

WHITE COLLAR CRIME AND PUNISHMENT:
REFLECTIONS ON MICHAEL, MARTHA, AND MILBERG
WEISS

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Yes, [former WorldCom CEO] Bernie Ebbers is a bad, bad guy. He's convicted of massively cheating investors, he ruined lots of lives. But 25 years? Many murderers get lighter sentences. Sending him away forever may make people feel better. But I'm not sure it will make their money safer.¹

Newsweek

Judge Barbara Jones sentenced 63-year-old-Ebbers—a first-time violator—to 25 years in prison . . . Judge Jones commented that, while she recognized that this was “likely to be a life sentence for Mr. Ebbers,” anything else “would not reflect the seriousness of the crime.”²

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INTRODUCTION

Our society is deeply conflicted about white collar crime and punishment. On the one hand, high-profile corporate fraud scandals have produced widespread condemnations of corporate wrongdoing and greed. With this outcry have come calls for more criminal statutes, more prosecutions, and greater penalties.³ The Sarbanes-Oxley Act of 2001, the revised federal

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¹ Allan Sloan, *Does the Punishment Fit?*, NEWSWEEK, July 25, 2005, at 18. Bernard John Ebbers was co-founder and CEO of telecommunications giant WorldCom. In 2005, he was convicted of fraud and conspiracy in connection with massive accounting fraud. See Carrie Johnson, *Ebbers Gets 25-Year Sentence For Role in WorldCom Fraud*, WASH. POST, July 14, 2005, at A1 (“The fraud at WorldCom ultimately topped \$11 billion and led to the country’s biggest bankruptcy filing, in July 2002.”). The Second Circuit affirmed Ebbers’s conviction and sentence. *United States v. Ebbers*, 458 F.3d 110 (2d Cir. 2006).

² Joseph Savage & Christine Sgarlata Chung, *Trends in Corporate Fraud Enforcement: A Calm During the Storm?*, BUS. CRIMES BULL., Oct. 2005, at 1, 1-2.

³ See Daniel C. Richman & William J. Stuntz, *Al Capone’s Revenge: An Essay On The Political Economy Of Pretextual Prosecution*, 105 COLUM. L. REV. 583, 626 (2005) (“The pressure to go after all forms of white collar crime remains strong—indeed, that pressure has intensified since the Enron and

corporate sentencing guidelines, and a spate of high-profile prosecutions have been fueled by a perceived public outcry over corporate fraud.⁴ The government has succeeded in many cases: the principal Enron defendants were found guilty, and Martha Stewart's and Bernard Ebbers's convictions and sentences were affirmed on appeal.⁵ And a number of these convictions, like Ebbers's, produced effective life sentences.⁶

On the other hand, many believe that individual prosecutions either have not been warranted or have led to draconian sentences that serve neither retributive nor utilitarian principles of punishment.⁷ Consider the recent wave of white collar cases. Critics railed when the government declined to charge Martha Stewart with insider trading in ImClone stock but proceeded to charge her for attempting to cover up her reasons for selling that stock.⁸ Some critics suggested that Stewart was targeted because she is

WorldCom scandals."); Savage & Chung, *supra* note 2 (stating that the Department of Justice and Securities and Exchange Commission were devoting ever-more attention and resources to corporate fraud). The government's focus on white collar crime may be lessening, as other areas compete for government resources. *See infra* note 238 and accompanying text.

⁴ For a summary of recent prosecutions of corporate executives, see Kathleen F. Brickey, *In Enron's Wake: Corporate Executives on Trial*, 96 J. CRIM. L. & CRIMINOLOGY 397 (2006) [hereinafter Brickey, *In Enron's Wake*].

⁵ *United States v. Stewart*, 433 F.3d 273 (2d Cir. 2006); *Ebbers*, 458 F.3d 110. Stewart has also settled the civil suit that the SEC brought against her. Press Release, Sec. & Exch. Comm'n, Martha Stewart and Peter Bacanovic Settle SEC's Insider Trading Charges (Aug. 7, 2006), available at <http://www.sec.gov/news/press/2006/2006-134.htm>.

⁶ For example, 80 year-old John Rigas, Adelphia's founder and former CEO, received a 15-year sentence; the sentence for 64 year-old Ebbers was 25 years. *See* Jane Sasseen & David Polek, *White-Collar Crime: Who Does Time?*, BUS. WK., Feb. 6, 2006, at 60. In addition, 64 year-old former Enron chairman Kenneth Lay and 52 year-old former Enron president Jeffrey Skilling were convicted of crimes that exposed them to up to 45 and 185 years in prison, respectively. *See* Mark A. Stein, *From Top of the Corporate World to Appeals Court*, N.Y. TIMES, May 27, 2006, at C2. Lay died before his sentencing, and his attorney asked the court to vacate his conviction and dismiss the indictment. *See* John C. Roper, *Lawyers Take Step To Clear Lay's Name*, HOUSTON CHRON., Aug. 11, 2006, at A1. On October 17, 2006, the judge dismissed the fraud and conspiracy charges against Lay. Kate Murphy, *Judge Throws Out Kenneth Lay's Conviction*, N.Y. TIMES, Oct. 18, 2006, at C1.

⁷ *See, e.g.*, Howard W. Goldstein, *Corporate Crime: Government Prosecutors Are Going to Extremes*, N.Y.L.J., Sept. 1, 2005, at A1. As one well-known federal judge stated in a recent sentencing decision, "there is considerable evidence that even relatively short sentences can have a strong deterrent effect on prospective 'white collar' offenders." *United States v. Adelson*, 441 F. Supp. 2d 506, 514 (S.D.N.Y. 2006) (Rakoff, J.) (citing Richard Frase, *Punishment Purposes*, 58 STAN. L. REV. 67, 80 (2005); Elizabeth Szockyj, *Imprisoning White Collar Criminals?*, 23 S. ILL. U. L.J. 485, 492 (1999)).

⁸ *See, e.g.*, Stuart P. Green, *Uncovering the Cover-Up Crimes*, 42 AM. CRIM. L. REV. 9, 11-12 & nn.12-16 (2005) [hereinafter Green, *Uncovering*] (summarizing criticisms of Stewart's prosecution); Geraldine Szott Moohr, *What the Martha Stewart Case Tells Us About White Collar Criminal Law*, 43 HOUS. L. REV. 591, 597-98 & n.347 (2006) [hereinafter Moohr, *Martha Stewart Case*] (summarizing debate over the prosecution).

a celebrity and a woman.⁹ Others criticized the lengthy sentences imposed on Ebbers and Adelphia's John Rigas. Those critics query whether effective life sentences were appropriate for previously upstanding citizens who pose no future threat to society.¹⁰ And the courts have reversed the convictions in a number of recent, high-profile white collar crime prosecutions, rejecting the government's attempt to expand white collar criminal statutes to new areas of alleged wrongdoing.¹¹

Thus, it is not only public perceptions that are contradictory.¹² Prosecutors and lawmakers are inconsistent in the degree to which they focus their time and resources on fighting white collar crime. Juries are inconsistent in their willingness to convict white collar defendants.¹³ And courts are inconsistent when deciding whether to interpret white collar crimes broadly or narrowly¹⁴ and whether to impose lengthy sentences on white collar criminals.¹⁵

⁹ See, e.g., Joan MacLeod Heminway, *Save Martha Stewart? Observations About Equal Justice In U.S. Insider Trading Regulation*, 12 TEX. J. WOMEN & L. 247 (2003) (concluding that the Stewart prosecution was infected with sexism at many stages).

¹⁰ See, e.g., Jamie L. Gustafson, Note, *Cracking Down on White-Collar Crime: An Analysis of the Recent Trend of Severe Sentences for Corporate Officers*, 40 SUFFOLK U. L. REV. 685, 701 (2007) (questioning "whether it is justifiable for corporate officers to receive and serve the same sentences as rapists, drug dealers, and murderers"); cf. Stanley S. Arkin, *Essentially Life Sentences for Commercial Crime in the U.S.*, N.Y.L.J., June 18, 2007, at 3 ("[T]he sentences handed down in other countries rarely come close to matching the sentences recently imposed in this country for similar crimes."). See generally Szockyj, *supra* note 7, at 502.

¹¹ In these cases, the government clearly sought to expand the reach of white collar statutes, either through new interpretations of those statutes or through aggressive applications of those statutes to fact patterns that did not plainly evince wrongful conduct. See, e.g., *Arthur Andersen LLP v. United States*, 544 U.S. 696, 708 (2005) (reversing obstruction of justice conviction because of flawed jury instruction that would have allowed criminalization of routine corporate document retention policies); *United States v. Lake*, 472 F.3d 1247 (10th Cir. 2007) (reversing wire fraud and money laundering convictions of Westar executives David Wittig and Douglas Lake, finding insufficient evidence of fraud); *United States v. Brown*, 459 F.3d 509 (5th Cir. 2006) (reversing wire fraud convictions in the Enron "Nigerian barge" case because the government's theory of honest services fraud was overly broad); *United States v. Quattrone*, 441 F.3d 153 (2d Cir. 2006) (reversing obstruction of justice conviction because of flawed jury instruction that would have criminalized innocent document destruction); *United States v. Howard*, 471 F. Supp. 2d 772 (S.D. Tex. 2007) (reversing, on the basis of *Brown*, various Enron fraud-related convictions).

¹² See, e.g., Green, *Uncovering*, *supra* note 8, at 10 (describing the public's varying responses to white collar "cover-up" crime prosecutions).

¹³ See Pamela H. Bucy, *Moral Messengers: Delegating Prosecutorial Power*, 59 SMU L. REV. 321, 335 (2006) ("Juries' struggles in recent cases demonstrate society's ambivalent attitude toward white collar crime.").

¹⁴ Compare *Chiarella v. United States*, 445 U.S. 222 (1980) (reversing insider trading conviction where defendant owed no duty to the shareholders of the company in which he purchased stock), and *United States v. McNally*, 483 U.S. 350 (1987) (holding that deprivation of the intangible right to honest services does not support a mail fraud conviction), *superseded in part by statute*, Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690, § 7603(a), 102 Stat. 4181, 4508 (codified at 18 U.S.C. § 4506 (2006)), with *United States v. O'Hagan*, 521 U.S. 642 (1997) (affirming insider trading conviction despite defen-

These inconsistencies in white collar criminalization weaken our confidence that criminal justice policy is being conducted fairly and appropriately. The oft-stated goal of criminal punishment is that it should match the blameworthiness of the offender.¹⁶ In a system where the players at all levels do not operate under any sort of consistent guiding principle, we are left with the nagging suspicion that justice is not being served.

This lack of confidence is exacerbated by two aspects of white collar crime about which there is widespread agreement: white collar regulation in the United States is over-federalized and over-criminalized.¹⁷ “Over-federalization” describes federal expansion into matters historically reserved for state and local law enforcement. As commentators have repeatedly noted, this trend has resulted in an overly burdened federal law enforcement system and has caused disruptions in the balance between federal law enforcement on the one hand and state and local law enforcement on the other.¹⁸

Although the term “over-criminalization” has a number of meanings, I use the term to describe the imposition of criminal punishment for acts that are more properly the subject of civil and/or administrative remedies.¹⁹ This

dant’s lack of any duty to the target company’s shareholders, on the basis that defendant had misappropriated the information), *and* *Carpenter v. United States*, 484 U.S. 19 (1987) (holding that deprivation of an intangible property interest supports a mail fraud conviction).

¹⁵ See, e.g., *United States v. Ebbers*, 458 F.3d 110, 129 (2d Cir. 2006). In *United States v. Booker*, 543 U.S. 220, 245 (2005), the Supreme Court held that the U.S. Sentencing Guidelines as written violate a defendant’s Sixth Amendment right to a jury trial. The Court thus required that the Guidelines no longer be considered mandatory, and that sentences now be reviewed only for “reasonableness.” *Id.* at 261. The Second Circuit only reluctantly affirmed Ebbers’s sentence, characterizing the sentence as “harsh” and noting that “[t]wenty-five years is a long sentence for a white collar crime, longer than the sentences routinely imposed by many states for violent crimes, including murder, or other serious crimes such as serial child molestation.” *Ebbers*, 458 F.3d at 129. The court concluded that the sentence was reasonable, in part because it was actually a below-Guidelines sentence. *Id.*

¹⁶ See, e.g., JOSHUA DRESSLER, *UNDERSTANDING CRIMINAL LAW* 3 (4th ed. 2006) (“It is deeply rooted in our moral sense of fitness that punishment entails blame and that, therefore, punishment may not justly be imposed where the person is not blameworthy.” (quoting Sanford H. Kadish, *Why Substantive Criminal Law—A Dialogue*, 29 CLEV. ST. L. REV. 1, 10 (1980))).

¹⁷ See sources cited *infra* notes 18-19.

¹⁸ See, e.g., John S. Baker, Jr., *State Police Powers and the Federalization of Local Crime*, 72 TEMP. L. REV. 673, 712 (1999) (arguing that the over-federalization of criminal law has had the effect of consolidating power in the federal government at the expense of the states); Kathleen F. Brickey, *Criminal Mischief: The Federalization of American Criminal Law*, 46 HASTINGS L.J. 1135, 1172-74 (1995) (arguing that over-federalization damages state and local law enforcement); Ellen S. Podgor, *Jose Padilla and Martha Stewart: Who Should Be Charged With Criminal Conduct?*, 109 PENN ST. L. REV. 1059, 1059 (2005) (arguing that federal prosecutorial power has expanded due in part to the ever increasing number of federal criminal statutes and the broad interpretation given these statutes).

¹⁹ See, e.g., Sara Sun Beale, *The Many Faces of Overcriminalization: From Morals and Mattress Tags to Overfederalization*, 54 AM. U. L. REV. 747, 748 (2005) (arguing that federal criminal law has experienced enormous growth and that “a good deal of so-called regulatory or ‘white collar crime’ should fall outside the ambit of the criminal law, to be dealt with by other bodies of specialized civil law

sort of over-criminalization is the product of vague, duplicative, and sometimes incomprehensible criminal statutes that aggressive prosecutors apply to an ever-widening array of circumstances.

Although Congress's attention to white collar crime waxes and wanes, when Congress does take the time to focus on white collar crime that focus invariably leads to new and ever-more expansive criminal statutes.²⁰ When the Department of Justice decides to devote resources to white collar crime, the decision leads to a flurry of prosecutions initiated via treatise-length indictments threatening decades-long sentences.²¹ This pattern reflects that the business of fighting serious crime often falls victim to congressional and prosecutorial grandstanding.

Most commentators, including academics, practitioners, and judges, seem to agree that white collar criminalization is in need of substantial reform.²² The system of creating, enforcing, and interpreting white collar criminal statutes seems to be askew, and none of the myriad proposals for refining our system of white collar criminalization has helped solve the fundamental problems.

I argue that reform efforts should focus on providing guiding principles for Congress, prosecutors' offices, and the courts. Most importantly, such guiding principles should operate to constrain the application of white collar criminal statutes to conduct not previously deemed criminal, what I term "gray area" cases. I use the term "gray area" to describe cases that others have called "peripheral" or "marginal" cases, that is, cases that attack behavior that does not plainly fall within the scope of the criminal statute or

. . . ."); Erik Luna, *The Overcriminalization Phenomenon*, 54 AM. U. L. REV. 703, 743-44 (2005) (arguing that the current expansion of federal criminal law runs "contrary to the principles of limited government and narrow congressional powers, looking instead like the usurpation of a de facto police power by federal lawmakers"). For an analysis of the political roots of over-criminalization, see William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505 (2001) [hereinafter Stuntz, *Pathological Politics*].

²⁰ See sources cited *supra* notes 18-19.

²¹ See Richman & Stuntz, *supra* note 3; Savage & Chung, *supra* note 2. See generally Brickey, *In Enron's Wake*, *supra* note 4.

²² See, e.g., Bucy, *supra* note 13, at 342-43 (arguing that federal prosecutors are given too much discretion in the prosecution of white collar crimes and that "[w]henver success in a criminal action is uncertain, prosecutors should utilize punitive civil actions instead of criminal prosecution"); Stuart P. Green, *Moral Ambiguity in White Collar Criminal Law*, 18 NOTRE DAME J.L. ETHICS & PUB. POL'Y 501, 502 (2004) [hereinafter Green, *Moral Ambiguity*] (arguing that it is difficult to identify who the victims are, and what harm was caused, in white collar crime cases); John Hasnas, *Ethics and the Problem of White Collar Crime*, 54 AM. U. L. REV. 579, 667 (2005) ("[T]he solution to the problem of white collar crime might not consist in more vigorous federal enforcement efforts, but in no such enforcement efforts at all."). But see J. Scott Dutcher, Comment, *From the Boardroom to the Cellblock: The Justifications for Harsher Punishment of White-Collar and Corporate Crime*, 37 ARIZ. ST. L.J. 1295, 1303-08 (2005) (arguing that further criminalization of business regulatory violations and longer prison terms are necessary to deter white collar crime effectively).

statutes being employed to prosecute that behavior.²³ Of course, to succeed such prosecutions must rest upon sufficiently broad criminal statutes and upon sufficiently broad judicial interpretations of those statutes. In that sense, each of the three branches of government is complicit.

To test the proposition that white collar criminalization should be constrained when applied to gray areas, I focus on white collar financial fraud prosecutions because such cases typically garner significant governmental resources²⁴ and public attention.²⁵ Of course, aggressive extensions of existing financial fraud statutes may be warranted in extraordinary cases. I propose that financial fraud prosecutions based upon new interpretations of existing law—“gray-area” cases—should only be brought when: (1) civil and/or administrative remedies are insufficient; and (2) the harm is identifiable and substantial. In the financial fraud arena, the “harm” is usually financial harm that is relatively simple to define, if not to quantify.

Gray-area prosecutions have a cost. The novel legal theories they rely on can result in prosecutions and convictions that undermine our confidence that the system is operating fairly and efficiently. To counteract the risk entailed in criminalizing marginal behavior, gray-area financial fraud prosecutions should be limited to instances of substantial harm. Basic criminal punishment principles support this conclusion. For example, under utilitarian principles, cases in which the harm caused is sufficiently substantial would justify pushing the criminal law envelope in order to deter that harm. Under retributive principles, the greater the harm caused—financial or otherwise—the more blameworthy the culprit. This conclusion is all the more sound because in the white collar arena substantial civil and administrative alternatives to criminal punishment are readily available.

To illustrate the need for a consistent, harm-based approach that is both theoretically sound and applicable in the real world context of white collar crime, this Article focuses on three high-profile financial fraud investigations and prosecutions. These prosecutions span twenty years, and pro-

²³ See STUART P. GREEN, LYING, CHEATING, AND STEALING: A MORAL FRAMEWORK OF WHITE-COLLAR CRIME 24 (2006) [hereinafter, GREEN, LYING, CHEATING] (describing “white-collar criminal statutes in which core cases can be treated as unambiguously criminal, but peripheral cases only controversially so”); William J. Stuntz, *Self-Defeating Crimes*, 86 VA. L. REV. 1871, 1873 (2000) [hereinafter Stuntz, *Self-Defeating Crimes*] (“Broad definitions of federal fraud and misrepresentation offenses have produced a number of famous (or infamous) prosecutions of marginal misbehavior.”). As explained in Part III below, this Article focuses only on financial fraud cases. Of course, “gray area” white collar cases may be brought in many other contexts, see generally GREEN, LYING, CHEATING, *supra*, but here I maintain a narrow focus in an attempt to refine the argument.

²⁴ For example, in March 2007 the vast majority of the white collar prosecutions initiated by the Department of Justice involved various forms of financial fraud, principally bank fraud and mail and wire fraud. See TRAC Reports, White Collar Crime Prosecutions for March 2007, http://trac.syr.edu/tracreports/bulletins/white_collar_crime/monthlymar07/fil/.

²⁵ For an overview of the numerous high-profile financial fraud prosecutions, see Brickey, *In Enron's Wake*, *supra* note 4.

vide an historical perspective on white collar criminalization.²⁶ The case studies begin with the granddaddy of modern white collar cases: the 1980s securities fraud prosecution of “junk bond” king Michael Milken, followed by an analysis of the Martha Stewart securities fraud investigation and prosecution, and concluding with an examination of the May 2006 indictment of Milberg Weiss, a high-profile plaintiffs’ class action law firm, on mail and wire fraud charges. The case studies reveal that white collar criminalization and enforcement efforts are not moored to any guiding principles. Each case rests on a novel, gray-area legal theory, in circumstances in which the harm was uncertain and civil and administrative remedies were available. In none of these cases was a gray-area criminal charge justified.

In Part I of this Article, I briefly set forth the historical circumstances in which these three cases arose and spell out a proposed set of guidelines for limiting gray-area financial fraud prosecutions. In Part II, I discuss the three paradigmatic cases, with a view towards demonstrating that the harm arising from the alleged financial frauds in those cases was uncertain and the legal theories questionable. In Part III, I propose an overarching principle to guide legislators, prosecutors, and courts when enacting, enforcing, and interpreting white collar financial fraud statutes.

I. THE WHITE COLLAR CONUNDRUM

A. *An Historical Perspective*

The unsettled state of white collar criminalization was born in the acceleration in the federalization of crime that has occurred since the 1970s.²⁷ Over the last several decades, Congress has adopted broad-ranging statutes

²⁶ Others have also made first steps at attempting to bridge the divide between the theory of criminalization and the real-world application of white collar criminalization, though their focus has principally been on using morality as the guiding principle. Most significantly, in his book *LYING, CHEATING, AND STEALING*, *supra* note 23, Stuart Green undertakes a comprehensive analysis of the range of white collar crimes and constructs what he terms, in the book’s subtitle, “a moral theory of white-collar crime.” See also Stephen F. Smith, *Proportionality and Federalization*, 91 VA. L. REV. 879 (2005) (concluding that efforts to punish the “morally blameworthy” have led to disproportionately severe punishments for various federal offenses, including white collar offenses).

²⁷ See William J. Genego, *The New Adversary*, 54 BROOK. L. REV. 781, 787 (1988) (“In the mid-1970s federal prosecutors became increasingly interested in white collar offenses”); Peter J. Henning, *Testing the Limits of Investigating and Prosecuting White Collar Crime: How Far Will The Courts Allow Prosecutors to Go?*, 54 U. PITT. L. REV. 405, 408 (1993) (“Beginning in the mid-1970s . . . the federal government began targeting white collar crime as a high-priority prosecutorial area.”); J. Kelly Strader, *The Judicial Politics of White Collar Crime*, 50 HASTINGS L.J. 1199, 1205 & n.19 (1999) [hereinafter Strader, *Judicial Politics*] (citing Norman Abrams, *Assessing the Federal Government’s “War” on White-Collar Crime*, 53 TEMP. L. Q. 984, 984 (1980)) (noting the new “war” on white collar crime).

that have in some ways usurped the states' role as the principal source of criminal law enforcement.²⁸ Most notably, the federal RICO²⁹ and money laundering statutes³⁰ apply to a wide range of activities, including mundane fraud and local political corruption cases.³¹

In addition, over the last thirty years prosecutors have used new theories to expand the boundaries of white collar criminal law in ever more creative ways.³² These efforts have occurred with respect to a broad range of federal statutes, from the mail and wire fraud statutes to RICO and the securities laws. In most cases, the courts have acceded to these efforts.³³ With the benefit of hindsight, we can see that the explosions of creative, aggressive white collar prosecutions tend to come in cycles. Not surprisingly, these waves tend to coincide with political pressure on the government to address areas of public concern.

We can see the development of such cycles over the last three decades. For example, in the 1980s, the wave of corporate consolidations led to job losses and massive economic uncertainty.³⁴ The popular perception of corporate America at the time was reflected in Oliver Stone's film "Wall Street."³⁵ The antihero of the film, Gordon Gekko (played by Michael Douglas) was a take-over maven whose sights were set on a company that employed the father of Gekko's protégé, Bud Fox (Charlie Sheen). When the father's job was threatened, Fox turned on Gekko and became an undercover government informant. The film reflected widespread unease at what was perceived to be a ruthless and inhumane culture of corporate takeovers.

Prosecutors responded to the unease. The 1980s produced a flurry of high-profile prosecutions, including those of Ivan Boesky (upon whom Gekko's character was said to be based), Michael Milken, and a myriad of others. Few cases went to trial, however, and convictions in major cases

²⁸ See sources cited *supra* note 18 (discussing over-federalization).

²⁹ See 18 U.S.C. § 1961(1) (2006). For an overview of the RICO statute's applicability to white collar cases, see Paul Vizcarrondo, Jr., *Racketeer Influenced and Corrupt Organizations (RICO)*, in *WHITE COLLAR CRIME* (Otto G. Obermaier & Robert G. Morvillo eds., 2007).

³⁰ 18 U.S.C. §§ 1956-57 (2006).

³¹ See JOSEPH F. MCSORLEY, *A PORTABLE GUIDE TO FEDERAL CONSPIRACY LAW*, at xxi-xxiv (2d ed. 2003); J. KELLY STRADER, *UNDERSTANDING WHITE COLLAR CRIME* §§ 15.01, 16.01, 16.02[B] (2d ed. 2006) [hereinafter STRADER, *UNDERSTANDING*]; Helen Gredd & Karl D. Cooper, *Money Laundering*, in *WHITE COLLAR CRIME*, *supra* note 29, § 2A.01.

³² Perhaps the most notorious source of prosecutorial creativeness has been the federal mail and wire fraud statutes, 18 U.S.C. §§ 1341 and 1343 (2006). For an overview of the expansive use of these statutes, see *infra* Parts II.A-B.

³³ See generally STRADER, *UNDERSTANDING*, *supra* note 31, §§ 4.01-5.11, 16.01-16.09.

³⁴ See sources cited *infra* note 60.

³⁵ *WALL STREET* (Twentieth Century Fox 1987). Michael Douglas won the Academy Award as Best Actor for his performance. Dave Kehr, "Emperor" Dominates the Oscars, *CHI. TRIB.*, Apr. 13, 1988, at 5.

were overturned on grounds that did not reflect well on the government's aggressive use of new legal theories.³⁶

Another cycle of prosecutions arose from the wave of massive accounting scandals that swept corporate America at the turn of the twenty-first century.³⁷ In most instances, the books were cooked in an effort to prop up the firm's stock price, often to the benefit of corporate management whose compensation was based upon stock options.³⁸ Once again, of the few cases that have gone to trial, a number of convictions have been overturned because the government used untested and unsound legal theories.³⁹

Now that the wave of accounting scandals seems to be ebbing, prosecutors are turning their focus elsewhere. It is perhaps too early to clearly identify the next wave of creative prosecutions. In that light, I have chosen to include perhaps the highest profile financial fraud prosecution since the wave of post-Enron cases has ebbed: the government's massive indictment of the Milberg Weiss law firm. In that case, the government targeted class action lawsuits and alleged abuses in those suits.⁴⁰ The government's action has come at a time when business groups are urging Congress and the executive branch to act to curtail shareholder class action lawsuits.⁴¹

I have chosen to focus on three high-profile financial fraud cases. I have limited my study to financial fraud for several reasons. First, financial fraud cases are arguably the core white collar offenses: the ones that have the most potential for causing widespread harm, the ones that garner the most prosecutorial resources, the ones that gain the greatest public attention.⁴² Second, the theories in financial fraud cases are, I believe, the most susceptible to the employment of gray-area legal theories. Because many of the cases tend to be high-profile, prosecutors have many motivations for employing expansive readings of criminal statutes in these cases.⁴³ Third, the financial fraud cases have broad implications for expansion of the

³⁶ See, e.g., *United States v. Mulheren*, 938 F.2d 364, 368 (2d Cir. 1991) (reversing conviction in a Boesky-related prosecution and stating that "in America we still respect the dignity of the individual, and [a defendant] . . . is not to be imprisoned except on definite proof of a specific crime" (quoting *United States v. Bufalino*, 285 F.2d 408, 420 (2d Cir.1960))); *United States v. Regan*, 937 F.2d 823, 826-27 (2d Cir. 1991) (reversing convictions in a Milken-related case and questioning the government's principal theory in the case).

³⁷ See Brickey, *In Enron's Wake*, *supra* note 4, at 401-06 (listing cases).

³⁸ See *id.* at 411-18.

³⁹ See cases cited *supra* note 11.

⁴⁰ See *infra* Part II.C (discussing the Milberg Weiss prosecution).

⁴¹ See Stephen Labaton, *Businesses Seek New Protection on Legal Front*, N.Y. TIMES, Oct. 29, 2006, § 1, at 1 (describing business efforts to obtain measures to curtail "abusive class action lawsuits by investors"); Martha Nell, *U.S. v. Milberg Weiss: Have Prosecutors Gone Too Far?*, A.B.A.J., Dec. 2006, at 36 (observing that critics complain that "class actions are little more than a money machine minting attorney fees for lawyers while the plaintiffs themselves receive little more than token recoveries").

⁴² See *supra* notes 24-25.

⁴³ See *infra* note 243 and accompanying text.

criminal law into areas of economic regulation where civil and administrative remedies are often readily available.

The three cases I have chosen share these characteristics. Each was initiated as an economic fraud prosecution. In the Milken-related cases, the focus was on mail fraud, securities fraud, and tax fraud; in Stewart's case, on securities fraud; and in the Milberg Weiss case, on mail and wire fraud. Although other charges were brought in these cases, the government's original focus in each was on economic fraud. And in each case, the economic fraud theory was based on a substantial extension of existing law. Finally, each case was a high-profile case that garnered national headlines, in a sense representing a zeitgeist moment in federal law enforcement: in the Milken cases, the attempt to rein in perceived Wall Street corruption; in Stewart's case, the attempt to make an example of a high-profile public figure in an insider trading investigation; in the Milberg Weiss case, the attempt to put an end to perceived abuses in class action litigation. The cases arose at different times and in different contexts, but we can glean common lessons from the dynamics at work in each case.

B. *Justifying Gray-Area Prosecutions*

Extensions of criminal statutes based upon novel theories need to be justified. When a prosecution relies upon a novel application of a criminal statute to a gray-area of the law, care should especially be taken to ensure that criminalization is warranted. Many white collar crime statutes operate in gray areas almost by definition because those statutes seek to regulate complex activities that are difficult to define in advance. As a result, the risks of over-criminalization in the white collar context are substantial.⁴⁴

Two considerations make it essential that we use guiding principles in deciding when to attempt to expand the reach of the criminal law. First, defendants have a due process right to be advised of possible crimes with which they may be charged. Applying statutes beyond established bounds necessarily risks violating principles of fair notice. Second, the criminal justice system's integrity depends upon the perception that it is operating fairly and consistently. To maintain its unique expressive focus, criminal punishment should be constrained by guiding principles that limit its application to only those instances where the condemnation associated with criminal conviction is appropriate.

⁴⁴ See GREEN, LYING, CHEATING, *supra* note 23, at 23-29 (discussing the inherent difficulties in defining white collar crimes).

C. *A Framework for Analysis*

Focusing here on financial fraud prosecutions, I suggest that gray-area criminal prosecutions be limited to cases of substantial, identifiable harm. Without proof of such harm, the government should not resort to the criminal law but instead should rely on the civil or administrative remedies available to it in the vast majority of high-profile cases involving alleged financial fraud.

1. The Civil/Criminal Distinction Matters

The approach I recommend rests upon the fundamental assumption that criminal punishment is qualitatively different from, and more painful than, civil and regulatory sanctions.⁴⁵ There is a good reason why constitutional law principles provide special protections to criminal defendants, for the loss of liberty really is different from the loss of money or employment status.⁴⁶ The vast majority of white collar defendants would undoubtedly prefer fines and other civil sanctions to jail time and the taint of being branded a felon. There is simply no doubt that defendants in parallel administrative, civil, and criminal proceedings consider criminal sanctions to be of a qualitatively different order than civil and administrative sanctions.⁴⁷

Criminal punishment represents the most severe intrusion by the government into the sphere of individual autonomy. Thus, when the grounds for criminalization are suspect, the government should instead rely upon civil or administrative remedies. As Claire Finkelstein has argued, “we should begin with a presumption against the use of the criminal sanction” and define criminal offenses “in a way that makes the infringement of liberty justified in light of the harm the prohibited conduct inflicts.”⁴⁸ The damaging effects that subjects of criminal investigations and prosecutions suffer, even if criminal charges are never brought or are ultimately unsuc-

⁴⁵ See MONRAD G. PAULSEN & SANFORD H. KADISH, *CRIMINAL LAW AND ITS PROCESSES* 1-17 (1st ed. 1962); SANFORD H. KADISH & STEPHEN J. SCHULHOFER, *CRIMINAL LAW AND ITS PROCESSES* 160-64 (6th ed. 1995).

⁴⁶ See generally U.S. CONST. amends. V, VI, VIII. Of course, fines may be imposed in criminal cases in addition to civil cases. Under the United States Sentencing Guidelines, however, the vast majority of convicted white collar defendants are subject to jail time, usually substantial jail time, even in the aftermath of *United States v. Booker*, 543 U.S. 220 (2005). See *supra* note 15; *infra* note 154.

⁴⁷ See sources cited *supra* note 45.

⁴⁸ Claire Finkelstein, *Positivism and the Notion of an Offense*, 88 CAL. L. REV. 335, 335 (2000). Finkelstein focuses both on legislative crime definition and on judicial interpretation of those definitions. *Id.* at 375-81; see also Luna, *supra* note 19, at 714 (“[T]he criminal sanction should be reserved for specific behaviors and mental states that are so wrongful and harmful to their direct victims or the general public as to justify the official condemnation and denial of freedom that flow from a guilty verdict.”).

cessful at trial or on appeal, reinforce this conclusion.⁴⁹ As discussed in Part III, this criminalization analysis applies to all branches of government: legislative crime definition, executive crime enforcement, and judicial crime interpretation.

2. The Alleged Harm is Key

In criminalization theory commentary over the last twenty years, there has been an increasing tendency to focus on the morality (or immorality) of criminalized acts rather than on the harm they cause.⁵⁰ Commentary on white collar criminalization in particular has focused on morality instead of, or in addition to, the harm caused as the primary basis for criminalization.⁵¹ I hope to show, however, that focusing on the harm caused by core white collar financial fraud offenses provides a far more efficacious means for guiding criminalization.

⁴⁹ See Moohr, *Martha Stewart Case*, *supra* note 8, at 597.

⁵⁰ See Bernard E. Harcourt, *Criminal Law: The Collapse of the Harm Principle*, 90 J. CRIM. L. & CRIMINOLOGY 109, 113-14 (1999) (“Claims of harm have become so pervasive that the harm principle has become meaningless: the harm principle no longer serves the function of a critical principle because non-trivial harm arguments permeate the debate.”). Harcourt’s views have been influential. See Luna, *supra* note 19, at 703, 720 (quoting Harcourt and concluding that “the harm principle has lost its effectiveness”); V.F. Nourse, *Reconceptualizing Criminal Law Defenses*, 151 U. PA. L. REV. 1691, 1742 (2003) (citing Harcourt and stating that “the ‘harm’ principle has appeared to unravel in the latter half of the twentieth century”); Stuntz, *Pathological Politics*, *supra* note 19, at 507 n.2 (citing Harcourt and stating that the harm principle “has mostly collapsed over the course of the past generation, as our ideas about ‘harm’ have become sufficiently capacious to take in almost anything legislators might wish to criminalize”).

⁵¹ See, e.g., Peter Arenella, *Convicting the Morally Blameless: Reassessing the Relationship between Legal and Moral Accountability*, 39 UCLA L. REV. 1511, 1513 (1992) (addressing the question, “Who does the criminal law consider to be morally culpable for engaging in conduct that breaches community moral norms?”); Stuart P. Green, *White Collar Criminal Law in Comparative Perspective: The Sarbanes-Oxley Act of 2002*, 8 BUFF. CRIM. L. REV. 1, 13 (2004) (focusing on “the moral content of white collar offenses such as insider trading, tax evasion, extortion, blackmail, obstruction of justice, and many regulatory and intellectual property crimes”); Hasnas, *supra* note 22, at 662 (analyzing white collar criminalization and concluding that it does not meet the criminal law’s “purpose of punishing only morally culpable conduct”); Stephen F. Smith, *Proportionality and Federalization*, 91 VA. L. REV. 879, 882 (2005) (“There is the abiding sense among academics and judges that federal criminal law is out of kilter with any sense of moral proportion.”); Stuntz, *Self-Defeating Crimes*, *supra* note 23, at 1883 (“[T]he sheer breadth of white-collar criminal law ensures that trials will tend to focus on conduct that strikes the public as less than awful, on conduct that is far removed from the moral core of the offense.”); John Shepard Wiley Jr., *Not Guilty by Reason of Blamelessness: Culpability in Federal Criminal Interpretation*, 85 VA. L. REV. 1021, 1065 (1999) (arguing that federal strict liability statutes give “prosecutors the power to convict the morally innocent”).

The point here is not to undertake a critique of the morality versus harm debate.⁵² Rather, it is to recommend a straightforward focus on harm as our guiding principle. If we cannot identify that a defendant's alleged fraud caused or threatened to cause an identifiable harm, then criminal sanctions are not appropriate. This argument does, of course, rest on a normative assumption: that "harm" is something to be avoided and, in appropriate cases, punished.

In this Article, I focus on only one subset of white collar prosecutions: financial fraud prosecutions. In that context, the harm caused is generally financial. There will be some exceptions—the honest services theory of mail and wire fraud, for example—but by and large the prosecutions discussed below attempt to redress alleged financial harm to the victims. The harm may be difficult to quantify, but it is usually not hard to identify.⁵³

II. THREE CASE STUDIES

This Part presents a straightforward application of the harm-based approach to three paradigmatic white collar fraud investigations, and to the cases that grew out of those investigations. I do not argue that criminal charges were inappropriate in these cases. For example, in two of the cases, the defendants were charged with cover-up crimes that may well have warranted criminal charges.

In each case, my focus is narrow. I examine the principal financial fraud theory that the government asserted. The analysis rests on three inquiries: (1) Did the fraud theory rest on a significant expansion of existing law? (2) If so, did the prosecution seek to punish substantial identifiable harm? (3) If not, would administrative or civil proceedings have provided effective remedies?

These cases share some important common characteristics. Each case named a high-profile, successful, and controversial defendant: Michael Milken, the "junk bond" king; Martha Stewart, the "life-style" queen; and

⁵² The literature on the relationship between law and morality is vast. For a thorough listing of some of the best-known works by authors including Patrick Devlin, Joel Feinberg, H.L.A. Hart, Ronald Dworkin, Richard Posner, and many others, see Suzanne B. Goldberg, *Morals-Based Justifications for Lawmaking: Before and After Lawrence v. Texas*, 88 MINN. L. REV. 1233, 1235 n.9 (2004). For an insightful analysis of a morality-based approach to white collar criminalization that employs aspects of the harm principle, see GREEN, LYING, CHEATING, *supra* note 23, at 34-39.

⁵³ This Article leaves for another day a discussion of the complexities of the definition of "harm," as elucidated most notably by Joel Feinberg. *See, e.g.*, JOEL FEINBERG, *THE MORAL LIMITS OF THE CRIMINAL LAW: HARMLESS WRONGDOING* 323 (1988); JOEL FEINBERG, *THE MORAL LIMITS OF THE CRIMINAL LAW: HARM TO OTHERS* 10, 187 (1984). In the white collar crime context, Stuart Green describes the sorts of harm resulting from white collar crime. *See, e.g.*, Green, *Uncovering*, *supra* note 8, at 28 n.106 (arguing that "harmfulness" reflects the degree to which criminal acts cause, or risk causing, harm to others or self). *See generally* GREEN, LYING, CHEATING, *supra* note 23.

Milberg Weiss, the champion plaintiffs' class action law firm. Each case also raised serious criminal justice policy concerns: in the Milken-related cases, fears over the junk-bond financed corporate takeover boom; in the Stewart case, fears over widespread financial fraud; and in the Milberg Weiss case, concern over the abuse of class action litigation. Each case achieved substantial notoriety, and each led to congressional hearings to consider the policy contexts.⁵⁴

These cases reveal fundamental flaws in our system of white collar criminalization. In the Milken cases, the tax and mail-fraud based RICO theory used by the government was unprecedented and highly controversial. In the Stewart criminal case, the securities fraud theory was novel and unproven. And in the Milberg Weiss case, the mail and wire fraud theory is based upon a substantial extension of existing law. In none of the cases has substantial, direct harm been alleged or proven. And in each case, significant civil and administrative remedies provided alternatives to criminal sanctions. In such circumstances, resort to a criminal fraud theory was inappropriate at best and counterproductive at worst.

A. *Michael Milken and Mail Fraud/Tax Fraud*

If ever there were people who believed themselves to be so rich and powerful as to be above the law, they were to be found in and around Wall Street in the mid-eighties. If money could buy justice in America, Milken and [his firm Drexel Burnham] were prepared to spend it, and spend it they did But they failed, thanks to the sometimes heroic efforts of underpaid, overworked government lawyers who devoted much of their careers to uncovering the scandal.⁵⁵

James B. Stewart, *Den of Thieves*

Investment bankers weren't the only ones who swaggered through the 1980s Encouraged by Wall Street competitors and Washington legislators . . . , lawmen saw that advancement, reputation, and future prosperity depended on their success in the Milken prosecution. And, like Milken, they had a sense of holy purpose. In the certainty that they were breaking important ground and saving the Republic from ruin, [prosecutors] may have thrown accepted rules of conduct out the window.⁵⁶

Jesse Kornbluth, *Highly Confident*

⁵⁴ See *infra* notes 69, 126, 180 (pertaining to the Milken-related cases, the Martha Stewart case, and the Milberg Weiss case, respectively). See generally Stuntz, *Self-Defeating Crimes*, *supra* note 23 ("Broad definitions of federal fraud and misrepresentation offenses have produced a number of famous (or infamous) prosecutions of marginal misbehavior.").

⁵⁵ JAMES B. STEWART, *DEN OF THIEVES* 16-17 (1991).

⁵⁶ JESSE KORNBLUTH, *HIGHLY CONFIDENT* 365 (1992).

1. History

In many ways, the explosive use of federal criminal statutes in white collar cases began with the investigation and prosecution of “junk bond” king Michael Milken, his firm, Drexel Burnham Lambert, and other defendants, in the 1980s. Milken was, and in some ways still is, the white collar crime poster boy; he continues to be compared to the highest-profile white collar defendants, including Bernard Ebbers and Martha Stewart.⁵⁷

With the benefit of hindsight, it is clear that the Milken investigation marked an historical shift.⁵⁸ In the cases that arose from that investigation, federal prosecutors employed a newly aggressive approach to white collar crime, which included the first use of the RICO statute in cases of alleged Wall Street corruption.⁵⁹

To review some essential history, Milken was the Beverly Hills-based head of Wall Street firm Drexel’s high-yield bond department. Milken pioneered the use of risky “high-yield” or “junk” bonds as a means of corporate financing. He was also the most highly compensated investment banker of his time. The use of high-yield bonds to finance corporate takeovers was extremely controversial, for at least two reasons. First, the take-over craze of the 1980s led to numerous corporate consolidations, often resulting in the perception of economic damage and job losses.⁶⁰ Second, this type of financing by upstart Drexel stole the thunder from more traditional types of

⁵⁷ See, e.g., Alex Berenson, *Ideas & Trends: Defining Martha Stewart’s Alleged Crime*, N.Y. TIMES, June 8, 2003, § 4, at 5 (comparing Milken’s notoriety with Martha Stewart’s); Richman & Stuntz, *supra* note 3, at 626 (same); Savage & Chung, *supra* note 2, at 1 (comparing Milken and Ebbers).

⁵⁸ See JAMES Q. WHITMAN, HARSH JUSTICE: CRIMINAL PUNISHMENT AND THE WIDENING DIVIDE BETWEEN AMERICA AND EUROPE 43-44 (2003) (“[N]ew economic offenses have swollen the roster of acts penalized as ‘criminal’ in the United States. These include the effectively new crime of insider trading, which . . . has been the basis of some spectacular prosecutions since the early 1970s—most memorably of Ivan Boesky and Michael Milken.”). Boesky’s role is detailed below. See *infra* text accompanying notes 63-68.

⁵⁹ The Racketeer Influenced and Corrupt Organizations (“RICO”) statute is codified at 18 U.S.C. §§ 1961-64 (2006). For historical background and entertaining, and contrasting, analyses of the Milken/Drexel matter, see JESSE KORNBLUTH, HIGHLY CONFIDENT (1992); JAMES B. STEWART, DEN OF THIEVES (1991); and L. Gordon Crovitz, *How the Rico Monster Mauled Wall Street*, 65 NOTRE DAME L. REV. 1050, 1056 (1990) (noting that the Milken-related cases “revolutionized law enforcement by applying RICO’s draconian provisions for pre-trial restraints and government-approved allegations of ‘racketeering’ to entirely new kinds of cases and defendants”).

⁶⁰ See, e.g., Crovitz, *supra* note 59, at 1050 (noting that junk bond financing of corporate transactions “caused great dislocations and in some quarters great anger”); Randall Smith & Ann Monroe, *New Insecurity: Insider-Trading Jitters Deal Another Setback to Junk-Bond Market; Drexel Burnham Connection to SEC Probe Hurts Price of Takeover Instruments; Residue of the LTV Collapse*, WALL ST. J., Nov. 20, 1986, § 1, at 11 (“[J]unk bonds are best known for their most controversial use—supplying ammunition for corporate raiders Because junk bonds have financed so many takeovers and stock buybacks by corporations, they have come to underpin the entire stock market.”).

corporate financing, much to the chagrin of the more established Wall Street firms.⁶¹

Some speculated at the time that the criminal investigation of Milken and Drexel, led by Rudolph Giuliani's U.S. Attorney's Office in Manhattan, was motivated both by Wall Street's call for Drexel to be put in its place and by the United States Attorney's political ambitions.⁶² But the case actually began on a much more mundane level, as a fairly routine insider trading case involving mid- and lower-level employees at Wall Street investment firms and even some law firms.⁶³ This scandal, however, ensnared a bigger fish: Ivan Boesky. Boesky was the most high-profile arbitrageur of his time,⁶⁴ and when Boesky was threatened with criminal indictment, he gave up sometime business associate Milken.⁶⁵

2. The Milken and Drexel Cases

The government's investigation of Milken, like its investigation of Martha Stewart, started as a fairly straightforward insider trading case. But, as in Stewart's case, the government ultimately focused on a novel securities fraud theory, in Milken's case in connection with a "stock parking" arrangement. Stock parking occurs when one party nominally sells stock to a second party, with the understanding that the second party will sell the stock back to the original owner at a later time.⁶⁶ Typically, the second party is not at risk; the original owner compensates the nominal owner for

⁶¹ See, e.g., Crovitz, *supra* note 59, at 1050; Winston Williams, *At Drexel, a New Chief's New Problems*, N.Y. TIMES, May 26, 1985, § 3, at 4.

⁶² See, e.g., Williams, *supra* note 61; Stephen J. Adler, Ann Hagedorn & Laurie P. Cohen, *Litigator's Legacy: After Advancing Use of Racketeering Law, Giuliani Eyes Politics; The Resigning U.S. Attorney Prosecuted Insider Traders and Several Mafia Dons; Is He a Too-Hasty Zealot?*, WALL ST. J., Jan. 11, 1989, § 1, at 11 ("[Giuliani's] tough stance on crime, even his use of RICO, might well stand him in good stead in any political campaign.").

⁶³ See Robert J. Cole, *Wall Street's Defensive Line*, N.Y. TIMES, Mar. 30, 1987, at D1 (observing that Boesky's admission to insider trading activities widened the government's investigation of the corruption on Wall Street and led to "dozens of subpoenas for information from Wall Street traders, investment bankers and brokerage firms"); James Sterngold, *SEC Is Said to Widen Its Wall Street Inquiry*, N.Y. TIMES, Jan. 19, 1987, at D1 (noting that the SEC and the U.S. Attorney were no longer limiting their investigations to insider trading, but were "exploring more complex schemes that could involve breaches of technical securities laws").

⁶⁴ An arbitrageur is one who engages in arbitrage. "Arbitrage" generally involves buying and selling securities very quickly based upon market information. See Donald C. Langevoort, *Taming the Animal Spirits of the Stock Market: A Behavioral Approach to Securities Regulation*, 97 NW. U. L. REV. 135, 140 n.15 (2002). Often, such trading occurs in anticipation of extraordinary corporate transactions, such as mergers and acquisitions. Because such transactions can cause quick and substantial changes in stock prices, arbitrage is generally very risky and potentially very profitable.

⁶⁵ See *Trial and Error: American Companies*, ECONOMIST, June 22, 2002, at 2.

⁶⁶ See *United States v. Bilzerian*, 926 F.2d 1285, 1290 (2d Cir. 1991) (defining "stock parking").

losses, and the nominal owner returns any profits to the original owner. Parties may park their stock for any number of reasons. For example, the original owner may wish to keep the stock in the long-term portfolio, but may also wish to sell the stock to take a tax loss in a given year.

The government theorized that Milken and Boesky had entered into a stock parking arrangement in order to conceal the Boesky's stake in a company's stock. This arrangement allowed Boesky to avoid publicly disclosing his stake in filings with the SEC.⁶⁷ This theory was the basis of conspiracy, securities fraud, mail fraud, market manipulation and tax fraud charges against Milken.⁶⁸ The government also filed criminal charges against Milken's brother, Lowell, but those charges were dropped when Michael Milken agreed to plead guilty.⁶⁹ In addition, the government charged Drexel with, among other crimes, violating the RICO statute, based upon the predicate acts of mail fraud and securities fraud. Drexel subsequently pleaded guilty, filed for bankruptcy, and went out of business.⁷⁰ Because Milken and Drexel pleaded guilty, the government's securities fraud and RICO theories were not challenged in those cases.

3. The Princeton-Newport Partners Case

As part of the Drexel and Milken investigation, the government also filed criminal charges against an investment firm, Princeton-Newport Partners ("PNP"), and certain of its principals.⁷¹ Because this was the only

⁶⁷ Federal Securities laws require individuals and entities, or groups of either acting in concert, to make a public disclosure whenever they acquire 5% or more of a class of voting stock in a company, in part to alert the company and the investing public to a potential takeover. *See SEC v. Drexel Burnham Lambert, Inc.*, 837 F. Supp. 587, 589-90 (S.D.N.Y. 1993).

⁶⁸ Milken was originally charged in a 98-count RICO-driven indictment, but ultimately pleaded guilty to only six counts. *See United States v. Milken*, 759 F. Supp. 109, 110 (S.D.N.Y. 1990).

⁶⁹ *See Laurie P. Cohen, Public Confession: Milken Pleads Guilty to Six Felony Counts and Issues an Apology; He Admits Cheating Clients and Plotting with Boesky to Assist a Posner Raid; Teary Scene in the Courtroom*, WALL ST. J., Apr. 25, 1990, at A1. Milken agreed to pay \$600 million in fines and restitution and was sentenced to ten years in prison. At the time, this pre-Guidelines sentence was considered extraordinarily harsh. *See Laurie P. Cohen, Milken's Attorneys Expected to Act Soon to Appeal His 10-Year Prison Sentence*, WALL ST. J., Nov. 28, 1990, at B6. Because of good behavior, Milken's sentence was later reduced to two years in prison and three years' probation and community service. *Wade Lambert, Milken Wins Early Release from Prison; Time to Be Served Is Cut to Two Years; His Aid to Prosecutors Is Cited*, WALL ST. J., Aug. 6, 1992, at A3.

⁷⁰ Arthur F. Mathews, *Defending SEC and DOJ FCPA Investigations and Conducting Related Corporate Internal Investigations: The Triton Energy/Indonesia SEC Consent Decree Settlements*, 18 NW. J. INT'L L. & BUS. 303, 427 n.475 (1998). After pleading guilty to six felony counts and paying over \$650 million in fines and penalties, Drexel filed for bankruptcy in 1990 and thereafter ceased to operate. *Id.* at 429.

⁷¹ *See United States v. Regan*, 937 F.2d 823, 826-27 (2d Cir. 1991) (reversing principal convictions).

Milken-related case to be fully litigated at trial and on appeal, it provides the richest source for examining the government's tactics.

From the beginning, the PNP defendants asserted that the criminal charges were part of an effort to persuade the defendants to cooperate in the government's long and, up to that point, unfruitful investigation of Drexel and Milken.⁷² Such a government tactic, of course, is not unprecedented and often not unwarranted.

But the strange aspect of the PNP case—and the key point here—is the manner in which the government charged the case. Once again, this was a stock parking case based upon an arrangement with Milken. Before the PNP case, stock parking had been viewed as a civil violation of SEC record-keeping requirements. There had never been a criminal case built on stock parking before.⁷³ Stock parking can certainly be a serious matter, particularly if willfully undertaken to evade taxes or securities reporting requirements. So, a securities or tax fraud case in such circumstances would arguably be justifiable. But the government did not stop with securities and tax fraud charges. Because PNP mailed its tax returns, the government also charged the defendants with mail fraud based upon the tax fraud. Because it charged mail fraud, the government could bring charges under the RICO statute, with mail fraud as the principal predicate acts.⁷⁴ And because RICO contains forfeiture provisions, the government could, and did, assume con-

⁷² See L. Gordon Crovitz, *RICO's Broken Commandments*, WALL ST. J., Jan. 26, 1989, at A14.

⁷³ See John C. Coffee, Jr., *Does "Unlawful" Mean "Criminal"?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. REV. 193, 217-18 & n.101 (1991) [hereinafter Coffee, *Unlawful*] (citing the PNP case, *Regan*, 937 F.2d 823, and *United States v. Mulheren*, 938 F.2d 364, 366 (2d Cir. 1991), as examples of the SEC's beginning to make "criminal referrals in stock parking cases" and thus seeking criminal sanctions in what had been a "traditionally civil area"). The *Mulheren* case was another offshoot of the Boesky investigation, and Boesky was the star witness at the trial. *Mulheren* was charged under a 42-count indictment alleging that he committed market manipulation, engaged in "stock parking," committed mail fraud in connection with the stock parking, and caused another to make and keep false books and records in connection with the parking. Of those counts, most were either dismissed or led to a hung jury; *Mulheren* was convicted on only four counts. Noting that it "harbor[ed] doubt about the government's theory of prosecution," the Second Circuit reversed those convictions on the grounds of insufficient evidence. See *Mulheren*, 938 F.2d at 366.

⁷⁴ 18 U.S.C. § 1962 (2006). For the elements of a RICO prosecution, see STRADER, UNDERSTANDING, *supra* note 31, § 16.02[B].

trol over PNP's assets prior to trial.⁷⁵ When that happened, to no one's surprise, PNP's investors pulled out and the company went out of business.⁷⁶

This sequence of events was widely publicized.⁷⁷ Congressional hearings ensued, and the Department of Justice issued guidelines discouraging the use of mail fraud to prosecute tax fraud.⁷⁸ The PNP defendants were convicted at trial, but the heart of the government's case was overturned on appeal, in an opinion that questioned the government's theory of the case.⁷⁹

4. The Harm Caused

The government's theory in the PNP case was that the stock parking arrangement led to phony tax losses and thus to the filing of false returns.

⁷⁵ See *United States v. Regan*, 858 F.2d 115 (2d Cir. 1988) (upholding the government's right to restrain the dissipation of potentially forfeitable assets under 18 U.S.C. § 1963(d)(2)). Under federal forfeiture laws, the government may obtain pre-trial seizure of and ultimate ownership over a wide range of property that was used in the commission of, or that represents the proceeds from, numerous federal crimes, including white collar crimes. For an overview of these laws, see J. Kelly Strader & Diana Parker, *Civil and Criminal Forfeitures*, in *WHITE COLLAR CRIME* (Otto G. Obermaier & Robert G. Morvillo eds., 2007).

⁷⁶ See Ann Hagedorn, *Princeton/Newport Sets Liquidation; Officials Faced Racketeering Charges*, WALL ST. J., Dec. 8, 1988, at A1; Steven Labaton, *Business and the Law: A Difficult Choice Confronts Drexel*, N.Y. TIMES, Dec. 12, 1988, at D2; David A. Vise, *RICO Goes to Wall St.: Racketeer Law's Impact Felt Even Before Verdict in First Case*, WASH. POST, July 30, 1989, at H1.

⁷⁷ See, e.g., Steven J. Adler, *Heated Argument: Are RICO Seizures a Violation of Rights, as Critics Contend?; Presumption of Innocence Doesn't Prevent Restraint of Accused Before Trial; Milken Allies Fuel Debate*, WALL ST. J., Feb. 15, 1989; Laurie P. Cohen, *Princeton/Newport Prosecutor Opens Trial by Quoting Defendant on "Sleaze,"* WALL ST. J., June 21, 1989; Kurt Eichenwald, *Six Charged with Racketeering in Wall Street Insider Inquiry*, N.Y. TIMES, Aug. 5, 1988, at A1; Kurt Eichenwald, *Court Freezes Assets of Six in Tax Fraud Case*, N.Y. TIMES, Aug. 9, 1988; Editorial, *Ham-Sandwich RICO*, WALL ST. J., Aug. 11, 1989; Editorial, *The Queen's Justice*, WALL ST. J., Dec. 9, 1988; Editorial, *The Six RICOteers*, WALL ST. J., Feb. 2, 1989.

⁷⁸ See ORGANIZED CRIME AND RACKETEERING SECTION, U.S. DEPARTMENT OF JUSTICE, RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS (RICO): A MANUAL FOR FEDERAL PROSECUTORS § 2(A)(2)(a) (4th ed. 2000) ("Because of legitimate concerns about the possible overuse of the mail fraud statute to generate RICO cases out of relatively minor conduct, the Criminal Division has imposed policy limitations on its use as a predicate offense. . . . [T]he Organized Crime and Racketeering Section will not approve a proposed RICO indictment that contains mail fraud predicates involving federal tax evasion or other offenses arising under the federal internal revenue laws unless previously approved by the Criminal Section of the Tax Division."); see also Crovitz, *supra* note 59.

⁷⁹ The Court of Appeals reversed the tax fraud charges because the district court failed to instruct the jury on the issue of whether the defendants' reliance on the controverted provisions of the tax code was in good faith and stated that in light of its reversal of the predicate tax offenses on which the RICO charges were based, "[b]efore this lengthy case is retried, the Government may decide to withdraw the RICO count in view of the Department of Justice's July 1989 guidelines, which substantially curtail the use of tax frauds as direct or indirect predicate RICO offenses, and the district court's judicious decision to eliminate the forfeiture of assets by the defendants." *United States v. Regan*, 937 F.2d 823, 826-27 (2d Cir. 1991).

The false returns charges were parlayed into mail fraud and RICO charges, what the Second Circuit collectively termed the “tax hierarchy” offenses.⁸⁰

Did this prosecution fulfill the requirements of a harm-principle based system of justice? It would seem not. First of all, PNP did not underpay its taxes, so the government did not lose any money and the crime of tax evasion did not occur.⁸¹ Yet, the government has a strong interest in tracking tax-related information, and the crime of filing a false return does not require proof of underpayment. So, the alleged harm was to the government in its ability to assess taxes.

Was the harm sufficient, however, to merit a sixty-four count indictment, including a RICO count? Or, to pose the question more directly, was the government’s response proportionate to the alleged harm? The tax issue was complex and technical. At trial, the defense argued that the defendants honestly believed that they were entitled to deduct losses from the sales of parked stock and that the returns therefore were accurate.⁸² Under Supreme Court precedent, such a belief would be a complete defense to tax fraud.⁸³ The Second Circuit reversed the tax-based convictions because the trial judge failed to provide an adequate good faith defense instruction.⁸⁴ Because the tax fraud charges were reversed, so were the mail fraud and RICO convictions.⁸⁵ The government declined to refile those charges.⁸⁶

The Drexel, Milken, and PNP cases raise a myriad of issues under a harm-principle-based scheme. First, were these cases properly filed as criminal cases? In such technical, disputed areas of the law, would civil enforcement proceedings have been preferable? Second, even if criminal charges were warranted, were the cases, especially the PNP case, dramatically overcharged?

⁸⁰ *Id.* at 827.

⁸¹ See Jane Rohrer, *What Price Investor Confidence? RICO Abuse as Compensable Takings*, 66 S. CAL. L. REV. 1675, 1688 (1993) (“[T]he Internal Revenue Service later determined that Princeton/Newport had in fact overpaid its taxes.”); see also L. Gordon Crovitz, *Rule of the RICO Monster Turns Against His Master*, WALL ST. J., Jan. 15, 1992, at A13 (“This sentence-first, verdict-later twist included the irony that the Internal Revenue Service said [Princeton/Newport] actually overpaid its taxes.”).

⁸² *Regan*, 937 F.2d at 826.

⁸³ See *Cheek v. United States*, 498 U.S. 192 (1991) (holding that tax fraud requires intent to defraud).

⁸⁴ *Regan*, 937 F.2d at 826-27.

⁸⁵ *Id.* at 827. All that remained were securities fraud and conspiracy counts. *Id.* at 830. On those charges, the defendants were sentenced to prison terms ranging from three to six months. *United States v. Regan*, No. 88 Cr. 571 [RLC] (order dated Nov. 6, 1989). In October 1991, the Court entered an order amending that opinion and vacating the conspiracy charges against four of the defendants. *United States v. Regan*, 946 F.2d 188, 188 (2d Cir. 1991). This left the securities fraud charges against two defendants. *Id.* at 188-89. Their sentences were vacated in September 1992. Christi Harlan, *Prison Sentences For Two Princeton/Newport Defendants Thrown Out*, WALL ST. J., Sept. 9, 1992, at B8.

⁸⁶ Ronald Sullivan, *Insider Jail Terms Set Aside*, N.Y. TIMES, Sept. 9, 1992, at D16.

With respect to Drexel, we will never know the answers to these questions because the facts will never be fully revealed. After its indictment, the firm pleaded guilty and ceased to exist. Milken also pleaded guilty, perhaps largely to protect his brother from criminal exposure,⁸⁷ and the theory in his case was never tested either.

With respect to PNP, the Second Circuit's questioning of the legal theory, and the Justice Department's adoption of policies against building a mail fraud and RICO case based on tax fraud, strongly suggest that a criminal case was not appropriate, and certainly that a RICO case was not appropriate. A civil tax enforcement proceeding would have certainly been preferable to a criminal case. And even if a criminal case was justified—a doubtful conclusion—it was certainly not justifiable to parlay a narrow tax fraud case into a multi-count mail fraud and RICO indictment.

Had the government focused on the alleged harm caused by PNP's actions, it would have reached these conclusions on its own. In reversing the principal convictions, perhaps the court implicitly recognized the disconnect between the charges and the harm. This result occurred, however, only after the company had gone out of business and the defendants had spent millions in legal fees over the course of investigation, trial, and appeal. This was not an efficient, effective, or fair use of criminal justice resources.

B. *Martha Stewart and Securities Fraud*

On the scale of highly publicized misdeeds in the past decade, Stewart's [ImClone] trade must rank among the most trivial. . . . It seems almost implausible that such a misstep could send Stewart to prison and lead her company to ruin.⁸⁸

Jeffrey Toobin, *The New Yorker*

Virtually everybody who takes Ms. Stewart's side conveniently ignores the fact that there was some poor schmo (or schmoes) out there who bought her shares of ImClone. . . . Martha Stewart ripped her buyers off as certainly as if she'd sold them silk sheets that she knew were actually synthetic.⁸⁹

Scott Turow, *The New York Times*

The Martha Stewart securities fraud investigation and prosecution illustrate the indeterminate nature of white collar harm. Much commentary has been written about Stewart's legal woes, mostly focusing on the criminal trial and on the cover-up crimes (perjury, false statements, and obstruc-

⁸⁷ See Cohen, *supra* note 69 (stating that the government's decision to drop the criminal charges against Milken's brother Lowell was the "crucial aspect" of Milken's decision to plead guilty).

⁸⁸ Jeffrey Toobin, *A Bad Thing: Why Did Martha Lose?*, NEW YORKER, Mar. 22, 2004, at 60.

⁸⁹ Scott Turow, *Cry No Tears for Martha Stewart*, N.Y. TIMES, May 27, 2004, at A29.

tion of justice) of which Stewart and her co-defendant were convicted. Relatively little attention has been paid to the criminal and civil securities fraud charges brought against Stewart, and few have written on the incongruity between the securities fraud theories the government asserted in the criminal and civil cases it filed against her.⁹⁰ Nor has much attention been paid to the relationship between the alleged harm from Stewart's actions and the government's theories in those cases.

Stewart's criminal case was affirmed on appeal,⁹¹ and the SEC's civil case settled.⁹² This is, then, a particularly opportune time to reevaluate those cases. To reiterate, the issue is not whether Martha Stewart should have been charged with the cover-up crimes of which she was convicted. Rather, the issue is whether the *criminal securities fraud* count, which carried by far the longest possible sentence of the charges, was justified by the alleged harm caused.

To review briefly, in the criminal case the Department of Justice filed both cover-up crime charges and one criminal securities fraud charge against Martha Stewart.⁹³ The securities fraud charge was based on the trading of Martha Stewart Living Omnimedia ("MSLO") stock. In the civil case, the SEC based its theory on trading in ImClone stock.⁹⁴ As explained

⁹⁰ For a variety of treatments that do not give attention to this issue, see Kathleen L. Brickey, *Mostly Martha*, 44 WASHBURN L.J. 517 (2005) [hereinafter Brickey, *Mostly Martha*]; Podgor, *supra* note 18; and Michael L. Seigel & Christopher Slobogin, *Prosecuting Martha: Federal Prosecutorial Power and the Need for a Law of Counts*, 109 PENN ST. L. REV. 1107 (2005). For analysis of the securities fraud charges, see Moohr, *Martha Stewart Case*, *supra* note 8, at 602-08; and Jeanne L. Schroeder, *Envy and Outsider Trading: The Case of Martha Stewart*, 26 CARDOZO L. REV. 2023, 2043-44 & n.87 (2005). See generally JOAN MACLEOD HEMINWAY, *MARTHA STEWART'S LEGAL TROUBLES* (2006) (collecting materials relating to the Stewart case).

⁹¹ *United States v. Stewart*, 433 F.3d 273 (2d Cir. 2006).

⁹² Press Release, Sec. & Exch. Comm'n, *supra* note 5. Stewart agreed to an injunction against future securities law violations; disgorgement, plus interest, for a total of \$58,062; a civil penalty of \$137,019; and a five-year ban on serving as a director, officer, or employee of a public company. *Id.* Stewart did not admit any wrongdoing. See *id.* (containing no mention of an admission).

⁹³ The indictment charged Stewart with two counts of making false statements to the government, under 18 U.S.C. § 1001 (2006); with one count of obstruction of justice, under 18 U.S.C. § 1505 (2006); with one count of conspiracy to commit obstruction, make false statements and commit perjury, under 18 U.S.C. § 371 (2006); and with one count of securities fraud, under 15 U.S.C. § 78j(b) (2006). Superseding Indictment, *United States v. Stewart*, 03 Cr. 717 (MGC) [hereinafter *Stewart Indictment*], available at <http://news.findlaw.com/hdocs/docs/mstewart/usmspb10504sind.html>; Complaint, SEC v. Stewart, 03 CV 4070 (NRB) [hereinafter *Stewart Complaint*], available at <http://www.sec.gov/litigation/complaints/comp18169.htm>. The criminal securities fraud charge was dismissed for insufficient evidence of willfulness. *United States v. Stewart*, 305 F. Supp. 2d 368, 376 (S.D.N.Y. 2004). Stewart was convicted of the cover-up crime charges, and the convictions were affirmed on appeal. *Stewart*, 433 F.3d 273. Stewart was imprisoned for five months, served five months under house arrest, and was fined \$30,000. See Constance L. Hays, *5 Months in Jail, and Stewart Vows, "I'll Be Back,"* N.Y. TIMES, July 17, 2004, at A1.

⁹⁴ See *infra* note 126 and accompanying text.

more fully below, these two theories implicated vastly different amounts of alleged loss.

As the quotations at the beginning of this section illustrate, much of the public discourse surrounding Martha Stewart's case focused on the alleged insider trading of ImClone stock that formed the basis of the SEC's theory in its civil case. That securities fraud theory, and the different securities fraud theory used in the criminal case, illustrate the dangers and confusion caused by over-criminalization of white collar offenses. The Stewart case is also yet another example of the sort of prosecutorial practices employed in the Milken investigation. Both Milken and Stewart were high-profile, controversial public figures who were prosecuted based upon novel extensions of white collar criminal statutes.⁹⁵

1. Insider Trading Law and Policy

a. *Overview of Insider Trading Law*

Securities fraud, including insider trading law, presents one of the most visible examples of over-criminalization, when seen through the prism of the harm principle. The securities fraud statutes do not define securities fraud in general, or even proscribe, much less define, insider trading in particular. In fact, the principal securities fraud statute under which insider trading is prosecuted, Section 10(b) of the Securities and Exchange Act of 1934, does not mention insider trading.⁹⁶ The task of defining the crime has largely fallen to the United States Supreme Court, which has attempted to do so in a number of sometimes contradictory decisions spreading over more than two decades.⁹⁷ Thus, as many commentators have noted, securi-

⁹⁵ See Richman & Stuntz, *supra* note 3, at 626 ("High-end white-collar defendants like Michael Milken or Martha Stewart became celebrities in part because they got more than their share of the benefits of American prosperity."); Alex Berenson, *supra* note 57 ("Overnight, Ms. Stewart became the most controversial white-collar defendant since Mr. Milken [M]any conservatives defended [Mr. Milken], arguing that he had been singled out by prosecutors more for the money he had made and the economic dislocations his bonds had caused than for any actual crimes.").

⁹⁶ 15 U.S.C. § 78j(b) (2006). Insider trading is also proscribed by SEC Rule 10b-5, 17 C.F.R. § 240.10b-5 (2006), which is the general antifraud regulation promulgated pursuant to the Act. In addition, the SEC has recently attempted to provide some definition to insider trading in Rules 10b5-1 and 10b5-2, 17 C.F.R. § 240.10b5-1 to -2 (2006). Neither of those provisions is directly relevant to the discussion here.

⁹⁷ For cases narrowly defining securities laws, see *Central Bank of Denver v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 191 (1994); *Dirks v. SEC*, 463 U.S. 646 (1983); and *Chiarella v. United States*, 445 U.S. 222 (1980). For cases broadly defining securities laws, see *SEC v. Zandford*, 535 U.S. 813 (2002); and *United States v. O'Hagan*, 521 U.S. 642 (1997). For an analysis of the inconsistency, see Mark L. Loewenstein, *The Supreme Court, Rule 10b-5 and the Federalization of Criminal Law*, 39 IND. L. REV. 17 (2005).

ties fraud doctrine in general, and insider trading law in particular, tend to be vague and confusing.⁹⁸ Indeed, as discussed more fully below, commentators have long been divided over whether insider trading actually causes harm; that is, whether such trading undermines, or benefits, market efficiency.⁹⁹

Under controlling Supreme Court precedent, insider trading charges can be brought under two theories. The first theory, called the “traditional” theory or the “classical” theory, applies when a corporate officer, director, or other “insider” takes confidential corporate information and uses it to trade in the corporation’s stock. In a long line of cases, beginning with the SEC’s seminal decision in *In re Cady, Roberts & Co.*, the SEC and the courts have imposed liability in such circumstances based upon the insider’s breach of fiduciary duties to the corporation and its shareholders.¹⁰⁰ Also falling under the traditional theory are cases against “temporary” or “quasi” insiders, such as outside corporate lawyers or accountants, who assume a temporary duty to the corporation and its shareholders.¹⁰¹

The second, and far more controversial, insider trading theory is the misappropriation theory. Under this theory, a person is liable when that person takes information from a party to whom the person owes a fiduciary duty and then trades on the information. This is true regardless of whether the person has any relationship with the company the stock of which was traded. Lower courts had split on whether this is a viable theory, and a divided United States Supreme Court approved the misappropriation theory in *United States v. O’Hagan*.¹⁰²

⁹⁸ See Schroeder *supra* note 90, at 2043-44. See generally James Boyle, *A Theory of Law and Information: Copyright, Spleens, Blackmail, and Insider Trading*, 80 CAL. L. REV. 1413 (1992); James D. Cox, *Insider Trading and Contracting: A Critical Response to the “Chicago School,”* 1986 DUKE L.J. 628; Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 GA. L. REV. 179 (1991).

⁹⁹ See generally HENRY G. MANNE, *INSIDER TRADING AND THE STOCK MARKET* (1966); Dennis W. Carlton & Daniel R. Fischel, *The Regulation of Insider Trading*, 35 STAN. L. REV. 857 (1983); Stuart P. Green, *Cheating*, 23 LAW & PHIL. 137, 177-78 (2004) [hereinafter Green, *Cheating*]; David D. Haddock & Jonathan R. Macey, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449 (1986); Jonathan R. Macey, *From Fairness to Contract: The New Direction of Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984).

¹⁰⁰ *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961). The Supreme Court has rejected an expansive application of the *Cady, Roberts* rule that would impose a “duty to the market” on all market participants. Instead, violations of the insider trading laws are limited to instances of breach of a specific fiduciary duty to the owner of the nonpublic information. *Chiarella*, 445 U.S. at 235 (“When an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak. We hold that a duty to disclose under § 10(b) does not arise from the mere possession of nonpublic market information.”).

¹⁰¹ See *Dirks*, 463 U.S. at 655 n.14.

¹⁰² 521 U.S. 642 (1997). The Court split six to three, with Chief Justice Rehnquist and Justices Scalia and Thomas dissenting. The Court had first considered the misappropriation theory in *Carpenter v. United States*, 484 U.S. 19 (1987), but divided four to four on its validity. Largely because it relies

Even when a person is not an insider or misappropriator, that person can be liable for insider trading as a “tippee.” Under the Supreme Court’s decision in *Dirks v. SEC*, a person who receives material, nonpublic information from a “tipper” and who trades on that information can be liable if certain conditions are met.¹⁰³ In an insider trading case against a tippee, the government must show that: (1) the tipper obtained material nonpublic information as a corporate insider or quasi-insider, or by misappropriating the information from one to whom the tipper owed a duty; (2) the tipper gave the information to the tippee for personal gain to the tipper; (3) the tippee bought or sold securities; (4) the tippee knew (or recklessly disregarded facts showing) the information was material, nonpublic information; and (5) the tippee acted willfully.¹⁰⁴ Most courts find that the willfulness requirement is met where the tippee knew (or, according to some courts, recklessly disregarded facts showing) that the tipper breached a duty when revealing the information to the tippee.¹⁰⁵

b. *The Policy Debate*

Insider trading is a relatively “new” crime, and is emblematic of the broadening scope of white collar criminalization.¹⁰⁶ A debate has raged over whether insider trading is harmful or, in fact, beneficial. The courts and the SEC adhere to the view that insider trading harms both individual traders and the market in general. Under this view, the person who trades with someone who possesses the inside information is damaged because that person is operating at an informational disadvantage. Further, the market itself is harmed by the perception of an uneven playing field; average investors will shy away if they believe they are handicapped vis-à-vis insiders.¹⁰⁷

upon breaches of ill-defined fiduciary duties, the theory has been attacked as vague and unprincipled. See, e.g., David M. Brodsky & Daniel J. Kramer, *A Critique of the Misappropriation Theory of Insider Trading*, 20 CARDOZO L. REV. 41, 80 (1998); Steve Thel, *Statutory Findings and Insider Trading Regulation*, 50 VAND. L. REV. 1091, 1120-21 (1997).

¹⁰³ *Dirks*, 463 U.S. at 646.

¹⁰⁴ See STRADER, UNDERSTANDING, *supra* note 31, § 5.07[E][2].

¹⁰⁵ See *id.* § 5.07[E][2][a]. Remote tippees—tippees who gained their information from other tippees—can also be liable, so long as all the requirements of *Dirks* are met. See *id.* §§ 5.07[E][2][a]-[b], and cases cited therein.

¹⁰⁶ See WHITMAN, *supra* note 58, at 43-44 (“[N]ew economic offenses have swollen the roster of acts penalized as ‘criminal’ in the United States. These include the effectively new crime of insider trading . . .”).

¹⁰⁷ See *United States v. O’Hagan*, 521 U.S. 642, 658 (1997) (“[A]n animating purpose of the Exchange Act [is] to insure honest securities markets and thereby promote investor confidence.”); *Cady, Roberts & Co.*, 40 S.E.C. 907, 911-12 (1961) (positing that it is unfair for an insider to profit from secret information that belongs to the corporation and its shareholders); Carol B. Swanson, *Insider Trading Madness: Rule 10b5-1 and the Death of Scienter*, 52 U. KAN. L. REV. 147, 159 (2003) (noting that some

Many commentators argue, however, that insider trading is neither unfair nor harmful to the market.¹⁰⁸ As to harm to individual investors, as one commentator has noted, “it is difficult to conceptualize how public investors are any worse off simply because the person with whom they trade did not disclose her intent to trade to the source of her information.”¹⁰⁹ As to harm to the market, many argue that trading based upon nonpublic information causes stock prices to change based upon that information.¹¹⁰ The market price will adjust to the new (nonpublic) information. Those who trade after the market has absorbed the effect of the insider trading will thus benefit from the insider trading because the stock price will more accurately reflect the stock’s value. One recent survey of the literature thus found that “most commentators conclude that insider trading prohibitions are probably not worth the heavy regulatory cost and that the underlying efficiencies, rather than more amorphous ‘fairness’ concepts, should rule the day.”¹¹¹ The insider trading harm debate is central to an analysis of the Martha Stewart saga.

2. The Martha Stewart Cases

As was widely reported, the government’s criminal investigation of Martha Stewart was initially premised on her potential liability as a tippee. Specifically, the government began investigating Stewart’s trading in the stock of ImClone, a pharmaceutical company.¹¹² According to the criminal indictment and the SEC complaint against Stewart, the facts are straightforward. ImClone’s CEO, Sam Waksal, was Stewart’s personal friend. As was widely known in late 2001, an announcement was pending from the

argue that insider trading “could cripple market integrity by scaring away investors who fear the insurmountable advantages enjoyed by those possessing inside information”).

¹⁰⁸ The most often cited source for this position is MANNE, *supra* note 99. For a rejoinder to Manne and his followers, see Ian B. Lee, *Fairness and Insider Trading*, 2002 COLUM. BUS. L. REV. 119.

¹⁰⁹ Richard W. Painter et al., *Don’t Ask, Just Tell: Insider Trading After United States v. O’Hagan*, 84 VA. L. REV. 153, 168 n.57 (1998).

¹¹⁰ Many commentators have argued that trading based on inside information promotes market efficiency. JONATHAN R. MACEY, *INSIDER TRADING: ECONOMICS, POLITICS, AND POLICY* 24-28 (1991); Frank H. Easterbrook, *Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information*, 1981 SUP. CT. REV. 309, 325; *cf.* *Dirks v. SEC*, 463 U.S. 646, 658 (1983) (noting the role of market analysts in bringing information to the market and helping the market to function more effectively). For a contrary view, see LEO KATZ, *ILL-GOTTEN GAINS: EVASION, BLACKMAIL, FRAUD AND KINDRED PUZZLES OF THE LAW* 171 (1996).

¹¹¹ Swanson, *supra* note 107, at 160-61.

¹¹² See Constance L. Hays, *Stewart Inquiry Is Said to Focus on Lack of a Sell Order*, N.Y. TIMES, June 28, 2002, at C2; Jerry Markon, *Martha Stewart Sale of Stock Under Inquiry*, WALL. ST. J., June 14, 2002, at C1; Andrew Pollack, *Martha Stewart Said to Sell Shares Before F.D.A. Ruling*, N.Y. TIMES, June 2, 2002, at C4; *Stewart Inquiry Said Widened; Securities: Shares of Her Firm Have Fallen 34% Since Insider-Trading Probe Was Revealed*, L.A. TIMES, June 26, 2002, § 3, at 3.

United States Food and Drug Administration (“FDA”) concerning its possible approval of Erbitux, an important ImClone product. In advance of the FDA’s announcement, Waksal learned that the FDA would reject the company’s application for approval of the product. Through his Merrill Lynch stockbroker, Peter Bacanovic, Waksal then attempted to sell his ImClone stock and caused family members to sell their stock.¹¹³

Stewart became involved when Bacanovic instructed his assistant, Douglas Faneuil, to inform Stewart that Waksal family members were selling their stock because the stock was likely to decline in price. Stewart then sold her ImClone stock, avoiding about \$45,673 in additional losses that she would have incurred had she sold after the FDA announcement.¹¹⁴

Given that the civil and criminal investigations focused on ImClone, and that Stewart’s cover-up crimes all related to ImClone, why did the government choose not to charge her based upon her ImClone sales? Some commentators have stated that such a theory would have had no legal basis.¹¹⁵ They are only partly correct, however.¹¹⁶ Of course, Stewart had no relationship with ImClone; she was not an agent or employee of the company and owed its shareholders no fiduciary duty. Stewart thus could not have been charged as an insider of, or misappropriator from, ImClone.¹¹⁷

Stewart could well have been criminally liable as Bacanovic’s tippee, however. In its civil case, the SEC in fact charged Stewart with “illegal insider trading” based upon precisely that theory.¹¹⁸ Further, it is unlikely that a court would have dismissed a criminal case brought against Stewart on a tippee theory. The SEC’s complaint tracks the *Dirks* requirements step-by-step, setting forth allegations that would also support criminal charges. The complaint alleges that the knowledge that the Waksals intended to sell their stock was material, nonpublic information.¹¹⁹ The complaint alleges that Bacanovic breached his duty to his employer, Merrill

¹¹³ See Stewart Indictment, *supra* note 93; Stewart Complaint, *supra* note 93; see also Donald C. Langevoort, *Reflections on Scierter (and the Securities Fraud Case Against Martha Stewart that Never Happened)*, 10 LEWIS & CLARK L. REV. 1 (2006); *Insiders Trading*, N.Y. TIMES, June 23, 2002, § 4, at 12.

¹¹⁴ See Susanne Craig & Michael Schroeder, *SEC’s Insider-Trading Case Isn’t Likely to Be Easy as Pie*, WALL ST. J., June 5, 2003, at C1.

¹¹⁵ See, e.g., Hasnas, *supra* note 22, at 613 (“Stewart was never charged with insider trading, and, in fact, could not be because she was not an ImClone insider, she was not tipped by such an insider, and she did not breach any fiduciary duty to the source of the information, who was her broker and who recommended the trade to her.”); Schroeder, *supra* note 90, at 2045 (“A prosecution of Stewart on insider trading charges would require a court to adopt a new interpretation of the law of both misappropriation and tipping far beyond existing precedents.”).

¹¹⁶ As discussed below, Stewart could well have been charged as a tippee. See *infra* notes 118-22 and accompanying text.

¹¹⁷ See *supra* note 100.

¹¹⁸ Stewart Complaint, *supra* note 93, ¶¶ 16-21.

¹¹⁹ *Id.* ¶ 20.

Lynch, when revealing the information to Stewart.¹²⁰ Under this theory, Bacanovic misappropriated the information “in breach of a fiduciary duty, or other duty arising out of a relationship of trust and confidentiality that he owed to Merrill Lynch.”¹²¹ The complaint further alleges that “Bacanovic benefited from his illegal tip by, for example, improving his relationship with Stewart, an important client of Bacanovic,” and that the information was material and nonpublic.¹²²

Finally, the complaint alleges that Stewart possessed the requisite mens rea under *Dirks*: “Stewart knew or acted in reckless disregard of the fact that information about the Waksals’ efforts to sell their ImClone stock was nonpublic and that Bacanovic had communicated that information to her in breach of Bacanovic’s duty of confidentiality to Merrill Lynch.”¹²³ Stewart’s knowledge would have been based upon, among other facts, her status as a licensed stockbroker. This insider trading allegation is not substantially different from, and certainly no weaker than, the allegations that courts have sustained against tippees in both civil and criminal cases.¹²⁴

Unlike the SEC, however, the United States Attorney’s Office in New York did not choose to charge Stewart with insider trading as a tippee. Many commentators noted that this was somewhat strange, given that the bulk of the indictment—eight of its nine counts and thirty-six out of its forty-two pages—was composed of charges arising out of Stewart’s and

¹²⁰ *Id.* ¶ 21.

¹²¹ *Id.* ¶ 29.

¹²² *Id.* ¶ 21. The government argued that this was clearly material information; the average shareholder would want to know that the head of ImClone was attempting to dump his stock in advance of the FDA announcement. *Id.* ¶ 20. For a discussion of the standard of materiality in general, see *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976). The information that Waksal was attempting to sell was also nonpublic, and in fact was governed by Merrill Lynch’s confidentiality policy. Stewart Complaint, *supra* note 93, ¶ 16 (“Information should be considered non-public if it has not been disclosed in the news media, research reports, corporate public filings or reports, or in some other similar public manner. Non-public information should generally be regarded as material unless it is clearly unimportant to investors.”).

¹²³ Stewart Complaint, *supra* note 93, ¶ 21.

¹²⁴ See, e.g., *United States v. Carpenter*, 791 F.2d 1024, 1031 (2d Cir. 1986) (affirming conviction of *Wall Street Journal* reporter/tipper and co-conspirators/tippees based on misappropriation of information the reporter gathered from public sources and that was to be later published in the *Journal*), *aff’d by an equally divided court*, 484 U.S. 19 (1987); *United States v. Falcone*, 97 F. Supp. 2d 297, 303 (E.D.N.Y. 2000) (affirming conviction of broker/tippee who traded on material that was to be published in a *Business Week* column and that was provided to him by the tipper, a *Business Week* employee); see also *SEC v. Yun*, 327 F.3d 1263, 1274-75 (11th Cir. 2003) (affirming liability of tipper and tippee where the tipper had misappropriated the information from her husband and provided the information to the tippee). Although the Supreme Court has not yet affirmed a tippee’s conviction in a case where the tipper was a misappropriator rather than an insider, there is nothing in the Court’s insider trading jurisprudence to suggest that the Court would reject such a theory. Cf. *Seigel & Slobogin*, *supra* note 90, at 1112 n.19 (citing cases and suggesting that the government may have made a strategic decision not to test this theory in Stewart’s case).

Bacanovic's efforts to concoct an alternate reason for Stewart's ImClone sale.¹²⁵

Instead of basing the securities fraud charge on tippee liability, the government charged Stewart with securities fraud in connection with trading in the stock of her own company, MSLO, of which Stewart was CEO and Chairman. The theory was that Stewart defrauded MSLO's shareholders and investors. The ImClone investigation was widely publicized, and even led to Congressional hearings.¹²⁶ In response to the publicity, Stewart denied that she acted wrongly in selling her ImClone stock. In three public statements, she asserted the alternate story that she had told the government and that formed the basis of her conspiracy, false statements, and obstruction of justice convictions.¹²⁷ The indictment alleged that Stewart's reputation seriously affected her company's stock price, and that she denied guilt to bolster the price of MSLO stock. Her false statements allegedly deceived MSLO shareholders by encouraging them not to sell their stock and deceived potential investors by encouraging them to buy the stock.¹²⁸ According to this theory, because Stewart held stock giving her substantial majority control over the company, this deception was designed to accrue to her own financial benefit.¹²⁹

At the end of the government's case, at a point when the decision could not be appealed, the trial court dismissed the securities fraud charge.¹³⁰ The court held that the evidence was insufficient to support a finding beyond a reasonable doubt that Stewart had acted with the intent to defraud MSLO shareholders and investors. Some commentators have suggested that this decision was in error, and that the issue of intent should

¹²⁵ See, e.g., Podgor, *supra* note 18, at 1068-69.

¹²⁶ See generally Chris Adams & Geeta Anand, *Congress Widens Inquiry of Sales of ImClone Stock by Ex-CEO Kin*, WALL ST. J., June 6, 2002, at B3; Chris Adams & Geeta Anand, *ImClone Had Early Word on U.S. Action*, WALL ST. J., June 10, 2002, at B2; Andrew Pollack & David Cay Johnston, *Former Chief of ImClone Systems Is Charged with Insider Trading*, N.Y. TIMES, June 13, 2002, at C1.

¹²⁷ Stewart and Bacanovic maintained that they previously arranged that they would sell Stewart's ImClone shares if the stock ever fell below \$60 and that they arrived at this arrangement more than a month before the sale of the ImClone shares. See Stewart Indictment, *supra* note 93, ¶¶ 24(a), 27(a). The jury determined that this story was false. See *United States v. Stewart*, 305 F. Supp. 2d 368 (S.D.N.Y.) (affirming conviction).

¹²⁸ Stewart Indictment, *supra* note 93, ¶ 60.

¹²⁹ *Stewart*, 305 F. Supp. 2d at 375.

¹³⁰ *Id.* at 376. Prior to trial, Stewart moved to dismiss the securities fraud charge on First Amendment and other grounds. The court denied the motion. Following the presentation of evidence, Stewart filed a motion to acquit on the securities fraud charge based on insufficiency of the evidence under Rule 29 of the Federal Rules of Criminal Procedure. The court granted the motion, finding that the government had not adduced sufficient evidence from which the jury could conclude beyond a reasonable doubt that Stewart had acted willfully. *Id.* See generally Cynthia A. Caillavet, *From Nike v. Kasky to Martha Stewart: First Amendment Protection for Corporate Speakers' Denials of Public Criminal Allegations*, 94 J. CRIM. L. & CRIMINOLOGY 1033, 1040 (2004).

have gone to the jury.¹³¹ At the very least, however, and granting the government the benefit of the doubt, the government lacked any direct evidence of intent to defraud. This was a novel case, where the allegedly fraudulent statements were denials of wrongdoing and where the prosecution's theory was subject to serious First and Fifth Amendment challenges.¹³² In such circumstances, direct evidence of fraudulent intent might have been expected.¹³³ In any event, whether or not the evidence was sufficient to go to the jury, the government's theory was certainly unusual, possibly unprecedented, and legally shaky.¹³⁴

To revisit the question, why did the government use an untested and controversial criminal theory instead of the fairly straightforward insider

¹³¹ One commentator suggested that the trial judge imposed on the government the burden of proving a higher level of mens rea—intent to deceive the MSLO shareholders—than was necessary. Langevoort, *supra* note 113, at 6-8. This is an interesting observation that plays upon the continuing confusion in securities fraud cases as to whether: (1) recklessness is a sufficient standard for mens rea; and (2) the mens rea standard is the same in civil and criminal cases. Although the trial court certainly could have provided more support for its holding, the result seems justifiable both in terms of existing precedent and the possibility that future cases could be brought based upon mere denials of wrongdoing. There is also support in Supreme Court cases for the proposition that securities fraud incorporates the common law of fraud, which in turn is widely described as a “specific intent” crime. *See Chiarella v. United States*, 445 U.S. 222, 235 (1980) (stating that crimes of fraud require a purpose to defraud); *see also United States v. Ruggiero*, 56 F.3d 647, 656 (5th Cir. 1995) (“[T]he government must prove a specific intent to defraud, which requires a showing that the defendant intended for some harm to result from his deceit.” (quoting *United States v. Loney*, 959 F.2d 1332, 1337 (5th Cir. 1992))). Also, criminal cases require proof of “willfulness.” If that term means anything, then a higher level of mens rea should be required in a criminal case than in a civil case. In that light, the trial court may not have been off the mark at all, particularly given the beyond a reasonable doubt standard applicable to Stewart's case. In addition, other commentators have suggested that there was sufficient proof of intent to go to the jury. *See Seigel & Slobogin, supra* note 90, at 1117 n.41. Once again, given the burden of proof in a criminal case, the conclusion that the jury would have had to speculate as to Stewart's intent is more than justifiable on the proof adduced in the case. *See, e.g., John C. Coffee, Jr., Overcriminalization?*, NAT'L L.J., Aug. 16, 2004, at 13 [hereinafter Coffee, *Overcriminalization*] (“[T]he court properly dismissed [the securities fraud count against Stewart] for lack of evidence.”).

¹³² Indeed, Stewart's motion to dismiss this charge attacked it directly as a violation of her rights under the First and Fifth Amendments. *See Memorandum of Law in Support of Martha Stewart's Omnibus Pre-Trial Motions at 74-85, United States v. Stewart*, No. 03 Cr. 717 (MGC), 2003 WL 22762402 (S.D.N.Y. Oct. 6, 2003) [hereinafter Stewart Motion Memorandum]; *see also Seigel & Slobogin, supra* note 90, at 1117 n.41 (discussing the strength of the First Amendment challenge).

¹³³ The trial court might well have been justified had it dismissed the securities fraud count before trial, especially given that the government's evidence at trial did not materially add to the allegations in the complaint. The government could and in all likelihood would have appealed such a ruling; by dismissing the charge during trial as a factual matter rather than a legal matter, the judge insulated the ruling from appeal.

¹³⁴ *See Moohr, Martha Stewart Case, supra* note 8, at 603 (summarizing critical commentary on the criminal securities fraud theory the government asserted against Stewart and noting that “[Stewart's] conduct fell outside the heartland of securities fraud and did not obviously constitute securities fraud”).

trading/tippee theory the SEC employed?¹³⁵ It is hard to know, of course, but the facts alleged in the SEC complaint and adduced at the criminal trial provide three possible answers.

One possibility is that the government decided that it could not prove beyond a reasonable doubt that Stewart acted willfully when selling her ImClone stock, while the SEC concluded that it could meet the preponderance standard applicable in the civil case.¹³⁶ Under a tippee theory, the government would have to prove that Stewart knew that Bacanovic was breaching a duty to Merrill Lynch by revealing the information and that she knew that the information was nonpublic.¹³⁷

Although the evidence of willfulness may have been thin,¹³⁸ it seems unlikely that doubt over proof of willfulness was the sole reason that the government decided not to charge Stewart in connection with ImClone trading.¹³⁹ The evidence of a cover-up in the Stewart case was substantial, leading the jury to convict Stewart and Bacanovic of almost all the charges after only twelve hours of deliberations at the end of a six-week trial.¹⁴⁰ In that light, I believe it is more likely than not that the jury would have also convicted Stewart of securities fraud on a tippee theory. The prosecutor's closing argument would have been simple: if Stewart did not know that she had done something wrong when she sold her ImClone stock, then why did she repeatedly lie to the government and attempt to obstruct its investigation into that sale?¹⁴¹

¹³⁵ See Langevoort, *supra* note 113, at 11 ("The SEC's civil case against Stewart is fairly clear in its theory of liability."). For a discussion of the tipper/tippee theory, see Moohr, *Martha Stewart Case*, *supra* note 8, at 599-600.

¹³⁶ Seigel & Slobogin, *supra* note 90, at 1112 (speculating that Stewart was not charged for insider trading because prosecutors wanted to pursue the issue on the civil side "where the government's burden of proof is lower").

¹³⁷ See *supra* note 131 (discussing mens rea).

¹³⁸ Apparently, the government's only proof on willfulness was that: (1) Bacanovic left a phone message with Stewart's assistant, Douglas Faneuil, stating that "Peter Bacanovic thinks ImClone is going to start trading downward"; and (2) Stewart retrieved this message while on an airport runway in Texas en route to a vacation in Mexico. She then spoke to Faneuil, who told her that the Waksals "were selling or attempting to sell all of their ImClone shares at Merrill Lynch and that Bacanovic believed that Stewart might wish to act on that information." Stewart Indictment, *supra* note 93, ¶¶ 16-17.

¹³⁹ There was substantial circumstantial evidence of willfulness: (1) Stewart was a licensed stockbroker familiar with the functioning of the stock market; (2) it was widely known that the FDA announcement concerning Erbitux was pending and that the announcement would dramatically affect the price of ImClone stock; and (3) Sam Waksal was the head of ImClone and a major shareholder. Stewart Complaint, *supra* note 93, ¶¶ 6, 10, 13-14.

¹⁴⁰ See Brickey, *Mostly Martha*, *supra* note 90.

¹⁴¹ On appeal, the defendants argued that they were entitled to a specific instruction advising the jury that they were not charged with insider trading, even though they were charged with covering up the trading that would have been the basis for such a charge. The Second Circuit rejected the argument. *United States v. Stewart*, 433 F.3d 273, 310 (2d Cir. 2006).

A second possible reason why the government declined to charge Stewart as a tippee is that it anticipated having difficulty showing that Bacanovic breached his duty to Merrill Lynch.¹⁴² For example, as one commentator has suggested, perhaps it was in Merrill Lynch's interests for Bacanovic to treat Stewart well by revealing this information. Thus, if Bacanovic was simply doing his job properly, there was no breach of duty.¹⁴³ Another commentator has suggested that Bacanovic did not breach a duty because Waksal's trading information was not Merrill Lynch's property, and the theft of that information could not give rise to the kind of fiduciary breach that is required for tipper/tippee liability.¹⁴⁴

These explanations, however, rest on an overly cramped reading of the kinds of fiduciary breaches that courts have used to sustain criminal and civil misappropriation cases.¹⁴⁵ Other Merrill Lynch clients would hardly be happy to know that the firm did not consider their trading activity secret. In fact, revelation of that activity is the very breach upon which the SEC's charges rested; Merrill Lynch policy explicitly forbade disclosing client information and disclosing or using client trading plans (here, Waksal's trading plans).¹⁴⁶

Bacanovic's disclosure of Waksal's trading information violated these policies and misused information belonging to Merrill Lynch. This is the very type of misappropriation that lay at the heart of the *Carpenter* deci-

¹⁴² Professor Langevoort suggests that perhaps Bacanovic did not breach his duty to Merrill Lynch because he was acting in the company's interests by acting in Stewart's interests. Langevoort, *supra* note 113, at 11-13.

¹⁴³ *Id.*

¹⁴⁴ Schroeder, *supra* note 90, at 2076 (arguing that Bacanovic would not be a misappropriator because "it is not enough that the defendant violate a fiduciary type duty of confidentiality," but that "[t]he information disclosed must be the property of the person to whom the confidentiality runs, otherwise the disclosure . . . [is] merely a breach of contract"). Professor Schroeder perhaps sets forth a more coherent theory of misappropriation than the Supreme Court employed in *United States v. O'Hagan*, 521 U.S. 642 (1997), but so far the courts have not limited tippee liability in the manner that Professor Schroeder suggests they should.

¹⁴⁵ See, e.g., *SEC v. Yun*, 327 F.3d 1263, 1272-73 (11th Cir. 2003) ("[A] spouse who trades in breach of a reasonable and legitimate expectation of confidentiality held by the other spouse sufficiently subjects the former to insider trading liability."); *United States v. Carpenter*, 791 F.2d 1024, 1031 (2d Cir. 1986) (holding that an employee's use of nonpublic, material information in breach of a duty of confidentiality to an employer is sufficient for liability), *aff'd by an equally divided court*, 484 U.S. 19 (1987); *SEC v. Materia*, 745 F.2d 197, 203 (2d Cir. 1984) (stating that liability may arise merely because one "misappropriates non-public information in breach of a fiduciary duty and trades on that information to his advantage"); *United States v. Newman*, 664 F.2d 12, 18 (2d Cir. 1981) (implying that liability for a securities violation can arise from "deceitful misappropriation of confidential information by a fiduciary"); *United States v. Falcone*, 97 F. Supp. 2d 297, 303 (E.D.N.Y. 2000) ("[T]he so-called misappropriation theory bars only trading on the basis of information that the wrongdoer converted to his own use in violation of some fiduciary, contractual or similar obligation to the owner or rightful possessor."); *SEC v. Willis*, 825 F. Supp. 617, 622 (S.D.N.Y. 1993) (holding that knowing use of material, nonpublic information obtained in breach of a fiduciary duty to a patient is sufficient for liability).

¹⁴⁶ Stewart Complaint, *supra* note 93, ¶ 16.

sion.¹⁴⁷ In that case, Winans was a *Wall Street Journal* reporter who gathered information from public sources for publication in a *Journal* column; that information became the *Journal*'s information. Winans tipped others, who used the information to trade. A parallel sequence of events occurred in the ImClone trading: Waksal relayed his trading plans to Bacanovic, who received the information in his role as a Merrill Lynch employee; that information became Merrill Lynch's information. Bacanovic then tipped Stewart, who used the information to trade.

Significantly, in *Carpenter*, the *Journal* employee did not steal the information from inside sources, and did not alter the information to his advantage. Instead, he merely benefited from the research he did for his *Journal* column. Yet, his actions were enough to show a breach of duty. Had *Journal* readers come to believe that the *Journal*'s reporters' personal financial interests influenced the *Journal*'s contents, the *Journal*'s integrity would have been compromised.¹⁴⁸ This possible harm to the *Journal* evinced the breach of duty.

The harm to Merrill Lynch resulting from Bacanovic's actions would have been no less tangible than the harm to the *Journal* in *Carpenter*. Indeed, the ImClone trading posed more danger to market integrity than the trading in *Carpenter*, for the ImClone trading was based upon inside information, while the trading in *Carpenter* was based upon publicly available information concerning the companies at issue.¹⁴⁹

So, to restate the question, why did the government employ a novel securities fraud theory in its criminal case instead of a tested insider trading theory? As the press widely reported, the government's stated explanation

¹⁴⁷ *Carpenter*, 791 F.2d at 1035.

¹⁴⁸ *Id.* Although the Supreme Court split evenly on the misappropriation theory in *Carpenter*, it later affirmed that theory in *O'Hagan*, 521 U.S. 642, and also upheld the mail fraud convictions in *Carpenter*, 791 F.2d at 1034-45, based upon that very breach of duty. There is no reason today to think that *Carpenter* would not again work as an insider trading case. As Professor Schroeder and others have suggested, *Carpenter* was probably wrongly decided because it criminalizes mere breaches of fiduciary duties. See Schroeder, *supra* note 90, at 2075; see also Coffee, *Unlawful*, *supra* note 73. Nonetheless, *Carpenter* remains good law and is nowhere stronger precedent than in the Second Circuit, where the Stewart case was filed. See *United States v. Libera*, 989 F.2d 596 (2d Cir. 1993); *United States v. Teicher*, 987 F.2d 112 (2d Cir. 1993); *United States v. Chestman*, 903 F.2d 75 (2d Cir. 1990).

¹⁴⁹ Of course, the information that was not publicly available in *Carpenter*—that Winans' research would be published in Winans' *Wall Street Journal* column—was highly valuable to potential investors because the column's contents had the potential to, and indeed did, affect the stock prices of the companies discussed in the column. But this information, unlike Waksal's trading plans, did not belong to any market participant. See Judith G. Greenberg, *Insider Trading and Family Values*, 4 WM. & MARY J. WOMEN & L. 303, 331 n.135 (1998); cf. *Carpenter*, 791 F.2d at 1037 (Miner, J., dissenting) ("It seems especially ludicrous for the government to contend that the court should enforce the Wall Street Journal's conflict of interest policy prohibiting employees from trading on the basis of pre-publication information while conceding that the Journal itself is not prohibited from trading on such information.").

was that such a charge would have been unprecedented.¹⁵⁰ But neither the government nor anyone else has convincingly explained why this is so. As seen above, a tippee case against Stewart would have hardly been a stretch, and in any event, certainly less of a stretch than the theory the government ultimately employed.¹⁵¹

The third, and most likely, explanation is not that the tippee theory was implausible. Rather, the explanation returns us to the nebulous nature of the harm in many securities fraud cases, particularly insider trading cases. Under the theory in the SEC's civil case, the harm was to the people who bought ImClone stock from Stewart and who did not have the inside information that she had. Their stock was worth less than they thought. The total loss that they suffered was \$45,673.¹⁵² By way of dramatic contrast, according to the government's pleadings in the criminal case Stewart's three allegedly fraudulent statements had a market impact on MSLO stock of approximately \$365 million.¹⁵³

¹⁵⁰ See, e.g., Scott Turow, *Cry No Tears for Martha Stewart*, N.Y. TIMES, May 27, 2004, at A29; see also Kara Scannell, *Stewart Trial: White Collar, White Heat*, WALL ST. J., Jan. 16, 2004, at C1.

¹⁵¹ See *supra* notes 118-25 and accompanying text.

¹⁵² See *supra* note 114 and accompanying text.

¹⁵³ Jeffrey Sagalewicz, *The Martha Duty: Protecting Shareholders from the Criminal Behavior of Celebrity Corporate Figures*, 83 OR. L. REV. 331, 332 (2004). There were nearly 50 million outstanding shares of MSLO at the time of Stewart's alleged fraud. *Id.* at 332 n.9. Not surprisingly, given the stakes, in the pleadings on Stewart's motion to dismiss, both sides focused on the securities fraud count. See Stewart Motion Memorandum, *supra* note 132; Government's Memorandum of Law in Opposition to Defendant Stewart's Motions to Dismiss Counts Eight, Nine and Three Specifications of Counts Four and Five, United States v. Stewart, No. 03 Cr. 717 (MGC), 2003 WL 23671450 (S.D.N.Y. Nov. 5, 2003) [hereinafter Government's Memorandum in Opposition to Stewart's Motions]. According to the government, Stewart's three allegedly fraudulent statements had a market impact of \$365 million, calculated as follows:

With respect to Stewart's first statement, the government argued:

The decline in stock price of \$4.22 per share, or more than 26% of MSLO's value, based on news that Stewart's reasons for her sale of ImClone stock may be false, is strong evidence that people had relied on Stewart's public statements of the reasons for her sale, believed them, and found them to be material.

Id. A decline of \$4.22 multiplied over 50 million shares amounts to a \$210 million impact from the statement.

With respect to Stewart's second statement, the government argued:

The impact of this statement on MSLO's stock price is compelling proof of its materiality. MSLO's stock price closed at \$15 per share on June 12, 2002. After Stewart issued her false detailed public statement during the evening of June 12, MSLO's stock price opened the next morning a full point higher, at \$16.05 per share, an increase of 7%, influenced solely by the issuance of Stewart's statement.

Id. An increase of \$1.05 multiplied over 50 million shares amounts to a \$52.5 million impact.

With respect to Stewart's third statement, the government argued:

After Stewart made this statement to investors and securities analysts, MSLO's stock price increased more than two dollars, or approximately 14%, from an opening price of \$14.40 per share on June 19, 2002 to a closing price of \$16.45 per share.

Id. An increase of \$2.05 multiplied over 50 million shares amounts to a \$102.5 million impact.

Why should the amount of alleged harm drive a charging decision? This question can largely be answered by the role of loss in calculating a sentence range under the U.S. Sentencing Guidelines.¹⁵⁴ In connection with the ImClone trading, the loss/gain of approximately \$45,000 would have produced a sentence of from thirty-three to forty-one months.¹⁵⁵ With respect to the MSLO trading, the nearly \$400 million of gain/loss would have produced a sentence of the then-statutory maximum¹⁵⁶ of ten years.¹⁵⁷ In terms of leverage in plea negotiations, the government's possible motivations are obvious.¹⁵⁸

¹⁵⁴ At the time the criminal case was filed, the Guidelines were mandatory. Since that time, the U.S. Supreme Court issued its two-part decision in *United States v. Booker*, 543 U.S. 220 (2005). In the first part of the opinion, the Court held that the Guidelines violate a defendant's Sixth Amendment right to a jury trial because Guidelines sentences are based upon fact-finding by the judge. *Id.* at 232. In the second part of the opinion, a different majority held that the Guidelines can be applied in a constitutional fashion if they are considered advisory. *Id.* at 245. To date, courts are continuing to impose Guidelines sentences to roughly the same degree that courts imposed Guidelines sentences before *Booker*. UNITED STATES SENTENCING COMMISSION, FINAL REPORT ON THE IMPACT OF UNITED STATES V. BOOKER ON FEDERAL SENTENCING 62 (2006), available at http://www.ussc.gov/booker_report/Booker_Report.pdf (showing that 62% of post-*Booker* sentences were within Guidelines ranges, virtually the same as before *Booker*).

¹⁵⁵ Under the Guidelines, the base offense level for an insider trading conviction under 15 U.S.C. § 78j is eight. U.S. SENTENCING GUIDELINES MANUAL § 2B1.4 (2006). With a gain to Stewart of \$45,000 (more than \$30,000 but less than \$70,000), six points are added. *Id.* §§ 2B1.1(b)(1)(D), 2B1.4. Assuming that between ten and fifty persons bought Stewart's ImClone stock and are counted as victims, two more points are added. *Id.* § 2B1.1(b)(2)(A). Because the crime was securities-related and Stewart was an officer and director of MSLO, four more points are added, *id.* § 2B1.1(15), for a total of twenty. Under the Sentencing Table, the result for a defendant who has no prior criminal history is a range of thirty-three to forty-one months. *Id.* at 381.

¹⁵⁶ The maximum sentence under the criminal securities fraud provision, 15 U.S.C. § 78ff(a) (2006), was increased on July 30, 2002, from ten to twenty years. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 1106, 116 Stat. 745, 810. In addition, the Sarbanes-Oxley Act added a new crime, entitled "Securities Fraud," § 807(a), 116 Stat. at 804. The crime is not codified in the securities laws, but rather in Title 18, the federal criminal code. 18 U.S.C. § 1348 (2006). Violations of the statute are punishable by up to 25 years in prison. *Id.*

¹⁵⁷ Under the Guidelines, the base level for crimes of theft or fraud is seven. U.S. SENTENCING GUIDELINES MANUAL § 2B1.1(a)(1) (2006). Given a loss of between \$200 million and \$400 million, twenty-eight points are added. *Id.* § 2B1.1(b)(1)(D). If the loss involved more than 250 victims, six points are added. *Id.* § 2B1.1(b)(2)(C). Because the crime was securities-related and Stewart was an officer and director of MSLO, four more points are added, for a total of forty-five points. *Id.* § 2B1.1(15). Under the Sentencing Table, the result is a life sentence. *Id.* at 381. Stewart thus would have been subject to the then-statutory maximum of ten years. Note that had Stewart made her statements a couple of months later, the maximum would have been 20 years. See *supra* note 156.

¹⁵⁸ Of course, the government could have asserted both securities fraud theories. We will never know why the government declined to bring an ImClone-based charge. To speculate, it could be that, in light of the potential weaknesses with the ImClone-based securities fraud theory, the prosecutors decided not to muddy the waters with respect to the related—and much more straightforward—ImClone-based cover-up crimes.

Is this the way our criminal justice system should work? Should the government be able to cherry pick its theory to maximize the theoretical harm and attempt to force a plea?¹⁵⁹ The Sentencing Guidelines ensure that this calculation will inevitably drive prosecutorial decisions.¹⁶⁰ But the problem goes deeper than the Guidelines, and lies with the amorphous nature of the harm in such cases.

3. The Harm Caused

The Stewart cases demonstrate the difficulty in assessing the harm in many white collar cases. With ImClone, the alleged crime was insider trading. Commentators cannot even agree whether such trading benefits or harms the securities markets.¹⁶¹ Some commentators have opined that insider trading sounds like cheating and is therefore morally wrong.¹⁶² It is justifiable to reconcile the draconian sentences that insider trading can produce, however, based solely on a motivating concern for fairness as opposed to concrete harm.¹⁶³ In fact, the Supreme Court—in one of its many struggles to define the boundaries of this murky crime—concluded that, “not every instance of financial unfairness constitutes fraudulent activity under Section 10(b).”¹⁶⁴ We might even conclude that unfairness alone is not sufficient

¹⁵⁹ For a critique of this sort of prosecutorial strategy, see Richman & Stuntz, *supra* note 3, at 629-30 (“Federal law enforcers decide whom to send up the river, then select the appropriate items from the [statutory] menu in order to induce a guilty plea with the desired sentence.”). For pointed criticism of the role of loss in white collar crime sentencing, see *United States v. Adelson*, 441 F. Supp. 2d 506 (S.D.N.Y. 2006).

¹⁶⁰ See, e.g., *United States v. Ebbers*, 458 F.3d 110, 129 (2d Cir. 2006) (reluctantly affirming Bernard Ebbers’s 25-year sentence and explaining the coercive effect that the role of loss has in Guidelines sentencing); Joseph E. Kennedy, *Making the Crime Fit the Punishment*, 51 EMORY L.J. 753, 825 (2002) (“[R]elatively ‘innocent’ transactions violating various federal regulatory laws can easily result in mandatory prison sentences, often as a function of the amounts of money involved.”).

¹⁶¹ See sources cited *supra* note 100.

¹⁶² See, e.g., Green, *Cheating*, *supra* note 99 (summarizing arguments concerning insider trading’s moral wrongfulness); Gary Lawson, *The Ethics of Insider Trading*, 11 HARV. J.L. & PUB. POL’Y 727, 743, 759 (1988) (stating that some commentators morally object to insider trading on the basis of “informational equality” while others morally object because the insider trading involves theft of information); Kim Sheppele, “*It’s Just Not Right*”: *The Ethics of Insider Trading*, 56 L. & CONTEMP. PROBS. 123, 162 (1993) (“Equal access to information is the moral concept on which a prohibition on insider trading would be grounded.”); Alan Strudler & Eric W. Orts, *Moral Principle in the Law of Insider Trading*, 78 TEX. L. REV. 375, 382 (1999) (“[I]nsider trading law protects the autonomy of public securities traders from unfair and wrongful deception.”); Swanson, *supra* note 107, at 159 (“Most folks have the gut instinct that insider trading is just plain wrong, but cannot explain why. . . . The strongest arguments against insider trading initially centered on the intuitive feeling that such conduct is simply unfair or immoral.”).

¹⁶³ Cf. U.S. SENTENCING GUIDELINES MANUAL § 2B1.4 (2006) (insider trading guidelines); 15 U.S.C. § 78ff(a) (2006) (20-year maximum).

¹⁶⁴ *United States v. Chiarella*, 445 U.S. 222, 232 (1980).

grounds for criminalization. In that light, merely unfair actions that do not produce concrete harm should be subject to civil regulation, perhaps, but not to criminalization. This is not to argue that insider trading should never be criminalized, but instead to suggest that, at a minimum, criminal insider trading cases should be reserved for the most egregious wrongdoing. So, in the case of ImClone, the correct result may have occurred.¹⁶⁵ Stewart was civilly charged under a theory of unfair gain, and later settled the case without admitting or denying the charges.¹⁶⁶

With the MSLO trading, the alleged crime was a novel form of securities fraud that rested upon Stewart's proclamations of innocence.¹⁶⁷ The trial judge chose not to dismiss the charge as legally insufficient, a decision that the government would surely have appealed. Instead, the judge later dismissed the charges on unappealable factual grounds. But, under the assumptions here, this matter should never have been criminally charged. Proving the harm from Stewart's statements would have been exceedingly difficult and complex.¹⁶⁸ Indeed, the government assuredly caused far more harm to MSLO shareholders by investigating and charging Stewart than Stewart caused by making three statements denying wrongdoing; these were self-serving statements that any rationale investor would likely have

¹⁶⁵ Cf. Podgor, *supra* note 18, at 1070 (“[I]n the case of Martha Stewart, the government wanted information and called on her to speak before the Securities and Exchange Commission. She went, and she talked, but they did not like what was said. Therefore, they proceeded to charge her with crimes related to lying instead of proceeding exclusively in the civil sphere or charging the substantive crimes for which they were initially investigating her.”).

¹⁶⁶ See Press Release, Sec. & Exch. Comm'n, *supra* note 5.

¹⁶⁷ As shown by the quotations at the beginning of this Part, the press varied widely in its assessment of Stewart's culpability. See *supra* text accompanying notes 87-88. The commentators were uniform, however, in describing the criminal securities fraud theory against Stewart as novel. See, e.g., Coffee, *Overcriminalization*, *supra* note 131 (stating that the securities fraud charge against Stewart was “novel and questionable”); Jonathan D. Glater, *Stewart Judge Said to Retain a Key Charge*, N.Y. TIMES, Feb. 27, 2004, at C3 (stating that the securities fraud charge was “unusual”); Bethany McLean & Peter Elkind, *Uneven Justice*, N.Y. TIMES, Feb. 4, 2004, at A25 (reporting that the judge presiding over Stewart's case stated that the fraud charge was “a particularly novel application of securities law”); see also Seigel & Slobogin, *supra* note 90, at 1107-08 (describing the varied commentary concerning the Stewart case).

¹⁶⁸ Indeed, both sides began posturing over the proof of loss even before the trial began. See Stewart Motion Memorandum, *supra* note 132, at 17-57; Government's Memorandum in Opposition to Stewart's Motions, *supra* note 153, at 22-44. One court recently explained the problem with measuring the loss in securities fraud cases: “Since successful public companies typically issue millions of publicly traded shares . . . the precipitous decline in stock price that typically accompanies a revelation of fraud generates a multiplier effect that may lead to guideline offense levels that are, quite literally, off the chart.” *United States v. Adelson*, 441 F. Supp. 2d 506, 509 (2006). Because so many market factors affect a stock's price, the court seemed to credit the defense expert's conclusion that “it was literally impossible to determine what portion of the actual loss was attributable to the [fraud].” *Id.* at 510. These conclusions were certainly true in Stewart's case, where the only alleged fraudulent acts were her three public statements proclaiming her innocence.

discounted in any event.¹⁶⁹ The irony, of course, is that the SEC, the government agency principally responsible for enforcement of the federal securities laws, declined to pursue an MSLO-based theory, apparently concluding that such a theory was not merited due to the relatively inconsequential harm caused.

As with the Milken cases, a clear-eyed application of the harm principle would have produced a different result. Had the prosecutors focused on the uncertain nature of the harm Stewart allegedly caused, they would not have brought the criminal securities fraud charge. In dismissing the charge, the court may have intuited this difficulty with the government's theory, but the result occurred only after enormous resources—months of investigation, and weeks of trial—were expended.

Society did not benefit when the government asserted an unprecedented criminal securities fraud theory against Martha Stewart. Whether Stewart should have been criminally charged for her obstructive efforts is not the focus here.¹⁷⁰ The focus here is solely on the single substantive financial fraud charge against Stewart. When the government uses a novel theory based upon a substantial extension of existing law, as in the securities fraud count against a defendant, the presumption should be in favor of civil and/or administrative remedies in the absence of clear proof of substantial harm. No such proof existed in the Stewart case.

C. *Milberg Weiss and Mail Fraud*

[T]he Milberg indictment has had one benefit; it has directed a bright, overdue light on the great tort-lawyer money-laundering machine.¹⁷¹

Editorial, *The Wall Street Journal*

¹⁶⁹ See Schroeder, *supra* note 90, at 2023-24 (noting that MSLO announced its first ever quarterly losses in March 2003, which it attributed largely to adverse publicity, and that the price of MSLO stock dropped an additional 23% immediately upon the announcement of Stewart's conviction); Constance L. Hays, *Market Place; Stewart's Woes Hurt Company; Losses Expected Through 2004*, N.Y. TIMES, Aug. 4, 2004, at C1 (describing decline in MSLO's revenues and stock prices following Stewart's trial, conviction, and sentencing); Editorial, *What a Fraud*, WALL ST. J., Mar. 1, 2004, at A16 (noting that "with regard to the now-dismissed securities fraud charge, it's worth noting that ever since the feds intervened to 'protect' Miss Stewart's shareholders, their stock has been languishing" and that since the securities charge was dismissed, these shareholders "watched their stock rise nearly 11%, closing at a level it hadn't seen since June 2002"); see also Moohr, *Martha Stewart Case*, *supra* note 8, at 603 ("Stewart's statements were arguably not material because they referred to a personal transaction that did not concern business at Omnimedia.").

¹⁷⁰ For an analysis of the Stewart case in the context of the criminalization of cover-up crimes, see Green, *Uncovering*, *supra* note 8.

¹⁷¹ Editorial, *Milberg Mores*, WALL ST. J., June 16, 2006, at A15.

The larger worry here is one of due process. The Justice Department essentially held a gun to Milberg Weiss's head and threatened to indict unless the firm waived attorney-client privilege and agreed to label its own partners criminals.¹⁷²

Editorial, *The Wall Street Journal*

Following a six-year investigation, in May 2006 a federal grand jury issued a twenty count, 102-page indictment¹⁷³ against the law firm of Milberg Weiss Bershad & Schulman, LLP (“Milberg Weiss” or “the firm”), two of its partners, and two other individuals.¹⁷⁴ For the last two decades, Milberg Weiss has been known as the preeminent plaintiffs’ class action and shareholders’ derivative action law firm in the country,¹⁷⁵ with a specialty in securities fraud claims.¹⁷⁶ The firm has recovered as much as \$45 billion on behalf of plaintiffs against such defendants as Raytheon Corporation, Enron, and Prudential Insurance.¹⁷⁷

¹⁷² Editorial, *Very Rough Justice*, WALL. ST. J., May 22, 2006, at A12.

¹⁷³ First Superseding Indictment, *United States v. Milberg Weiss Bershad & Schulman LLP*, CR 05-587(A)-DDP (N.D. Cal. May 19, 2006) [hereinafter *Milberg Indictment*], available at http://www.usdoj.gov/usao/cac/pr2006/Milberg_Indictment.pdf.

¹⁷⁴ Anthony Lin, *Milberg Weiss, Two Partners Indicted in Kickback Probe*, 235 N.Y.L.J. 1 (2006). The indicted partners are David Bershad and Steven Schulman. Both were members of the firm’s management committee and, according to the indictment, “each possessed substantial control over the management and conduct of Milberg Weiss’s business affairs.” *Milberg Indictment*, *supra* note 173, ¶¶ 2-4. The other indicted individuals are Seymour Lazar and Paul Selzer. Lazar and his family members often acted as named plaintiffs in Milberg Weiss’s cases, and Selzer was Lazar’s attorney. *Id.* ¶¶ 5-6. The indictment also names other members of the firm as unindicted co-conspirators. *Id.* ¶ 41. Since the indictment, the firm has changed its name to Milberg, Weiss, and Bershad.

¹⁷⁵ See *NASDAQ Market-Makers Antitrust Litigation*, 187 F.R.D. 465, 474 (S.D.N.Y. 1998). An indication of the firm’s impact can be seen in the recusal of the first five federal district judges assigned to the case. See Molly Selvin, *Milberg Case Hits Delays as Five Judges Withdraw*, L.A. TIMES, June 16, 2006, at C1. For an overview of these types of cases, see Michael C. Dorf, *The Indictment of the Milberg Weiss Law Firm and America’s Love/Hate Relationship with Class Action Litigation*, May 22, 2006, <http://writ.news.findlaw.com/dorf/20060522.html>.

¹⁷⁶ The firm’s success even drew the attention of Congress, which in 1995 passed the Private Securities Litigation Reform Act (“PSLRA”) in part to limit the ability of law firms such as Milberg Weiss to bring such claims. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.); see Stephen D. Susman, *Class Actions: Consumer Sword Turned Corporate Shield?*, 2003 U. CHI. LEGAL F. 1, 10. The Act envisioned that large institutional investors would become the named plaintiffs in most securities fraud class actions, but this has not come to pass. See John C. Coffee Jr., *Milberg Weiss Indictment*, NAT’L L.J., June 19, 2006, at 18 [hereinafter *Coffee, Milberg Weiss Indictment*]. But see Lisa L. Casey, *Reforming Securities Class Actions from the Bench: Judging Fiduciaries and Fiduciary Judging*, 2003 BYU L. REV. 1239, 1324-25 (2003) (positing that the PSLRA has inspired more and more institutional investors to step forward as lead plaintiffs).

¹⁷⁷ See Selvin, *supra* note 175. Class actions may be considered an effective remedy for corporate malfeasance or a burden on business designed to line the lawyers’ pockets. For divergent views on the merits of class actions and shareholders’ derivative actions, compare Patrick M. Garry et al., *The Irrationality of Shareholder Class Action Lawsuits: A Proposal for Reform*, 49 S.D. L. REV. 275 (2004)

The essence of the government's case is that for over two decades the defendants arranged for \$11.3 million in kickbacks to be paid to named plaintiffs in suits for which the firm acted as lead plaintiffs' counsel, thereby defrauding the unnamed class members and shareholders. This arrangement, according to the government, also enabled the firm to have named plaintiffs at the firm's disposal so that it could be the first to file a class action, become lead counsel, and earn the lion's share of attorneys' fees.¹⁷⁸

The indictment has drawn comparisons to the criminal charges against big-five accounting firm Arthur Andersen, LLP, which went out of existence after the government charged Arthur Andersen with obstruction of justice in connection with the Enron debacle.¹⁷⁹ Most of the commentary has centered on whether Milberg Weiss will likewise be subject to the "corporate death penalty" merely because it has been indicted.¹⁸⁰

An analysis of the charges shows, however, that the Milberg Weiss case is more closely analogous to the criminal charges arising from the Michael Milken/Drexel Burnham investigation. Whatever the ultimate disposition of the Milberg Weiss case, the government's theory in the case—essentially based upon mail and wire fraud, with the class members as the allegedly defrauded parties—is unprecedented in many of the same ways that the theories used in the Milken-related cases were unprecedented. In both instances, the legal theories were novel and the alleged harms unclear at best.

The point here is not to question whether criminal charges were appropriate in the alleged Milberg Weiss kickback scheme. The alleged scheme, if true, raises serious legal and ethical issues. For example, the indictment alleges that the defendant both obstructed justice and bribed

(describing how shareholder lawsuits lack value and fail to achieve their purported goals) with Robert B. Thompson & Randall S. Thomas, *The Public and Private Faces of Derivative Lawsuits*, 57 VAND. L. REV. 1747 (2004) (discussing how shareholder derivative suits are an effective means of providing recovery to shareholders and curbing management misconduct).

¹⁷⁸ Lin, *supra* note 174. The Milberg Weiss case has led to congressional hearings to consider legislation for competitive bidding to select lead counsel in securities fraud class actions. See Securities Litigation Attorney Accountability and Transparency Act, H.R. 5491, 109th Cong. (2006) (seeking to amend the Securities Exchange Act of 1934 to give courts the discretion to use a competitive bidding process for selecting lead counsel).

¹⁷⁹ Arthur Andersen was convicted, but the Supreme Court later overturned that conviction on the grounds of faulty jury instructions. *Arthur Andersen LLP v. United States*, 544 U.S. 696, 708 (2005).

¹⁸⁰ See, e.g., Coffee, *Milberg Weiss Indictment, supra* note 176; *Charges Could Drive Milberg Weiss Clients Away*, USA TODAY, May 22, 2006, at 5B; *Dire Case for Law Firm?*, NEWSDAY, May 19, 2006, at A14; *Very Rough Justice*, WALL ST. J., May 22, 2006, at A12. The "corporate death penalty" has been the subject of substantial critical commentary, particularly since the indictment and subsequent demise of the Arthur Andersen accounting firm. See, e.g., Mary Kreiner Ramirez, *The Science Fiction of Corporate Criminal Liability: Containing the Machine Through the Corporate Death Penalty*, 47 ARIZ. L. REV. 933 (2005); Christopher A. Wray & Robert K. Hur, *Corporate Criminal Prosecution in a Post-Enron World: The Thompson Memo in Theory and Practice*, 43 AM. CRIM. L. REV. 1095 (2006).

witnesses, serious charges that are not based upon any extension of existing law. Rather, the concern here is solely on the mail and wire fraud theory.

1. The Mail and Wire Fraud Charges

The government's core theory in the Milberg Weiss case is that the kickbacks gave the named plaintiffs an interest in the case that was not congruent with class members' and shareholders' interests.¹⁸¹ Specifically, the theory alleges that the arrangement subverted the requirement that "the named plaintiff ha[ve] no interest in the outcome of the action that is antagonistic to, or in conflict with, the interests of the absent class members or shareholders."¹⁸² The indictment also alleges that the kickback scheme violated both various state laws and the named plaintiffs' and the law firm's fiduciary duties to class members.¹⁸³ Here is the central allegation: "[T]he kickback arrangements created a conflict of interest between the paid plaintiffs and those to whom they owed fiduciary duties because, as a result of the kickback arrangements, the paid plaintiffs had a greater interest in maximizing the amount of attorneys' fees awarded to Milberg Weiss than in maximizing the net recovery to the absent class members and shareholders."¹⁸⁴ The indictment further alleges that the defendants committed various criminal acts in attempting to cover up the payments.¹⁸⁵

The alleged breach of fiduciary duty underlies the mail and wire fraud charges that are at the heart of the government's case. The bulk of the charges, and the ones that carry the most substantial penalties, derive from the mail and wire fraud charges. Both the money laundering and RICO charges are principally based upon mail and wire fraud as the "specified unlawful activity" and "predicate acts," respectively. Mail and wire fraud are also the principal crimes underlying the three criminal forfeiture counts, which seek to divest the defendants of over \$500 million in alleged criminal proceeds.¹⁸⁶ Although the indictment alleges other acts (including, at various points, bribery, obstruction, and travel act violations) in support of the money laundering, RICO, and forfeiture counts, those alleged acts are given short shrift in the indictment.¹⁸⁷

¹⁸¹ Milberg Indictment, *supra* note 173, ¶¶ 17, 29.

¹⁸² *Id.* ¶ 17.

¹⁸³ *Id.* ¶¶ 20-21.

¹⁸⁴ *Id.* ¶ 29.

¹⁸⁵ *Id.* ¶¶ 76-81.

¹⁸⁶ *Id.* ¶¶ 82-92.

¹⁸⁷ Of those crimes, only obstruction of justice forms the basis for an independent count in the indictment, and that count (Count 17) does not list the firm as a defendant. Milberg Indictment, *supra* note 173, ¶¶ 78-81. The bribery, obstruction, and Travel Act allegations are otherwise only briefly set forth, and in sketchy terms. *See id.* ¶¶ 32, 41(c), 41(f), 56(b).

An outline of the counts implicating Milberg Weiss shows that the mail and wire fraud allegations are central to the government's case against the firm. (An outline of the indictment is provided in the Appendix.) The mail and wire fraud charges assert the essential scheme to defraud the unnamed plaintiffs. These charges thus provide the glue that holds the government's theory of the case together. Without the mail and wire fraud charges, the government would lose three substantive counts, and the RICO, money laundering, and forfeiture counts would be substantially weakened. The bulk of the remaining charges are bribery and cover-up crimes that rest on the defendants' alleged attempts to hide the underlying fraud. Without that underlying mail and wire fraud, this is a minor cover-up crimes case, not a major mail and wire fraud case.

In any mail or wire fraud case, the government must allege that the scheme was designed to deprive the victims of: (1) money or property, including intangible property rights;¹⁸⁸ or (2) "honest services."¹⁸⁹ Thus, the indictment alleges that the class members were deprived of: (1) the honest services of the named plaintiffs and the law firm; (2) the intangible property interest in "material economic information that affected their right and ability to influence and control" the cases; and (3) the amount of the kickbacks that the firm paid using its attorneys' fees.¹⁹⁰

The very breadth, and vagueness, of the mail and wire fraud statutes invite the sort of prosecutorial creativeness at work here.¹⁹¹ Courts have responded, but only haltingly. In *McNally v. United States*, for example, the Supreme Court ended the courts' unbridled expansive readings of the mail and wire fraud statutes.¹⁹² Overturning every court of appeals that had considered the issue, the Court held that an actionable mail or wire fraud scheme must envision the loss of money or property.¹⁹³ More recently, a

¹⁸⁸ See *McNally v. United States*, 483 U.S. 350, 356 (1987), *superseded in part by statute*, Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690, § 7603(a), 102 Stat. 4181, 4508 (codified at 18 U.S.C. § 4506 (2006)); *Carpenter v. United States*, 484 U.S. 19, 25 (1987).

¹⁸⁹ 18 U.S.C. § 1346 (2006) ("For the purposes of [the mail and wire fraud statutes], the term 'scheme or artifice to defraud' includes a scheme or artifice to deprive another of the intangible right of honest services."). Congress passed this statute to overturn the result in *McNally*. See STRADER, UNDERSTANDING, *supra* note 31, § 4.05[B]. The specific text of 18 U.S.C. § 1346 was first inserted in an Omnibus Drug Bill the day that bill was passed, and there is little legislative history in connection with § 1346. See *United States v. Brumley*, 116 F.3d 728, 742 (5th Cir. 1997) (Jolly, J., dissenting).

¹⁹⁰ *Milberg Indictment*, *supra* note 173, ¶ 33. For an overview of mail and wire fraud theories, see STRADER, UNDERSTANDING, *supra* note 31, §§ 4.01-.07.

¹⁹¹ For one of the most frequently cited critiques, see John C. Coffee, Jr., *Hush!: The Criminal Status of Confidential Information after McNally and Carpenter and the Enduring Problem of Overcriminalization*, 26 AM. CRIM. L. REV. 121 (1988).

¹⁹² 483 U.S. at 358-61.

¹⁹³ *Id.* Congress subsequently overrode *McNally* in part. See *supra* note 189.

Second Circuit panel held the mail fraud statute unconstitutionally vague.¹⁹⁴ The breadth of the statutes continues to trouble courts and commentators.¹⁹⁵ Nonetheless, prodded by a congressional override of *McNally*, prosecutors continue to read the mail and wire fraud statutes ever more expansively.

As in the Milken-related cases and in the Martha Stewart case, the government has constructed a central financial fraud theory in the Milberg Weiss case that can only charitably be described as creative. This is especially true with respect to the supposed money or property that the victims allegedly lost. The indictment does not allege that the firm failed to represent its clients effectively or that the settlements specifically deprived the class members of what was owed them. As is widely known, class actions and shareholder derivative actions are generally lawyer-driven suits, with the named plaintiffs as figureheads who pretty much do the attorneys' bidding.¹⁹⁶ Indeed, courts have approved settlements even in some rare instances when the named plaintiffs objected.¹⁹⁷ Given this reality, it is hard to see how paying kickbacks to the named plaintiffs deprived the shareholders of money or property. This is especially so given that payments to named plaintiffs appears to have been customary throughout the field.¹⁹⁸

¹⁹⁴ *United States v. Handakas*, 286 F.3d 92, 96 (2d Cir. 2002). The Second Circuit, sitting en banc in a different case, later abrogated the *Handakas* decision without reaching the merits of the vagueness challenge. *See United States v. Rybicki*, 354 F.3d 124, 142-43 (2d Cir. 2003).

¹⁹⁵ *See, e.g., United States v. Lamoreaux*, 422 F.3d 750, 754 n.3 (8th Cir. 2005) (noting that courts have found the mail fraud statute to be so vague as to be unconstitutional); *United States v. Braunstein*, 281 F.3d 982, 995-97 (9th Cir. 2002) (finding that the government's wire fraud theory was frivolous and unsupported by the facts of the case); Ryan Y. Blumel, *Mail and Wire Fraud*, 42 AM. CRIM. L. REV. 677, 682 (2005) (discussing the broad scope of the requisite fraud under the mail and wire fraud statutes and the lack of consensus among courts); *see also* Ben Rosenberg, *The Growth of Federal Criminal Common Law*, 29 AM. J. CRIM. L. 193, 203-05 (2002) (discussing the vagueness of the mail and wire fraud statutes and their differing treatment by the various circuits).

¹⁹⁶ During Congressional hearings held in response to the Milberg Weiss indictment, Chief Judge Vaughn Walker of the Northern District of California stated that "[l]awyers still run many, if not most, securities class actions with little or no oversight by any actual client." *Investor Protection: A Review of Plaintiffs' Attorney Abuses in Securities Litigation and Legislative Remedies: Hearing on H.R. 5491 Before the Subcomm. on Capital Markets, Securities and Gov't Sponsored Enters. of the H. Comm. on Banking and Fin. Servs.*, 109th Cong. (2006) (statement of Vaughan R. Walker, Chief Judge of the U.S. District Court for the Northern District of California). For more of Judge Walker's views, *see* Vaughn R. Walker & Ben Horwich, *The Ethical Imperative of a Lodestar Cross-Check: Judicial Misgivings About "Reasonable Percentage" Fees in Common Fund Cases*, 18 GEO. J. LEGAL ETHICS 1453 (2005). For a similar view, *see* Martin H. Redish, *Class Actions and the Democratic Difficulty: Rethinking the Intersection of Private Litigation and Public Goals*, 2003 U. CHI. LEGAL F. 71, 77-83 (concluding that many class actions are attorney driven and amount "to little more than private attorneys acting as bounty hunters"). *See generally* John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877 (1987) (discussing role of plaintiffs' attorneys in class action litigation).

¹⁹⁷ *See, e.g., Thomas v. Albright*, 139 F.3d 227, 232 (D.C. Cir. 1998) ("[A] settlement can be fair even though a significant portion of the class and some of the named plaintiffs object to it.").

¹⁹⁸ John Coffee writes:

Of course, the government is correct that the applicable laws forbid named plaintiffs from receiving payments other than their pro rata share of the recovery, plus reasonable costs and expenses approved by the court.¹⁹⁹ But the additional payments—the kickbacks—allegedly came not from the class members’ share of the recoveries or from falsely inflated costs and expenses. Instead, the kickbacks allegedly came from court-approved attorneys’ fees.

Reading between the lines of the indictment, the government apparently recognizes the potential weakness as to proof of loss of money or property. The indictment seeks to overcome this difficulty by alleging that, “as a result of the kickback arrangements, the paid plaintiffs had a greater interest in maximizing the amount of attorneys’ fees awarded to Milberg Weiss than in maximizing the net recovery to the absent class members and shareholders.”²⁰⁰ To support this loss of property theory, the indictment further alleges that the unnamed plaintiffs were deprived of “the amount of any kickback that Milberg Weiss paid using attorneys’ fees obtained in the lawsuit.”²⁰¹ Given that the kickbacks were allegedly paid from court-approved attorneys’ fees, this theory does not plainly describe a deprivation of property.

With respect to the loss of intangible property rights, the indictment once again is on thin ice. The alleged intangible property interest in “material economic information that affected [the class members’] right and ability to influence and control” is vague at best. In past cases, where the mail and wire fraud charges have been based on a similar theory, the victims typically were deprived of information such as trade secrets or confidential business information.²⁰² In such cases, the victims plainly had business and monetary interests in the intangible property rights at issue.²⁰³ Here, on the other hand, the information at issue—the amount of the kickbacks—held no such value to the unnamed plaintiffs.

On the honest services theory, the named plaintiffs and the firm did owe the class members and shareholders fiduciary duties, and the kickback scheme certainly appears to place the named plaintiffs’ interests over those of the unnamed plaintiffs. Yet even here the theory is unusual. Most high-profile honest services prosecutions are of public sector defendants accused

Many have long wondered as to what could motivate anyone with no real financial stake to be deposed in hundreds of cases, and the [Milberg Weiss] indictment will suggest to some that under-the-table payments have long been customary. Indeed, professional plaintiffs appear to have maintained broad and inclusive stock portfolios with trivial holdings that were designed to give their law firms immediate access to court. One does not logically do this for free.

Coffee, *Milberg Weiss Indictment*, *supra* note 176.

¹⁹⁹ See *Milberg Indictment*, *supra* note 173, ¶¶ 24, 29.

²⁰⁰ *Id.* ¶ 29.

²⁰¹ *Id.* ¶ 33(c).

²⁰² See, e.g., *United States v. Carpenter*, 484 U.S. 19, 25 (1987).

²⁰³ *Id.*

of political corruption.²⁰⁴ In these cases, the alleged loss is usually clear: the public official has taken a bribe or acted in some other way to deprive the public of the official's honest services.

The standards for criminal liability in private sector honest services cases are far less settled.²⁰⁵ In the vast majority of private sector honest services kickback cases, an employee was receiving kickbacks to the employer's clear detriment.²⁰⁶ Outside the employer-employee context, neither Congress nor the courts have clearly delineated the scope of fiduciary duties that give rise to honest services liability.²⁰⁷

Further, in private sector honest services cases, the courts generally require something more than a breach of duty. Some courts require that the scheme be designed to inflict some economic, pecuniary, or other harm on the intended victim.²⁰⁸ Other courts require proof that the fraud be "material," that is, that the scheme had the natural tendency to influence, or was capable of influencing, the victim to alter its behavior.²⁰⁹ Under either test, the government will be required to show that the unnamed plaintiffs were either harmed or altered their behavior because of the kickbacks.²¹⁰

In light of the realities of plaintiffs' class action litigation, neither result is self-evident in the Milberg Weiss case. Although the indictment alleges a conflict, it does not specifically articulate how this conflict reduced the recovery or otherwise negatively affected the unnamed plaintiffs.²¹¹ The indictment also alleges that the kickback arrangement led the firm to put the

²⁰⁴ See, e.g., *United States v. McNally*, 483 U.S. 350, 358-61 (1987), *superseded in part by statute*, Anti-Drug Abuse Act of 1988, Pub. L. No. 100-690, § 7603(a), 102 Stat. 4181, 4508 (codified at 18 U.S.C. § 4506 (2006)); *United States v. Czubinski*, 106 F.3d 1069, 1076-77 (1st Cir. 1997). See generally STRADER, UNDERSTANDING, *supra* note 31, § 4.05[B].

²⁰⁵ The court in *Rybicki* attempted a survey of the private sector cases. See *United States v. Rybicki*, 354 F.3d 124, 138-42 (2d Cir. 2003). As the dissent in that case pointed out, however, the standards for criminal liability are far from clear, and the honest services statutes remains open to vagueness challenges. See *id.* at 156-57 (Jacobs, J., dissenting).

²⁰⁶ See, e.g., *United States v. Vineyard*, 266 F.3d 320, 327-28 (4th Cir. 2001); *United States v. George*, 477 F.2d 508, 512-13 (7th Cir. 1973).

²⁰⁷ *United States v. Handakas*, 286 F.3d 93, 106-07 (2d Cir. 2002), *abrogated in part by Rybicki*, 354 F.3d 124.

²⁰⁸ See STRADER, UNDERSTANDING, *supra* note 31, § 4.05[B][3][b] (listing cases).

²⁰⁹ *Rybicki*, 354 F.3d at 146.

²¹⁰ If the defendant acted in the purported victim's interest, then there may be no breach of duty. In reversing the honest services wire fraud convictions in connection with an alleged Enron-related fraud scheme, the Fifth Circuit stated:

What makes this case exceptional is that, in typical bribery and self-dealing cases, there is usually no question that the defendant understood the benefit to him resulting from his misconduct to be at odds with the employer's expectations. This case, in which Enron employees breached a fiduciary duty in pursuit of what they understood to be a corporate goal, presents a situation in which the dishonest conduct is disassociated from bribery or self-dealing and indeed associated with and concomitant to the employer's own immediate interest.

United States v. Brown, 459 F.3d 509, 522 (5th Cir. 2006).

²¹¹ See Milberg Indictment, *supra* note 173, ¶ 34(a).

named plaintiffs' interests over those of the unnamed plaintiffs, but does not explain whether or how this actually happened.²¹² Theoretically, in cases where the firm was paid based upon hourly submissions approved by the court after recovery, the firm and named plaintiffs had an interest in maximizing the amount of fees over the amount of recovery. But this incentive exists whenever the lead plaintiffs' fees are awarded in this manner, irrespective of any kickbacks. And because the plaintiffs' class action attorneys, not the named plaintiffs, typically drive the litigation,²¹³ the kickbacks as a practical matter likely had no effect on the actual conduct of the litigation. Yes, the kickbacks may have enabled the firm to have a stable of named plaintiffs ready to go to court, but this merely allowed the firm to obtain lead counsel status. If anything, having Milberg Weiss as lead counsel probably benefited rather than harmed the unnamed plaintiffs.²¹⁴

This case rests upon untested theories of mail and wire fraud. Of course, so long as the very malleable statutes governing these forms of fraud remain on the books the government will bring cases that stretch existing law. But here, the alleged harm from the fraud is nebulous at best. From the facts alleged in the indictment, the harm alleged does not justify the government's means.

Where the alleged harm from the mail and wire fraud charges is ambiguous, then perhaps civil or regulatory remedies would be most appropriate. Stricter scrutiny of plaintiffs' law firms' practices is certainly called for, perhaps by state bar disciplinary committees.²¹⁵ But, based on the facts alleged so far, the expansive financial fraud charges against the Milberg Weiss defendants hardly seem justified.

²¹² See *id.* ¶ 29. Generally, plaintiffs' firms are compensated in one of two ways. Firms can receive either a reasonable percentage of the recovery, or a reasonable hourly fee. The latter type of arrangement is commonly called the lodestar approach. In class action cases involving a common fund, courts have the discretion to apply either the percentage or the lodestar method of calculating attorneys' fees. See Walker & Horwich, *supra* note 196; Sandra R. McCandless et al., *Report on Contingent Fees in Class Action Litigation*, 25 REV. LITIG. 459 (2006).

²¹³ See Garry et al., *supra* note 177 (lawyers drive class actions, and lawyers' interests and the interests of class members are frequently in conflict); Geoffrey P. Miller, *Conflicts of Interest in Class Action Litigation: An Inquiry into the Appropriate Standard*, 2003 U. CHI. LEGAL F. 581, 610 (asserting that attorneys, not class members, control class actions). Note that the Supreme Court has held that conflicts of interest between the named plaintiffs and the class members may render the class certification invalid. See *Amchem Prods. v. Windsor*, 521 U.S. 591, 625-26 (1997).

²¹⁴ See, e.g., Julie Creswell, *U.S. Indictment for Big Law Firm in Class Actions*, N.Y. TIMES, May 19, 2006, at A1 (describing Milberg Weiss as the "nation's leading class-action securities law firm" and estimating that the firm has recovered \$45 billion).

²¹⁵ Referral fees to non-lawyers violate ethical rules. See MODEL RULES OF PROF'L CONDUCT R. 5.4(a) (2003). Admittedly, bar associations to date have been largely ineffective in policing these kinds of violations. See Coffee, *Milberg Weiss Indictment*, *supra* note 176 ("Conceivably, the reaction [to the Milberg Weiss indictment] could even be strong enough that state bar associations and disciplinary committees, which have long rivaled the ostrich in their ability to keep their heads buried, might awake and conduct investigations.").

2. Naming the Firm as a Defendant

What is the cost of bringing criminal charges? It is extremely rare for a law firm, as opposed to individual attorneys, to be indicted.²¹⁶ Predictably, some of the firm's partners and clients have abandoned ship.²¹⁷ As many commentators have noted, the indictment has threatened the firm's very existence.²¹⁸ The indictment threatened to kill the firm—like Drexel Burnham and Arthur Andersen before it—because the government used an untested legal theory to charge a case that could well have been addressed in an effective, but less draconian, manner.²¹⁹

In addition to the substantive charges, Milberg Weiss is named on three forfeiture counts, which would enable the government to seek pre-trial seizure of the firm's assets. This, in fact, was the fatal blow to Princeton-Newport Partners, which ceased to exist under the strain of government control over its assets.²²⁰ The forfeiture counts in the indictment have re-

²¹⁶ See Leigh Jones, *Milberg Dwindles, Questions Multiply: If Firm Is Convicted, Who Pays The Price?*, NAT'L L.J., July 10, 2006, at 1 (stating that it is rare for a firm to be indicted, because of the immediate damage to the entity caused by the charges).

²¹⁷ *Id.*

²¹⁸ E.g., Lin, *supra* note 174; Martha Neil, *Milberg Weiss Indicted: Charges in Alleged Fee-Sharing Scheme Hit Firm, Two Partners*, A.B.A. J. E-REPORT, May 19, 2006, at 1. *But see In re WRT Energy Sec. Litig.*, No. 96 Civ. 3610 (JFK), 2006 U.S. Dist. LEXIS 47483, at *11 (S.D.N.Y. July 13, 2006) (appointing Milberg Weiss as lead counsel); Molly Selvin, *California and the West: Milberg Enters Not Guilty Plea; Prosecutors Say More Indictments Could Come in the Case Alleging that the Law Firm Paid Illegal Kickbacks to Plaintiffs*, L.A. TIMES, July 18, 2006, at C2 (reporting Milberg's appointment).

²¹⁹ The Milberg Weiss case also implicates the controversial "Thompson Memorandum," which calls for penalizing entities that decline to waive the attorney-client privilege or that pay employees' attorneys' fees during a criminal investigation. Memorandum from Larry D. Thompson, Deputy Att'y Gen. to Heads of Dep't Components & U.S. Attorneys, Principles of Federal Prosecution of Business Organizations (Jan. 20, 2003), available at http://www.usdoj.gov/dag/cftf/corporate_guidelines.htm. The Memorandum states, among other things, that an entity's decision whether to waive the attorney-client privilege may affect the government's decision whether to prosecute the entity. *Id.* According to press reports, Milberg Weiss's decision not to waive the privilege led to its indictment. See Andrew Longstreth, *Communication Breakdown: The Final Weeks Before the Milberg Weiss Indictments Led to an Impasse*, AM. LAW., July 2006, at 18. For an analysis of the Thompson Memorandum, see Peter J. Henning, *Targeting Legal Advice*, 54 AM. U. L. REV. 669 (2005). The Thompson Memorandum has now been replaced by the "McNulty Memorandum," which leaves many of the earlier policies in place. See John J. Carney & Dennis O. Cohen, *McNulty Memo: Changes Game or Keeps Congress Out?*, N.Y.L.J., Jan. 3, 2007, at 3.

²²⁰ See Marcia Chambers, *Sua Sponte*, NAT'L L.J., Feb. 10, 1992, at 15; Crovitz, *supra* note 59, at 1059; Sherry R. Sontag, *Forfeitures Void: Princeton/Newport Case; RICO Stretched Too Far?*, NAT'L L.J., Nov. 20, 1989, at 3; Sherry R. Sontag, *Princeton-Newport Ends: RICO Fades Away on Wall Street*, NAT'L L.J., Sept. 28, 1992, at 3; see also William W. Taylor III, *The Problem of Proportionality in RICO Forfeitures*, 65 NOTRE DAME L. REV. 885 (1990). Milberg Weiss, of course, does not depend on investors as did PNP and does not risk loss of investor funds. Nonetheless, the forfeiture charges, and the prospect of pre-trial restraints, pose a serious risk to the firm.

ceived practically no attention from commentators or the media, but pose a serious threat to the firm's ability to continue to do business while under indictment. The forfeiture counts would be substantially weakened without the mail and wire fraud charges.

3. The Harm Caused

Once again, this is a case based on harm that is at best uncertain. Taken as a whole, the mail and wire fraud charges against the firm and the attorneys are unusual and open to significant challenge. Thus, there are serious questions as to whether these charges are justified. Further, the case exhibits a questionable exercise of prosecutorial discretion with respect to indicting the firm, an unusual action the purported merits of which have so far gone unexplained. Finally, the government's overkill is especially apparent in the broad forfeiture counts, which can threaten the existence of any ongoing entity.

III. CASE STUDY LESSONS

A. *Recognizing the Costs of Gray-Area Prosecutions*

The three case studies provide us with some profound lessons in over-criminalization in the context of white collar fraud cases. The phenomenon occurs when conduct of uncertain wrongfulness is subject to criminal sanctions. I argue that "wrongfulness" can and should be assessed by reference to the alleged harm caused.

The sources of over-criminalization at the federal level can be traced to all three branches of government. Congress enacts too many, often overlapping, criminal statutes, many of which are vague and overbroad; prosecutors apply these statutes in too many circumstances; and courts interpret the statutes too broadly. Each of the case studies illustrates these phenomena. The focus here is not upon whether these defendants should have been criminally charged at all. Rather, it is upon whether the particular statutory fraud theories were properly asserted, that is, mail-fraud-based RICO, in the Milken cases; securities fraud, in the Stewart civil and criminal cases; or mail and wire fraud, in the Milberg Weiss case.

In the Milken-related cases, there seems little doubt, with the benefit of hindsight, that the government vastly overcharged. The RICO theory was not justified against Drexel, Milken, or PNP; the RICO-based charges put two major investment firms out of business, and forced Milken to plead guilty. Only the PNP defendants had their day in court, where their vindication on appeal—like Arthur Andersen's—was a hollow victory. A reversal

on appeal is not of much solace when the threatened entity has ceased to exist.

In the PNP case, what merited a multi-count securities fraud, tax fraud, mail fraud, and RICO indictment? Was it the defendants' attempt to use an obscure provision of the tax code to create tax losses? It is difficult to defend the government's approach, given that: (1) PNP overpaid its taxes; and (2) the tax code section at issue was untested and open to varying interpretations. The alleged harm (interfering with the IRS's ability to track tax liability) was uncertain. These circumstances called out for a civil tax enforcement case in which the court could determine the proper scope of an uncertain area of the law, and make appropriate findings of liability, if any.

Martha Stewart was the most famous white collar defendant since Milken. Like Milken, she was very successful and controversial. Once again, the government used a novel legal theory—this time, that Stewart defrauded MSLO shareholders simply by proclaiming her innocence. Here, the loss was just as uncertain as it was in the PNP case. The calculation of loss would have been mind-bogglingly difficult, but would surely have produced the maximum possible Guidelines sentence, a sentence completely out of proportion to Stewart's alleged wrongdoing.

If we assume that insider trading should be regulated, then the civil SEC case, based on the ImClone trading, was by way of contrast an appropriate and proportional government response. The civil penalties to which Stewart ultimately agreed—a fine, injunction, and five-year ban from being an officer or director of her company—²²¹ also seem commensurate with the alleged wrong. This was a case where the right result probably occurred, but only after a wasteful detour. This detour was all the more dubious in light of the SEC's decision not to pursue the MSLO-based theory in a civil case, in which liability would have been determined under a preponderance standard.

Finally, the allegations in the Milberg Weiss case raise serious legal and ethical concerns. But the facts hardly seem to support the core government theory, that the firm and certain of its principals committed a massive fraud on the unnamed plaintiffs. The government asserted this theory without identifying any concrete harm whatsoever. The indictment threatened to put the entire firm out of business, a result that makes no sense.

²²¹ See Press Release, Sec. & Exch. Comm'n, *supra* note 5.

B. *Finding a Solution*

1. Re-Writing the Statutes

How can we avoid such results? Start with Congress. The RICO statute at issue in the Milken cases, the securities fraud statute at issue in the Stewart case, and the honest services statute at issue in the Milberg Weiss case are classic examples of statutes run amok. Each statute is need of serious reform.

There is no more glaring example than RICO, particularly in its application to white collar cases.²²² There is little doubt that the statute was born of Congress's attempt to find a statutory solution to a wave of organized crime.²²³ Criminalizing membership in a group proved constitutionally impossible, but the alternative hardly seems any better. As most frequently used, the statute criminalizes "conducting" the affairs of an "enterprise" through a "pattern" of "racketeering activity." Each of these elements has produced a huge body of case law that has done practically nothing to cabin prosecutors or guide courts when applying and interpreting the statute.²²⁴ Justice Scalia was right on the money when he described the Court's guideline for interpreting the pattern element—the infamous "relationship plus continuity" test—as being "about as helpful . . . as life is a fountain."²²⁵ In truth, his conclusion could well apply to judicial interpretations of all the RICO elements.²²⁶

Apart from being incomprehensible, the RICO statute's potential application is nearly boundless,²²⁷ principally because of its inclusion of the mail and wire fraud statutes as predicate acts. These statutes can be used just about anytime anyone puts anything in the mail, makes an interstate phone call, or sends an e-mail in suspicious circumstances. To return to the PNP case, the government was able to build a RICO case, and thus assume control over PNP's assets and put it out of business before any trial had even occurred, because the defendants did not have the foresight to hand-deliver their tax returns. Never mind that the tax fraud theory itself was

²²² Commentators have long debated whether Congress intended that RICO apply to white collar crimes. Compare Gerard E. Lynch, *A Reply to Michael Goldsmith*, 88 COLUM. L. REV. 802, 802 (1988) (arguing that Congress never intended for RICO to be applied as broadly as prosecutors have applied the statute), with Michael Goldsmith, *RICO and Enterprise Criminality: A Response to Gerald E. Lynch*, 88 COLUM. L. REV. 774, 776-81 (1988) (disputing Lynch's conclusion).

²²³ See Gerald E. Lynch, *RICO: The Crime of Being a Criminal, Parts I & II*, 87 COLUM. L. REV. 661, 664-80 (1987).

²²⁴ See Vizcarrondo, *supra* note 29, § 11.03.

²²⁵ *H.J. Inc. v. Nw. Bell Tel. Co.*, 492 U.S. 229, 252 (1989) (Scalia, J., concurring).

²²⁶ See Vizcarrondo, *supra* note 29.

²²⁷ See Barry Tarlow, *RICO: The New Darling of the Prosecutor's Nursery*, 49 FORDHAM L. REV. 165, 305-06 (1980).

open to serious legal debate, or that this was the first time that the government had built a RICO case on tax fraud as mail fraud.

The securities fraud statutes exhibit similar ambiguities, particularly in cases of alleged insider trading. Congress, the SEC, and the courts have yet to define with any precision the range of fiduciary duties that may give rise to misappropriation cases, for example.²²⁸ To take another example, the tender offer rules prohibit knowingly trading on inside information involving a tender offer, even when there is no breach of duty.²²⁹ But what, exactly, must the defendant know in order to be criminally liable? That the information is secret? That the information relates to a tender offer? One court reversed a conviction because the government failed to prove knowledge of the latter, but the statute itself gives us no real guidance in answering this question.²³⁰ This was another case in which a vague statute was used to prosecute a criminal case where the alleged insider trading loss was indeterminate. An SEC civil case may have been appropriate; a criminal case was not. And in the Martha Stewart case, the securities fraud theory was unprecedented, raising serious issues of due process and fair notice.²³¹

The Milberg Weiss case lays open another wound in the body of white collar crime: the notoriously ambiguous “intangible property rights” and “honest services” theories of mail and wire fraud. Under the loss of property theory, the indictment fails to identify any harm to the class members. The indictment also relies upon the “honest services” theory.²³² But the criminal code does not define the term “honest services,” and judicial interpretations of that term are as confused and confusing as those of the RICO elements. No one knows just how dishonest actions must be to qualify under the statute. For example, if an IRS employee violates office policy by sneaking peeks at taxpayer files, has that employee violated the public’s interests or the IRS’s interests as a private employer? A jury convicted a defendant on this theory, but an appeals court found that this violation just was not quite serious enough, whether the defendant was considered a public official or a private employee, to support the conviction.²³³

²²⁸ See David M. Brodsky & Daniel J. Kramer, *A Critique of the Misappropriation Theory of Insider Trading*, 20 CARDOZO L. REV. 41, 44-45 (1998).

²²⁹ 17 C.F.R. § 240.14e-(3)(a) (Rule 14e-3, promulgated under Securities Exchange Act of 1934 section 14e (codified as amended at 15 U.S.C. § 78(n)(e) (2006))).

²³⁰ *United States v. Cassese*, 290 F. Supp. 2d 443, 450-51 (S.D.N.Y. 2003), *aff’d*, 428 F.3d 92 (2d Cir. 2005) (“Since there is no general duty to refrain from trading on material nonpublic information, the defendant must have believed that the information related to, or most likely related to, a tender offer in order to impose criminal liability. . . . To conclude otherwise would impose absolute liability for all who trade on material nonpublic information, and this is not the law.”).

²³¹ See Moohr, *Martha Stewart Case*, *supra* note 8, at 605 (describing the vagueness of securities fraud statutes, as demonstrated in the Martha Stewart case).

²³² See 18 U.S.C. § 1346 (2006).

²³³ See *United States v. Czubinski*, 106 F.3d 1069, 1076-77 (1st Cir 1997).

The same problem arose in one of the principal Enron-related prosecutions. In that case, the Fifth Circuit reversed the wire fraud convictions in connection with an alleged Enron-related fraud scheme.²³⁴ The government's theory was that the defendants, former Enron and Merrill Lynch executives, participated in a sham transaction designed to create artificial revenues to help Enron meet its earnings goals. The court held that, because the defendants were acting in Enron's interests, they did not deprive Enron of their "honest services." Much ink has been spilled attempting to glean some meaning from the honest services statute, but the Fifth Circuit summed it up well. Stating that it refused to engage in the exercise of defining federal "common-law crimes," the court concluded that it would "resist the incremental expansion of a statute that is vague and amorphous on its face and depends for its constitutionality on the clarity divined from a jumble of disparate cases."²³⁵ This conclusion is all the more valid because the mail and wire fraud statutes are applied in circumstances where there is no discernable harm.²³⁶

The vagueness of many white collar statutes should be news to no one. The myriad proposals for solving the problem, however, have yet to make any headway.²³⁷ Yet the cases discussed above provide some meaningful guidance. The mail-fraud based RICO, insider trading, and honest services cases show that all too often prosecutors overreach in instances of ambiguous harm and unproven legal theories.

More carefully crafted statutes would begin to help solve this problem. We indeed may be approaching a window of opportunity for legislative reform. In the post-Enron world, the most recent cycle of high-profile financial fraud prosecutions seems to be waning.²³⁸ There is a strong likelihood that the post-Enron era of expansive regulations may also be over.

²³⁴ *United States v. Brown*, 459 F.3d 509 (5th Cir. 2006). The court affirmed one defendant's cover-up crime convictions. *Id.*

²³⁵ *Id.* at 523. One Second Circuit panel went so far as to hold the honest services statute unconstitutionally vague, though the Second Circuit sitting en banc later abrogated that holding without reaching its merits. *See United States v. Handakas*, 286 F.3d 92, 103 (2d Cir. 2002), *abrogated in part by* *United States v. Rybicki*, 354 F.3d 124 (2d Cir. 2003). The *Rybicki* decision provides the most comprehensive attempt by any court to date to make some sense of the honest services provision. *See Rybicki*, 354 F.3d at 138-42.

²³⁶ *See Hasnas*, *supra* note 22, at 587-88 ("These broad provisions authorize the punishment of almost any kind of dishonest or deceptive behavior, even when no other party suffered any harm.").

²³⁷ *See sources cited supra*, note 19 (discussing the over-criminalization crisis).

²³⁸ For an overview of these cases and their resolutions, see Brickey, *In Enron's Wake*, *supra* note 4. Recent statistics indicate that the number of white collar prosecutions declined by 6% from January 2006 to January 2007, and by nearly 22% from January 2002 to January 2007. *See* TRAC Reports, White Collar Crime Prosecutions for January 2007, http://trac.syr.edu/tracereports/bulltins/white_collar_crime/monthlyjan07/fil/.

Indeed, there are indications that there may be a retrenchment of recent regulatory reforms.²³⁹

In the best of all possible worlds, Congress would not only halt its tendency to enact ever-broader criminal regulations. It would go further, and actually refine overly expansive criminal statutes, such as the RICO statute, the honest services statute, and the securities fraud statutes discussed above.

2. Enforcing the Statutes

Whatever the current regulatory environment, Congress concededly has not paid much attention to the broadsides that academics and even judges frequently send its way.²⁴⁰ So, a betting person would be unwise to wager that substantial statutory reform is in the offing. Are there better targets for reform efforts?

For all the questionable cases the government has brought, there are many instances where prosecutorial discretion has yielded the right result.²⁴¹ Whatever the tactical basis for the decision, the prosecutors were right not to charge Martha Stewart with insider trading based upon her ImClone sales. And in the wake of the Drexel/PNP imbroglio, the Department of Justice actually amended its prosecutorial guidelines to discourage charging tax fraud as mail and wire fraud, or charging tax fraud-based mail and wire fraud as a RICO predicate.²⁴²

²³⁹ See, e.g., John D. McKinnon & Christopher Conkey, *Politics and Economics: Bush Gives Hope to Foes Of Sarbanes-Oxley Law; President Offers Political Cover For Easing Burden on Business, but Joins Executive-Pay Critics*, WALL ST. J., Feb. 1, 2007, at A4 (reporting President Bush as repeating his view that the Act, which he signed amid a wave of corporate scandals, was successful but acknowledging the need to relax certain sections that “may be discouraging companies from listing on our stock exchanges”); Peter Nicholas, *Looser Rules Sought for Accountants: Regulatory Officials Take Steps to Promote the Profession and Roll Back Tough Standards Imposed in the Post-Enron Era*, L.A. TIMES, June 19, 2006, at B1 (reporting that accountants in California are lobbying the Governor’s office for a relaxation of regulations); Floyd Norris, *Moves at S.E.C. to Loosen Rules on Many Companies*, N.Y. TIMES, December 15, 2005, at C14 (reporting that the SEC is considering a proposed change to the Sarbanes-Oxley Act that would make it easier for foreign companies to avoid having to comply and that also would exempt 80% of American companies from having to fully comply). *But see* Kathleen Day, *SEC Denies Exception to Sarbanes-Oxley: Small Public Firms Must Comply*, WASH. POST, May 18, 2006, at D2 (reporting that, despite intense lobbying efforts, small companies must also adhere to new SEC rules requiring “companies to document, and an outside auditor to confirm, that adequate internal controls are in place to ensure that financial statements filed with the SEC are accurate and paint a realistic picture for investors”).

²⁴⁰ See Stuntz, *Pathological Politics*, *supra* note 19, at 508 (“Criminal law scholars may be talking to each other (and to a few judges) but they do not appear to be talking to anyone else.”).

²⁴¹ Others have noted the role of prosecutors in the process of over-criminalization. See, e.g., Henning, *supra* note 219; Richman & Stuntz, *supra* note 3, at 599-618.

²⁴² See U.S. DEPARTMENT OF JUSTICE, UNITED STATES ATTORNEYS’ MANUAL § 6-4.210 (2007).

Prosecutorial discretion may seem a thin reed upon which to hang hopes of reforming white collar criminalization. Much has been written on prosecutorial discretion,²⁴³ but so far no principled system has been implemented for preventing abuse of discretion. And, except in an egregious circumstance such as race bias, courts decline to regulate prosecutors' exercise of discretion in deciding whether to bring a criminal case, what charges to assert, or whom to charge.²⁴⁴

Yet, at least at the federal level, there is some cause for hope. The prosecutorial guidelines set forth in the *U.S. Attorneys Manual* attempt to provide some principled restraints on the exercise of prosecutorial discretion. As noted above, the PNP case led to one such guideline. There are other meaningful guidelines, including the guideline limiting the initiation of successive and dual prosecutions.²⁴⁵

We could, then, at least hope that the Department of Justice would adopt a policy that would provide a principled basis for determining when it is appropriate to bring criminal charges based upon substantial extensions of existing law. Novel, gray-area theories should only be brought when: (1) civil and/or administrative remedies are insufficient; and (2) the harm is substantial. Such a solution would lead to a more efficient use of government resources, restore some confidence in our system of white collar criminalization, and limit the risk of proceeding on a legal theory of which a defendant may not have been fairly on notice.

Certainly, such reform will be difficult to achieve. First, there are system-wide disincentives for limiting prosecutorial discretion in this fashion. Unlike state and local chief prosecutors, who are usually elected, U.S. Attorneys are appointed. The U.S. Attorneys do not have to answer to an electorate, and do not have to worry much if they overreach.²⁴⁶ And the Assis-

²⁴³ See, e.g., Harry Litman, *Pretextual Prosecution*, 92 GEO. L.J. 1135 (2004); Erik Luna, *Principled Enforcement of Penal Codes*, 4 BUFF. CRIM. L. REV. 515 (2000); Gerard E. Lynch, *Our Administrative System of Criminal Justice*, 66 FORDHAM L. REV. 2117 (1998). For a discussion of the exercise of prosecutorial power in the Martha Stewart case, see Geraldine Szott Moohr, *Prosecutorial Power in an Adversarial System: Lessons from Current White Collar Cases and the Inquisitorial Model*, 8 BUFF. CRIM. L. REV. 165, 182 (2002) (“[T]he Martha Stewart case illustrates the prosecutors’ power to decide what to charge.”).

²⁴⁴ See Litman, *supra* note 243, at 1141-42.

²⁴⁵ U.S. DEPARTMENT OF JUSTICE, UNITED STATES ATTORNEYS’ MANUAL section 9-2.031 provides:

This policy precludes the initiation or continuation of a federal prosecution, following a prior state or federal prosecution based on substantially the same act(s) or transaction(s) unless three substantive prerequisites are satisfied: first, the matter must involve a substantial federal interest; second, the prior prosecution must have left that interest demonstrably unvindicated; and third, applying the same test that is applicable to all federal prosecutions, the government must believe that the defendant’s conduct constitutes a federal offense, and that the admissible evidence probably will be sufficient to obtain and sustain a conviction by an unbiased trier of fact. In addition, there is a procedural prerequisite to be satisfied, that is, the prosecution must be approved by the appropriate Assistant Attorney General.

²⁴⁶ See Stuntz, *Self-Defeating Crimes*, *supra* note 23, at 1884-85.

tant U.S. Attorneys, who lead the investigations and litigate the cases, often come to their jobs with little practical experience and are usually not subject to substantial constraints on the sorts of cases they pursue.

The lack of constraints may lead federal prosecutors to pursue high-profile defendants using untested legal theories, often in the prosecutors' own career-building interests.²⁴⁷ The prosecutors' motivation to employ novel theories to catch big fish may particularly be strong in times of economic upheaval, when the public clamors for accountability. This certainly was true during the junk bond financed take-over boom/bust of the 1980s; there was no more obvious target than the country's highest-paid investment banker, Michael Milken. And in the early 21st century, the corporate accounting scandals netted many high-profile targets; Martha Stewart may have been collateral damage, but a number of Enron defendants and star technology investment banker Frank Quattrone are among those apparently charged on questionable legal theories.²⁴⁸ There is little in the way of systematic safeguards to prevent such results.

A second reason why there would be substantial hurdles in erecting effective controls via guidelines is that the guidelines do not have the force of law, and the government can and does violate its own guidelines, even in high-profile cases.²⁴⁹ Also, many current guidelines, such as those for mail and wire fraud, are so vague as to be useless.²⁵⁰

But even the vague mail and wire fraud guideline provides for a ray of hope, for it suggests that if the fraud "involve[ed] minor loss to the victims," then "the parties should be left to settle their differences by civil or criminal litigation in the state courts." This very kind of presumption—that

²⁴⁷ *See id.*

²⁴⁸ *See infra* notes 259, 274-76 and accompanying text (discussing reversals of convictions in Enron-related cases and in Quattrone's case).

²⁴⁹ *See Brogan v. United States*, 522 U.S. 398 (1998) (rejecting an "exculpatory no" defense to a false statements charge under 18 U.S.C. § 1001); *id.* at 415 (Ginsburg, J., concurring) (noting that the prosecutorial guidelines in effect at the time of the case discouraged such a charge when the defendant merely uttered an "exculpatory no"). Apparently, the government decided to violate its own guidelines because the statute of limitations had run on four of the five substantive offenses. *See id.* at 411. For a critical analysis of the *Brogan* decision from the point of view of the morality principle, see Stuart P. Green, *Lying, Misleading, and Falsely Denying: How Moral Concepts Inform the Law of Perjury, Fraud, and False Statements*, 53 HASTINGS L.J. 157, 198-201 (2001).

²⁵⁰ U.S. DEPARTMENT OF JUSTICE, UNITED STATES ATTORNEYS' MANUAL section 9-43.100, titled Prosecution Policy Relating to Mail Fraud and Wire Fraud, provides:

Prosecutions of fraud ordinarily should not be undertaken if the scheme employed consists of some isolated transactions between individuals, involving minor loss to the victims, in which case the parties should be left to settle their differences by civil or criminal litigation in the state courts. Serious consideration, however, should be given to the prosecution of any scheme which in its nature is directed to defrauding a class of persons, or the general public, with a substantial pattern of conduct.

The meaninglessness of this guideline is shown by the innumerable federal mail and wire fraud cases brought in cases of "isolated fraud" involving relatively "minor losses." *See Hasnas, supra* note 22, at 587-88.

the federal criminal law not be invoked where the harm is minimal or indeterminate—can and should be applied whenever the government seeks to assert a gray-area financial fraud theory.

3. Interpreting the Statutes

So far, only the courts seem to have recognized, however haltingly, the structural deficiencies with our current system of white collar criminalization. As discussed below, cases in several areas show some recognition that expansive white collar statutes should be read narrowly in instances of ambiguous harm.²⁵¹

Not surprisingly, the Supreme Court has most often narrowly interpreted white collar statutes that regulate economic activity. This may comport with a conservative court's philosophical antipathy to government regulation, but the cases also show recognition that such regulations may not entail the sorts of harm that merit criminalization.²⁵²

This narrowing has occurred in areas including antitrust, insider trading, and tax-related crimes. In *United States Gypsum*, the Court narrowly interpreted an antitrust statute to avoid over-criminalizing "economically justifiable business conduct."²⁵³ In *Dirks*, the Court declined to define tip-pee liability broadly because to do so "could have an inhibiting influence on the role of market analysts, which . . . is necessary to the preservation of a healthy market."²⁵⁴ In *Cheek*, the Court read the tax fraud statutes narrowly and imposed an intent-to-violate-the-law requirement in criminal tax cases. To criminalize tax fraud more broadly, the Court said, would be unfair and infeasible in an area of such complexity as tax regulations.²⁵⁵

With respect to cover-up crimes, the Court has reached similar conclusions. In these cases, the threat is of harm to administrative or judicial functioning. Thus, in *Bronston v. United States*, the Court narrowly interpreted the federal perjury statute, finding that a literally true statement cannot be perjurious.²⁵⁶ The Court recognized that criminalizing a wide range of non-responsive but potentially misleading answers could lead witnesses to decline to testify, a cost greater than simply imposing the burden on the ques-

²⁵¹ See *infra* notes 253-61 and accompanying text.

²⁵² See Strader, *Judicial Politics*, *supra* note 27, at 1261-63.

²⁵³ *United States v. U.S. Gypsum Co.*, 438 U.S. 422, 441 (1978); *cf.* *United States v. Bajakajian*, 524 U.S. 321, 339 (1998) ("Failure [of the defendant] to report his currency affected only one party, the Government, and in a relatively minor way. There was no fraud on the United States, and respondent caused no loss to the public fisc.").

²⁵⁴ *Dirks v. SEC*, 463 U.S. 646, 658 (1983) (citation omitted).

²⁵⁵ *Cheek v. United States*, 498 U.S. 192 (1991).

²⁵⁶ 409 U.S. 352 (1973).

tioner to ask the follow-up question.²⁵⁷ In *Arthur Andersen*, the Court narrowly interpreted a federal obstruction of justice statute, requiring proof that the defendant knowingly acted wrongfully when destroying documents.²⁵⁸ To do otherwise, the Court noted, would criminalize routine corporate document retention and destruction policies that are widely employed to legitimate business ends.²⁵⁹

In the political corruption context, in *McCormick v. United States*, the Court narrowly interpreted the federal extortion statute and reversed the extortion conviction of a state official.²⁶⁰ The Court found that, in such a prosecution, the government must prove that the official took something of value in exchange for a quid pro quo. To hold otherwise, the Court concluded, “would open to prosecution not only conduct that has long been thought to be well within the law but also conduct that in a very real sense is unavoidable so long as election campaigns are financed by private contributions or expenditures.”²⁶¹ The harm from criminalization, once again, was ambiguous.

To be sure, each of these examples is mirrored by other cases in which the Court has broadly interpreted federal criminal statutes.²⁶² But this observation only tells us that the Court is inconsistent when using the alleged harm caused as a guiding criminalization principle. At least the examples we have where the Court explicitly or implicitly applied that principle give us some guidance as to how the Court might apply a more consistent, coherent criminalization principle in its white collar cases.

²⁵⁷ *Id.* at 358 (“[W]e perceive no reason why Congress would intend the drastic sanction of a perjury prosecution to cure a testimonial mishap that could readily have been reached with a single additional question by counsel alert—as every examiner ought to be—to the incongruity of petitioner’s unresponsive answer.”).

²⁵⁸ *Arthur Andersen LLP v. United States*, 544 U.S. 696, 702-04 (2005) (interpreting 18 U.S.C. § 1512(b)(2)).

²⁵⁹ The *Arthur Andersen* decision led to a reversal in another high-profile obstruction case brought in the context of a document retention policy. *See United States v. Quattrone*, 441 F.3d 153 (2d Cir. 2006). In Quattrone’s first trial, the jury was unable to reach a verdict. *Id.* at 161. The government has declined to try Quattrone for a third time, agreeing to dismiss the charges after one year without requiring Quattrone to admit any wrongdoing. *See Andrew Ross Sorkin, Star Banker, With Future, Emerges Free*, N.Y. TIMES Aug. 23, 2006, at C1.

²⁶⁰ 500 U.S. 257 (1991) (interpreting 18 U.S.C. § 1951).

²⁶¹ *Id.* at 272.

²⁶² *See, e.g., Brogan v. United States*, 522 U.S. 398 (1998) (rejecting an “exculpatory no” defense to a false statements charge under 18 U.S.C. § 1001); *United States v. O’Hagan*, 521 U.S. 642 (1997) (affirming the use of the misappropriation theory of insider trading); *Evans v. United States*, 504 U.S. 255, 268 (1992) (holding that a public official may be guilty of extortion under color of official right even where the victim of the extortion initiated the payment).

C. *An Alternate Approach*

The approach proposed here has been long discussed but has yet to be implemented.²⁶³ A number of considerations support the conclusion that when the government seeks to bring a criminal case based upon a substantial extension of existing law, it should only do so when civil and/or administrative remedies are inadequate and the harm is definite and substantial. First, civil and administrative sanctions are more effective and efficient than criminal penalties in white collar cases. There is substantial evidence that white collar defendants are strongly deterred by civil/administrative sanctions, including debarment.²⁶⁴ The public humiliation and loss of status that attend such sanctions create their own deterrent effect. Particularly when the government must resort to a borderline theory, and the alleged harm is indefinite, the incremental deterrent effect of criminal penalties is often not worth the effort.²⁶⁵ In addition, imprisoning a defendant undermines any efforts towards restitution. Finally, because white collar criminals have extremely low recidivism rates, restraint through incarceration arguably provides only marginal societal benefit.²⁶⁶ Thus, the marginal deterrent effect of a gray-area prosecution is only justified when there is proof of substantial harm.

Second, the proposal could help build public confidence in the system of white collar criminalization. To return to the theme that opened this Article, white collar criminalization is in disarray largely because all three branches of government send profoundly mixed messages. In an important work, James Whitman outlined America's increasing tendency both to

²⁶³ See, e.g., Darryl K. Brown, *Street Crime, Corporate Crime, and the Contingency of Criminal Liability*, 149 U. PA. L. REV. 1295, 1327 (2001) ("An extensive regulatory regime to address corporate wrongdoing—civil and administrative fines, restitution orders, injunctions, and other forms of creative remedies—can take the place of criminal sanctions covering the same conduct and serving the same deterrence goals."); Richard Posner, *Optimal Sentences for White-Collar Criminals*, 17 AM. CRIM. L. REV. 409, 417 (1980) (undertaking a cost-benefit analysis and concluding that white collar crime "should be punished only by monetary penalties . . . rather than by imprisonment or other 'afflictive' punishments"); see also Green, *Uncovering*, *supra* note 8, at 26-28 (describing alternatives to criminal prosecutions in cover-up crime cases); Wilson Meeks, Note, *Corporate and White-Collar Crime Enforcement: Should Regulation and Rehabilitation Spell an End to Corporate Criminal Liability?*, 40 COLUM. J.L. & SOC. PROBS. 77 (2006) (arguing for civil/regulatory liability for corporations).

²⁶⁴ For example, the SEC has the authority to seek an order prohibiting a party from operating as a broker-dealer, or from acting as an officer or director of a public company for a set period or for life. See *supra* notes 92-93 (sanctions in Martha Stewart case).

²⁶⁵ See *United States v. Adelson*, 441 F. Supp. 2d 506, 514 (2006) (citing Richard Frase, *Punishment Purposes*, 58 STANFORD L. REV. 67, 80 (2005)); Elizabeth Szockyj, *supra* note 7; see also Brown, *supra* note 263, at 1360 ("Civil sanctions serve prevention and restitution goals better than criminal law and give more attention to punishment's social costs, effects on social norms, and backlash effects."); Posner, *supra* note 263, at 416-17 (arguing that sufficiently high civil fines will provide effective deterrence).

²⁶⁶ See Szockyj, *supra* note 7, at 494.

over-criminalize and over-punish white collar offenses, comparing our practices with those in Europe to reach this conclusion.²⁶⁷ This tendency is the symptom of a broken system, one that sends defendants to jail more often than necessary and for longer terms than are warranted.

The public can have little confidence, in such a system, that a particular defendant's culpability will match the punishment. This is particularly so with white collar crimes because the public and all levels of government have such inconsistent responses to such crimes.

How do we fix the system? We should start with statutory definitions. As Claire Finkelstein has argued, "[v]aguely worded statutes that fail to identify the harm towards which the criminal measure is directed are problematic because they will often be used to target nonharmful conduct by police and prosecutors."²⁶⁸ To this we should add a proportionality requirement, under which the punishment must be commensurate with the harm caused or threatened. In this light, the mail-fraud-based RICO charges in the Milken cases, the securities fraud charge against Martha Stewart, and the mail fraud charges against Milberg Weiss are improper applications of the criminal law.

Prosecutorial guidelines also need adjusting. Because most white collar criminal statutes can be stretched so broadly, prosecutors' choices send powerful messages concerning the appropriate scope of criminalization.²⁶⁹ As Pamela Bucy has written, "prosecutors educate society about the nature of white collar offenses: why these offenses are harmful and why the rest of us should not commit them."²⁷⁰

When a prosecutor uses an untested legal theory to target an individual, as apparently happened with both Milken and Stewart, the integrity of federal law enforcement is undermined, for the law itself appears manipulable and unprincipled.²⁷¹ The same conclusion applies when prosecutors

²⁶⁷ See WHITMAN, *supra* note 58, at 43-44, 47-48.

²⁶⁸ Finkelstein, *supra* note 48, at 377; *see also* Wiley, *supra* note 52, at 1067 ("If Congress writes vague and encompassing federal crimes, it is likely to get vague and encompassing federal prosecutions.").

²⁶⁹ See Richman & Stuntz, *supra* note 3, at 586 ("[T]he law's messages are filtered through prosecutors' litigation choices, and those choices can change the message dramatically."). The authors were discussing the "Al Capone" approach to charging criminal cases. The notorious mobster Capone was ultimately convicted of tax fraud because that was the charge that prosecutors could prove. Some have argued that, similarly, the government charged Martha Stewart with cover-up crimes because insider trading would have been hard to prove. *Id.* at 589-90.

²⁷⁰ Bucy, *supra* note 13, at 336. Bucy surveys the literature on the "expressive function" of the law. *See id.* at 334 n.74.

²⁷¹ *Cf.* Richman & Stuntz, *supra* note 3, at 628-29 ("Too many federal crimes . . . are defined both broadly and strategically . . . Instead of specifying the conduct that law enforcers or legislators actually wish to punish, these statutes seem designed to facilitate convictions in cases where the real crime lies somewhere else.").

pile on charges, as occurred in the original Milken indictment and as appears to have occurred in the Milberg Weiss indictment.²⁷²

Other cases show similar symptoms. The prosecutions arising from the Enron investigation are instructive here. Undoubtedly, Enron's demise was terrible costly.²⁷³ So, criminal prosecution was warranted if wrongdoing caused the harm and if the prosecutions were based upon well-grounded legal theories. But did the government overreach in charging the cases? Consider the prosecution of Enron's accounting firm. The *Arthur Andersen* case was questionable both because of its legal theory, which encompassed routine and potentially innocent document retention policies, and because the government killed the firm by charging it in the first place.²⁷⁴ Serious questions have been raised concerning the legal theories used in the case against Enron Chairman Kenneth Lay.²⁷⁵ Other Enron-related convictions have been overturned because of apparent prosecutorial overreaching.²⁷⁶

The approach proposed in this Article requires us to identify precisely the sorts of harm that warrant criminalization of alleged instances of financial fraud.²⁷⁷ This is not to suggest that harm identification will be an easy task; it will always be more difficult to identify harms and victims in white collar cases than in street crime cases.²⁷⁸ In financial fraud cases, however, the government must undertake this task in order to avoid the sort of overcriminalization that gray-area prosecutions so often entail.

²⁷² See *supra* note 68 (Milken cases); *supra* notes 173, 186-87 and accompanying text (Milberg Weiss). For an argument that the prosecutors also overcharged in the Martha Stewart case, see Seigel & Slobogin, *supra* note 90.

²⁷³ See Beale, *supra* note 19, at 780 n.153 ("Enron lost \$100 billion in shareholder equity, and more than 6,500 employees lost their jobs."). For an analysis of the Enron matter, see Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937 (2003).

²⁷⁴ See Beale, *supra* note 19, at 779. As the Supreme Court noted in overturning the conviction, it is not improper to destroy documents pursuant to a routine document retention policy. *Arthur Anderson LLP v. United States*, 544 U.S. 696, 704 (2005).

²⁷⁵ See, e.g., Coffee, *Overcriminalization*, *supra* note 131, at 1 (questioning the government's theory in its fraud case against Lay and concluding that "an intense political need to indict Lay may explain why prosecutors have pushed the envelope of securities and mail fraud theories to their limit"). For an example of the news media's perspective, see Allan Sloan & Carol Rust, *Truth, Justice and the Enron Trial*, NEWSWEEK, Apr. 10, 2006, at 18 (examining the government's theories at the Enron trial and concluding that one should "try not to confuse the results of criminal trials with justice").

²⁷⁶ *United States v. Brown*, 459 F.3d 509 (5th Cir. 2006); *United States v. Howard*, 471 F. Supp. 2d 772 (S.D. Tex. 2007) (reversing various Enron-fraud-related convictions on the basis of *Brown*).

²⁷⁷ For an economic approach to the issue, see Darryl K. Brown, *Cost-Benefit Analysis in Criminal Law*, 92 CAL. L. REV. 323 (2004). Hard issues arise when we address criminalization of cover-up crimes and political corruption. With cover-up crimes, the harm may be diffuse, but we can still identify the threats to the functioning of the justice system. See Green, *Uncovering*, *supra* note 8, at 29. We can reach similar conclusions with the threats to our government arising from political corruption crimes. This Article leaves for another day, however, an assessment of the "harm" from such conduct.

²⁷⁸ See Green, *Moral Ambiguity*, *supra* note 22, at 509.

In light of the potential life sentences for conviction of the charges asserted in the indictment, it is not surprising that the Milberg Weiss case will likely be resolved by plea bargain.²⁷⁹ In one plea agreement with a named defendant, that defendant agreed to plead guilty to conspiracy to obstruct justice and make a false statement.²⁸⁰ This plea carries a Guidelines range of twenty-seven to thirty-three months, with a possible downward departure for substantial cooperation.²⁸¹ The plea is based upon cover-up crimes that seem proportionate to the alleged wrongdoing in this case and that stand in stark contrast to the numerous gray-area charges asserted in the massive original indictment. As in the Milken case, the government has used novel legal theories to force a plea; once again, the underlying gray-area theory is likely to go untested in court. These are the very sorts of case resolutions that undermine our confidence in our system of white collar criminalization.

CONCLUSION

Though the task of constructing a more efficient and effective white collar criminalization system inevitably will be complex, it is a task worth undertaking if we are to resolve our ambivalence and uncertainty over white collar criminalization. The public is justifiably confused over the reach of the law, a confusion that will remain so long as the law as written, enforced, and interpreted is unmoored from any guiding principle. The ambivalence undermines the law's ability to affect social behavior and undercuts the law's utilitarian benefits.

The principal theories in the Milken, Stewart, and Milberg Weiss cases show this result in practice. The public and commentators remain strongly conflicted over whether Milken and Stewart were properly punished, and the same conflict is likely to emerge should the Milberg Weiss defendants be convicted of the mail-fraud-based crimes. The solution is a clear-eyed focus on identifying the harm caused and assessing whether civil and administrative remedies are sufficient in instances of uncertain harm.

This is an inhospitable time, perhaps, in which to advocate such refinement of white collar criminalization. But more carefully crafted crimes and guidelines for applying those crimes would make us all better off by focusing lawmakers' and prosecutors' energies and resources on the most

²⁷⁹ See Molly Selvin, *Lawyer Admits to Kickbacks*, L.A. TIMES, July 10, 2007, at A1 (detailing plea agreement by Milberg Weiss ex-partner David Bershad).

²⁸⁰ *Id.*

²⁸¹ The plea agreement stipulates an offense level of 18. Plea Agreement for Defendant David J. Bershad at 5-6, *United States v. Bershad*, No. CR 05-587(B)-JFW (C.D. Cal.), available at, http://www.nylawyer.com/adgifs/decisions/071007bershad_agreement.pdf. That offense level carries a sentence of 27-33 months, with the possibility of a downward departure for substantial cooperation. See U.S. SENTENCING GUIDELINES MANUAL at 381 (2006).

egregious wrongdoing. Such focus might, at least, restore the public's confidence in our white collar justice system.

APPENDIX

Outline of Milberg Weiss Indictment²⁸²

(Counts on which the firm and/or its principals are named as defendants)

<i>Count(s)</i>	<i>Charge</i>	<i>Offenses underlying the charge</i>
1	Conspiracy, 18 U.S.C. § 371 (firm and partner-defendants)	Object offenses: <i>mail and wire fraud</i> , 18 U.S.C. §§ 1341, 1343, 1346; obstruction of justice, 18 U.S.C. § 1503; false declarations, 18 U.S.C. § 1623; travel act, 18 U.S.C. § 1952; witness bribery, 18 U.S.C. § 201(c)(2)
2	RICO conspiracy, 18 U.S.C. § 1962(d) ²⁸³ (partner-defendants)	Predicate acts: <i>mail and wire fraud</i> , 18 U.S.C. §§ 1341, 1343, 1346; obstruction of justice, 18 U.S.C. § 1503; travel act, 18 U.S.C. § 1952; witness bribery, 18 U.S.C. § 201(c)(2); money laundering, 18 U.S.C. § 1956
6-8	<i>Mail fraud</i> , 18 U.S.C. §§ 1341, 1346 (firm and partner-defendants)	—
9	Money laundering conspiracy, 18 U.S.C. § 1956(h) (firm and partner-defendants)	Specified unlawful activities: <i>mail and wire fraud</i> , 18 U.S.C. §§ 1341, 1343, 1346; obstruction of justice, 18 U.S.C. § 1503; witness bribery, 18 U.S.C. § 201(c)(2)
18	Criminal forfeiture, 28 U.S.C. §	Specified unlawful activities: <i>mail and wire fraud</i> , 18 U.S.C. §§ 1341,

²⁸² Milberg Indictment, *supra* note 173.

²⁸³ The defendants allegedly conspired to violate 18 U.S.C. § 1962(c) (2006), which criminalizes conducting and participating in the affairs of an enterprise through a pattern of racketeering activity. Because the firm is the named enterprise, controlling precedent prohibits naming the firm as a defendant on this theory. *See Cedric Kushner Promotions v. King*, 533 U.S. 158, 162 (2001). *See generally* STRADER, UNDERSTANDING, *supra* note 31, § 16.04[G][2][a].

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<i>Count(s)</i>	<i>Charge</i>	<i>Offenses underlying the charge</i>
	2461(c); 18 U.S.C. § 981(a)(1)(C); and 21 U.S.C. § 853 (firm and partner-defendants)	1343; ²⁸⁴ witness bribery, 18 U.S.C. § 201(c)(2); obstruction of justice, 18 U.S.C. § 1503; travel act violations, 18 U.S.C. § 1952
19	Criminal RICO forfeiture, 18 U.S.C. § 1963 (partner-defendants)	Predicate acts: <i>mail and wire fraud</i> , 18 U.S.C. §§ 1341, 1343, 1346; obstruction of justice, 18 U.S.C. § 1503; false declarations, 18 U.S.C. § 1623; travel act, 18 U.S.C. § 1952; witness bribery, 18 U.S.C. § 201(c)(2); money laundering, 18 U.S.C. § 1956
20	Criminal money laundering forfeiture, 18 U.S.C. § 982(a)(1) (firm and partner-defendants)	Specified unlawful activities: <i>mail and wire fraud</i> , 18 U.S.C. §§ 1341, 1343, 1346; obstruction of justice, 18 U.S.C. § 1503; witness bribery, 18 U.S.C. § 201(c)(2)

²⁸⁴ This count seeks forfeiture based upon conviction for Count I, conspiracy. That count lists object offenses that can give rise to criminal forfeiture. A number of statutory steps must be taken to reach the conclusion that forfeiture is available. First, 18 U.S.C. § 981(a)(1)(C) (2006) lists offenses (either completed offenses or conspiracies to commit the offenses) giving rise to civil forfeiture. The list incorporates the “specified unlawful activities” of the money laundering statute, 18 U.S.C. § 1956(7). Second, § 1956(7) incorporates RICO predicate acts, as defined in 18 U.S.C. § 1961(1)(B), as offenses giving rise to forfeiture. The RICO predicates include witness bribery, 18 U.S.C. § 201(c)(2), obstruction of justice, 18 U.S.C. § 1503, travel act violations, 18 U.S.C. § 1952, and mail and wire fraud, 18 U.S.C. §§ 1341, 1343, all of which are listed as objects of the conspiracy in Count I of the Milberg Weiss indictment. Finally, under 28 U.S.C. § 2461, the government may incorporate offenses that give rise to civil forfeiture as part of its criminal case.