

## The Impact of Criminal Sanctions on Corporate Misconduct

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DONNA M. NAGY\*

## CRIMINALIZATION OF CORPORATE LAW

### The Impact of Criminal Sanctions on Corporate Misconduct

I WHOLEHEARTEDLY SHARE THE CONCERNS RAISED BY OTHERS at this table about the often blurry line separating legal from illegal corporate conduct, as well as their concerns about the risk of over-deterrence. I would like to introduce into the discussion three additional types of blurry lines affecting corporate conduct.

The first is the increasingly blurry line between civil penalties and criminal sanctions. The second is the uncertain line between criminal and civil investigations. And the third is the very murky line between public actors and private actors, a subject which I have written in connection with the constitutional status of the Public Company Accounting Oversight Board.<sup>1</sup> These blurry lines are worthy of our attention and discussion because they have serious ramifications for corporate entities as well as their executives and employees.

Let me begin with the distinction between civil monetary penalties and criminal sanctions. The Securities and Exchange Commission's ability to seek monetary penalties for violations of the federal securities laws is certainly a substantial weapon in its enforcement arsenal, but it is also a relatively recent one.

For the first 50 years as an agency, when the SEC initiated enforcement actions against corporate defendants, the principal remedies available to the agency were court-ordered injunctions and disgorgement.<sup>2</sup> In 1984, Congress gave the SEC the ability to seek penalties in insider trading cases.<sup>3</sup> In 1990, however, as part of the Securities Enforcement Remedies and Penny Stock Reform Act,<sup>4</sup> Congress substantially expanded the SEC's authority to seek civil monetary penalties to reach virtually any person who has violated virtually any provision of the federal securities laws.<sup>5</sup> Over the last 16 years, the penalties collected by the SEC have been increasing

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1. Donna M. Nagy, *Playing Peekaboo with Constitutional Law: The PCAOB and its Public/Private Status*, 80 NOTRE DAME L. REV. 975 (2005).

2. See, e.g., *Sec. & Exch. Comm'n v. First City Fin. Corp.*, 890 F.2d 1215, 1228 (D.C. Cir. 1989).

3. *Insider Trading Sanctions Act*, Pub. L. No. 98-376, 98 Stat. 1264 (Aug. 12, 1984) (codified at 15 U.S.C. § 78u-1).

4. *Securities Enforcement Remedies & Penny Stock Reform Act of 1990*, Pub. L. No. 101-429, 104 Stat. 931 (Oct. 15, 1990).

5. See *id.* (codified at 15 U.S.C. § 77t(d)).

steadily, both in size and frequency.<sup>6</sup> Indeed, it is not at all uncommon today to see SEC settlements in which companies have agreed to pay penalties of more than a hundred million dollars.<sup>7</sup>

SEC enforcement thus often takes on a highly punitive role, even though punishment is an objective supposedly reserved for the criminal justice system. As others have noted, there are fundamental differences between criminal prosecutions and civil enforcement proceedings, including the government's burden of proof—"beyond a reasonable doubt" versus "preponderance of the evidence"—and other constitutional and procedural safeguards.<sup>8</sup> Accordingly, when punishment is the principal objective behind a governmental proceeding, the prosecution should occur in the criminal justice system. The principal focus of an SEC proceeding should be forward-looking. That is, the SEC should seek to ensure that unlawful conduct does not continue in the future, that securities law violators do not profit from their illegal activities, and that other actors are deterred from engaging in similar misconduct. Drawing the line between what constitutes effective deterrence and what constitutes punishment is exceedingly difficult, but government officials must bear in mind these differing objectives.

This leads me to my second point concerning parallel SEC investigations and criminal investigations. In his keynote address, David stated that he could not recall a securities fraud case on which he had worked as an Assistant U.S. Attorney without a parallel SEC investigation.<sup>9</sup> He also emphasized the frequent cooperation and close contact between attorneys from the SEC and the Department of Justice. Provided parallel investigations are truly operating on a parallel course, parties under investigation will be accorded the requisite process that is due. But, "parallel" investigations often inappropriately intersect, when government attorneys have engaged in conduct found to be egregious, we have seen indictments dismissed and evidence excluded from trial.<sup>10</sup> Attorneys from both the SEC and the DOJ could undoubtedly benefit from clearer policies regarding parallel investigations. Indeed, when attorneys from the SEC are actively assisting DOJ attorneys with an ongoing

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6. See SEC Commissioner Paul S. Atkins, *Remarks Before the U.S. Chamber Institute for Legal Reform*, Feb. 16, 2006 (observing that "multi-million dollar SEC settlements have become almost commonplace over the last few years"), available at <http://www.sec.gov/news/speech/spch021606psa.htm>; see also Deborah Solomon, *As Corporate Fines Grow, SEC Debates How Much Good They Do*, WALL ST. J., Nov. 12, 2004, at A1 (stating that "[o]verall penalties have soared").

7. See William R. McLucas et al., *The Decline of the Attorney-Client Privilege in the Corporate Setting*, 96 J. CRIM. L. & CRIMINOLOGY 621, 627 (2006) (stating that "[t]he SEC has imposed enormous penalties in the years since Enron, including a \$750 million penalty against WorldCom, \$250 million penalty against Qwest, \$100 million penalty against Bristol-Myers Squibb Company, and \$100 million penalty against Alliance Capital").

8. Mary M. Cheh, *Constitutional Limits on Using Civil Remedies to Achieve Crucial Law Objectives: Understanding and Transcending the Criminal-Civil Law Distinction*, 42 HASTINGS L.J. 1325, 1389 (1991); Kenneth Mann, *Punitive Civil Sanctions: The Middleground Between Criminal and Civil Law*, 101 YALE L.J. 1795 (1992).

9. David Anders, *Criminalization of Corporate Law*, 2 J. Bus. & Tech. L. \_\_ (2007).

10. See *U.S. v. Stringer*, 408 F. Supp. 1083 (D. Or. 2006); *United States v. Scruschy*, 366 F. Supp. 2d 1134 (N.D. Ala. 2005).

criminal investigation, a strong argument can be made that the SEC should inform counsel for the person under investigation before that person testifies or produces documents.

My third point concerns the blurry line between public actors and private actors. To be sure, there is much scholarship written on the so-called public/private dichotomy, and scholars argue that it makes very little sense, particularly in an enforcement or regulatory context, to talk about action that is “purely” government or “purely” private.<sup>11</sup> The irony, though, is that constitutional law, and most particularly the so-called “state action” doctrine, demands that we classify entities precisely on that basis.<sup>12</sup>

Consider this one example. Persons who are called to testify in an investigation by the SEC or a U.S. Attorney have a Fifth Amendment right to refuse to testify.<sup>13</sup> If the NASD is the entity taking the testimony, however, this constitutional privilege against self-incrimination has been held inapplicable because the NASD is a private entity.<sup>14</sup> Yet, as we have discussed previously, there is substantial cooperation among the various securities regulators—the SEC, NYSE, NASD, and DOJ. Thus, it is not always possible to put those regulators back into their respective private and public boxes.

We have seen this very fact pattern in the Frank Quattrone matter, which involved the NASD’s decision to bar him for life from the securities industry for his failure to testify in an NASD investigation.<sup>15</sup> The SEC very recently reversed that bar order.<sup>16</sup> Although not conceding that state action was involved in the NASD’s demand for testimony, the SEC did acknowledge that Quattrone should have been given the opportunity to introduce evidence supporting his contention that the NASD’s participation in a joint investigation by the SEC, NASD, and the NYSE amounted to “state action” under the Constitution.<sup>17</sup>

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11. See Nagy, *supra* note 1, at 1029–31; see also Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. Rev. 543, 547 (2000); Gillian E. Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367, 1369 (2003).

12. See Freeman, *supra* note 11, at 579 (contending that “state action doctrine demands that we demarcate the public from the private, a task that proves ever more difficult and unrealistic in the face of public/private interdependence”); Metzger, *supra* note 11, at 1371 (contending that “constitutional law’s current approach to privatization is fundamentally inadequate in an era of increasingly privatized government” and that “much of this inadequacy results from current doctrine’s failure to appreciate how privatization can delegate government power to private hands”).

13. See *Bellis v. United States*, 417 U.S. 85, 87 (1974).

14. See, e.g., *United States v. Shvarts*, 90 F. Supp. 2d 219, 222 (E.D.N.Y. 2006) (“[i]t is . . . beyond cavil that questions put to the defendants by the NASD in carrying out its own legitimate investigative purposes do not activate the privilege against self-incrimination”).

15. See Randall Smith, *SEC Overturns Lifetime Ban on Quattrone by NASD*, WALL ST. J., Mar. 25, 2006, at A3.

16. *In re Frank P. Quattrone*, Exchange Act Release No. 53,547 (Mar. 24, 2006), available at <http://www.sec.gov/litigation/opinions/34-53547.pdf>.

17. *Id.*

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My time is up so I will conclude by saying that when talking about blurry lines, the three lines I have identified should be included in the discussion as well.