

The Impact on Shareholders and Other Constituents

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CHRISTINE HURT*

CRIMINALIZATION OF CORPORATE LAW The Impact on Shareholders and Other Constituents

WELL, AS WE CLOSED BEFORE LUNCH DAVID [SKEEL, JR.] asked, “why do we care about the shareholders?” I want to go back to that, even though I understand that caring about the retail investor is not very trendy. One of the things that I have been thinking about is that yes, we have had this “over-criminalization” and, for want of a better word, we have had an “under-civilization” of the corporate law.

We have mentioned the SEC’s civil investigation authority but I want to talk more about private civil remedies. I think that we all acknowledge that it is very, very hard for an investor to recoup losses. Now, we can talk about whether those losses were proximately caused by the corporate misconduct, but if we put that aside for a second, if we assume that there was an investor and the investor does have a loss, and that loss was directly caused by some bad action, it is almost impossible to believe that that shareholder will ever be made one hundred percent whole. Right? So at the same time that we have increased this criminal liability, we have made it almost certain that the retail investor will not be made whole. In the street crime or the non-white-collar crime world, there has been a sort of resurgence in victim rights and the focus on the victim, so the irony of the “under-civilization” of corporate law seemed a little interesting to me.

Also, if you consider other criminal law cases, if you had a parallel case, a criminal case for murder and a civil case for wrongful death, it would be easier theoretically to win the wrongful death case than to win the criminal case because of the burdens of proof and the rules of evidence. However, it is almost flipped in the corporate crime arena. Well, it is flipped, right? In corporate law you can have the same sets of facts and it will be much easier to get a criminal conviction than a civil judgment or settlement. One example that puts this irony in stark relief is the global settlement on analyst conflicts. Over three years ago, we had the global settlement on analyst conflicts where the ten biggest banks on Wall Street paid this ungodly sum of money in fines, penalties, and restitution to the DOJ and the SEC for publishing analyst research that may have been biased because of conflicts with

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investment banking clients that the analysts were covering.¹ And the settlement was fairly quick, but some of that money was supposed to be used for restitution.² Apparently, that may or may not have happened yet, but investors at best would have gotten basically pennies on a dollar. Another chunk was to be used for investor education, how ever useful that would be, and that did not really happen either.

And under the same set of facts, investors have fared horrendously in their civil lawsuits under the same set of facts. For example, if investors wanted to sue the analyst's firm they had to be a client of the analyst's firm, but then they could not sue but only participate in NASD arbitration because they had signed an arbitration agreement as a client of the firm.³

And so we had this case a couple of weeks ago where Mr. Sturm, whom the University of Denver is named after, had lost almost one billion dollars because Jack Grubman told him on the phone, "Don't sell that WorldCom stock, hold onto that, it is a strong hold, it is a strong buy."⁴ Now, Jack Grubman is barred from the securities industry by the DOJ and the SEC for hawking the stock of his firm's investment banking clients,⁵ like WorldCom, but poor Mr. Sturm cannot get his billion dollars back in NASD arbitration.⁶ So, that is the controversial thing I just wanted to lay out on the table, the "under-civilization" of criminal law.

1. Joint Press Release, U.S. Sec. & Exch. Comm'n., N.Y. Attorney Gen., N. Am. Sec. Adm'rs. Assoc., N.A.S.D., and N.Y. Stock Exch., Ten of Nation's Top Ten Investment Firms Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking (Apr. 28, 2003), available at <http://www.sec.gov/news/press/2003-54.htm>.

2. *Id.* at 2, 4-5.

3. See *Essex Corp. v. Indep. Fin. Mktg. Grp., Inc.*, 944 F. Supp. 532, 535 (1996) ("The arbitrability of this dispute turns on whether the relevant NASD requirements have been satisfied. Those requirements are found in Rule 10101 of the NASD Code of Arbitration Procedure. . . [which] sets forth the 'matters eligible for submission' to arbitration. First, only disputes between or among members, associated persons or certain 'others' may be arbitrated. Second, a party can arbitrate only those issues either 'arising out of or in conjunction with the business of any member of the Association'. . . . If both NASD Code requirements are satisfied, the Court must compel arbitration.")

4. See *Donald L. Sturm v. Jack Grubman, & Citigroup, Inc.*, NASD Arbitration No. 03-07612 (consolidated with 03-07644) (Nov. 29, 2005) (Celand, Davis and Drennen, Arbs.) at 3 ("Claimants alleged that they relied exclusively on Jack Grubman's advice relating to WorldCom, but that Grubman and Citigroup made misrepresentations and omissions, and breached their contractual, legal and fiduciary duties in an effort to induce Claimants to hold their WorldCom stock in stead of selling it. Claimant's alleged that Grubman touted WorldCom's value and vigorously encouraged investors to buy the purported undervalued stock, despite Grubman's knowledge that market conditions within the telecommunications industry had deteriorated WorldCom's financial situation, the price at which WorldCom stock was trading was inflated, and the WorldCom was not a prudent investment for the Claimants.")

5. *Id.* at 4-5.

6. Joint Press Release, U.S. Sec. & Exch. Comm'n., N.Y. Attorney Gen., N.A.S.D., and N.Y. Stock Exch., The Securities and Exchange Commission, New York Attorney General's Office, NASD, and the New York Stock Exchange Permanently Bar Jack Grubman and Require \$15 Million Payment (Apr. 28, 2003), available at <http://www.sec.gov/news/press/2003-55.htm>.