What is a Business Crime?

Richard A. Booth

Follow this and additional works at: http://digitalcommons.law.umaryland.edu/jbtl

Part of the Business Organizations Law Commons, and the Criminal Law Commons

Recommended Citation
Available at: http://digitalcommons.law.umaryland.edu/jbtl/vol3/iss1/9

This Article is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Journal of Business & Technology Law by an authorized editor of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.
What Is a Business Crime?

Why do we decide to criminalize some offenses while other offenses are left to lesser remedies? The answer should be simple: we should criminalize actions only when less drastic sanctions do not deter those actions. The principle that criminalization should be the last resort may not need further explanation. It seems obvious that it is more efficient to rely on private remedies when they work. Why use public resources to prosecute and punish offenses that private litigants can handle? Moreover, in a civil action the point is to make whole the victim of the offense. In a criminal action, compensation is at best an afterthought (and at worst a distraction). Finally, it is more consistent with a government of limited powers to rely on the criminal law only when all else fails. That is what freedom—and free enterprise—are all about. Nevertheless, there currently seems to be some sort of presumption at work that where there is a wrong there ought to be a criminal law to punish the wrongdoer.

There are many forms of business crimes. The focus here is on the relatively new subset of business crimes that has emerged in connection with corporate governance and securities regulation. In general, the subject matter is an extension of fiduciary duty. That is, the ultimate issue is whether the directors, officers, or agents of a corporation are guilty of a breach of trust vis-à-vis investors or the corporation itself. To be sure, there is an ambiguity here. It is not clear that a

---

* Martin G. McGuinn Professor of Business Law, Villanova University School of Law.
1. Kenneth Mann, *Punitive Civil Sanctions: The Middleground between Criminal and Civil Law*, 101 YALE L.J. 1795, 1809 (1992) (noting that one of the “two paradigmatic remedies” available through civil law is “the court order mandating a return to the status quo ante, so as to make the injured party whole... [the order to pay money as compensation for damage caused]”).
2. See id. at 1799, 1806-09 (explaining that the original purpose of criminal law sanctions was to punish and deter public wrongs, regardless of whether an individual person suffered an injury, while civil law developed to compensate private individuals for actual damage to their interests).
3. See Gerard E. Lynch, *The Role of Criminal Law in Policing Corporate Misconduct*, LAW & CONTEMP. PROBS., Summer 1997, at 23, 31; Mann, supra note 1, at 1811, 1850-53 (highlighting the differences between civil and criminal law as well as exploring Congress’s tendency to apply civil law over criminal law). Criminal law “should be reserved for the most damaging wrongs and the most culpable defendants.” Mann, supra note 1, at 1863.
5. Reinier Kraakman et al., *When Are Shareholder Suits in Shareholder Interests?*, 82 GEO. L.J. 1733, 1734 (1994). “The procedural form of a shareholder suit depends on whether managers are said to have harmed the corporation or instead its shareholders in the first instance.” Id.
What Is a Business Crime?

corporation has any interests independent of its investors’ interests. But leaving that puzzle aside for the moment, it is worth noting that the investors in question are almost always the stockholders. There are relatively few cases—civil or criminal—in which the interests of creditors or other constituencies are the focus. So the question is: what do stockholders want the law to do? The answer depends on the nature of the offense.

I. THE VARIETIES OF CIVIL REMEDIES

Civil remedies come in many shapes and sizes. There are few offenses that cannot be effectively addressed by one of three forms of civil remedies: simple damages, punitive and multiple damages, and class and derivative actions.

A. Simple Damages (and No Damages)

Simple damages are enough to deter most offenses. If the offense arises from inadvertence or even recklessness and does not involve gain to the culprit, a civil action for a simple monetary remedy should suffice. If the culprit cannot gain from the offense, a simple monetary remedy is sufficient to deter bad behavior.

There is a danger that a simple monetary remedy may be too much in some cases. As a matter of state corporation law, the business judgment rule and the ability of a corporation to absolve management of liability in negligence mean that

6. See id. at 1733. “Shareholder suits are the primary mechanism for enforcing the fiduciary duties of corporate managers.” Id.

7. See Morey W. McDaniel, Bondholders and Corporate Governance, 41 BUS. LAW. 413, 413 n.1 (1986) (providing a description of the position of bondholders and other creditors in the corporate realm in comparison to that of stockholders). Unlike the rights of stockholders, the rights of bondholders and other creditors are not protected against corporate abuses and thus there are few interests able to be brought before the court. Id.

8. See infra Part I.A.

9. See infra Part I.B.

10. See infra Part I.C. Admittedly, class actions and derivative actions are not remedies technically speaking, but they are procedures that afford access to a remedy when it might otherwise be impractical for a plaintiff to pursue it.


12. Lynch, supra note 3, at 32, 40. “Because such crimes are typically committed for financial gain, by people who often have significant economic resources, the use of fines has seemed to many an adequate deterrent.” Id. at 32. To be sure, there are many forms of gain. Monetary gain is the most obvious. But it may be another form of gain simply to keep a business afloat. Although intangible benefits may motivate some bad behavior, requiring a threshold showing of tangible benefit would filter out dubious cases.

13. See, e.g., Easterbrook & Fischel, supra note 11, at 334–35. Easterbrook and Fischel present a hypothetical in which a manager proclaims that his firm will soon be worth billions, which in turn causes the firm’s stock to increase dramatically. Shortly thereafter, the manager admits that his proclamation was a “false alarm” and the price drops back down to the “original level.” Id. at 334. The people who bought stocks during the interval in which it was believed that the firm was worth billions would at this point be faced with great loss. The manager and firm would not have financially benefited from the situation. In this scenario, “[a] rule that required the firm to compensate the buyers for their full loss would impose damages far in excess of the net harm.” Id. at 335.
managers cannot be held liable for mere mistakes of judgment. Stockholders have no remedy in such cases. But a rational stockholder does not want a remedy in such cases. By holding a diversified portfolio of stocks, a stockholder can eliminate the risk of good faith mistakes of judgment. Because stockholders can insure themselves effectively through diversification, they should be opposed to wasteful litigation by other stockholders seeking recovery in such circumstances. Diversification works for stockholders because the goal of a business is to make money and because business does in fact make money in the aggregate. As long as the decision or behavior in question is part of a good faith effort to further that goal, a stockholder has no complaint. On the other hand, if the bad act is one that subtracts money from the pot—on purpose—stockholders have a legitimate complaint.

The business judgment rule only applies to business decisions made in good faith. If a decision is made other than in good faith and gives rise to losses, a manager may be held liable for the harm done to the corporation. If a decision is tainted by conflict of interest, the manager may be required to disgorge any ill-gotten gains or may be required to restore the corporation to the status it would have had if the decision had been made in good faith.

14. See, e.g., id. at 93 (acknowledging that the business judgment rule absolves managers from liability even when they act negligently).
15. See id. at 28–30 (defining diversification as having an "investment in the economy as a whole" and explaining that such diversification allows investors to concern themselves with the value maximization of firms in the entirety instead of the value maximization of individual firms, which therefore eliminates the risks associated with individual firms).
16. See id. at 120 ("When there is competition, investors agree that the corporation should have the objective of maximizing wealth because greater wealth gives them the ability to consume or rejugle their portfolios to yield greater returns . . . "). Although investors may not always prefer the wealth maximization in every corporate decision, the overall objective is to increase wealth.
17. See id. at 121 (relating diversification to the idea of how businesses in the aggregate make money by providing an example of an investor whose stock in an individual firm is near worthless while the aggregate of his investments in multiple firms is financially profitable).
18. See Richard A. Booth, Stockholders, Stakeholders, and Bagholders (Or How Investor Diversification Affects Fiduciary Duty), 53 BUS. LAW. 429, 437–38 (1998); see also Easterbrook & Fischel, supra note 11, at 93–100 (detailing the interests of the stockholders and how they tend to react to corporate decisions and behavior affecting those interests).
19. See Richard A. Booth, The End of the Securities Fraud Class Action as We Know It, 4 BERKELEY BUS. L.J. 1 (2007) [hereinafter Booth, End of Securities Fraud]. Creditors and other stakeholders are in a different boat. They do not gain when a company increases in value. See McDaniel, supra note 7, at 418–19, 435. But they can lose when a company loses value. Id. This is no great insight. It is well known among scholars of corporation law. See id. The point is that the interests of stockholders and other constituencies conflict. Accordingly, the conventional wisdom is that creditors and other constituencies must protect themselves by contract. Id. at 413 n.1; see also Richard A. Booth, The Duty to Creditors Reconsidered—Filling a Much Needed Gap in Corporation Law, 1 J. BUS. & TECH. L. 415, 416 (2007) [hereinafter Booth, Duty to Creditors]. And there are few cases in which creditors have succeeded in connection with a claim that they have been harmed by business decisions intended to benefit the stockholders. A fortiori, it is quite difficult to say such a decision should ever be seen as a crime. Booth, Duty to Creditors, supra at 416 n.7.
20. S. Samuel Arsht, The Business Judgment Rule Revisited, 8 HOFSTRA L. REV. 93, 130, 134 (1979). "[I]n the absence of the business judgment defense, [which does not apply in situations indicating a lack of good faith,] directors are liable to the corporation for losses sustained by the corporation because of knowingly illegal conduct." Id. at 130.
have enjoyed if the transaction never happened. Although different from simple damages, these remedies are still simple remedies that merely seek to restore the parties to their former state.

Similarly, federal securities law relies on simple remedies for the most part. Indeed, it is noteworthy that federal securities law expressly prohibits awarding damages in excess of actual loss. On the other hand, the business judgment rule does not apply in connection with claims arising under federal securities law. Under the Securities Act of 1933, an issuer is absolutely liable if there is a misstatement or omission of a material fact in connection with an offering of securities. In essence, investors can demand a refund if they have been misled in connection with an offering of securities. The Securities Exchange Act of 1934 governs trading in securities. Here a plaintiff must allege and prove that the defendant acted with scienter— some level of intent to defraud. This requirement is similar in a way to the business judgment rule. A mere mistake does not give rise to liability. But the scienter requirement is different from the business judgment rule.

21. See Easterbrook & Fischel, supra note 11, at 333–35; see also Vernazza v. SEC, 327 F.3d 851, 861 (9th Cir. 2003) (ordering defendants to be disgorged because the public needed to be protected from their deceptive tactics in selling municipal bonds and other securities), amended by 335 F.3d 1096 (9th Cir. 2003).
22. See Arnold S. Jacobs, The Measure of Damages in Rule 10b-5 Cases, 65 Geo. L.J. 1093 (1977) (offering a thorough discussion of available remedies under federal security laws); see also Herpich v. Wallace, 430 F.2d 792, 810 (5th Cir. 1970) ("The gist of the Rule 10b-5 action for damages is economic injury to the plaintiff resulting proximately from the acts of the defendant[ . . . ]").
23. Securities Exchange Act of 1934 § 28(a), 15 U.S.C. § 78bb(a) (2000). Section 28(a) provides: [T]he rights and remedies provided by [the 1934 Act] shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of [the 1934 Act] shall recover, through satisfaction of judgment in one or more actions, a total amount in excess of his actual damages on account of the act complained of. . . . Nothing in [the 1934 Act] shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person insofar as it does not conflict with the provisions of [the 1934 Act] or the rules and regulations thereunder.
24. Burks v. Lasker, 441 U.S. 471, 486 (1979) (holding that federal policy disallows the application of the business judgment rule to suits involving federal securities laws violations); Laurie C. Nelson, Note, Judgment Day for the Business Judgment Rule, Galef v. Alexander, 47 Brook. L. Rev. 1169, 1170, 1172–91 (1981) (noting that the Second Circuit ruling in Galef v. Alexander, 615 F.2d 51 (2d Cir. 1980), laid the groundwork for the argument that the policy underlying section 14(a) of the Securities Exchange Act of 1934 is "so significant that any business judgment rule dismissal . . . would likewise violate the statute and should not be permitted").
30. See Easterbrook & Fischel, supra note 11, at 343–44 (explaining how the intent to defraud requirement relates to rules on damages).
31. See Fla. State Bd. of Admin. v. Green Tree Fin. Corp., 270 F.3d 645, 654 (8th Cir. 2001) (noting that a successful complaint in a securities fraud case must state specific facts that show a "strong inference" that defendant acted with scienter); Camp v. Dena, 848 F.2d 655, 661 (8th Cir. 1991) (specifying that clear recklessness is required to hold defendant liable in securities fraud case where duty to disclose is concerned); SEC v.
rule in that it does not matter if a misstatement or omission was prompted by a valid business purpose.\textsuperscript{32}

B. Punitive Damages \& Multiple Damages

The situation is complicated if the culprit stands to gain from the offense. For example, in the case of insider trading, the culprit may not be deterred by the prospect of simple damages.\textsuperscript{33} If the culprit is caught, he must disgorge the profit. If not, he keeps the profit. It seems fair to assume that sometimes the culprit will get away with it. So there is no reason not to give it a go.\textsuperscript{34} Similarly, a broker may be tempted to engage in excessive trading in customer accounts in order to generate commissions—a practice known as churning.\textsuperscript{35} As with insider trading, it is not clear that simple damages will work to deter churning. The broker will reckon that he can simply pay back his ill gotten gains if he gets caught.

Although simple damages will not deter insider trading or churning, punitive damages or something similar should work. The problem with simple damages is that insider trading and churning are both offenses from which the culprit stands to gain and that may not be detected or pursued by the victim.\textsuperscript{36} So the solution is to award some multiple of damages based on the likelihood that victims will sue, thus eliminating the potential for profit.\textsuperscript{37} For example, if only one-third of insider trading cases are detected, then the culprit should be required to pay damages equal to three times the gain. Accordingly, the Insider Trading \& Securities Fraud Enforcement Act of 1988\textsuperscript{38} (ITSFEA) (like its predecessor the Insider Trading Sanc-

\textsuperscript{32} United States v. Chiarella, 588 F.2d 1358, 1368 n.15 (2d Cir. 1978) (noting that "the presence or absence of a business purpose has no bearing on [defendant's] liability for defrauding the sellers"), rev'd on other grounds, 445 U.S. 222 (1980).

\textsuperscript{33} See Comment, A Role for the 10-b Private Action, 130 U. PA. L. REV. 460, 484–85 (1981) (arguing that absent an additional punishment such as negative publicity or payment of plaintiffs' attorney's fees, mere disgorgement of "ill-gotten profits" will not deter a defendant from insider trading).

\textsuperscript{34} Id. Of course, this reasoning ignores other consequences, such as the cost of litigation or the possibility that one will get fired. In some cases, agents who fear they are in the "last period of employment," for financial reasons or otherwise, may be more likely to commit fraud. Jennifer H. Arlen \& William J. Carney, Vicarious Liability for Fraud on Securities Markets: Theory and Evidence, 1992 U. ILL. L. REV. 691, 724–27.

\textsuperscript{35} See Note, Churning By Securities Dealers, 80 HARV. L. REV. 869, 869 (1967) (explaining that churning occurs when a dealer acts in his own interest rather than the customer's interests and "induces transactions in the customer's account which are excessive in size and frequency in light of the character of the account"). As Woody Allen once said: "A stockbroker is someone who takes all your money and invests it until it's all gone." See Europe's Small Shareholders. Unloved?, ECONOMIST, Oct. 25, 1997, at 83.


\textsuperscript{37} See Edward D. Cavanagh, Detrebling Antitrust Damages: An Idea Whose Time Has Come?, 61 TUL. L. REV. 777, 787 (1987) (stating that "multiplying actual damages is necessary because some violations of the antitrust laws go undetected").
WHAT IS A BUSINESS CRIME?

tions Act of 1984\(^3\) (ITSA)), provides for up to a triple-the-gain fine for insider trading in addition to disgorgement of profit. Moreover, punitive damages are quite common in churning cases (albeit as a matter of pendent state law claims for breach of fiduciary duty or fraud).\(^4\)

The argument for multiple damages raises a question about cases arising under the Securities Act of 1933. A public offering affords an opportunity for gain. Why is there no need for multiple damages under the 1933 Act? There are several answers. There is almost no chance that an offense will not be detected because market prices are readily available following a public offering of stock. And the victims will almost always sue because the 1933 Act affords an issuer no defenses. Finally, it seems less likely that an offender under the 1933 Act would engage in repeat offenses.\(^4\)

C. Class Actions & Derivative Actions

While punitive damages fix the problem of harms that are difficult to detect or pursue, some claims are too small to justify legal action by any single plaintiff. The solution is a class action or derivative action. Indeed, virtually all securities fraud actions are maintained as class actions.\(^4\) Class actions address the problem of individual claims that are too small to justify legal action by any single plaintiff.\(^4\)

One danger with class actions is that plaintiffs may seek (and courts may award) punitive damages on the simplistic rationale that they would be appropriate in an individual action. But punitive damages make no sense in a class action if the primary rationale for punitive damages is that plaintiffs are reluctant to sue because of

---


40. See, e.g., Davis v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 906 F.2d 1206, 1227 (8th Cir. 1990); Miley v. Oppenheimer & Co., 637 F.2d 318, 332 (5th Cir. 1981) (finding that a jury award in the "three-times-compensatory-damages ballpark" was reasonable and not an abuse of discretion); Michael Siconolfi, NASD Is Developing Guidelines for Punitive Awards to Investors, Wall St. J., June 7, 1991, at Cl. One problem is that the culprit may be effectively judgment-proof with regard to any penalty. Richard A. Booth, Damages in Churning Cases, 20 Sec. Reg. L.J. 3, 19–20 (1991). That is, the culprit may have little net worth in addition to the ill-gotten gains. And indeed ill-gotten gains may have been dissipated. Id. Another problem is that under ITSFEA, the government keeps the money. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 21A(d)(1), 102 Stat. 4677.

41. Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988). See generally Robert Bacon, Initial Public Offerings and Professional Sports Teams: The Regulations Work, But Are Owners and Investors Listening?, 10 Seton Hall J. Sport L. 139, 155 (2000) (noting corporations' tendencies to use "extreme caution" to prepare required disclosure materials because of "the Act's imposition of liability upon the corporation for omissions or material misrepresentations"). To be sure, underwriters are also liable under the 1933 Act and they are by definition repeat players.


small claims. Moreover, the allure of class actions is such that it induces plaintiffs and plaintiff's attorneys to seek out claims.

In some cases, a derivative works better than a class action. For example, in an insider trading case, the culprit may have made a significant profit, but when that profit is disgorged and spread over hundreds or thousands of trades, the recovery to any one individual will be miniscule. Indeed, the cost of administering the claims may exceed the recovery. On the other hand, if the issuer recovers, the claim is easy to administer and the stockholders are made whole by the slight increase in the value of the issuer.

II. THE PROPER ROLE OF CRIMINAL LAW

What does this leave for criminal law to do in the area of corporate governance and securities regulation? Perhaps not much. But it is possible to imagine cases that are not addressed well by lesser remedies. If the culprit causes harm that is disproportionate to the gain (or potential for gain), a criminal sanction may be the only remaining remedy.

One possible example that comes to mind is the fraud at Enron. Suppose the plan there was simply to report false income to induce investors to buy the stock and raise its price so that insiders could cash out their stock options. Specifically, suppose the idea was to suck in (say) $10 billion in new investment dollars (that could have gone to other ventures) to create a gain of $50 million on stock options. Such a case might be a legitimate occasion for criminal prosecution. The scheme

44. The same is true with regard to the award of punitive damages in arbitration. See Garrity v. Lyle Stuart, Inc., 353 N.E.2d 793, 795–96 (N.Y. 1976) (explaining why public policy prohibits punitive damages for private wrongs).
45. See Robert B. Thompson & Randall S. Thomas, The Public and Private Faces of Derivative Lawsuits, 57 Vand. L. Rev. 1747, 1774 (2004) (discussing the benefits of derivative suits with public company defendants); see also Booth, End of Securities Fraud, supra note 19, at 27 ("The practical question for a court is whether a securities fraud action is direct or derivative. The answer depends on whether the harm is primarily to the corporation or to individual stockholders and whether recovery should go to the corporation or individual stockholders.").
46. See Cox, supra note 43, at 497.
47. See id.
48. Booth, End of Securities Fraud, supra note 19, at 9–10, 27. Nevermind that the identity of the stockholders may have changed. If they are diversified it all comes out in the wash. Id. at 9.
49. This approach to the definition of crime may be seen as an extension of the notion that liability ought to lie with the party who can most cheaply avoid the harm. I am tempted to call this the principle of criminal indifference, the offense with which the characters of Seinfeld were charged in the final episode. Although the concept is sound, it may describe some acts and practices that are not likely to be seen as crimes. For example, studies indicate that the corporate income tax costs more than twice as much to administer as it raises in revenue. See generally J. Brent Wilkins, The Sarbanes-Oxley Act of 2002: The Ripple Effects of Restoring Shareholder Confidence, 29 S. Ill. U. L.J. 339, 352–55 (2005) (characterizing the added costs of certifying financial statements including tax consultant fees, experts, and internal investigations as opportunity costs of these compliance activities).
implies a disregard for the interests of others that is akin to malicious destruction of property. If that were the standard, the prosecutor would need to prove that the perpetrator had no lawful motivation for his actions. The obvious problem is that the prosecutor can always make such an assertion by not looking for a lawful motivation. So practically speaking, the burden must be on the defendant to prove a lawful purpose, or more precisely, to raise a reasonable doubt about the matter.51

Contrast simple insider trading. Insider trading does not usually involve the creation of any additional harm to investors.52 It simply redistributes gains and losses that would otherwise occur.53 Indeed, it is arguable that insider trading may mitigate redistribution problems by helping the market move to the correct price sooner. It is difficult to see how that should be crime.54

Criminal sanctions seem appropriate for offenses that involve the creation of additional harm—collateral damage—and not simply the redistribution or misappropriation of wealth.55 Criminal sanctions are not well-suited for situations in

---

51. Note that a $10 billion increase in market capitalization does not imply $10 billion in new money. So it might be difficult to prove criminal intent in cases in which it is not clear how to measure collateral damage. There is a similar problem generally with the federal sentencing guidelines. In some financial fraud cases, the courts have applied simplistic measures of harm in sentencing. See, e.g., Harris v. Am. Inv. Co., 523 F.2d 220, 224–25 (8th Cir. 1975); Mitchell v. Gulf Sulphur Co., 446 F.2d 90, 104–05 (10th Cir. 1971).

52. See Janet Cooper Alexander, Rethinking Damages in Securities Class Actions, 48 Stan. L. Rev. 1487, 1502 (1996). One worry is that the opportunity to trade on inside information may induce corporate actors to withhold information that is ripe for disclosure. Curiously, relatively few insider trading cases involve insiders that would be in a position to disclose the information to the market. See SEC v. Cherif, 933 F.2d 403 (7th Cir. 1991) (involving insider trading by a former employee); SEC v. Materia, 745 F.2d 197 (2d Cir. 1984) (finding employee of financial printing company guilty of fraud). Indeed, every case that has reached the Supreme Court has involved an unconventional insider. See, e.g., Carpenter v. United States, 484 U.S. 19 (1987) (involving a financial newspaper reporter); Dirks v. SEC, 463 U.S. 646 (1983); Chiarella v. United States, 445 U.S. 222 (1980). This suggests that the real worry may be more about keeping secrets than about disclosure. It also suggests that this crime may be less common in settings where its definition is clear. In any event, it is disturbing that prosecutors seem to focus on the exotic rather than the routine.

53. See Alexander, supra note 52, at 1502.

54. Similarly, securities fraud seldom results in gain to the perpetrators except in cases in which there is also insider trading. See Booth, End of Securities Fraud, supra note 19, at 9. It is somewhat curious that criminal enforcement focused almost exclusively on insider trading for so long. The explanation may be that such cases appeared to be the only cases that involved monetary gain. But that does not explain why prosecutors have not also pursued churning cases or violations of the 1933 Act.

55. See John Stuart Mill, On Liberty 13 (1863) (stating "the only purpose for which power can rightfully be exercised over any member of a civilized community, against his will, is to prevent harm to others"); see also Jerome Hall, General Principles of Criminal Law 213 (2d ed. 1960) (1947) ("Harm, in sum, is the fulcrum between criminal conduct and the punitive sanction . . . ."); Paul H. Robinson, A Theory of Justification: Societal Harm As a Prerequisite for Criminal Liability, 23 UCLA L. Rev. 266, 266–68 (1975) (suggesting that criminal law punishes conduct that creates harm, but not conduct that produces either benefit or no harm). It is ironic, but a criminal sanction seems more appropriate if the culprit has little to gain from the offense relative to the costs imposed on others. If the victim’s loss is the culprit’s gain, a civil remedy is likely to be adequate. The idea that the prospect of a monetary penalty should usually suffice to induce appropriate caution depends to some extent on whether the defendant has something to lose. The implication is that if the defendant has nothing to lose, there is no incentive for self-control, and criminal sanctions might be necessary. (As Bob Dylan said, when you got nothing, you got nothing to lose.) This suggests that criminal law is likely to apply more often to offenses involving poor people. This is not to say that the poor are prosecuted selectively, but rather that the offenses we criminalize are much more likely to involve poor people than rich people. See,
which there is real doubt about who is entitled to the gain. Money damages should be the remedy when the harm is such that it can be remedied and deterred by money damages. As with the law of equity, if there is an adequate remedy at law, the criminal law should keep out. Indeed, this principle seems to be particularly well suited to offenses relating to the conduct of business where the ultimate point is to generate financial return. Where money is the issue, money can fix the problem.

One (not very good) argument for the use of criminal sanctions is to satisfy public outrage. The public feels as though someone must be responsible when a major corporation fails and thousands of people lose their jobs or savings, or both, particularly if management enjoys a big payday. The obvious response is that we cannot necessarily depend on public opinion where the offenses are as complex as

e.g., Jeffrey Reiman, . . . And the Poor Get Prison: Economic Bias in American Criminal Justice 91–92 (1996) (noting that the incarcerated population is predominantly poor); Travis C. Pratt & Francis T. Cullen, Assessing Macro-Level Predictors and Theories of Crime: A Meta-Analysis, 32 CRIME & JUST. 373, 411–13 (2005) (statistical evidence supports the proposition that poverty has a significant effect on crime); Alice Ristroph, Desert, Democracy, and Sentencing Reform, 96 J. CRIM. L. & CRIMINOLOGY 1293, 1344 (2006) (crime and poverty are closely correlated). That seems wrong—or at least impolitic. It also may be a subtle force for creeping criminalization. If the poor must suffer jail for their offenses, so too should the rich. See J. Scott Drutcher, Comment, From the Boardroom to the Cellblock: The Justifications for Harsher Punishment of White-Collar and Corporate Crime, 37 ARIZ. ST. L.J. 1295, 1303, 1312 (2005) (arguing for harsher punishment of white collar crimes). Compare Jayne O’Donnell & Richard Willing, Prison Time Gets Harder for White-Collar Crooks, USA Today, May 11, 2003, at 1A (reporting that after the Enron and WorldCom scandals, the Justice Department began toughening up on white collar crime), with Howard Gleckman, Where White-Collar Criminals Belong: Jail, BUS. WK. ONLINE, Jan. 3, 2002, http://www.businessweek.com/bwdaily/dnflash/jan2002/nf2002012 _5188.htm (reporting that, unjustly, white collar criminals are rarely charged, receive short jail sentences, and are a low priority for the criminal justice system). Although this explanation seems at first to make sense, it misses a key point of economics: the less you have, the more you value what you have. So one could equally well argue that criminal sanctions are more important in a situation in which the defendant is likely to be relatively wealthy. Indeed, one common argument is that in the absence of criminal or quasi-criminal penalties such as punitive damages, simple compensatory damages will be viewed simply as part of the cost of doing business. See Simon v. San Paolo U.S. Holding Co., 113 P.3d 63, 78–79 (Cal. 2005); Grimshaw v. Ford Motor Co., 174 Cal. Rptr. 348, 387–89 (Cal. Ct. App. 1981); see also Jonathan Kagan, Comment, Toward a Uniform Application of Punishment: Using the Federal Sentencing Guidelines as a Model for Punitive Damage Reform, 40 UCLA L. REV. 753, 785 (1993) (explaining that inconsistent punitive damages awards prevent defendants from factoring such damages into the cost of doing business); O’Donnell & Willing, supra. The odd thing about that argument is that it is precisely the point of the civil justice system that a business (or an individual for that matter) will think about externalities as part of the true cost of doing business. Deborah J. La Fetra, Freedom, Responsibility, and Risk: Fundamental Principles Supporting Tort Reform, 36 IND. L. REV. 645, 648, 654–57 (2003). If the point is that paying damages occasionally covers only a small fraction of the costs generated by the defendant’s activities, that is another matter. But the point for present purposes is that the wealth of the defendant seems to have little to do with whether an offense should be seen as civil or criminal.

56. See Lynch, supra note 3, at 31–33 (arguing that punitive civil sanctions are the most appropriate sanctions for business crimes).

WHAT IS A BUSINESS CRIME?

they are in the business area. Moreover, prosecutors who have their own agenda need a fall guy.

The public may not have been all that outraged if the failure of Enron had been explained by a chain reaction involving the misuse of derivatives and falling demand for energy after 9/11. After all, no one went to jail because of the collapse of Long Term Capital Management. On the other hand, crowds can be wise. And it may be that in the age of derivatives there is no other way to contain the potential excesses of business than to maintain a vague threat of criminal prosecution based on know-it-when-you-see-it judgment calls.

Another more fundamental problem with a consensus definition of business crimes is that the interests of investors and managers have diverged in recent years. Diversified investors want their portfolio companies to maximize stock price. Un-diversified managers would prefer to minimize risk, but they are willing to take more risk for more pay. If undiversified managers fail to take risks that may maximize the stock price, someone else will assume control—through takeover or otherwise—and do the job. As I have argued elsewhere, the traditional notion of the CEO as a hired gun who works to maximize stockholder value—because the stockholders own the company—is not the only way—or even the best way—to view the corporation today. Why would a CEO work to maximize the wealth of others without bargaining for a significant share of the gain? So maybe it is better to see the CEO as an equity partner.

58. See Lynch, supra note 3, at 33.
59. See, e.g., Shaw v. Garrison, 467 F.2d 113, 114–15 (5th Cir. 1972) (noting that the prosecutor’s ambition “as the man who solved the Kennedy assassination” led to bad faith prosecution and harassment of defendant); Lewis v. Super. Ct., 62 Cal. Rptr. 2d 331, 332 (Cal. Ct. App. 1997) (involving a prosecutor who was both implicated in and a victim of the alleged crime); State v. Bell, 370 P.2d 508, 511–12 (Idaho 1962) (involving a prosecutor who was a personal friend of the defendant); City of Maple Heights v. Redi Car Wash, 554 N.E.2d 929, 930 (Ohio Ct. App. 1988) (disqualifying a prosecutor who had previously filed a libel suit against defendant and threatened him with additional criminal actions while defendant was testifying); see also Wilt v. Buracker, 443 S.E.2d 196, 211–12 (W. Va. 1993) (Neely, J., concurring) (noting that prosecutors tend to devote greater resources to pursuing cases that will bring more publicity or resources to the office or advance the prosecutor’s career); Joan McPhee, Corporate Criminal Liability and Punishment in the 21st Century: Departures from Constitutional and Criminal Norms and Anomalies in Practice, ANDREWS WHITE-COLLAR CRIME REP., June 29, 2006, at 1–2.
61. Indeed, I have argued elsewhere that fiduciary duty may work in a similar way. Richard A. Booth, The Missing Link Between Insider Trading and Securities Fraud, 2 J. BUS. & TECH. L. 185, 187 n.19 (2007). It is also possible that characterizing Enron as a criminal conspiracy may have been a strategy to divert public attention from the dangers of derivatives in order to avoid overreaction and overregulation of new ways of doing business.
65. See id. at 278; Booth, Who Owns, supra note 62, at 155–56; Charles M. Elson, The Answer to Excessive Executive Compensation is Risk, Not the Market, 2 J. BUS. & TECH. L. 403, 405 (2007). To be sure, risk-averse
risk that goes with being publicly held, better managers may opt for private companies, public investors may be denied better returns, and indeed we may see even more corporate scandals in the future. At the very least, the added risk of criminal prosecution will likely lead to even higher executive compensation.

managers should be naturally reluctant to stretch the envelope. So when they do cross the line—wherever it is—we can be somewhat more confident that the motive was inappropriate.


What Is a Business Crime?

As a general rule, criminal law should be about offenses that cannot be remedied or deterred by a monetary penalty, either because the monetary penalty is difficult or impossible to quantify (as with murder and other crimes involving bodily violations) or because it appears unlikely to work (as with crimes against property). As the Model Penal Code states, the primary goal of criminal law is "to forbid and prevent conduct that unjustifiably and inexcusably inflicts or threatens substantial harm to individual or public interests." To be sure, theft and embezzlement are crimes about money. Why do they seem to be appropriate subjects for criminal prosecution while insider trading and faulty accounting seem less so? One answer is that these offenses likely cannot be deterred by multiple damages. They are take-the-money-and-run offenses rather than ongoing practices. Another difference is the participation of the victim. If the victim voluntarily assumes the risk of the offense (as does a trader or an investor), it is difficult to see the offense as criminal. Yet another difference is the definition of the offense. If the offense is such that it may be legal under some circumstances, it is difficult to say that it is a criminal act under other circumstances, particularly when the prosecutor must prove the circumstances beyond a reasonable doubt.

---

68. With most crimes against person and property, the offense is one that could be the subject of a tort action. But the fact that the offense would give rise to an action for damages seems not to deter the perpetrator. See Richard A. Posner, An Economic Theory of the Criminal Law, 85 Colum. L. Rev. 1193, 1195 (1985); Steven Shavell, Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent, 85 Colum. L. Rev. 1232, 1236 (1985).

69. Model Penal Code § 1.02(a) (Official Draft 1985) (emphasis added).


72. See generally Vera Bergelson, Victims and Perpetrators: An Argument for Comparative Liability in Criminal Law, 8 Buff. Crim. L. Rev. 385 (2005) (discussing how certain affirmative defenses including victims' actions go toward the determination of "perpetrators' liability"). But see John M. Junker, Criminalization and Criminogenesis, 19 UCLA L. Rev. 697 (1972) (noting that a "consensual" or "victimless" crime should not mean that criminal law should be ignored). Although the fit may not be perfect, it seems roughly correct to say that if one cannot buy insurance against an offense, it is not likely to be criminal.

73. There is a real danger that overuse of criminal penalties will reduce the stigma that has traditionally gone with conviction of a criminal offense. Arguably, that has already occurred in some communities where a relatively high percentage of the population is incarcerated and jail is just another lifestyle. Joachim J. Savelberg, Controlling Violence: Criminal Justice, Society, and Lessons from the U.S., 30 Crime, Law & Soc. Change 185, 191 (1999). As for white collar criminals, Martha Stewart and Mike Milken are both good examples of ex-cons whose status in the community seems to be little affected.
Criminal law is a blunt instrument that carries all-or-nothing penalties. With a civil action, the plaintiff must plead and prove damages. Thus, with civil liability you know who lost what and who recovers. A prosecutor need not prove damages. Moreover, a private plaintiff must weigh the costs and benefits of filing a civil action. In other words, civil remedies are both self-executing and self-regulating. Indeed, there is little danger that the defendant will pay more than once in a civil suit, unless the offense is one that calls for punitive damages. In contrast, a prosecutor has little or no reason not to prosecute an offense other than the prospect of losing. We cannot really expect prosecutors to exercise much discretion about when (and when not) to prosecute. We should expect that prosecutors will use the tools they are given. We should assume that a prosecutor will throw the book at the crook.

74. See, e.g., Jeffrey S. Parker, *The Blunt Instrument*, in Debating Corporate Crime 71, 74 (William S. Loquisto et al. eds., 1997) (noting that punishment—one of the functions of criminal law—is a “blunt instrument” and though it may be appropriate in a given circumstance, it is a measure to be avoided). Further, efforts to make criminal law more scalable—such as the federal sentencing guidelines—seem only to have made matters worse. See United States v. Marshall, 908 F.2d 1312, 1326 (7th Cir. 1990) (stating that “[e]very attempt to make the system of sentences ‘more rational’ carries costs and concealed irrationalities, both loopholes and unanticipated severity”), aff’d, 500 U.S. 453 (1990); United States v. Williams, 746 F. Supp. 1076, 1081–82 (D. Utah 1990) (discussing “the exercise of police and court discretion in relation to the aims of our criminal justice system”), aff’d, 963 F.2d 1337 (10th Cir. 1992); see also Anne Bowen Poulin, *Prosecutorial Discretion and Selective Prosecution: Enforcing Protection after United States v. Armstrong*, 34 AM. CRIM. L. REV. 1071, 1080 n.33 (1997).

75. See generally 22 AM. JUR. 2D Damages § 703 (2007).

76. See *Damages*, supra note 75. As Gordon Gekko, the fictional character in the movie Wall Street, might have said, “the need to quantify the stakes clears the mind and focuses the will.” See *Wall Street* (20th Century Fox 1987).


78. The bigger worry is a staff with too little to do. Cf. Poulin, supra note 74, at 1085 (noting that prosecutors bring their own personal biases to their work and are often guided loosely, if at all, in making decisions regarding what crimes to prosecute).

79. Although one can only pay once in a civil action, one is likely to pay (so to speak) several times over in a criminal action. To be sure, in cases in which criminal prosecution is appropriate, there always will be a potential for lesser included civil remedies and accordingly a proliferation of actions. That seems unavoidable. A measure that “make in prosecution should be ‘indifferent’ [to the preferences and objectives of interested third parties]”. But see Kenneth L. Wainstein, *Comment, Judicially Initiated Prosecution: A Means of Preventing Continuing Victimization in the Event of Prosecutorial Inaction*, 76 CAL. L. REV. 727, 734 (1988) (suggesting that court initiated prosecution would provide victims with the most appropriate remedy). This is not to excuse the senseless destruction of Arthur Andersen. See generally George J. Benston & Al L. Hartgraves, *Enron: What Happened and What We Can Learn from It*, 21 J. ACCT. & PUB. POL’Y 105 (2002) (discussing the history of Arthur Andersen, the long-time accounting firm of Enron that was charged criminally and had civil suits filed against it for its role in Enron’s collapse). Likewise, studies indicate that the corporate income tax is very costly to administer. See generally Michael L. Marlow, *A Primer on the Corporate Income Tax: Incidence, Efficiency and Equity Issues* 1 (2001), available at http://www.taxfoundation.org/files/fs4081493f15d1a41c6b1102917010e9.pdf (noting that “[e]conomists have estimated that for every dollar collected by the federal govern-
WHAT IS A BUSINESS CRIME?

Accordingly, it is important to be certain about a crime and its definition. Again, the Model Penal Code is instructive. Another express goal of criminal law is to "give fair warning of the nature of the conduct declared to constitute an offense." If an offense is hard to define or the definition seems to shift with changing circumstances, it is not a good idea to make it a crime. In other words, we should only make an offense a crime if it is a crime all the time. Indeed, a good rule would be that unless we can say that conduct or behavior is always wrong—unless we can construct a definition that draws a bright line for all to see—we should eschew the creation of criminal penalties. The alternative is to depend on prosecutors both to define crimes and to prosecute them.

III. WHY THE (RECENT) EXPANSION OF CRIMINAL LAW?

Over the long haul, criminal law seems to have receded. There are no debtor prisons or workhouses nowadays. And few would argue that it is a crime to sell a stock short or charge usurious interest. Any suggestion that we should recriminalize these offenses—let alone simple breach of contract cases—would be positively medieval. Nevertheless, some of the high profile cases of the early 2000s could be characterized as an attack on limited liability albeit as it applies to publicly traded

...
companies. To be a bit more precise, it has become increasingly common for bankruptcy to give rise to criminal charges. While some cases have focused on creditors as victims, most other cases have focused on stockholders as victims. Thus, it would seem that the goal of the prosecutors in these cases has been to vindicate the harm suffered by stockholders (including employee stockholders), though there may well have been other creditors harmed in the process. Again, because there is no plaintiff other than the government, and because the prosecution need not plead and prove damages in any concrete way, it is difficult to discern the ultimate goal in these criminal proceedings, though it seems quite clear that the stockholders are seen as an important class of victims.

It is not at all clear that stockholders need or want such favors. In the aggregate and over time, business makes profits and investors enjoy positive returns. A well-diversified stockholder wants portfolio companies to seek maximum returns. It does not matter if a few portfolio companies go bankrupt trying. Others will exceed expectations. It all comes out in the wash. If there is reason to believe that a publicly traded corporation has been operated for the primary purpose of defrauding investors and not in a good faith effort to turn a profit, then criminal prosecution may be appropriate. But no one has suggested any such thing about Enron, WorldCom, or any other recent case.

It may be that much of the growth of the criminal law in this setting is a result of problems with civil remedies. Federal securities law provides that a willful violation

83. See Brickey, supra note 81, at 222 ("CORPORATION, n. An ingenious device for obtaining individual profit without individual responsibility."), Enron, WorldCom, Adelphia Communications, Rite Aid, Symbol Technologies, Qwest Communications, Dynegy and HealthSouth all were organized as corporations known for their limited liability. Id. at 225–28. The prosecution of these organizations are attacks on limited liability in the context of publicly traded companies.

84. See, e.g., United States v. Milwitt, 475 F.3d 1150, 1155–56 (9th Cir. 2007) (overturning a conviction for bankruptcy fraud because there was not sufficient evidence to prove specific intent); United States v. Wagner, 382 F.3d 598, 613–14 (6th Cir. 2004) (finding that a reasonable trier of fact could have found sufficient evidence to support the conviction for bankruptcy fraud).

85. For example, the Enron debacle has given rise to numerous actions against banks and other financial institutions that facilitated fraudulent transactions. See Brickey, supra note 81, at 253, 257–58 (listing the parallel civil and criminal proceedings against Enron; and also listing the criminal defendants in Enron-related prosecutions).

86. Cf. Douglas A. Henry, Comment, Subordinating Subordination: WorldCom and the Effects of Sarbanes-Oxley’s Fair Efunds Provision on Distributions in Bankruptcy, 21 EMORY BANKR. DEV. J. 259, 295–96 (2004) (noting that the WorldCom decision raised the claims of shareholders to be even with the claims of creditors).

87. But see Brickey, supra note 81, at 276 (noting that federal prosecution under SOX has made significant progress towards “pinning responsibility on all culpable parties . . . working up the corporate hierarchy to charge the highest blameworthy executives”). Moreover, there have been few if any cases of note involving large privately held companies, further suggesting that prosecutors are focused on the stockholders of publicly traded companies as the supposed victims. Limited liability always has been an uncertain benefit for very small companies. Although it is not easy to pierce the corporate veil in many jurisdictions, such cases are quite common, presumably because creditors succeed often enough.

88. See, e.g., Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919) (recognizing that “a business corporation is organized and carried on primarily for the profit of the stockholders . . . . [t]he discretion of directors is to be exercised in the choice of means to attain that end”).
What Is a Business Crime?

is a crime. The statutes also provide for civil enforcement by the Securities and Exchange Commission (SEC) as well as private civil actions under the 1933 Act. To complicate matters further, the courts have implied a broad private remedy under the 1934 Act and Rule 10b-5. The courts recognized long ago that securities fraud litigation can be abusive. Because investors may sue whenever they lose, investor protection can morph into investor insurance. Thus, in 1976 the Supreme Court ruled that to state a claim under Rule 10b-5, the plaintiff must plead and prove scienter. And in 1980 the Court ruled that the SEC must meet the same standard. Thereafter, Congress enacted the Private Securities Litigation Reform Act (PSLRA), which raised the bar for pleading scienter (among other things), followed by the Securities Litigation Uniform Standards Act (SLUSA), which prevented such actions from migrating to state courts. The bottom line is that the standard of pleading and proof in a criminal proceeding is lower than in a civil proceeding. Clearly, something is awry.

One problem is with the idea that an investor should have standing to assert a direct claim for damages in connection with a misstatement or omission that affects the trading market. To be sure, an investor has a direct claim against the issuer in the context of an offering by the issuer. But that is because the issuer took money from the investor and should give it back if the investor was misled. The situation is completely different if the issuer misleads the market outside the context of an offering. The market price of the stock is bound to move when the truth...

89. 17 C.F.R. § 240.10b-5 (2007). There is also an express private cause of action under section 18(a) of the Securities Exchange Act of 1934. See 15 U.S.C. § 78r (2000) (creating the right that a person knowingly misleading "shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading"). But because this remedy requires that the investor prove that he relied on a false statement in a document filed with the SEC—and is thus much narrower than Rule 10b-5—it is seldom invoked. See Julie A. Herzog, Fraud Created the Market: An Unwise and Unwarranted Extension of Section 10(b) and Rule 10b-5, 63 GEO. WASH. L. REV. 359, 399 (1995) (noting that section 18 has a specific requirement of reliance whereas Rule 10(b) does not, which has resulted in courts reading a more flexible reliance standard into Rule 10(b)). But see Lindner Dividend Fund, Inc. v. Ernst & Young, 880 F. Supp. 49, 56 (D. Mass. 1995) (finding that the purchasers of preferred stock satisfied the requirement for stating a cause of action under Securities Exchange Act section 18(a) when their loss caused by their reliance was subject to challenge was not so unsupportable that the cause of action should be dismissed for failure to state a claim).


94. Id.
96. Id.
comes out. The loss must fall somewhere. To afford a remedy to investors who happen to buy or sell at the wrong time is only to rearrange the gains and losses. 97 On the other hand, if insiders use the opportunity to extract gains by trading at a time when they know that the market is misinformed, outside investors suffer to the extent that the insiders gain. 98 The upshot is that diversified investors have nothing to gain from filing a securities fraud action except when insider misappropriation is involved. 99 Even then, investors can be made whole if the issuer recovers the insider gains. 100 In other words, investors would prefer that securities fraud actions be limited to an action by the company (or a derivative action) to recover insider gains. The problem is that the existing system of direct recovery by individual investors who happen to buy or sell at the wrong time is nothing more than a transfer of wealth among investors, less substantial attorney fees. 101 Investors gain nothing in the end. Indeed they lose to the extent of the costs of litigation. But plaintiff’s attorneys (and maybe even defense attorneys) have a big stake in the system as it stands. 102

There is a certain twisted logic in the expansion of criminal prosecution when civil remedies are in such disarray. A securities fraud class action is potentially devastating for a target company. 103 Indeed, at least one study has found that 30 percent of target companies end up bankrupt. 104 So it is understandable for a target company to circle the wagons. It is unlikely that a company (or its board of directors) will seek out those who misled the market or even those who may have traded at a gain during the fraud period. 105 It is also understandable that the courts and Congress have sought to limit the reach of private securities litigation. 106 But it is almost comical that they have done so in effect by telling plaintiff’s lawyers that

97. See Booth, End of Securities Fraud, supra note 19, at 3–4.
98. Id. at 4.
99. See id.
100. Id. at 24.
101. Id. at 3 n.2.
102. Id.
103. See Simmons & Ryan, supra note 42, at 14.
104. See id.; Anjan V. Thakor with Jeffrey S. Nielsen & David A. Gulley, U.S. Chamber Inst. for Legal Reform, The Economic Reality of Securities Class Action Litigation app. II, exhibit A (Oct. 26, 2005) (noting plaintiff attorney fees of $1.7 billion in connection with settlements totaling $11.9 billion in a sample of 482 class actions). Assuming that this sample is representative of the percentage of settlements awarded as plaintiff’s attorney fees (approximately 14 percent in the sample), a good estimate of the total plaintiff attorney fees awarded in Securities Fraud Class Actions (SFCAs) since 1995 is $3.6 billion (14 percent of $26 billion). Assuming that defendant firms have been paid roughly the same amount, it seems a fair estimate that SFCAs have generated about $7 billion in attorney fees over the last ten years. Defendant firms are paid in all cases, whether or not the plaintiff prevails, but presumably defendant firm fees are a good deal less than plaintiff firm fees in cases in which plaintiffs prevail. Note that plaintiff attorney fees are paid out of the settlement and that accordingly, the estimated amount available for investors was $26 billion less $3.6 billion, or about $22.4 billion. Id.
105. See Booth, End of Securities Fraud, supra note 19, at 7.
106. See id. at 28–29 n.78.
they may sue only if they really have the facts that will support the claim.\textsuperscript{107} The problem is not that plaintiff lawyers are too eager. The problem is that the remedy is too generous and not rationally related to the harm suffered by investors. It is thus not surprising that prosecutors have swept in to fill the near vacuum created by ever narrower private remedies and companies that cannot afford to be candid.

The simple solution is for the courts to recharacterize securities fraud class actions as derivative actions. As I have argued elsewhere, this would be more consistent with the statutory scheme than the current system of securities fraud class actions.\textsuperscript{108} For example, section 16(b) of the 1934 Act provides for issuer recovery in connection with short-swing trading (which is essentially a variety of insider trading).\textsuperscript{109} Moreover, the law of insider trading is founded primarily on the idea that an insider has a duty to the source of the information (usually the issuer) not to use the information for personal gain. So it seems quite clear that the issuer has standing to recover. And indeed there is solid state law precedent to that effect.\textsuperscript{110}

CONCLUSION

Disputes relating to corporate governance and securities regulation are singularly bad subject matter for criminal sanctions. The issues of corporation law come in many forms ranging from self-dealing, to corporate opportunity, to executive compensation, to simple mismanagement. And as for federal securities regulation, the question is almost always one of where the gain and loss should fall. Either way, the issue is ultimately one of distribution. The civil law does not presume any answers other than to allocate the burden of proof to one party or the other depending on the nature of the allegations. In contrast, the criminal law is one dimensional. Although the defendant is supposedly presumed innocent, the issue for the court in a criminal case is a simple factual one: Did the defendant do the crime? Although there may be some cases of outright fraud in which the perpetrator has made no good faith effort to run a profitable business, most cases of business failure are otherwise. A diversified stockholder is perfectly able (and indeed happy) to absorb the occasional loss from the failure of a business if management tries in good faith to maximize stockholder value. As long as management does not have its hand in


\textsuperscript{108} See Booth, \textit{End of Securities Fraud}, supra note 19, at 28.

\textsuperscript{109} \textit{Id}; see also 69A A.M. JUR. 2D Securities Regulation — Federal § 1415 (2007).

\textsuperscript{110} It is arguable that the creation of a claim for the benefit of contemporaneous traders under the ITSFEA preempts claims by the issuer. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (codified as amended in scattered sections of 15 U.S.C.). But claims under section 20A depend on proof of another independent violation of federal securities law. See Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 601, 605 (7th Cir. 2006), abrogated in part by 127 S. Ct. 2499. A claim under section 20A is not based on any duty to the source of the information. So it is difficult to see how such a claim could displace an issuer claim based on traditional notions of fiduciary duty. ITSFEA is an example of rampant confusion in federal securities law.
the cookie jar, gains will more than compensate for losses. The threat of criminal prosecution will likely cause better managers to be more conservative than stockholders want, and to seek more pay, or to go to work for privately held companies. Either way, investors lose. So if the issue is stockholder welfare, we should rein in the prosecutors somehow. If the issue is something else, somebody should say what it is.