledge, the government can aggregate fragmentary information dispersed throughout the company to contend that the company "knew" the critical facts.[7] This is a powerful tool for the government, particularly in combination with the respondeat superior theory of corporate criminal liability. The net result is to enable the government to bring criminal cases against companies that could not readily be brought against individuals.

The reason for not charging individuals arguably lies in a realistic assessment of the difficulty of proving an individual's guilt.

Settling Charges

Almost all cases against companies are resolved short of trial either through guilty plea, deferred or non-prosecution agreements or consent judgments.[8] Such settlements often reflect the enormous pressures on a corporate entity to avoid a high-risk, prolonged and public contest with the government, especially if the company is highly regulated by, or does substantial business with, the government.

When a company settles a case, the government drafts the criminal indictment or information, or the civil complaint or consent judgment in a Securities and Exchange Commission enforcement action, which naturally conveys the government's view of the facts. Although the company defendant reviews the documents before filing and has input into the text, the company often has little bargaining power or appetite to push back strongly against facts that it thinks are being overstated or even misstated. This is especially true in civil settlements that do not require the corporate defendant to admit the truth of the allegations.

Consequently, the government's description of the facts and violations is typically one-sided, and the public's view is therefore one-dimensional. What is missing are the inevitable weaknesses and gaps in the government's case—for example, a novel and untested legal theory, an incomplete documentary record or a plausible explanation for why certain decisions were made which, with the benefit of hindsight, seem improper. But such weaknesses in the government's case and viable arguments for the defense are not expressed in the documents filed in court or in the related press statements.

Litigating Charges

How can we test the notion suggested here that the facts and the law in cases against companies are not always so clear or compelling as they seem, and that the proof at a trial would not establish what the government so assuredly asserts? An obvious, if imperfect, test is to examine those cases in which individuals went to trial on virtually the same charges that their corporate employer had settled. While the outcome in a case against an individual can depend on many factors, the results of this examination are instructive.

A prime example of the divergence between the facts underlying a corporate settlement and the facts litigated at trial is the SEC's 2004 settlement with Knight Securities L.P., a market-making firm. Although the company neither admitted nor denied the SEC's findings that it had defrauded institutional customers by extracting excessive profits on trades, it agreed to pay $66.5 million in disgorgement, interest and civil penalties.[9] The SEC separately brought charges of securities fraud against Knight's former CEO and the former head of its institutional sales desk, both of whom contested the charges and went to trial.

In a sharply worded decision, the district court rejected in their entirety the factual and legal premises of the SEC's charges, finding that "the overwhelming evidence" indicated that the defendants and Knight "did nothing improper in executing the trades at issue." "Throughout the trial, although given ample opportunity, the SEC failed to solidify its theory of the case, or present sufficient evidence to establish any element required by the various statutes it invokes…."[10] In another recent case, an individual charged with misleading clients about investments in collateralized debt obligations was found not liable by a jury after Citigroup agreed to pay $285 million to settle charges arising out of essentially the same set of facts.[11]

Individuals have fared similarly in a number of cases brought by the Department of Justice, notably, following high-profile guilty pleas by pharmaceutical companies. In 2007, four former executives of Serono, S.A. were acquitted of charges that they had paid bribes to doctors in the form of free trips and other personal gifts to induce them to prescribe an AIDS drug marketed by the company.[12] The acquittal came after the company had pleaded guilty and settled civil charges in October 2005, agreeing to pay over $700 million premised on essentially the same conduct.[13]

The government's loss in that case followed acquittals in an earlier prosecution of employees of TAP Pharmaceuticals Inc. In 2001, TAP pleaded guilty and paid $885 million to resolve criminal and civil charges relating to the unlawful inducements to doctors and hospitals to prescribe a cancer-fighting drug. The individual defendants went to trial for essentially the same conduct and were acquitted in 2004.[14]

As these cases suggest, the charges settled by a corporation are not always sure guides to the facts and liability. Flaws and gaps may lurk in seemingly the most simple and straightforward government narrative. Whatever the specifics in a given case, individuals should often not be charged with offenses to which a company has pleaded guilty—either because the government's legal theory was flawed, the government lacked sufficient proof or the individuals were simply not guilty.

In short, we have good reason to believe that in recent years the government is not merely shying away from tough cases. Rather, in the majority of cases in which corporations settle charges, individuals are most likely not charged because the government has reasonably concluded that its theory and evidence are not sufficiently strong to establish individual liability. What goes unsaid is that the government's allegations and evidence are not as strong as a prior settlement with the company would suggest.

Conclusion

Companies continue to be charged on a regular basis for a wide range of misconduct. Most of these cases result in guilty pleas or other settlements. Individuals are not charged, or a small number are charged and they prevail in whole or in part at trial. But all the public remembers is a screaming headline about corporate malfeasance, calling for executives to be held accountable. We barely notice the acquittal of an employee reported on page 26 five years after the original headline appeared.

We have all seen this scenario play out time and again. It would be naïve to think this narrative could be rewritten any time soon. But it would be healthy for the public, and not just lawyers, to understand that the facts in such cases are usually more complicated than what the government alleges, and that individuals often should not be prosecuted for sound reasons. That would be a refreshing start to a more realistic assessment of corporate wrongdoing and individual accountability.

1. Solomon L. Wisenberg, "HSBC Settlement: The Unanswered Questions," White Collar Crime Prof Blog (Dec. 17, 2012) (available at: http://lawprofessors.typepad.com/whitecollarcrime_blog/2012/12/hsbc-settlement-the-unanswered-question.html); Michael S. Schmidt and Edward Wyatt, "Corporate Fraud Cases Often Spare Individuals," *The New York Times* (Aug. 7, 2012); "Barclays Deal With U.S. Over Trade Sanctions Is Approved," Reuters (Aug. 18, 2010).

2. Frontline Interview with Lanny Breuer, "Lanny Breuer: Financial Fraud Has Not Gone Unpunished" (Jan. 22, 2013) (available at: www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/untouchables/lanny-breuer-financial-fraud-has-not-gone-unpunished/).

3. Sari Horwitz, "Justice Department's Lanny Breuer Oversaw Some of the Largest Criminal Cases in U.S. History," *The Washington Post* (Jan. 30, 2013).

4. 821 F.2d 844, 855 (1st Cir. 1987).

5. Id. at 856. See also, *In re WorldCom Sec. Litig.*, 352 F.Supp.2d 472, 497 (S.D.N.Y. 2005) (proof of a corporation's collective knowledge and intent is sufficient to prove scienter against a corporate defendant accused of securities fraud).

6. While the collective knowledge doctrine has been invoked in private actions brought under the securities laws, the viability of the doctrine in SEC enforcement actions remains unsettled. See Bradley J. Bondi, "Dangerous Liaisons: Collective Scienter in SEC Enforcement Actions," 6 N.Y.U. J.L. & Bus. 1, 4 (2009).

7. See Ellen S. Podgor, "100 Years of White Collar Crime in 'Twitter,'" 30 Rev. Litig. 535, 538 (Spring 2011) (collective knowledge avoids need to prove individual agent's acts).

8. Elkan Abramowitz and Barry A. Bohrer, "The Debate About Deferred and Non-Prosecution Agreements," *New York Law Journal* (Nov. 6, 2012).

9. Jonathan S. Sack, "Knight's Saga: A Court Rejects the SEC's Theory of 'Best Execution,'" *The Review of Securities & Commodities Regulation*, Vol. 2, No. 2 (Jan. 21, 2009).

10. *Securities and Exchange Commission v. Pasternak and Leighton*, 561 F.Supp.2d 459, 517 (D.N.J. 2008).

11. Peter Lattman, "S.E.C. Gets Encouragement from Jury that Ruled Against It," *The New York Times* (Aug. 3, 2012).

12. Indictment, *United States v. Bruens*, 05Cr10102 (April 14, 2005).

13. Plea Agreement, *United States v. Serono Laboratories*, 05Cr10282 (Dec. 21, 2005). See also, "Ex-Serono Executives Acquitted in Massachusetts," *Reuters* (May 4, 2007).

14. Shelley Murphy and Alice Dembner, "All Acquitted in Drug Kickbacks Case. Jury Deals a Blow to US Prosecutors," *Boston Globe* (July 15, 2004). See also, Ron Leuty, "InterMune ex-CEO Harkonen Sentenced in Actimmune Drug Scandal," *San Francisco Business Times* (April 15, 2011) (corporate CEO, acquitted of misbranding charges after corporation settles for $36.9 million, sentenced to six months home confinement for wire fraud after court finds government failed to prove harm resulting from conduct).