

**CRIMINAL ACCOUNTABILITY AND WALL STREET  
EXECUTIVES:  
WHY THE CRIMINAL PROVISIONS OF THE DODD-FRANK  
ACT FALL SHORT**

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I. INTRODUCTION

On July 31, 2012, a federal jury acquitted Brian Stoker, a former mid-level manager of Citigroup Inc. (“Citigroup”), of charges that he misled investors as part of Citigroup’s complex mortgage securities scheme.<sup>1</sup> This investment scheme was just one of many that large

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<sup>1</sup> Chad Bray & Jean Eaglesham, *Loss in Citi Case Deals Blow to U.S.*, WALL ST. J. (July 31, 2012),

<http://online.wsj.com/article/SB10000872396390444860104577561380191553796.html>; Peter Lattman, *Former Citigroup Manager Cleared in Mortgage Securities Case*, DEALBOOK (July 31, 2012), <http://dealbook.nytimes.com/2012/07/31/former-citigroup-manager-cleared-in-mortgage-securities-case>; Grant McCool, *SEC Loses Civil Fraud Case Against Ex-Citigroup Manager*, REUTERS (July 31, 2012), <http://www.reuters.com/article/2012/07/31/citigroup-stoker-verdict-idUSL2E8IVFOE20120731>. The allegation against Brian Stoker was that, as lead structurer of Citigroup’s synthetic collateralized debt obligation (CDO), known as Class V Funding III, he defrauded investors by failing to disclose that Citigroup not only had a role in selecting the collateral for the CDO, but also was simultaneously betting against the same CDO. See Complaint at 19, SEC v. Stoker, 873 F. Supp. 2d 605 (S.D.N.Y. 2012) (No. 11-CV-7388). CDOs are bank-created securities, formed by bundling various debt-instruments together and then selling shares of that bundle to investors. Neal Deckant, *Criticisms of Collateralized Debt Obligations in the Wake of the Goldman Sachs Scandal*, 30 REV. BANKING & FIN. L. 407, 411–12 (2010). During the housing boom, CDOs became a popular way for banks to make a profit. See *id.* at 418–21. Soon afterwards, banks started creating synthetic CDOs by combining credit default swaps. See *id.* at 425–26. Credit default swaps are investments that function as a type of insurance on other securities; specifically, a party holding a debt obligation “swaps” the risk of investing in that obligation by paying another party a fee in exchange for a guarantee that the other party would pay the debt in the event of a default. *Id.* at 415. As a result, an investor buying a synthetic CDO was essentially betting that a bond held by someone else would not pay off. See *id.* The gravamen of the SEC’s complaint was that Citigroup was creating CDOs and selling them to investors without disclosing that they were also betting that those same CDOs would

banks perpetuated in the years leading up to the recent financial crisis, and this case was just another of the federal government's unsuccessful attempts to hold an individual banking executive accountable.<sup>2</sup> But there was something unique about this trial—its jury. In an unexpected move, the *Stoker* jury delivered a special message to the Securities and Exchange Commission (SEC).<sup>3</sup> Penned on a scrap of yellow paper torn from a legal pad, a note enclosed within the verdict envelope read, “[t]his verdict should not deter the S.E.C. from continuing to investigate the financial industry[.]”<sup>4</sup>

It is unusual for a jury to supplement its verdict with a statement, but this jury felt an explanation was necessary. Although the SEC did not make a compelling case against *this* executive, the jury wanted it to be clear that the federal government must continue to pursue actions against the individuals responsible for the financial crisis.<sup>5</sup> The problem in *Stoker*, according to jury foreman Beau Brendler, was that the SEC targeted a relatively low-level manager, one whose behavior was not only tolerated, but possibly encouraged, by his bosses.<sup>6</sup> Mr. Stoker did not act in a vacuum. His actions were merely a glimpse into a much broader culture on Wall Street, one pervaded with greed and irresponsibility.<sup>7</sup> The jury believed that the SEC was

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fail. See Complaint, *Stoker*, 873 F. Supp. 2d 605 (No. 11-CV-7388). CDOs are considered to be a “root cause” of the 2008 financial crisis. Peter Lattman, *S.E.C. Gets Encouragement from Jury That Ruled Against It*, DEALBOOK (Aug. 3, 2012), <http://dealbook.nytimes.com/2012/08/03/s-e-c-gets-encouragement-from-jury-that-ruled-against-it>.

<sup>2</sup> See Gretchen Morgenson & Louise Story, *A Financial Crisis with Little Guilt*, N.Y. TIMES, Apr. 14, 2011, at A1, available at <http://www.nytimes.com/2011/04/14/business/14prosecute.html?pagewanted=all&r=0> (online version titled, *In Financial Crisis, No Prosecutions of Top Figures*).

<sup>3</sup> The SEC is a federal agency created by the Securities Exchange Act of 1934, 15 U.S.C. § 78a (2006) (“Exchange Act”). The Exchange Act provides the SEC with disciplinary powers bring civil enforcement actions against those that violate the federal securities laws. *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM’N (Feb. 20, 2014, 8:56 AM), <http://www.sec.gov/about/whatwedo.shtml> [hereinafter *How the SEC Protects Investors*].

<sup>4</sup> Lattman, *S.E.C. Gets Encouragement from Jury That Ruled Against It*, *supra* note 1.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> See generally Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper’s Guide to the Psychology, Culture, and Ethics of Financial Risk Taking*, 96 CORNELL L. REV. 1209 (2010) (analyzing the culture of financial firms in the years preceding the financial crisis and discussing how risk taking that begins as a calculated, rational action can become emotionally compromised, and consequently irrational, as a result of unnaturally prolonged periods of prosperity, increased competitive pressures, and unrealistic market demands).

making Mr. Stoker into a scapegoat for more generalized grievances toward the financial industry.<sup>8</sup> For this reason, Mr. Brendler does not regret the verdict. But he does have one lingering thought: “I wanted to know why the bank’s C.E.O. wasn’t on trial[.]”<sup>9</sup>

In this regard, Mr. Brendler is not alone—his remarks are representative of a general public sentiment. In the aftermath of the recent financial crisis, many are wondering why there have been no successful prosecutions of high-ranking bank executives.<sup>10</sup> Although the SEC filed a handful of civil cases against managers of financial institutions,<sup>11</sup> the Department of Justice (DOJ)<sup>12</sup> has not filed a single

<sup>8</sup> Lattman, *S.E.C. Gets Encouragement from Jury That Ruled Against It*, *supra* note 1.

<sup>9</sup> Susan Beck, *Stoker Jury Foreman Explains How Verdict Didn’t Absolve Citi*, CORPORATE COUNSEL (Aug. 3, 2012), <http://www.corpcounsel.com/id=1202565823107/Stoker-Jury-Foreman-Explains-How-Verdict-Didn't-Absolve-Citi>; Lattman, *S.E.C. Gets Encouragement from Jury That Ruled Against It*, *supra* note 1; Brian Stoker Jury Wants Wall Street CEOs Put on Trial, HUFFINGTON POST (Aug. 6, 2012), [http://www.huffingtonpost.com/2012/08/06/brian-stoker-jury\\_n\\_1747218.html](http://www.huffingtonpost.com/2012/08/06/brian-stoker-jury_n_1747218.html).

<sup>10</sup> See, e.g., Peter J. Boyer & Peter Schweizer, *Why Can’t Obama Bring Wall Street to Justice?; Maybe the Banks Are Too Big to Jail. Or Maybe Washington’s Revolving Door Is at Work.*, NEWSWEEK, May 14, 2012, at 26, available at <http://www.thedailybeast.com/newsweek/2012/05/06/why-can-t-obama-bring-wall-street-to-justice.html>; Morgenson & Story, *supra* note 2; Marian Wang, *Why No Financial Crisis Prosecutions? Ex-Justice Official Says It’s Just Too Hard*, PROPUBLICA (Dec. 6, 2011), <http://www.propublica.org/article/why-no-financial-crisis-prosecutions-official-says-it-just-too-hard>; see also *60 Minutes: Prosecuting Wall Street* (CBS television broadcast Dec. 4, 2011), available at [http://www.cbsnews.com/8334-504803\\_162-57418062-10391709/full-coverage-60-minutes-on-the-financial-crisis/?pageNum=2&tag=next](http://www.cbsnews.com/8334-504803_162-57418062-10391709/full-coverage-60-minutes-on-the-financial-crisis/?pageNum=2&tag=next); *Frontline: The Untouchables* (PBS television broadcast Jan. 22, 2013), available at <http://www.pbs.org/wgbh/pages/frontline/untouchables>.

<sup>11</sup> Brian Stoker’s case was the first of these CDO-related cases to go to trial. McCool, *supra* note 1. At the time of Stoker’s acquittal, former bank managers Fabrice Tourre of Goldman Sachs Group Inc. (“Goldman Sachs”) and Edward Steffelin of GSC Capital Corp. were awaiting trial on similar charges. *Id.* The SEC ultimately dropped the case against Steffelin. Bob Van Voris & Greg Farrell, *SEC Drops Case Against Manager Who Packaged ‘Squared’ CDO*, BLOOMBERG (Nov. 16, 2012), <http://www.bloomberg.com/news/2012-11-16/sec-drops-case-against-manager-who-packaged-squared-cdo.html>. But the case against Tourre was successful. In August 2013, a jury found Mr. Tourre liable on “six counts of civil securities fraud after a three-week jury trial” in which the SEC accused Mr. Tourre of “misleading a small group of investors about the role of a big client in a 2007 trade he helped structure. That client, the hedge fund Paulson & Company, made about \$1 billion on the trade while [the other investors] lost big.” Susanne Craig, *Fabrice Tourre Seeks a New Trial*, DEALBOOK (Oct. 1, 2013), [http://dealbook.nytimes.com/2013/10/01/fabrice-tourre-seeks-a-new-trial/?\\_r=0](http://dealbook.nytimes.com/2013/10/01/fabrice-tourre-seeks-a-new-trial/?_r=0).

<sup>12</sup> While the SEC has authority to bring civil actions in response to violations of federal securities laws, *How the SEC Protects Investors*, *supra* note 3, the DOJ has authority to file criminal charges. *About DOJ*, U.S. DEP’T OF JUST. (Feb. 20, 2014, 9:14 AM), <http://www.justice.gov/about/about.html>.

criminal charge against any senior banking executive of a large financial institution since its first attempt at prosecuting two managers of The Bear Stearns Companies, Inc. (“Bear Stearns”) resulted in acquittals in 2009.<sup>13</sup>

This Comment evaluates whether recently enacted criminal provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)<sup>14</sup> can facilitate the imposition of criminal liability on financial executives and allow for more effective prosecutorial efforts. Part II of this Comment discusses the underlying causes of the 2008 financial crisis as well as the potentially criminal actions by banking executives that contributed to the burst of the housing bubble and the resulting economic collapse. This Part then examines the aftermath of the financial crisis—specifically, the apparent decision of the DOJ not to pursue criminal actions against large financial institutions and their chief executive officers. Finally, Part II describes the legislative response to the financial crisis—the Dodd-Frank Act<sup>15</sup>—which, like the Sarbanes-Oxley Act<sup>16</sup> before it, creates new federal crimes that the DOJ could use to prosecute individuals in the financial industry who use misleading and deceptive tactics for their own financial gain. Part III explains the potential impact of criminal sanctions on corporate executives and articulates the importance of effectively imposing criminal liability on these individuals, as it can obtain deterrence objectives that civil liability cannot. Part IV then examines specific criminal provisions of the Dodd-Frank Act and concludes that they will not be effective in imposing criminal liability on corporate executives; despite their appearances, these provisions do not substantively give the DOJ a new way to prosecute individual financial crimes, nor do they address the

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<sup>13</sup> Ben Hallman, *Too Big to Jail: Wall Street Executives Unlikely to Face Criminal Charges, Source Says*, HUFFINGTON POST (Sept. 8, 2012), [http://www.huffingtonpost.com/2012/09/08/criminal-charges-wall-street\\_n\\_1857926.html?view=screen](http://www.huffingtonpost.com/2012/09/08/criminal-charges-wall-street_n_1857926.html?view=screen); Peter J. Henning, *Is That It for Financial Crisis Cases?*, DEALBOOK (Aug. 13, 2012), <http://dealbook.nytimes.com/2012/08/13/is-that-it-for-financial-crisis-cases>.

<sup>14</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified as amended in scattered sections of 7 U.S.C., 12 U.S.C. and 15 U.S.C.).

<sup>15</sup> *Id.* at 1376 (“An Act [t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”).

<sup>16</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002) (“An Act [t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.”).

issues that the DOJ seems to be having in bringing such criminal actions. This Part then suggests how the government could improve the Dodd-Frank Act to better achieve deterrence objectives and allow the DOJ to more effectively prosecute individuals in the financial industry. Part V concludes.

## II. THE 2008 FINANCIAL CRISIS AND ITS AFTERMATH

### A. *The Causes of the Financial Crisis: Action and Inaction of Financial Executives*

Since late 2007, the United States has suffered through its worst economic downturn since the Great Depression.<sup>17</sup> Economic growth is slow,<sup>18</sup> unemployment rates are high,<sup>19</sup> and the housing market remains fragile.<sup>20</sup> In May 2009, Congress passed, and the President signed, the Fraud Enforcement and Recovery Act.<sup>21</sup> This Act established the Financial Crisis Inquiry Commission (“the Commission”), an independent panel of ten private citizens tasked with “examin[ing] the causes, domestic and global, of the current financial and economic crisis in the United States.”<sup>22</sup> In January 2011, after reviewing thousands of documents, interviewing over seven hundred witnesses, and holding nineteen public hearings in New York, Washington, D.C., and other communities affected by the financial crisis, the Commission published a comprehensive report detailing its findings.<sup>23</sup>

<sup>17</sup> Edward P. Lazear, *The Worst Economic Recovery in History*, WALL ST. J., Apr. 3, 2012, at A15, available at <http://online.wsj.com/article/SB10001424052702303816504577311470997904292.html>; Bob Willis, *U.S. Recession Worst Since Great Depression, Revised Data Show*, BLOOMBERG (Aug. 1, 2009), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aNivTjr852TI>.

<sup>18</sup> Annie Lowrey, *Last Quarter's Growth Is Revised Down Sharply*, N.Y. TIMES (Sept. 27, 2012), <http://www.nytimes.com/2012/09/28/business/economy/last-quarters-growth-is-revised-down-sharply.html>.

<sup>19</sup> Phil Izzo, *Good News! The Unemployment Rate Rose*, WALL ST. J. (Nov. 2, 2012, 8:58 AM), <http://blogs.wsj.com/economics/2012/11/02/good-news-the-unemployment-rate-rose>.

<sup>20</sup> Kasia Klimasinska & Betty Liu, *Housing-Market Recovery in U.S. Not 'Resounding,' Shiller Says*, BLOOMBERG (Nov. 6, 2012), <http://www.businessweek.com/news/2012-11-06/housing-market-recovery-in-u-dot-s-dot-not-resounding-shiller-says>.

<sup>21</sup> Fraud Enforcement and Recovery Act of 2009 (FERA), Pub. L. No. 111-21, 123 Stat. 1617 (“An Act [t]o improve enforcement of mortgage fraud, securities and commodities fraud, financial institution fraud, and other frauds . . . for the recovery of funds lost to these frauds, and for other purposes.”).

<sup>22</sup> *Id.* at § 5, 123 Stat. at 1625.

<sup>23</sup> FIN. CRISIS INQUIRY COMM’N, 978-0-16-087983-8, THE FINANCIAL CRISIS INQUIRY

First, the Commission concluded that the 2008 financial crisis was avoidable—"the result of human action and inaction."<sup>24</sup> Although many individuals on Wall Street claimed that this crisis could not be foreseen or averted, the Commission found that warning signs, or "red flags," were both abundant and largely ignored.<sup>25</sup> In the years leading up to the crisis, financial institutions were creating, buying, and selling mortgage securities that they knew, or at least should have known, were defective.<sup>26</sup> The spike in subprime mortgage lending and subsequent securitization<sup>27</sup> led to an unsustainable rise in housing prices and, correspondingly, a substantial increase in individual household debt; simultaneously, a vast expansion of the unregulated derivatives trading market served to exacerbate the problem.<sup>28</sup> Despite signs that these activities were posing a significant threat to the financial stability of the country, Wall Street institutions not only failed to take any mitigating actions, but continued to be active players in these risky markets.<sup>29</sup>

The Commission also found that another significant contributing factor to the crisis was the failure among financial institutions in the areas of corporate governance and risk

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REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, at xi–xii (2011), *available at* <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

<sup>24</sup> *Id.* at xvii.

<sup>25</sup> *Id.* at xvii–xviii.

<sup>26</sup> *Id.* at xx.

<sup>27</sup> Subprime mortgage lending refers to the practice of issuing "low-quality" mortgages, or mortgages issued to borrowers who lack "a quality credit history." Deckant, *supra* note 1, at 422. The subsequent securitization of these mortgages refers to their being "bundled together" and sold to investors as CDOs. *Id.* Unsurprisingly, in early 2007, many of these subprime mortgages began to default, causing the "bubble" of inflated home prices to collapse. *Id.*

<sup>28</sup> FIN. CRISIS INQUIRY COMM'N, *supra* note 23, at xx.

<sup>29</sup> *Id.* For example, in 2007, just as the crisis was beginning to come to light, Citigroup was criticized for being a major provider of loans used in leveraged buyouts. See *Citi Chief on Buyouts: 'We're Still Dancing'*, DEALBOOK (July 7, 2007), <http://dealbook.nytimes.com/2007/07/10/citi-chief-on-buyout-loans-were-still-dancing>; Joe Nocera, Op-Ed., *The Safest Bank*, N.Y. TIMES, June 16, 2012, at A23, *available at* <http://www.nytimes.com/2012/06/16/opinion/nocera-the-safest-bank.html>. Although initially lucrative, excessive lending of this kind was particularly risky because, in the case of a credit downturn, the bank would be unable to support the loans. *Id.* Former Citigroup Chief Executive Officer Charles Price, however, defended his bank's participation in this market by saying, "[a]s long as the music is playing, you've got to get up and dance[.]" *Citi Chief on Buyouts: 'We're Still Dancing'*, *supra*.

management.<sup>30</sup> Prior to 2007, the prevailing view was that regulating financial institutions would restrain innovation.<sup>31</sup> Without sufficient regulation, however, banks engaged in extremely reckless behavior, “taking on too much risk, with too little capital, and with too much dependence on short-term funding.”<sup>32</sup> In addition, executive compensation systems worked to further incentivize excessive risk-taking by rewarding executives for taking short-term risks, often by leveraging excessive shareholder funds, without sufficient regard for the long-term consequences.<sup>33</sup>

Another study recently found further support for the notion that inadequate regulatory oversight may foster a criminogenic environment.<sup>34</sup> A survey of five hundred “financial services professionals” across the United States and the United Kingdom revealed that twenty-four percent of respondent professionals believed, in order to be successful, they would need to engage in unethical or illegal conduct; twenty-six percent claimed they had firsthand knowledge of wrongdoing in the workplace; and sixteen percent said they would commit a crime if they knew they could get

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<sup>30</sup> FIN. CRISIS INQUIRY COMM’N, *supra* note 23, at xviii–xix.

<sup>31</sup> *Id.*

<sup>32</sup> *Id.* at xviii.

<sup>33</sup> *Id.* at xviii–xix. Specifically, some scholars argue that executive compensation packages focus solely on short-term profits, which enable executives to receive large cash amounts, equity-based compensation, and bonus compensation before the long-term consequences of their actions are realized. Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers’ Pay*, 98 GEO. L.J. 247, 249 (2010). These executives therefore have an incentive to focus on short-term results, without giving sufficient weight to the consequences that risk-taking may have on shareholder value in the long-term. *Id.* Further, these scholars argue that some executive compensation packages are “tied to highly levered bets on the value of the banks’ assets” and the structure of these compensation packages gives executives even less incentive to account for the “losses that risk-taking could impose on preferred shareholders, bondholders, depositors, and taxpayers.” *Id.* Not all scholars, however, agree that executive risk-taking was a driving factor in the financial crisis. See Andrea Beltratti & Rene M. Stulz, *Why Did Some Banks Perform Better During the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation* (Nat’l Bureau of Econ. Research, Working Paper No. 15180, 2009), available at <http://www.nber.org/papers/w15180.pdf> (arguing that banks with “more loans and more liquid assets” performed better than banks with “stronger capital supervision” during the financial crisis).

<sup>34</sup> *Financial Services Professionals Feel Unethical Behavior May Be a Necessary Evil and Have Knowledge of Workplace Misconduct, According to Labaton Sucharow Survey*, LABATON SUCHAROW (Feb. 20, 2014, 9:47 AM), <http://www.labaton.com/en/about/press/Labaton-Sucharow-announces-results-of-financial-services-professional-survey.cfm>.

away with it.<sup>35</sup> Furthermore, thirty-nine percent of respondents said they believed their competitors are likely to have engaged in illegal or unethical activity in order to be successful; thirty percent stated that their compensation or bonus plans create pressure to compromise ethical standards or violate the law; and twenty-three percent reported other pressures that may lead to unethical or illegal conduct.<sup>36</sup>

Finally, the Commission concluded that “there was a systemic breakdown in accountability and ethics.”<sup>37</sup> Mortgage fraud, for example, flourished during 2006–2007 as a result of low lending standards and lenient regulation.<sup>38</sup> Financial institutions were making loans that they knew borrowers would not be able to afford.<sup>39</sup> These banks then packaged the loans and sold them to investors, even though they knew that these loans did not “meet their own underwriting standards or those of the originators.”<sup>40</sup> Banks accomplished this scheme by disingenuously sampling the packages of loans that they were selling so that this information would remain undisclosed to potential investors.<sup>41</sup>

Eventually, the borrowers of the underlying mortgages began to default—the housing market bubble burst and owners of the mortgage-backed securities lost their investments.<sup>42</sup> Many of these

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<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> FIN. CRISIS INQUIRY COMM’N, *supra* note 23, at xxii.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.* For example, Richard Bowen, who served as senior vice president and chief underwriter for correspondent and acquisitions for Citigroup’s commercial lending group from 2002 to 2005, described in a recent interview how loans that were being considered for purchase from Citigroup would consistently be missing critical documents that would have been necessary to determine whether they met the bank’s credit policy guidelines (e.g., income documentation necessary to verify a loan applicant’s income to debt ratio). In sum, Mr. Bowen found that sixty percent of loans purchased either did not meet the bank’s standards or were missing too much information for the underwriters to make an adequate evaluation of their creditworthiness. Nevertheless, the decisions of the underwriters to turn down the purchase of such loans were reversed by “someone high up the chain of command, the chief risk officer of the Wall Street channel.” This resulted in an increase in the “execution percentage” of these pools and a subsequent purchase of them by Citigroup. Azmat Khan, *Blowing the Whistle on the Mortgage Bubble*, PBS (Jan. 22, 2013 9:44PM), <http://www.pbs.org/wgbh/pages/frontline/business-economy-financial-crisis/untouchables/blowing-the-whistle-on-the-mortgage-bubble>.

<sup>42</sup> Seema G. Sharma, *Over-the-Counter Derivatives: A New Era of Financial Regulation*, 17 L. & BUS. REV. AM. 279, 290–91 (2011).

investors, however, had purchased CDOs<sup>43</sup> to insure against these losses.<sup>44</sup> As a result, the magnitude of the impact that these defaults would ultimately have on the economy was not fully realized until it was revealed that many CDO issuers were not adequately capitalized to make good on their promises to compensate protected investors from losses.<sup>45</sup> This resulted in a domino effect of defaults and insolvency, shaking the foundation of many Wall Street firms and crippling the United States economy.<sup>46</sup>

*B. The Department of Justice's Response: No Criminal Prosecutions*

Since the publication of the Financial Crisis Inquiry Report, Phil Angelides, who served as chairman of the Commission, has repeatedly called upon the DOJ to pursue criminal investigations against Wall Street executives.<sup>47</sup> In these appeals, Chairman Angelides stressed the importance of focusing on criminal, rather than civil, wrongdoing because the latter fails to deter future crimes,<sup>48</sup> something which is especially true in light of the fact that “[c]laims of financial fraud against companies like Citigroup and Bank of America have been settled for pennies on the dollar, with no admission of wrongdoing.”<sup>49</sup> Chairman Angelides has further urged the federal government to devote more resources toward pursuing these investigations, stating that, as the situation stands, justice has not been served.<sup>50</sup> But despite the findings of the Commission and against the advisement of its chairman, the DOJ has failed to

<sup>43</sup> Collateralized debt obligations. See discussion *supra* note 1.

<sup>44</sup> Sharma, *supra* note 42, at 290.

<sup>45</sup> See *id.* at 290–91.

<sup>46</sup> See *id.*

<sup>47</sup> Phil Angelides, Op-Ed., *Will Wall Street Ever Face Justice?*, N.Y. TIMES, Mar. 1, 2012, at A25, available at [http://www.nytimes.com/2012/03/02/opinion/will-wall-street-ever-face-justice.html?\\_r=0](http://www.nytimes.com/2012/03/02/opinion/will-wall-street-ever-face-justice.html?_r=0); Phil Angelides, Op-Ed., *Renew Urgency on Wall Street Probe*, POLITICO (Sept. 4, 2012), <http://www.politico.com/news/stories/0912/80606.html>.

<sup>48</sup> Angelides, *Renew Urgency on Wall Street Probe*, *supra* note 47 (“Deterring future crimes can’t be accomplished simply through fines or negotiated financial settlements—which many banks regard as the cost of doing business. Senior executives need to know that if they violate the law, there will be real consequences.”).

<sup>49</sup> Angelides, *Will Wall Street Ever Face Justice?*, *supra* note 47.

<sup>50</sup> *Id.* (“No one should seek or condone prosecutions for revenge or political purposes. But laws need to be enforced to deter future malfeasance. Just as important, the American people need to believe that a thorough investigation has been conducted; that our judicial system has been fair to all, regardless of wealth and power; and that wrongs have been righted.”).

prosecute any top executive of a Wall Street institution in the years since the crisis.<sup>51</sup> Furthermore, as time passes, it becomes increasingly unlikely that any such prosecution will materialize.<sup>52</sup>

In the immediate aftermath of the crisis, the prospect of an aggressive response from federal law enforcement seemed promising. On June 19, 2008, the DOJ announced that the United States Attorney's Office for the Eastern District of New York had indicted Ralph Cioffi and Mathew Tannin, two senior managers of Bear Stearns, on counts of conspiracy, securities fraud, and wire fraud.<sup>53</sup> The indictments alleged that Cioffi and Tannin "marketed the two funds as a low risk strategy, backed by a pool of debt securities such as mortgages" and, even though they "believed the funds were in grave condition and at risk of collapse," they "made misrepresentations to stave off investor withdrawal."<sup>54</sup>

As the first major prosecution stemming from the financial crisis, many followed this case closely, as they believed it would set the scene for how future cases would unfold.<sup>55</sup> The prosecution, however, proved futile—a jury acquitted the managers in November 2009.<sup>56</sup> The government's case, which relied primarily on statements made

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<sup>51</sup> Boyer & Schweizer, *supra* note 10; Morgenson & Story, *supra* note 2; Peter Schweizer, *Obama's DOJ and Wall Street: Too Big For Jail?*, FORBES (May 7, 2012), <http://www.forbes.com/sites/realspin/2012/05/07/obamas-doj-and-wall-street-too-big-for-jail>.

<sup>52</sup> Generally, the statute of limitations for securities fraud and other federal offenses is five years from the commission of the alleged wrongdoing for civil actions, 28 U.S.C. § 1658(b)(2) (2006), and ten years from the commission of the alleged wrongdoing for a criminal offense. 18 U.S.C. § 3293(3) (2006). Time, therefore, is running out, especially for actions that occurred during the "bubble years" (i.e., the years prior to 2007 when excessive subprime mortgage lending and securitization caused the unsustainable spike in housing prices). *No Crime, No Punishment*, Editorial, N.Y. TIMES, Aug. 26, 2012, at SR10, available at <http://www.nytimes.com/2012/08/26/opinion/sunday/no-crime-no-punishment.html>; see Hallman, *supra* note 13; Henning, *supra* note 13; Wang, *supra* note 10.

<sup>53</sup> Press Release, U.S. Dept. of Justice, More Than 400 Defendants Charged for Roles in Mortgage Fraud Schemes as Part of Operation "Malicious Mortgage" (June 19, 2008), available at <http://www.justice.gov/opa/pr/2008/June/08-odag-551.html>.

<sup>54</sup> *Id.*

<sup>55</sup> Amir Efrati & Peter Lattman, *U.S. Loses Bear Fraud Case*, WALL ST. J. (Nov. 11, 2009), <http://online.wsj.com/article/SB125788421912541971.html>; *Ex-Bear Stearns Hedge Fund Managers Acquitted*, REUTERS (Nov. 10, 2009), <http://www.reuters.com/article/2009/11/10/bearstearns-managers-idUSN1032890420091110>; Zachery Kouwe, *Bear Stearns Managers Acquitted of Fraud Charges*, DEALBOOK (Nov. 10, 2009), <http://dealbook.nytimes.com/2009/11/10/2-ex-fund-managers-found-not-guilty-of-fraud>.

<sup>56</sup> Efrati & Lattman, *supra* note 55; Kouwe, *supra* note 55.

by the executives via email,<sup>57</sup> demonstrated the difficulty of proving guilt beyond a reasonable doubt in modern financial fraud cases.<sup>58</sup> Not only do these cases involve complex investment instruments that the government had little information on prior to the crisis,<sup>59</sup> but, within the framework of this unprecedented market failure, the distinction between executives' intentionally misleading statements and their "positive spin[s] on sagging returns" that just ultimately proved to be incorrect seems blurred.<sup>60</sup> Particularly in the Bear Stearns case, despite the government's best attempts to present Cioffi and Tannin's actions as a straightforward case of lying, the jury did not believe that the statements, once put into context, were sufficient to prove guilt beyond a reasonable doubt.<sup>61</sup> After the trial, one juror explained: "The entire market crashed . . . . You can't blame that on two people."<sup>62</sup>

Despite this setback, the federal government remained committed to its prosecutorial efforts. That same month, President Obama appointed United States Attorney General Eric Holder as chairman of the newly created Financial Fraud Enforcement Task Force.<sup>63</sup> At the time, Attorney General Holder stated that mission of the Task Force was to "hold accountable those who helped bring about the last financial meltdown" and "to prevent another meltdown from happening."<sup>64</sup> He further declared that "[w]e will be relentless in our investigation of corporate and financial wrongdoing, and will

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<sup>57</sup> The prosecution used email exchanges between Cioffi and Tannin in an attempt to prove that the two managers were personally aware of the true financial condition of the funds and lied to investors in order to keep them from withdrawing. Landon Thomas Jr., *2 Face Fraud Charges in Bear Stearns Debacle*, N.Y. TIMES, June 20, 2008, at A1, available at [http://www.nytimes.com/2008/06/20/business/20bear.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2008/06/20/business/20bear.html?pagewanted=all&_r=0) (online version titled, *Prosecutors Build Bear Stearns Case on E-Mails*). Excerpted portions of the emails include statements such as: "[The subprime market looks] pretty damn ugly"; "[W]e should close the funds now . . . . The entire subprime market [is] toast"; "I'm fearful of these markets"; and "Believe it or not—I've been able to convince people to add more money." *Id.*

<sup>58</sup> Kouwe, *supra* note 55.

<sup>59</sup> Morgenson & Story, *supra* note 2.

<sup>60</sup> Efrati & Lattman, *supra* note 55.

<sup>61</sup> *Bear Stearns Trial: How the Scapegoats Escaped*, DEALBOOK (Nov. 12, 2009), <http://dealbook.nytimes.com/2009/11/12/bear-stearns-trial-how-the-scapegoats-escaped>.

<sup>62</sup> *Id.*

<sup>63</sup> Schweizer, *supra* note 51.

<sup>64</sup> Ted Kaufman, *Why DOJ Deemed Bank Execs Too Big To Jail*, FORBES (July 29, 2013), <http://www.forbes.com/sites/tedkaufman/2013/07/29/why-doj-deemed-bank-execs-too-big-to-jail>.

not hesitate to bring charges, where appropriate, for criminal misconduct on the part of businesses and business executives.”<sup>65</sup>

But in the years since the formation of this task force, the DOJ still has not filed a single criminal charge against any major banking executive.<sup>66</sup> It dropped its most recent attempt at such a pursuit, an investigation into Goldman Sachs’s “Abacus” deal,<sup>67</sup> in August 2012.<sup>68</sup> Furthermore, this lack of prosecutions seems to be indicative of a more general trend. Financial fraud prosecutions, as a whole, are down thirty-nine percent since the accounting scandals of the early 2000s<sup>69</sup>—a time when the DOJ was much more aggressive in prosecuting not only financial fraud generally, but also high-level executives individually, for this type of fraud.<sup>70</sup>

For example, in October 2001, regulators discovered that Enron Corporation (“Enron”) had been misrepresenting its earnings and

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<sup>65</sup> *Id.*

<sup>66</sup> *Id.*; GOV’T ACCOUNTABILITY INST., JUSTICE INACTION: THE DEPARTMENT OF JUSTICE’S UNPRECEDENTED FAILURE TO PROSECUTE BIG FINANCE 4 (2012), available at <http://g-a-i.org/wp-content/uploads/2012/08/DOJ-Report-8-61.pdf> [hereinafter JUSTICE INACTION].

<sup>67</sup> In 2007, Goldman Sachs created a risky investment called Abacus 2007-AC1 at the request of a prominent client. Goldman Sachs then allowed the client to choose bonds to shape the investment instrument. Although Goldman Sachs and the client bet against the Abacus instrument, Goldman Sachs did not disclose this information or information about how the bonds were selected to its other clients who had invested in its success. These uninformed clients lost more than a billion dollars on the deal. As a result, the SEC charged Goldman Sachs with securities fraud, specifically for making materially misleading statements or omissions; the SEC simultaneously referred the case to the DOJ for criminal investigation. Boyer & Schweizer, *supra* note 10.

<sup>68</sup> The case with the SEC eventually settled, with Goldman Sachs maintaining no wrongdoing. Press Release, U.S. Sec. & Exch. Comm’n, Goldman Sachs to Pay Record \$550 Million to Settle SEC Charges Related to Subprime Mortgage CDO (July 15, 2010), available at <http://www.sec.gov/news/press/2010/2010-123.htm>. In the settlement papers, Goldman Sachs merely acknowledged that “the marketing materials for the ABACUS 2007-AC1 transaction contained incomplete information” and that “Goldman regrets that the marketing materials did not contain [the] disclosure.” *Id.* Robert Khuzami, Director of the SEC’s Division of Enforcement, noted that “[h]alf a billion dollars is the largest penalty ever assessed against a financial services firm in the history of the SEC” and “[t]his settlement is a stark lesson to Wall Street firms that no product is too complex, and no investor too sophisticated, to avoid a heavy price if a firm violates the fundamental principles of honest treatment and fair dealing.” *Id.* But, as some commentators have noted, for Goldman Sachs, this penalty is “a relative pittance.” Boyer & Schweizer, *supra* note 10. In fact, “[t]he fine amounted to about 4 percent of the sum that Goldman paid its executives in bonuses (\$12.1 billion) in 2007, the year of the Abacus transaction.” *Id.*

<sup>69</sup> JUSTICE INACTION, *supra* note 66, at 6.

<sup>70</sup> *Id.*

altering its balance sheets in order to make the company seem more profitable than it actually was.<sup>71</sup> Eventually, this behavior prompted Enron to declare bankruptcy.<sup>72</sup> Shortly afterward, the DOJ charged Enron Chief Executive Officers (CEOs) Kenneth Lay and Jeffrey Skilling with securities fraud, wire fraud, and conspiracy; both executives were found guilty on all counts.<sup>73</sup> The DOJ obtained similar guilty verdicts in criminal actions against Worldcom, Inc. (“Worldcom”) CEO Bernard Ebbers,<sup>74</sup> Tyco International Ltd. (“Tyco”) CEO Dennis Koslowski, and Tyco Chief Financial Officer (CFO) Mark Swartz.<sup>75</sup>

Various theories exist to explain why the DOJ is not more actively pursuing cases of financial fraud since the recent financial crisis. Some commentators suggest the lack of regulation that perpetuated the crisis has, in its aftermath, made it difficult to subsequently pursue those same behaviors that more adequate regulation could have prevented.<sup>76</sup> This is because, in the past, regulators who were specifically trained to understand and dissect complex financial matters were able to identify fraudulent practices early and, when necessary, refer cases to the DOJ for criminal prosecution. The data collected by these regulators was crucial to the DOJ’s efforts to build criminal cases.<sup>77</sup> No such information is available, however, for cases alleging fraud in connection with complex derivative securities, which were unregulated before the crisis.<sup>78</sup>

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<sup>71</sup> Marianne M. Jennings, *A Primer on Enron: Lessons From a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163, 262 n.35 (2003).

<sup>72</sup> *Id.* at 262, n.1

<sup>73</sup> Paul Davies & Kara Scannell, *Guilty Verdicts Provide ‘Red Meat’ To Prosecutors Chasing Companies*, WALL ST. J., May 26, 2006, at A1, available at <http://online.wsj.com/article/SB114860468837563784.html>.

<sup>74</sup> Bernard Ebbers was charged with, and found guilty of, securities fraud, conspiracy, and making false filings with securities regulators. He was alleged to have been using dishonest accounting practices to inflate Worldcom’s stock price. *Id.*

<sup>75</sup> Dennis Koslowski and Mark Swartz were charged with, and found guilty of, conspiracy, grand larceny, securities fraud, and falsifying business records after they were discovered stealing millions of dollars from Tyco. Walter Hamilton & Thomas S. Mulligan, *Ex-Chiefs Convicted of Looting Tyco*, L.A. TIMES, June 18, 2005, at A1, available at <http://articles.latimes.com/2005/jun/18/business/fi-tyco18>.

<sup>76</sup> Morgenson & Story, *supra* note 2.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.* (“[I]n 1995, bank regulators referred 1,837 cases to the Justice Department. In 2006, that number had fallen to 75. In the four subsequent years, a period encompassing the worst of the crisis, an average of only 72 a year have been referred for criminal prosecution.”).

Another possibility is that the element of mens rea, or intent, that prosecutors must prove in a criminal case imposes too high a burden. The DOJ proffered this explanation when it announced its decision not to prosecute Goldman Sachs.<sup>79</sup> It was also a reason why the DOJ was not successful in the Bear Stearns trial.<sup>80</sup> To prove fraud in federal cases, the prosecution must show that the defendant intended to make material misstatements or omissions,<sup>81</sup> and this intent must be established beyond a reasonable doubt.<sup>82</sup> This can be difficult in cases involving complex securities sold to sophisticated investors because investment banks tend to include voluminous, generic disclosure statements that they can later use to claim a lack of intent to deceive.<sup>83</sup> Moreover, in the context of the recent financial crisis and its “unprecedented market turmoil,” the question of whether financial executives were intentionally misleading their investors or merely “putting a positive spin” on the banks’ market performance is unclear.<sup>84</sup> Thus, banks can argue that “while certain statements by executives ultimately proved incorrect . . . they believed what they were saying.”<sup>85</sup>

Notwithstanding the merits of these theories, the sentiment among government officials, prosecutors, and commentators seems to support the notion that, although the individual conduct that led to the financial crisis was undoubtedly reprehensible, criminal accountability is not realistically attainable under current law.<sup>86</sup>

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<sup>79</sup> Reed Albergotti & Elizabeth Rappaport, *U.S. Not Seeking Goldman Charges*, WALL ST. J. (Aug. 9, 2012), <http://online.wsj.com/article/SB10000872396390443537404577579840698144490.html>; David Ingram, *Justice Department Will Not Prosecute Goldman Sachs, Employees for Abacus Deal*, REUTERS (Aug. 9, 2012), <http://www.reuters.com/article/2012/08/09/us-usa-goldman-no-charges-idUSBRE8781LA20120809>; Phil Mattingly, *U.S. Won't Prosecute Goldman Sachs, Employees Over CDO Deals*, BLOOMBERG (Aug. 10, 2012), <http://www.bloomberg.com/news/2012-08-09/justice-finds-no-viable-basis-for-charges-against-goldman.html>.

<sup>80</sup> Efrati & Lattman, *supra* note 55.

<sup>81</sup> 18 U.S.C. § 1348 (2012).

<sup>82</sup> *In re Winship*, 397 U.S. 358, 364 (1970) (“[T]he Due Process Clause protects the accused against conviction except upon *proof beyond a reasonable doubt* of every fact necessary to constitute the crime with which he is charged[.]”) (emphasis added); see also David Ingram & Aruna Viswanatha, *Goldman Sachs Will Not Face Criminal Charges: Justice Department*, HUFFINGTON POST (Aug. 9, 2012), [http://www.huffingtonpost.com/2012/08/09/goldman-sachs-justice-department\\_n\\_1762455.html](http://www.huffingtonpost.com/2012/08/09/goldman-sachs-justice-department_n_1762455.html); *No Crime, No Punishment*, *supra* note 52.

<sup>83</sup> Henning, *supra* note 13.

<sup>84</sup> Efrati & Lattman, *supra* note 55.

<sup>85</sup> *Id.*

<sup>86</sup> See JUSTICE INACTION, *supra* note 66, at 16 (quoting Attorney General Eric Holder: “[W]e found that much of the conduct that led to the financial crisis was

*C. The Congressional Response: The Dodd-Frank Act*

Legislators responded to the financial crisis by enacting the Dodd-Frank Act.<sup>87</sup> The stated purpose of the Dodd-Frank Act is to improve “accountability and transparency in the financial system.”<sup>88</sup> As a result, the Dodd-Frank Act’s primary function is to introduce various new reforms for regulating the financial industry, but it also creates some new federal crimes related to fraud and misrepresentations made by individuals engaging in derivatives trading, futures contracts, and swaps.<sup>89</sup> These provisions, largely found in Title VII of the Dodd-Frank Act, serve primarily to expand upon existing laws, such as the Commodity Exchange Act,<sup>90</sup> in order to include previously unregulated derivatives and security swap transactions.<sup>91</sup>

Specifically, there are two sections in the Dodd-Frank Act that address the use of deceptive devices, materially misleading statements or omissions, and fraud in financial transactions: Sections 741 and 747. Section 741 provides that it shall be a crime for a person to, in connection with making a future contract or swap of securities, “employ any device, scheme, or artifice to defraud”; “make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading”; or “engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.”<sup>92</sup> Section 747 states that it shall be a crime for a person who, while entering into a securities swap transaction,<sup>93</sup> knows or acts in reckless disregard

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unethical and irresponsible . . . we have also discovered that some of this behavior—while morally reprehensible—may not necessarily be criminal”); Peter Lattman, *U.S. Goldman Disclosure a Rare Break in Secrecy*, DEALBOOK (Aug. 10, 2012), <http://dealbook.nytimes.com/2012/08/10/justice-department-closes-investigation-of-goldman> (“[B]ased on the law and evidence as they exist at this time, there is not a viable basis to bring a criminal prosecution against Goldman Sachs.”); see also Mattingly, *supra* note 79 (quoting Senator Carl Levin: “Whether the decision by the Department of Justice is the product of weak laws or weak enforcement, Goldman Sachs’ actions were deceptive and immoral.”).

<sup>87</sup> Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> Commodity Exchange Act, 7 U.S.C. § 1 (2012).

<sup>91</sup> Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>92</sup> *Id.* at § 741, 124 Stat. at 1731.

<sup>93</sup> One example of a securities swap transaction is a credit default swap. In a

of the fact that “its counterparty will use the swap as part of a device, scheme, or artifice to defraud any third party.”<sup>94</sup>

The Dodd-Frank Act contains several other provisions that purport to be enforceable by criminal sanctions.<sup>95</sup> The scope of this Comment, however, is limited to evaluating whether the criminal provisions of the Dodd-Frank Act can facilitate the imposition of criminal liability on financial executives for fraud and misrepresentation. Therefore, the analysis that follows<sup>96</sup> will focus solely on those aforementioned provisions in Title VII, as they specifically relate to the making of false or misleading statements or omissions.

### III. INDIVIDUAL CRIMINAL LIABILITY FOR CORPORATE EXECUTIVES

#### A. *The Need for Personal Liability for Corporate Crimes*

The imposition of personal liability on corporate executives serves important deterrence objectives.<sup>97</sup> The threat of personal liability for misconduct can dissuade managers and directors from abusing their positions of power for personal gain.<sup>98</sup> It can also encourage these managers and directors to utilize their oversight authority to prevent other executives from engaging in self-serving misconduct.<sup>99</sup>

Furthermore, in the absence of personal liability, punishment would be levied against the corporation itself. A corporation,

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credit default swap, the investor of the security pays a premium to a counterparty (e.g., a third party which, by virtue of a contract, becomes vulnerable to financial risk). In exchange, the counterparty agrees to pay the investor a specified sum upon the occurrence of a “credit event.” An example of a triggering credit event would be a default in payments on the underlying asset. This exchange functions as a type of insurance against credit risk for the investor. Erik F. Gerding, *Code, Crash, and Open Source: The Outsourcing of Financial Regulation to Risk Models and the Global Financial Crisis*, 84 WASH. L. REV. 127, 160 (2009).

<sup>94</sup> Dodd-Frank Act § 747, 124 Stat. at 1675–76.

<sup>95</sup> See, e.g., *id.* at § 723, 124 Stat. at 1675–76 (making it a crime for any person to enter into a swap transaction without first submitting the swap for clearing to a registered derivatives clearing organization); *id.* at § 746, 124 Stat. at 1737 (addressing insider trading); *id.* at § 747, 124 Stat. at 1739 (making it a crime for one engaged in trading to “violat[e] bids or offers”; “demonstrate[e] intentional or reckless disregard for the orderly execution of transactions”; be involved in “spoofing (bidding or offering with the intent to cancel the bid or offer before execution)”).

<sup>96</sup> See *infra* Part IV.A.

<sup>97</sup> See Lisa L. Casey, *Twenty-Eight Words: Enforcing Corporate Fiduciary Duties Through Criminal Prosecution of Honest Services Fraud*, 35 DEL. J. CORP. L. 1, 17 (2010).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

however, is a fictional entity.<sup>100</sup> When it acts, it is acting through its agents.<sup>101</sup> Therefore, it is not the behavior of the corporation as an entity that needs to be punished and deterred, but rather the behavior of its agents (i.e., its managers and directors).<sup>102</sup> Sanctions against the corporation, which usually take the form of fines, do not serve this deterrence goal because they “harm innocent parties such as shareholders, consumers, and creditors, rather than guilty corporate agents.”<sup>103</sup>

*B. Civil Actions Do Not Effectively Impose Personal Liability on Corporate Executives*

Not everyone believes that personal liability via the criminal justice system is an appropriate mechanism for dealing with corporate misconduct.<sup>104</sup> High-profile criminal prosecutions of corporate officers can result in lengthy terms of incarceration for individuals with no prior criminal history.<sup>105</sup> Accordingly, some scholars argue that private actions in the civil realm, which impose monetary penalties, provide a more suitable solution.<sup>106</sup> The problem with such an approach, however, is that it fails to address whether the civil system is actually effective in responding to this kind of misbehavior.<sup>107</sup>

Under traditional notions of corporate law, directors and officers of corporations are largely insulated from personal liability.<sup>108</sup> First, plaintiffs often face significant procedural and substantive hurdles in the context of shareholder derivative suits,<sup>109</sup> which are suits brought on behalf of the corporation against executives alleged

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<sup>100</sup> Wilson Meeks, *Corporate and White-Collar Crime Enforcement: Should Regulation and Rehabilitation Spell an End to Corporate Criminal Liability?*, 40 COLUM. J.L. & SOC. PROBS. 77, 85 (2006).

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* (citing John C. Coffee, Jr., “No Soul to Damn: No Body to Kick”: An Unscandalized Inquiry into the Problem of Corporate Punishment, 79 MICH. L. REV. 386 (1981)).

<sup>103</sup> *Id.* at 86.

<sup>104</sup> Christine Hurt, *The Undercivilization of Corporate Law*, 33 J. CORP. L. 361, 364 (2008).

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.* at 380.

<sup>108</sup> Lisa M. Fairfax, *On the Sufficiency of Corporate Regulation As an Alternative to Corporate Criminal Liability*, 41 STETSON L. REV. 117, 118 (2011); Martin Petrin, *Circumscribing The “Prosecutor’s Ticket To Tag the Elite”—A Critique of the Responsible Corporate Officer Doctrine*, 84 TEMP. L. REV. 283, 303 (2012).

<sup>109</sup> Fairfax, *supra* note 108.

to have breached their fiduciary duties.<sup>110</sup> Procedurally, shareholders are limited in the claims they can bring as a result of the demand requirement,<sup>111</sup> which allows a corporation's Board of Directors to terminate a derivative suit before it reaches trial.<sup>112</sup> Substantively, if the demand requirement does not bar the claims, executives are still protected by the deferential business judgment rule.<sup>113</sup> Second, even in cases where the business judgment rule is inapplicable, because either the director is found to have acted in bad faith or the action is one brought by a third party, statutory and contract provisions may work to exculpate the director from personal liability.<sup>114</sup> Finally, assuming that an executive is found liable and the situation is such

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<sup>110</sup> Officers and directors of corporations, while acting in their capacity as managers, owe fiduciary duties to the corporation and its shareholders. *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985). These duties include the duty of care, the duty of loyalty, and the duty to act in good faith. If a director breaches any one of these duties, a shareholder of the corporation may bring a derivative action on behalf of the corporation to enforce the duty. John A. Pearce II & Ilya A. Lipin, *The Duties of Directors and Officers Within the Fuzzy Zone of Insolvency*, 19 AM. BANKR. INST. L. REV. 361, 370 (2011).

<sup>111</sup> Every jurisdiction requires a shareholder to "make a demand" (i.e., seek redress for his or her grievances) on the corporation's Board of Directors before the shareholder can bring a derivative suit against those directors. Carol B. Swanson, *Juggling Shareholder Rights and Strike Suits in Derivative Litigation: The ALI Drops the Ball*, 77 MINN. L. REV. 1339, 1349–50 (1993). Generally, a shareholder is only excused from making a demand if he or she can demonstrate that making the demand would be futile. *Id.* The purpose of this requirement is to give the corporation's board a chance to address the shareholder's complaints without litigation. *Id.* If the managers believe that the shareholder's claims have merit, they may choose to take corrective actions. *Id.* If the managers do not agree with the claims, however, they may refuse to take action and even seek early dismissal of a derivative suit related to such claims. *Id.*

<sup>112</sup> Fairfax, *supra* note 108.

<sup>113</sup> *Id.* The business judgment rule is a doctrine of corporate law that works to protect directors and officers from being held liable for breaching their fiduciary duty of care if the basis for the alleged breach can be framed as a "business decision." The business judgment rule is broad and protects against most claims brought against these individuals by shareholders on behalf of the corporation, unless it can be shown that the decision was based on "intentional or bad faith misconduct." Petrin, *supra* note 108, at 303–04.

<sup>114</sup> Fairfax, *supra* note 108. All states provide an indemnification statute within their corporate laws. Petrin, *supra* note 108, at 317. These statutes proscribe mandatory and permissive instances where employees of a corporation would be indemnified from liability. *Id.* In addition, many corporate officers and directors will have even broader indemnification rights as a result of the corporation's charter or by-laws. *Id.* It is very common for public corporations to agree to indemnify their managers and directors "to the fullest extent permitted by law." These indemnification agreements generally cover an executive's litigation expenses and attorneys' fees in addition to any amounts incurred as judgments, fines, or settlements. Casey, *supra* note 97, at 21–22.

that the corporation does not indemnify his or her actions, the corporation may still provide director and officer insurance that would most likely cover all payments that are owed by the defendant.<sup>115</sup>

In addition to the obstacles imposed by law, civil suits also suffer from practical hindrances. Private lawsuits do not provide an effective response to instances of “low-level fraud.”<sup>116</sup> This is because, for the average shareholder, it is often not economically feasible to take on the cost of litigation against the managers and directors of a corporation, especially if the alleged misconduct did not cause substantial diminution in the value of their shares.<sup>117</sup> Joining together and filing a collective action can also be difficult, especially in light of the aforementioned procedural and substantive hurdles associated with these suits.<sup>118</sup> SEC enforcement actions against individual executives are similarly sparse, and even when the agency does decide to bring a case, the penalties are often not significant.<sup>119</sup> Therefore, while directors who engage in misconduct face a *theoretical* financial risk, this risk does not, in practice, constitute a truly deterrent threat.<sup>120</sup>

Because civil liability is not well-equipped to deter individual executives from engaging in wrongful acts, it does not provide an adequate remedy for corporate misconduct.<sup>121</sup> Since the risk of detection and liability is small, managers who stand to gain from unlawful activity will view the possibility of being sanctioned as a mere cost of doing business.<sup>122</sup> In the same way that under-enforcement of petty street crimes can lead to “urban decay,” which in turn leads to the commission of more serious crimes, one scholar has paralleled

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<sup>115</sup> Casey, *supra* note 97, at 36; Petrin, *supra* note 108, at 320–21 (“Corporations may purchase insurance to protect their directors, officers, employees, or agents against personal liability arising out of ‘wrongful acts’ for which they are not indemnified. For instance, virtually all public companies purchase directors and officers (‘D&O’) insurance. Insurance can provide for broader protection than indemnification, as corporate law does not place any limitations on the permissible scope of D&O coverage.”); *see also* Fairfax, *supra* note 108 (“[P]rocedural and substantive rules, together with the trinity of D&O insurance, indemnification provisions, and exculpatory statutes, have combined to make outside directors’ risk of personal liability under corporate law virtually non-existent.”).

<sup>116</sup> Hurt, *supra* note 104, at 372.

<sup>117</sup> *Id.* at 381.

<sup>118</sup> *Id.*

<sup>119</sup> Fairfax, *supra* note 108, at 121.

<sup>120</sup> *Id.*

<sup>121</sup> Casey, *supra* note 97, at 85.

<sup>122</sup> *Id.*

the under-enforcement of “small-scale corporate fraud” as similarly leading to “an environment of renegade entrepreneurs who are not able to properly assess the probabilities of penalties for certain behaviors.”<sup>123</sup>

*C. Criminal Law Provides a Solution*

When applied in the corporate context, criminal law can effectively deter executive misconduct because it is not inhibited by the protections that executives enjoy in the civil realm.<sup>124</sup> Criminal actions brought by the government are not subject to the same procedural and substantive hurdles, such as the demand requirement and the business judgment rule, that typically bar private shareholder actions.<sup>125</sup> In addition, exculpatory charter provisions cannot exculpate a manager or director from personal criminal liability, and there are no statutory indemnifications for violation of criminal laws.<sup>126</sup> As a result, these officers can be held accountable under criminal law for certain behaviors which, under traditional notions of corporate law, would not result in personal liability.<sup>127</sup>

When laws are under-enforced, their ability to deter violations is minimal, regardless of the potential sanction. It is the certainty of punishment, not its severity, which can more effectively dissuade an individual from violating the law.<sup>128</sup> Because corporate law protections do not apply to criminal actions, the government has procedural and substantive advantages in bringing criminal cases that allow it to attain higher conviction rates and, therefore, greater deterrent effects.<sup>129</sup>

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<sup>123</sup> Hurt, *supra* note 104, at 373.

<sup>124</sup> See Petrin, *supra* note 108, at 304.

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*; see Casey, *supra* note 97, at 1.

<sup>128</sup> Raymond Paternoster, *How Much Do We Really Know About Criminal Deterrence?*, 100 J. CRIM. L. & CRIMINOLOGY 765, 778 (2010) (citing Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 178 (1968)) (“[T]he certainty of legal penalties are more important than their severity.”); see also Hurt, *supra* note 104, at 373. An example of this principle, in a more prosaic situation, is a car driving on a road where violation of the speed limit results in a \$100 fine. If police rarely patrol the road, drivers would most likely not be deterred from violating the speed limit. Even if the fine is raised to \$200, as long as the road remains unpatrolled, violations are likely to continue at comparable rates. But, if instead of increasing the fine, the police begin patrolling more frequently, drivers will be encouraged to slow down. The increased certainty of detection will have more of a deterrent effect than the increase in severity of a potential sanction.

<sup>129</sup> See Casey, *supra* note 97, at 44.

From a procedural standpoint, prosecutors have significant discretion in charging decisions.<sup>130</sup> Substantively, they have a wide range of crimes within the federal criminal code from which to choose these charges.<sup>131</sup> Grand juries also do not pose much of a hurdle in criminal prosecutions because they frequently cooperate with prosecutors and return requested indictments.<sup>132</sup> In addition, pleading standards are more favorable for prosecutors than they are for private plaintiffs. “Unlike shareholder plaintiffs, who must plead fraud with height-ened [sic] particularity in both state and federal court, prosecutors need only provide a plain, concise, and definite written statement of the essential facts constituting the offense charged.”<sup>133</sup> As a result, it is very uncommon for criminal actions to be dismissed on a motion by the defendant at the pleading stage.<sup>134</sup>

Criminal law is also capable of deterring wrongdoing because of its unique sociological impact. At least one scholar has argued that the aspect of “shaming” implicit in criminal sanctions can have an “effective influence” on the individual and, correspondingly, corporate behavior, especially when applied to “top-level corporate executives.”<sup>135</sup> These executives are all part of a common community that is comprised of very “status-conscious” individuals.<sup>136</sup> Exposing this population to criminal prosecution, which carries with it the potential for incarceration, can have damaging effects on their reputations, even when the exposure comes only in the form of a threat.<sup>137</sup> Studies have found that both the anticipation, as well as the experience, of this type of “shame” can substantially deter corporate crime<sup>138</sup> on both the general and specific level.<sup>139</sup>

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<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.* at 45 (citing FED. R. CRIM. P. 7(c)(1)) (quotations omitted).

<sup>134</sup> *Id.*

<sup>135</sup> Jayne W. Barnard, *Reintegrative Shaming in Corporate Sentencing*, 72 S. CAL. L. REV. 959, 966 (1999).

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 970–71.

<sup>138</sup> BRENT FISSE & JOHN BRAITHWAITE, *THE IMPACT OF PUBLICITY ON CORPORATE OFFENDERS* 12, 283–314 (1983) (finding that the negative impact of adverse publicity on offenders and their employees may be more effective than the threat of formal sanctions in controlling corporate crime); Barnard, *supra* note 135, at 970–71 (citing Raymond Paternoster & Sally Simpson, *Sanction Threats and Appeals to Morality: Testing a Rational Choice Model of Corporate Crime*, 30 L. & SOC'Y REV. 549, 572 (1996)) (stating that individuals' feelings of guilt and shame, and the threat of informal sanctions are “significant deterrents” to corporate crime); Lori A. Elis & Sally S. Simpson, *Informal Sanction Threats and Corporate Crime: Additive Versus Multiplicative Models*, 32 J. CRIME &

The increased certainty of personal liability combined with the stigma associated with criminal prosecutions provides criminal law with a unique and effective way of targeting corporate misconduct. Civil suits rarely hold private individuals accountable in the corporate context.<sup>140</sup> The barriers to personal liability, however, do not apply to violations of criminal law.<sup>141</sup> Criminal prosecutions can also result in extra-monetary sanctions and implications, which enhance their ability to deter wrongdoing.<sup>142</sup> The possibility that a corporate executive may be put in jail, or even placed at a personal financial risk, will affect his or her decision-making differently than will the possibility of a fine that will ultimately be paid by the corporation. Executives are unlikely to consider individual criminal liability to be a “cost of doing business”; therefore, the imposition of such liability could have strong deterrent implications not otherwise achievable through civil law.<sup>143</sup>

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DELINQ. 399, 410 (1995) (concluding that subjects’ perceptions that friends, family and business associates will lose respect for them if they participate in corporate crime significantly decrease the likelihood that they will do so); Harold G. Grasmick & Robert J. Bursik, Jr., *Conscience, Significant Others, and Rational Choice: Extending the Deterrence Model*, 24 LAW & SOC’Y REV. 837 (1990) (concluding that like state-imposed sanctions, self-imposed shame and socially-imposed embarrassment can also deter future criminal activity); Daniel S. Nagin & Raymond Paternoster, *Enduring Individual Differences and Rational Choice Theories of Crime*, 27 LAW & SOC’Y REV. 467, 485 (1993) (stating that anticipation of shame is negatively related to likelihood of committing certain crimes).

<sup>139</sup> Grasmick & Bursik, *supra* note 138. Specific deterrence refers to the ability of a sanction to deter the specific individual punished from committing additional crimes. General deterrence refers to the ability of a sanction to deter others who have not yet offended from ever committing crime. See Paternoster, *supra* note 128, at 766. In this context, specific deterrence would apply to the corporate executive subject to criminal prosecution while general deterrence would apply to those in the “broader business community.” Barnard, *supra* note 135, at 971.

<sup>140</sup> See discussion *supra* Part III.B.

<sup>141</sup> Petrin, *supra* note 108, at 304.

<sup>142</sup> Barnard, *supra* note 135, at 971 (“[E]ffective deterrence (at least of individuals) can also come from non-economic sources. Shaming is one such source.”).

<sup>143</sup> Angelides, *Renew Urgency on Wall Street Probe*, *supra* note 47 (“Deterring future crimes can’t be accomplished simply through fines or negotiated financial settlements—which many banks regard as the cost of doing business. Senior executives need to know that if they violate the law, there will be real consequences.”).

#### IV. IMPOSING CRIMINAL LIABILITY ON CORPORATE EXECUTIVES AFTER THE FINANCIAL CRISIS

##### A. *An Evaluation of the Criminal Provisions of the Dodd-Frank Act*

Although the Dodd-Frank Act adds new crimes to the already expansive federal crime repertoire, it does not substantively give the DOJ a new way to criminally target the dishonest conduct that was an underlying cause of the recent financial crisis.<sup>144</sup> In addition, the fraud provisions of the Dodd-Frank Act do not address the issues that have prevented the DOJ from bringing criminal indictments against the executives of financial institutions.<sup>145</sup> As a result, it is unlikely that prosecutors will be able to use these provisions of the Dodd-Frank Act to more successfully impose criminal liability on Wall Street executives.

First, the Section 741 fraud provisions of Title VII appear to duplicate what is already criminalized by the mail fraud<sup>146</sup> and wire fraud<sup>147</sup> statutes of the United States Code.<sup>148</sup> The mail and wire fraud statutes are incredibly broad.<sup>149</sup> Wire fraud, which is more applicable today as information is usually transmitted electronically rather than by mail, imposes criminal liability on anyone who:

... having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. *If the violation . . . affects a financial institution, such person shall be fined not more than \$1,000,000 or imprisoned not more than 30 years, or both.*<sup>150</sup>

Section 741, by contrast, imposes criminal liability for fraud only when it relates to entering a futures contract or to making a swap on

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<sup>144</sup> See *supra* Part II.A for a discussion of the causes of the recent financial crisis.

<sup>145</sup> See *supra* Part II.B for a discussion of the DOJ's reasons for not pursuing financial fraud charges against financial executives.

<sup>146</sup> 18 U.S.C. § 1341 (2006).

<sup>147</sup> *Id.* at § 1343.

<sup>148</sup> Juliane Balliro, *Criminal Provisions and Implications of the Dodd-Frank Act*, FOR THE DEFENSE 50, 53 (July 2011), [http://www.nelsonmullins.com/DocumentDepot/Balliro\\_DRI.pdf](http://www.nelsonmullins.com/DocumentDepot/Balliro_DRI.pdf).

<sup>149</sup> *Id.*

<sup>150</sup> 18 U.S.C. § 1343 (emphasis added).

a securities transaction.<sup>151</sup> These types of transactions, however, are necessarily covered by the language of the wire fraud statute. Futures contracts and securities transactions are made for the purpose of “obtaining money or property.”<sup>152</sup> In addition, the jurisdictional requirement that a representation be “transmitted by means of wire . . . in interstate or foreign commerce”<sup>153</sup> is not difficult to meet today, since electronic communication exists in almost every industry. As a result, Section 741 does not criminalize any new behavior apart from what can already be prosecuted as wire fraud.

Section 741, moreover, imposes less harsh criminal penalties than the wire fraud statute does. A defendant who is convicted under Section 741 faces a potential prison term of up to ten years.<sup>154</sup> Under the wire fraud statute, however, the same defendant faces a penalty of up to thirty years.<sup>155</sup> While an increase in severity of punishment does not necessarily lend itself to more effective deterrence,<sup>156</sup> this point emphasizes that Section 741 does not provide any new mechanism for prosecuting financial fraud.

Furthermore, Section 741 neither alters the criminal intent requirement for federal securities fraud cases, nor affects the burden of proof that prosecutors must meet to obtain a criminal conviction.<sup>157</sup> But this requirement of showing that defendants, beyond a reasonable doubt, intended to deceive their investors is exactly what the DOJ struggled to prove in the Bear Stearns trial.<sup>158</sup> Additionally, the DOJ expressly acknowledged that its inability to fulfill this requirement was an instrumental factor in its decision to drop its criminal investigation against Goldman Sachs.<sup>159</sup> Since Section 741 does not address the underlying issues that the DOJ has with respect to these criminal prosecutions, it is unlikely that Section 741 will alter the status quo by providing a more effective way for the

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<sup>151</sup> Dodd-Frank Act, Pub. L. No. 111-203, § 741, 124 Stat. 1376, 1731 (2010).

<sup>152</sup> 18 U.S.C. § 1343.

<sup>153</sup> *Id.*

<sup>154</sup> 7 U.S.C. § 13(a)(5) (2006); *see also* Balliro, *supra* note 148.

<sup>155</sup> 18 U.S.C. § 1343.

<sup>156</sup> See *supra* Part III.C for a discussion on how the certainty and severity of punishment impact deterrence.

<sup>157</sup> Prosecutors must prove each element of a charged crime beyond a reasonable doubt before a conviction can be obtained against a criminal defendant. This standard is a constitutional right guaranteed to all criminal defendants by the Due Process Clause. *In re Winship*, 397 U.S. 358, 364 (1970).

<sup>158</sup> See *supra* notes 57–62 and accompanying text.

<sup>159</sup> See Albergotti & Rappaport, *supra* note 79; Ingram, *supra* note 79; Mattingly, *supra* note 79.

government to criminally investigate and indict corporate banking executives.

Section 747, by contrast, facially addresses the issue of proving mens rea, as it allows for liability to be imposed when one acts with *reckless disregard* that counterparties to his or her swap transaction will use the swap to defraud.<sup>160</sup> But although Section 747 allows a less culpable state of mind on the part of defendants,<sup>161</sup> it does not address the fact that, for liability to be imposed, the primary offenders (i.e., the ones committing the fraud) still must have intent to deceive. This is because, in order to show that defendants were criminally reckless, meaning they consciously disregarded a substantial and unjustifiable risk,<sup>162</sup> with regard to whether the counterparties would commit fraud, there must be some evidence that the counterparties did, in fact, intend to commit fraud.<sup>163</sup> Even with the lower mens rea standard for secondary offenders, the DOJ will likely struggle in bringing these cases; the evidentiary difficulties that hinder investigations against primary offenders will similarly persist during investigations against secondary offenders. As a result, it is unlikely that Section 747 will be effective in increasing individual criminal accountability.

*B. A Comparison with the Sarbanes-Oxley Act*

The scarcity and inadequacy of the criminal provisions in the Dodd-Frank Act stand in stark contrast to the criminal penalties in the Sarbanes-Oxley Act.<sup>164</sup> The two statutes are similar in that they were both passed in an effort to curb dishonesty and to increase accountability in the financial world.<sup>165</sup> The Sarbanes-Oxley Act,

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<sup>160</sup> Dodd-Frank Act, Pub. L. No. 111-203, § 747, 124 Stat. 1376, 1739 (2010).

<sup>161</sup> Criminal recklessness is a less culpable state of mind than both criminal intent and criminal knowledge. Compare MODEL PENAL CODE §§ 1.13(14), 2.02(2)(c) (2012) (defining recklessly), with MODEL PENAL CODE §§ 1.13(13), 2.02(2)(b) (2012) (defining knowingly).

<sup>162</sup> MODEL PENAL CODE § 2.02(2)(c).

<sup>163</sup> If there were no evidence that the counterparties (i.e., the primary offenders) intended to commit fraud, then under Section 747, defendants (i.e., the secondary offenders) could not be shown to have consciously disregarded a substantial and unjustifiable risk that the counterparties would, in fact, commit fraud.

<sup>164</sup> Compare Dodd-Frank Act, 124 Stat. 1376, with Sarbanes-Oxley Act, Pub. L. No. 107-204, 116 Stat. 745 (2002).

<sup>165</sup> Dodd-Frank Act, 124 Stat. at 1376 (“An Act [t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”); Sarbanes-Oxley Act, 116 Stat. at 745 (“An Act [t]o protect investors by

however, contains a myriad of certification provisions that are enforceable by criminal penalties.<sup>166</sup> For example, the Sarbanes-Oxley Act explicitly provides that a CEO or CFO can go to prison for “falsely certifying corporate financial reports and reports on internal controls[.]”<sup>167</sup> These provisions were a direct response to the Enron/WorldCom/Tyco accounting scandals<sup>168</sup> in the same way that the Dodd-Frank Act was a response to the recent financial crisis.<sup>169</sup>

In the years since Congress enacted the Sarbanes-Oxley Act, few, if any, individual criminal prosecutions have been brought as a result of it.<sup>170</sup> Some critics cite this as a failure of the Act to hold financial executives accountable.<sup>171</sup> What such criticism fails to recognize, however, is that even without being utilized as a prosecutorial tool, Sarbanes-Oxley has had a resounding effect on the behavior of corporate executives.<sup>172</sup>

After Congress passed the Sarbanes-Oxley Act, many corporations began to require multiple layers of sub-certification, which mandate that numerous lower-level officials “attest to the accuracy of financial reports” before such reports reach the CEO or CFO.<sup>173</sup> The threat of personal and criminal liability for false or materially misleading financial reports leads many CEOs to refuse to sign a report unless it is certified by a lower-level executive.<sup>174</sup> In fact, one survey of corporate leaders found that, on average, between twenty-two and twenty-three executives submit a sub-certification for a report before it is signed by the CEO or CFO.<sup>175</sup>

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improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.”).

<sup>166</sup> Sarbanes-Oxley Act, 116 Stat. 745.

<sup>167</sup> Alison Frankel, *Sarbanes-Oxley's Lost Promise*, REUTERS (July 27, 2012), <http://www.reuters.com/article/2012/07/27/us-financial-sarbox-idUSBRE86Q1BY20120727>.

<sup>168</sup> Kathleen A. Lacey, Barbara Crutchfield George & Clyde Stoltenberg, *Assessing the Deterrent Effect of the Sarbanes-Oxley Act's Certification Provisions: A Comparative Analysis Using the Foreign Corrupt Practices Act*, 38 VAND. J. TRANSNAT'L L. 397, 401–03 (2005).

<sup>169</sup> See *supra* Part II.C.

<sup>170</sup> Frankel, *supra* note 167; Wang, *supra* note 10.

<sup>171</sup> Daniel V. Dooley, Sr. & Mark Radke, *Does Severe Punishment Deter Financial Crimes?*, 4 CHARLESTON L. REV. 619, 620–21 (2010).

<sup>172</sup> Frankel, *supra* note 167.

<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> Jo Lynne Koehn & Stephen C. DelVecchio, *Revisiting the Ripple Effects of the Sarbanes-Oxley Act*, 76 C.P.A. J. 32 (May 2006), available at <http://www.nysscpa.org/printversions/cpaj/2006/506/p32.htm>.

The practical effect of this change is that corporations had to become more vigilant in their financial reporting procedures at all levels.<sup>176</sup> In this way, increased personal accountability for false or materially misleading financial statements deters fraudulent reporting, and as a result, “there have been few accounting scandals at major public corporations since Sarbanes-Oxley took effect.”<sup>177</sup>

Further, the fact that Congress passed the Sarbanes-Oxley Act during a time when the federal government was comparatively much more aggressive in prosecuting financial fraud<sup>178</sup> likely amplifies its effectiveness with regard to deterrence. The criminal convictions of financial CEOs such as Enron’s Kenneth Lay and Jeffrey Skilling send a message to the corporate world that the government will not tolerate this type of ethical misconduct. Combined with Sarbanes-Oxley’s creation of new targeted federal crimes, the perceived probability of an individual financial executive being held criminally liable for false or misleading financial statements is greatly increased. This consequence, in turn, allows for a much greater deterrent effect.

*C. A Proposal to More Effectively Impose Criminal Liability*

In the way that legislators specifically drafted the Sarbanes-Oxley Act to hold individual financial executives accountable for the conduct underlying the accounting scandals of the early 2000s, this Comment proposes that the Dodd-Frank Act would be a more valuable tool in deterring and prosecuting the conduct underlying the recent financial crisis if it contained more substantive criminal provisions that directly target financial executives.

For example, the Dodd-Frank Act could include provisions similar to the certification provisions of the Sarbanes-Oxley Act, imposing requirements on high-ranking corporate officials that are enforceable through criminal penalties. This could entail requiring high-level executives, such as CEOs and/or CFOs, to submit quarterly statements certifying that they have reviewed both the internal risk-management controls of the institution and the investor disclosures and have independently determined that both are adequate and non-misleading.

Additionally, the Dodd-Frank Act could impose disclosure requirements on any senior-level executive who decides to override

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<sup>176</sup> Frankel, *supra* note 167.

<sup>177</sup> *Id.*

<sup>178</sup> See *supra* notes 69–75 and accompanying text for a discussion of the Enron/Worldcom/Tyco prosecutions.

an underwriter's decision to not purchase and securitize a particular bundle of loans because the loans in the bundle do not meet the institution's underwriting standards. Namely, the executive could be mandated to issue a statement outlining the reasons behind the decision and why he or she believes that the risks associated with the investment should be overlooked. This requirement would impose a greater degree of individual accountability on senior-level executives for excessive risk-taking and encourage more *ex ante* consideration of consequences.

In addition, creating more targeted crimes would allow the DOJ to bring more narrowly tailored cases against individuals, which may help the DOJ in proving intent beyond a reasonable doubt to a jury. The DOJ cited an inability to prove *mens rea* as the key issue that forestalled its prosecution of the Bear Stearns managers for fraud in 2009.<sup>179</sup> The government tried to frame the case as one of straightforward lying, but the jury did not believe the situation to be so simple.<sup>180</sup> The ability to utilize a statute that more directly addresses the type of behavior at issue—making misleading, and even false, statements to investors regarding the risks of their investments—would increase the government's chances of convincing a jury of criminal intent.

This is because the criminality of the conduct would no longer be at issue. When the DOJ charged the Bear Stearns managers with fraud, it had to prove to the jury not only that the managers intentionally misled investors, but also that the *act* of misleading investors was an instance of criminal fraud, rather than a “permissible spin” of the facts.<sup>181</sup> If, however, statutory support had been available for the government to assert that misleading investors is a criminal act, then the government would only have needed to prove the first issue to the jury: that the individuals intended their statements to be misleading. The confusion that exists as to whether or not this type of misrepresentation should be criminally punished would dissipate.

Furthermore, this alternative would be more desirable than lowering the *mens rea* standard for criminal fraud to recklessness or gross negligence, as doing so could have potentially catastrophic consequences on the financial industry. Risk-taking is an inherent part of participation in financial markets, and criminal laws should not be aimed at constraining opportunistic behavior. Rather, it is

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<sup>179</sup> Efrati & Lattman, *supra* note 55; Kouwe, *supra* note 55.

<sup>180</sup> See *supra* notes 57-62 and accompanying text.

<sup>181</sup> Thomas, *supra* note 57.

only when one crosses the line and employs deceptive techniques to gain a tactical advantage within the market or to make excessive profits at the expense of others that the criminal law must intervene.

Finally, this is not to say that the Dodd-Frank Act, as currently enacted, holds no potential to facilitate the prosecution of financial fraud. The recent financial crisis was different from those of the past in that the allegedly fraudulent behavior took place on a secondary derivatives market which, prior to the Dodd-Frank Act, was virtually unregulated.<sup>182</sup> In past crises, the government brought successful criminal actions against individuals in part because regulators had the ability to refer such claims to prosecutors.<sup>183</sup> The lack of regulation, therefore, not only made the perpetration of fraud more feasible in the years leading up to the crisis, but also made fraud more difficult to pursue in the aftermath.<sup>184</sup> By increasing regulation in the world of derivative transactions and other swaps of complex securities, the Dodd-Frank Act will better equip the government to build criminal cases in the future, should the need arise.

#### V. CONCLUSION

In the years since the 2008 financial crisis, public criticism over the lack of criminal prosecutions against individual financial executives persists. There remains a lingering sense of injustice over the fact that those individuals largely responsible for the economic collapse have not been held accountable for their actions. Though this retributivist function of criminal punishment is not insignificant, this Comment argues that it is the utilitarian function of criminal liability—the goal of attaining deterrent effects—which must be emphasized going forward.

The imposition of criminal liability can deter financial executives and, correspondingly, financial institutions from defrauding their investors in a way that civil enforcement actions cannot. But to achieve this deterrence, wrongdoers must perceive criminal prosecution for such financial fraud to be likely. As long as the DOJ continues to have difficulty in bringing criminal charges in this area, the full potential of criminal law to deter corporate executive misconduct will not be realized.

As currently enacted, the criminal provisions of the Dodd-Frank

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<sup>182</sup> See Morgenson & Story, *supra* note 2.

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

Act will not effectively enable the DOJ in criminally prosecuting financial executives for their roles in bringing about the recent financial crisis because the provisions do not address the issues that have hindered these prosecutions in the past. This Comment therefore proposes alternative criminal provisions that would be better suited to address these impediments. By adopting these measures, the government could more successfully hold the individuals responsible for the financial crisis accountable and deter others from engaging in similarly self-serving misconduct. Moreover, even if not heavily utilized, the presence of strong, targeted criminal penalties in the Act could still serve a valuable deterrent function and prevent a similar crisis from arising again.