BETTER MARKETS

SEC REPORT

The SEC Must Hold Individuals Accountable for Corporate Misconduct

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"Corporations do not act; individuals do."

– Paul S. Atkins and Bradley J. Bondi, in their 2008 law review article about the SEC's enforcement program and the problems with corporate penalties.

Introduction

Paul Atkins, then a Commissioner at the SEC, wrote the above (along with his counsel) to justify his long-held view that imposing civil money penalties on corporations is often not appropriate. Atkins, who recently returned to the SEC as Chair, believes that these penalties punish the wrong parties—the corporation's shareholders and not the individual wrongdoers. This view has led to speculation that the SEC will bring fewer cases involving corporate penalties under Chair Atkins. But the more important question is whether it will lead to the SEC bringing more cases against individuals. Reducing corporate penalties only makes sense if it is accompanied by an increase in individual liability. If Chair Atkins is serious about punishing the right parties, then his SEC cannot only refrain from imposing corporate penalties; it must also abandon the SEC's practice of settling with large corporations without seeking relief against the individuals responsible for the misconduct.

The SEC's reputation for not pursuing top executives at large corporations is longstanding.

> [An] empirical analysis of SEC civil and administrative enforcement data from 2005-2007 found that individuals in big firms fare better in enforcement actions than those in smaller firms because (1) the actions taken against large entities are less likely to be accompanied by enforcement actions against individuals, and (2) because individuals at big firms face less punitive sanctions.

This analysis concluded that, in the time period right before the 2008 financial crisis, the SEC "'demonstrate[d] a systematic lack of action against individual violators in high profile cases.'"

Unfortunately, the SEC's reputation in this regard did not improve after the financial crisis. One of the enduring mysteries of the financial crisis is why there "were so few Wall Street bankers, traders, and executives held accountable." The prevailing narrative emerging from the financial crisis was that it was "exceedingly rare for an individual to be singled out by the SEC."

Eight years after the crisis, at the end of the Obama Administration, the situation had not improved. For example, in January 2016, Barclays and Credit Suisse agreed to pay more than $150 million for violating the federal securities laws while operating alternative trading systems. The case stemmed from allegations that these stock trading platforms were advertised as places where investors would not be preyed on by high-frequency traders when in reality investors trying to execute their transactions fairly on both banks' systems were harmed. The settlement itself was not particularly noteworthy as it was just "another multimillion-dollar settlement between regulators and a behemoth bank acting badly." Instead, what was notable was the trend in these types of cases:

> As has become all too common in these cases, not one individual was identified as being responsible for the activities. Once again, shareholders are shouldering the costs of unethical behavior they had nothing to do with.

Neither the first Trump Administration nor the Biden Administration substantially improved on this record. Indeed, the SEC during the Biden Administration imposed record-breaking fines on public companies but did not always (or even often) accompany those fines with sanctions against the responsible individuals. As a result, the perception remains that the SEC "largely refrain[s] from holding high-level executives of large cap publicly held companies responsible for their neglect."

This perception, grounded in reality, has real costs. The fact that corporate crime is too often addressed by fining the corporation without holding the individuals who committed the crime liable generates an accountability gap that undermines deterrence. As Senator Dick Durbin said in his opening remarks during a 2023 Senate hearing on ensuring accountability for corporate criminals,

> Countless companies have settled multi-billion dollar lawsuits outside of court, but far too often, the executives responsible for the decisions that led to those lawsuits have escaped prosecution and liability. . . . Corporate executives have little incentive to change their criminal conduct without fear of real consequences for their actions. Right now, they're not worried about much more than a measly fine—a rounding error compared to their enormous profits. It's an unacceptable process . . . .

The fact that corporations pay fines while the individuals who committed the crimes generally avoid sanctions leaves the public with the devastating impression that elites are immune from punishment. This leads to the view that there are two systems of justice—one for wealthy corporations and executives, and one for everyday Americans. The failure to hold bad actors accountable does not go unnoticed, as some have pointed to the failure to prosecute individuals in the wake of the financial crisis as a factor in the recent shift toward populism among the electorate.

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It is time for this to change. And Chair Atkins's views should lead him to effectuate this change. He recently reiterated his opposition to corporate penalties in his first Congressional testimony as SEC Chair. He stated both that he opposed corporate penalties in many situations and that in those situations it was appropriate to go after the responsible individuals. It is fair to expect Chair Atkins's SEC to impose fewer corporate penalties, and although it remains to be seen whether his SEC will also seek to hold individuals at large financial institutions and other corporations accountable, his rationale for opposing corporate penalties suggests such a course of action would make sense.

Chair Atkins's View

Chair Atkins's antipathy towards corporate civil penalties stems from an important recognition—that corporations are ultimately owned by shareholders. This means that, in his view, the shareholders are essentially the ones who pay the monetary penalties imposed on the corporation. So Chair Atkins views such penalties as harming shareholders rather than redressing misconduct.

Although this view obviously has ramifications for the SEC's imposition of corporate penalties, it should also have ramifications for the SEC's pursuit of individual liability. Indeed, the reasons Chair Atkins has given for opposing corporate penalties lead as easily to the conclusion that greater individual liability is appropriate as to the conclusion that corporate penalties are inappropriate.

> As both a philosophical and practice matter, the effectiveness of a corporate penalty as a means for deterrence is questionable. . . . Senior managers who commit fraud undoubtedly do so with the knowledge that their actions, if exposed, will cause reputational and economic harm to their corporation, such as a depressed stock price, loss of customers and business partners, shareholder litigation, and legal and investigative costs. Often, what motivates the wrongdoer to commit the fraud is the potential personal pecuniary gain of increased stock price, personal advancement within the corporation, or masking the negative effects of strategic or tactical management decisions on the performance of the company. If wrongdoers have little concern for their company and shareholders when they commit fraud, it is doubtful that the behavior of potential wrongdoers will be altered by the threat of a corporate penalty on the company and shareholders that they are seeking to victimize. Are would-be fraudsters more likely to be deterred by headlines trumpeting a multimillion dollar corporate fine, or by hearing that a senior executive was fired, lost his savings, became barred from serving as an officer or a director, suffered irreparable harm to his reputation, and perhaps faces incarceration?

Chair Akins also believes corporate penalties reduce the incentives to impose individual liability.

> The penalty obtained in the settlement with the corporation may satisfy the SEC's desire to garner public awareness (and thus enhance the 'deterrent' effect), causing the SEC to forgo seeking large penalties against individual managers.

Again, this suggests that if the SEC is going to seek fewer corporate penalties it must also bring more cases against the individuals responsible for corporate misconduct. Chair Atkins himself has almost made the point explicit. He has said that managers may hope that if the corporation agrees to pay a penalty the government may be satisfied, and therefore the managers of the corporation may agree to pay such a penalty to "deflect personal responsibility of particular managers." It may well be that corporations agree to pay penalties to prevent the government from going after individuals. This means that any reduction in corporate penalties should be accompanied by an increase in cases against individuals to prevent managers from deflecting personal responsibility.

Chair Atkins has said repeatedly since becoming Chair that he believes it is a new day at the SEC. One way he can make it a new day at the SEC in a way that would better protect investors would be to bring cases against the individuals who commit misconduct at large corporations. As the SEC's record in the last year alone shows, this is an area of SEC enforcement that is ripe for improvement.

Recent SEC Cases

UPS

In November 2024, the SEC settled a case against United Parcel Service (UPS) involving UPS's "material misrepresentations to investors regarding its earnings." UPS valued an asset at $2 billion in 2019 despite its own analysis indicating that the asset would not sell for more than $650 million. UPS did not inform investors that its disclosures regarding its earnings, goodwill balances, and shareowners' equity were materially dependent on a valuation that did not reflect the asset's fair value and did not align with information in the company's possession about the assumptions market participants would use in valuing the asset. After reaching an agreement to sell the asset for $650 million in 2020, UPS took a write-off that reduced its income from continuing operations by 6%, its net income by 20%, its goodwill balances by 13%, and its shareowners' equity by 32%.

UPS made false and misleading statements to investors in connection with the value of the asset. For example, in its Form 10-Q for the third quarter of 2020 it said there were no events or changes in circumstances during the quarter that necessitated re-valuing the asset. Yet several weeks before this filing UPS signed a non-binding term sheet to sell the asset for a "headline" price of $800, which subsequently resulted in a net sale price of $650 million. And the day after the filing UPS's Board of Directors authorized management to conclude a sale of the asset to the prospective buyer consistent with the term sheet. Management informed the Board that it expected the company would write off about $500 million in goodwill at the close of the transaction.

UPS settled the case by paying a $45 million penalty, but no individual was charged by the SEC. We hope Chair Atkins will take a different tact in similar cases in the future. The UPS case is the paradigmatic example of the type of case Chair Atkins believes would not warrant a corporate penalty. He has written that such penalties are inappropriate in "a typical financial fraud case" where "management misrepresented the corporation's financial performance to the owners of the corporation." If that's so, then the individuals responsible for the misrepresentation must be held liable.

Becton, Dickinson and Company

Similarly, in December 2024, the SEC settled a case against Becton, Dickinson and Company (Becton), a global medical technology company, involving Becton's "repeated misrepresentations to investors regarding the risks it was taking in selling one of its most important products." The product contributed about 10% of Becton's profits, but after Becton identified safety issues and determined it needed additional clearance from the FDA to continue selling it, it asked the FDA in October 2019 to allow it to continue selling the product while it worked on addressing the issues.

On October 31, 2019, the FDA rejected Becton's proposal, told Becton it could not continue selling the product without FDA approval, and added that the product needed to be recalled and fixed more quickly than Becton proposed. Although Becton understood it needed to stop selling the product until it addressed the FDA's concerns, it determined to resume selling an upgraded version of the product within three months under the assumption that the FDA would exercise its enforcement discretion to allow it to do so without first obtaining FDA clearance. Becton's then-senior management, in consultation with attorneys, experts, and executives, agreed to this plan.

On November 5, 2019, Becton held an earnings call in which it told investors it was pausing shipments of the product to make upgrades. Becton issued earnings and revenue forecasts that assumed it would recoup most of the sales it would not make during this pause. Becton's statements materially misled investors about the product's regulatory status and the reliability of its forecasts because they implied it was merely enhancing the product and were based on its undisclosed conjecture that FDA would allow it to continue selling the product without clearance.

Becton also overstated its operating income. By this point, Becton estimated the product's recall would cost $50 million. Yet it did not properly account for these costs, which resulted in it overstating its operating income for the fourth quarter of fiscal year 2018 by 82%.

When the FDA learned in mid-January 2020 that Becton had resumed shipping the product, it warned Becton that doing so was contrary to "our mutual agreement that your firm should not be distributing devices to new customers." In February 2020, Becton informed investors that it had ceased shipping the product to new customers and would not resume doing so until it obtained clearance from the FDA. That announcement led to a 12% decline in the company's share price.

Becton paid a $175 million penalty to settle the case, but no individual was charged by the SEC.

Entergy

Also in December 2024, the SEC settled a case against Entergy Corporation (Entergy), an energy company, involving its failure to review, identify, measure, and write-down surplus materials and supplies to ensure that they were accurately recorded in its books and financial statements. Between mid-2018 and the end of 2024, the value of Entergy's materials and supplies grew from a reported value of $752 million to $1.49 billion. During this period, Entergy should have reviewed its materials and supplies to determine if any of it was surplus to its business' needs and recognized a loss when remeasurement of the materials and supplies was required. But Entergy failed to provide reasonable assurances that surplus materials and supplies were timely identified and properly remeasured in its books and properly reported in its financial statements.

Instead, each quarter from mid-2018 to 2024, in quarterly reports, annual reports, and press releases, Entergy reported the value of its materials and supplies at average unit cost as an asset on its balance sheet and in its books and record without adequate consideration of whether those assets were in excess of its business needs and thus should have been considered surplus and remeasured accordingly. For example, both management consultants that Entergy hired and Entergy employees identified significant quantities of potential surplus materials and supplies. One consultant documented that Entergy had at least $177 million in potential surplus materials and supplies. The consultant's findings were shared with Entergy's finance department. Despite being informed that it held significant amounts of potential surplus, Entergy failed to take steps to regularly review, identify, and remeasure surplus materials and supplies for accounting purposes.

Entergy paid a $12 million penalty to settle the case, but no individual was charged by the SEC.

The Big Concern

Financial fraud cases are not the only ones in which deterrence might be better achieved through holding the responsible individuals liable. In the last six months, the SEC has settled cases with several of the largest financial services firms in the world. LPL Financial paid an $18 million penalty for anti-money laundering violations; Wells Fargo and Merrill Lynch paid $60 million in total penalties for compliance failures related to their cash sweep programs; BMO Capital Markets paid $40 million for failing to supervise its agency bond desk; Deutsch Bank paid $4 million for not timely filing certain suspicious activity reports; and Wells Fargo and LPL Financial each paid $900,000 for submitting deficient trading data to the SEC. In none of these cases did the SEC charge an individual. All of the cases involved firms that had settled cases with the SEC previously.

Chair Atkins's view that corporate penalties are unlikely to deter misconduct and prevent recidivism should lead to more enforcement actions against the responsible individuals in these types of cases and others. Our concern, though, is that Chair Atkins's SEC will stop imposing corporate penalties but will also not bring more cases against individuals at the largest corporations and financial institutions. In this regard, it is troubling that Chair Atkins has himself validated the defenses that individuals through whom corporations act often raise to avoid liability:

> Sometimes, of course, it is too hard—or just not appropriate—to pin the blame on individuals, particularly where they did not have the full picture, had no intent to do something underhanded, got wrong legal or other advice, and so on. We also have to guard against criminalizing business decisions by looking at them through the regulator's lens of 20/20 hindsight. So, in those cases, other steps against a corporate defendant may be in order, including remedial organizational or managerial steps. Fundamentally, we also have to remember that the corporation may already have been punished through reputational and stock-price damage.

Although it is undoubtedly true that “sometimes” individual liability is not appropriate, the problem is that all too often “sometimes” turns into “always.” Chair Atkins’s view that corporate penalties punish the wrong parties should lead to greater individual liability. It should not lead to the imposition of no meaningful sanctions whatsoever in response to corporate misconduct.

Conclusion

Chair Atkins’s views about corporate penalties have fueled predictions that the SEC will impose fewer and smaller corporate penalties under his leadership. Less attention has been given as to whether there will be a concomitant rise in actions against the individuals responsible for the corporation’s misconduct. The reasons that Chair Atkins has himself articulated for opposing corporate penalties suggests that there should be; whether there will be remains to be seen.

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