

'Swift' Prosecutions of Corporations And Executives

More Harm Than Good?

By Alexander H. Southwell and Oliver M. Olanoff

Last month, the Department of Justice (DOJ) celebrated the five-year anniversary of the Corporate Fraud Task Force with a press release and a party at which Attorney General Alberto Gonzales, in a prepared statement, hailed significant changes in the way white-collar cases have been prosecuted. Gonzales praised the Task Force's role in breaking "large investigations into smaller, less complex pieces," and bringing those cases faster.

Gonzales's remarks echoed prior statements from high-ranking DOJ officials about so-called "real-time" prosecution of corporate wrongdoing. For example, the Task Force's first report to President Bush insisted that "criminal consequences for individuals and businesses engaged in corporate fraud had to be swift and virtually certain." Subsequent reports to the President trumpeted the Task Force's "swift" and "decisive" prosecutions, the goal of which was to "restore investor confidence." In his prepared remarks, Gonzales explained the reason for this goal: "The markets want, and will reward, reliability, integrity, and transparency in American companies. Investors don't put their money into companies — or markets

— that they do not trust." To carry out this goal, Gonzales and other senior-level DOJ personnel urged prosecutors to bring cases quickly.

But expedited investigations mixed with quick charging decisions have not been a reliable recipe for success. Just one month before the Task Force's anniversary, a Boston jury quickly disposed of the DOJ's charges against four former high-level executives of the pharmaceutical company Serono SA related to an alleged doctor kickback scheme. On May 4, after a three-week trial, the jury took less than three hours to acquit all the defendants on 22 charges.

The Serono case is hardly an outlier. Despite the Task Force's many accomplishments, it has suffered a stunning number of acquittals, reversals, and hung juries in high-profile cases. Judge-ordered and prosecutor-volunteered dismissals, once quite rare, are more common, leaving one to wonder whether the goal of bringing complex fraud cases "swiftly" was sensible or desirable.

CLOSELY WATCHED CASES, BROUGHT QUICKLY, UNRAVEL

Although a number of cases have failed, few have imploded as publicly and awkwardly as the Duke Energy case. The case, brought by federal prosecutors after a coordinated investigation by the SEC, FBI and CFTC, sought to score a public-relations coup with quick charges brought after another energy-related scandal engulfed a beleaguered Texas-based energy sector, already reeling from the Enron case. In announcing the 60-page, 20-count indictment — charging Duke executives Timothy Kramer and Todd Reid with orchestrating "round-trip" energy trades to inflate Duke's revenue — the U.S. Attorney for the Southern

District of Texas proclaimed the DOJ's "commitment to ensure that those who enrich themselves through deception in the market place will be held to fully account for their conduct."

The results of the eight-week jury trial in December 2005 were disastrous for the DOJ: The jury acquitted Reid entirely, and acquitted Kramer on seven charges and hung on the other 12. When the U.S. Attorney dismissed the remaining charges against Kramer in January 2006, he said: "We have the responsibility to follow the law" and do "the right thing." One wonders what changed in the 30 days after federal prosecutors had urged a jury to convict these men.

The dismissal of one high-profile case is, no doubt, a difficult decision, undertaken with great deliberation and care. Dismissing *five* related cases in one fell swoop was truly extraordinary in November 2006, when the U.S. Attorney for the Southern District of New York dismissed a number of "specialist cases," in which various New York Stock Exchange specialists were indicted for a variety of questionable practices, including "interpositioning" in violation of New York Stock Exchange rules. In the seven-page press release announcing the indictment, the government had hailed the case, claiming that the defendants "cheated the markets and they cheated the investors who relied upon them." On that theory, a Manhattan jury convicted one of the defendants, Dennis Finnerty. The problem was — according to District Judge Denny Chin, who took the unusual step of dismissing Finnerty's case after the jury's verdict — the government lacked proof that the specialists cheated anyone. Although their conduct was morally ambiguous, Judge Chin found that the government offered no evidence that it

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was deceitful, which is “the very core of the federal securities laws in question. No rational juror could conclude that the interpositioning trades had a tendency to deceive or the power to mislead,” Judge Chin held.

By the time this decision was published, the government had apparently come to the same view, having already suffered two prior dismissals and two acquittals in other specialist cases. And in its November 2006 statement, the U.S. Attorney's office dismissed five other specialist cases, announcing that continuing the prosecutions was not “in the interests of justice.”

Federal prosecutors in the Eastern District of Michigan made a similar turnabout in the criminal case against former Kmart executives after a dramatic turn of events. In the press release announcing the indictment charging a scheme to manipulate Kmart's revenue, the U.S. Attorney for the Eastern District of Michigan proclaimed: “This office is committed to the thorough investigation and prosecution, where appropriate, of all allegations of corporate fraud.” Yet, months of preparation did not prevent the case from unraveling in the midst of trial when the only witness on a key element in the case — whether the defendants knew certain revenues were improper to book — fell apart on cross-examination. Having relied so heavily on a single witness, the government moved to dismiss the charges on just the second trial day: “In light of the testimony and evidence presented during the trial to date, it was more likely than not that the evidence would not sustain a conviction.” Again, *Kmart* leaves one to wonder: why did the government bring the case so quickly, and why was it based on so little evidence?

Several other notable cases seemed doomed from the start, leading to a fair inference that the rush to bring charges comes from a political expedient rather than sound enforcement policy. Highly problematic prosecutions have been criticized recently in virtually every circuit, as well as in the Supreme Court. In many of these cases, the courts' frustration with prosecutorial theories and tactics was palpable:

- The Second Circuit affirmed the District Court's reversal of a conviction against Frank Cassese, President and Chairman of Computer Horizons Corporation, on insider trading charges, in which the District Court chastised the government for offering “highly prejudicial evidence” that was “irrelevant” to proving criminal intent.

- The Third Circuit reversed a conviction in the Progressive Medical case, holding that the government had “stretched” the health care fraud statute to “cover activity beyond its plain words.”
- The Fifth Circuit reversed fraud convictions in the Merrill Lynch barge case, saying the prosecution theory represented “the incremental expansion of a statute that is vague and amorphous on its face and depends for its constitutionality on the clarity divined from a jumble of disparate cases.”
- The Tenth Circuit vacated fraud convictions against two high-ranking executives of Westar Energy, Inc., saying the “prosecution hung by a thin legal thread.”
- The Eleventh Circuit vacated convictions in the McDonald's fraud case, criticizing the government's “roaming theory of prosecution” and bemoaning the fact that individuals who were “not actually members” of the conspiracy were nevertheless “swept into the conspiratorial net.” The court harshly characterized the prosecution as a “regrettable and unconstitutional series of events.”
- The Arthur Andersen conviction itself was reversed when the Supreme Court found that the jury instructions proposed by the prosecution, which the district court had accepted, were “striking” for “how little culpability” was required for conviction.

That these cases initially ended in convictions is chilling. But many other cases resulted in acquittals or hung juries, including the fraud case against McKesson CFO Frank Hawkins, the recent “squawk box” case, the case against several executives of Symbol Technologies, the case against Tenet HealthSystem, Alvarado Hospital and Alvarado's CEO, the case against Healthsouth CEO Richard Scrushy, and many lesser-known corporate fraud cases. Did these failed cases, offsetting the successes touted in the Attorney General's five-year report card for the Corporate Fraud Task Force, also help “restore confidence” in our financial markets?

LESSONS LEARNED?

The prosecutors who brought these cases were no doubt well-meaning and diligent. Yet these cases, and others like them, were borne of a political goal: quickly restoring the public's confidence in the financial markets. Although the government could have achieved that goal in other ways, it chose to do so in part through the DOJ, and, in particular, through a directive that prosecutors

bring complex cases quickly. Political expediency, when applied to federal law enforcement, is never a cost-free proposition, bringing to mind the recent words of Judge Easterbrook concerning the criminal statute prosecutors had tried to stretch in another high-profile reversal of a conviction: “Haziness designed to avoid loopholes through which bad persons can wriggle can impose high costs on people the statute was not designed to catch.” *United States v. Thompson*, 484 F.3d 877, 884 (7th Cir. 2007).

In complex cases, where aggressive business tactics must be differentiated from deceitful or misleading conduct, where the existence or absence of “duties” between sophisticated market participants plays a crucial role in identifying wrongdoing, and where juries can improperly take high profits and salaries as evidence of guilt, how does our system decide which executives play an aggressive *but legal* role and which step over the line?

Prosecutors, of course, are always at the front line, usually making the right calls, but as these recent examples illustrate, sometimes getting it wrong. Our justice system heavily depends on prosecutors exercising sound discretion to avoid bringing “hazy cases” based on overly speculative and novel criminal theories, and, instead, to show respect for their duty to seek justice by ensuring criminal sanctions are reserved for those on notice of the wrongful nature of their conduct.

CONCLUSION

Numerous cases demonstrate that prosecutors are having difficulty differentiating dubious but legal practices from those that cross the line, particularly when under enormous pressure from Washington politicians to show results. But the goal of strengthening “investor confidence” cannot justify rash decisions to bring shaky cases against innocent corporate defendants. Protecting against wrongful or questionable convictions — and thereby ensuring the continued vitality of the Rule of Law — is a more important goal for the Justice Department.

