

Skilling's Martyrdom: The Case for Criminalization without Incarceration

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I. Introduction

Following the corporate scandals of the late 1990s there has been an increased focus on white-collar crime, buttressed by the popular perception that white-collar criminals are not punished enough. Despite the long sentences that alleged wrongdoers like Jeff Skilling of Enron,² Bernie Ebbers of Worldcom,³ and Joseph Nacchio of Qwest⁴ have received, popular opinion remains that the law is too lenient on these classes of offenders.⁵ The retributive impulse of the mobs baying for blood after Enron's collapse was not sated by the untimely death of Ken Lay shortly after his conviction: they claimed that "justice had been cheated."⁶ This societal turn to vengeance seems to be at the root of the creeping criminalization of conduct that was traditionally dealt with by other areas of the law, as reflected in the fact that of the approximately 3000 crimes in the federal statute books, over 1200 were created since 1970.⁷ Virtually every case of new legislation

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² Andrew Weissmann & Joshua A. Block, *White-Collar Defendants and White-Collar Crimes*, 116 YALE L.J. POCKET PART 286 (2007).

³ Convicted and sentenced to 25 years imprisonment. See, *United States v. Ebbers*, 458 F.3d 110, 129 (2d cir. 2006) ("twenty 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 including serial child molestation.")

⁴ Convicted on nineteen counts of insider trading and sentenced to six years in prison and to pay \$19 million in fines. See, http://www.denverpost.com/business/ci_11782036.

⁵ Statement of Joseph Biden, Hearings before the Subcommittee on Crime and Drugs, of the Committee of the Judiciary, US Senate, July 2002 (hereinafter "US Senate Hearings", available at <http://a257.g.akamaitech.net/7/257/2422/15may20031230/www.access.gpo.gov/congress/senate/pdf/107hr/g/86740.pdf>) ("...the strange thing is when it comes to those who rob us with a pen, rob us with a pencil, rob us with their financial shenanigans, or they steal from us, to be more precise, they tend to go to jail less than someone who would steal the same amount of money from us in a circumstance where they broke into our house."). See also, three local polls after Skilling's conviction and sentencing showing that 46% thought that his sentence was "not tough enough"; 38% thought it was "too lenient"; and 40% thought that "he deserves more time".

⁶ See also, statement by one of the jurors: "I feel bad for the people who really wanted to see him go to jail, that they needed the closure and they're not going to get it. You would hope [it] would be enough that ... we came back guilty."

⁷ See, Report of the ABA Task Force on Federalizing Criminal Law, available at [http://www.nacdl.org/public.nsf/legislation/overcriminalization/\\$FILE/fedcrimlaw2.pdf](http://www.nacdl.org/public.nsf/legislation/overcriminalization/$FILE/fedcrimlaw2.pdf) (83% of all federal criminal statutes have been enacted since 1930, and almost 40% of all federal criminal statutes have been

aimed at behavior modification seems to entail shrill claims about the need for criminalization, upon the pretext that civil sanctions do not pack enough punch.⁸ The Sarbanes-Oxley Act of 2002 is just one example of this phenomenon, enhancing existing penalties and creating new criminal offences in the wake of the collapse of Enron.⁹ Creeping criminalization has serious ramifications: it undermines the coercive power of the criminal law, dilutes its expressive power,¹⁰ over-deters otherwise desirable business activities,¹¹ conflates blameworthiness with imprisonment, creates incentives for prosecutors to abuse their powers, fuels an appetite for enhancing prison terms,¹² and increases social costs. Most importantly, it punishes people for actions that are not even

enacted in since 1970.) For scholarship that discusses overcriminalization, 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, 198 (1991) (criticizing the ever increasing tendency to authorize criminal sanctions for conduct that is “indistinguishable” from tort); Sara Sun Beale, *Too Many and Yet Too Few: New Principles to Define the Proper Limits for Federal Criminal Jurisdiction*, 46 Hastings L.J. 979 (1995); Kathleen F. Brickey, *Criminal Mischief: The Federalization of American Criminal Law*, 46 Hastings L.J. 1135 (1995); Franklin E. Zimring & Gordon Hawkins, *Toward a Principled Basis for Federal Criminal Legislation*, 543 Annals Am. Acad. Pol. & Soc. Sci. 15 (1996).

⁸ Susan L. Pilcher, *Ignorance, Discretion and the Fairness of Notice: Confronting “Apparent Innocence” in the Criminal Law*, 33 Am. Crim. L. Rev. 1, 32 (1995): “In contemporary America virtually every regulatory scheme, particularly in federal law, includes felony criminal enforcement provisions to add “teeth” to the costs of noncompliance, covering such diverse areas as environmental safety, securities markets, employment practices, consumer protection, public benefits, and international trade. Estimates suggest that over three hundred thousand federal regulations are punishable by criminal penalties enforceable through the combined efforts of as many as two hundred different federal agencies.”

⁹ Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. See for example, Sarbanes-Oxley Act section 807(a) which states that any individual who knowingly executes or attempts to execute a scheme or artifice(i) to defraud any person in connection with any security of a registered or reporting company; or (ii) to obtain by means of false or fraudulent pretenses, representations, or promises any money or property in connection with the purchase or sale of any registered or reporting company is subject to fine and imprisonment up to twenty five years, section 1102, imposing a fine and a 2 year maximum prison term on a person who corruptly ... alters, destroys, mutilates, or conceals a record, document, or other object, or attempts to do so, with the intent to impair the object's integrity or availability for use in an official proceeding; or ... otherwise obstructs, influences, or impedes any official proceeding, or attempts to do so, and section 906, which criminalizes CEOs for failure to make statements knowing that the periodic reports contain information that fairly presents, in all material respects, the financial condition and results of operations of the issuer with fines of up to \$ 1 million and imprisonment of up to ten years.

¹⁰ Richard J. Lazarus, *Assimilating Environmental Protection into Legal Rules and the Problem with Environmental Crime*, 27 Loy. L.A. L. Rev. 867, 883 (1994) (“The reason why criminal sanctions have greater deterrent value is also the reason why they must be used more selectively. Criminal sanctions should be reserved for the more culpable subset of offenses and not used solely for their ability to deter.”)

¹¹ Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, Duke L.J. 1, 14 (1990). (“High criminal penalties will deter people from desirable, but only marginally lawful, activity because they are uncertain whether they will be convicted of a crime.”) See also, Steven Shavell, *Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent*, 85 COLUM. L. REV. 1232 (1985).

¹² John M. Darley, *On the Unlikely Prospect of Reducing Crime Rates by Increasing the Severity of Prison Sentences*, 13 J.L. Pol'y 189, 199-201, 204 (2005).

civil wrongs,¹³ let alone undertaken with the taint of moral wrongfulness.¹⁴

This paper does not address every kind of white-collar crime (it does not apply to crimes like tax evasion, bribery, perjury, extortion, embezzlement and the like), and restricts itself to those involving corporate fiduciaries taking bad decisions at the expense of shareholders (corporate governance offenses). The arguments also do not apply to fraud as moral wrongfulness exists in that case.¹⁵ To the extent that the actions covered by this paper are blameworthy, I argue that this determination must be disentangled from punishment – which much of the legal scholarship in this area does not do.

Disentanglement of blame from deserts suggests a via-media between criminalization and decriminalization – criminalization without incarceration. Accordingly, the legal process stops at the determination of guilt.

My argument advances the criminalization debate in a novel way because it does not get bogged down in the irreconcilable quarrel about whether corporate governance misbehavior ought to be criminalized for deterrence, retribution, or rehabilitation reasons, and whether it achieves any of these purposes. For these offenses, I argue that whichever theoretical justification underpins the decision to criminalize, imprisonment must not follow conviction. The conviction, despite the lack of incarceration, and the consequential sanctions likely to be imposed on the wrongdoer are sufficient to satisfy

¹³ Wendy Gerwick Couture, *White Collar Crime's Gray Area: The Anomaly of Criminalizing Conduct Not Civilly Actionable*, 72 Alb. L. Rev. 1, 3 (2009). (“the imposition of criminal punishment for conduct not civilly actionable risks disrupting the current scheme of securities regulation, at the expense of considerations deemed important by Congress and the courts. The lower materiality standard and the unavailability of the safe harbor in criminal cases may chill corporate disclosure and may affect what information reasonable investors rely upon when making investment decisions.”)

¹⁴ As the Enron Task Force Prosecutor was quoted as saying in the *Houston Chronicle*: “Defendants and suspects understand that if you’re selling drugs or if you rob somebody or if you take their car, that that was wrong.... But the issue we face first in Enron is, was this conduct criminal? When dealing with violent crime cases or even narcotics cases, that’s never a question. That’s always very, very black and white. Here we have to spend a lot of time figuring out what was done and figuring out whether that was a violation of the criminal law.”)

¹⁵ Stuart P. Green, *Why it's a Crime to Tear the Tag Off a Mattress: Overcriminalization and the Moral Content of Regulatory Offenses*, 46 EMORY L.J. 1533, 1537 (1997) (“moral wrongfulness” ...is present if the conduct made criminal is viewed by a consensus of society as immoral or in violation of a moral norm.”)

the three main justifications for criminalization.¹⁶ In appropriate cases, disgorgement of the offender's gains will aid in the achievement of these objectives.¹⁷

The model proposed by this paper would yield significant savings by reducing prison costs.¹⁸ It would also allow the state to take advantage of the disproportionate cost/burden of conviction on corporate governance offenders. Owing to the offenders' high earning potential,¹⁹ deterrence can be achieved at lower cost by conviction alone because the cost of incarceration does not have to be borne by the state whereas the destruction of capacity to generate similar (or indeed, any) income has to be suffered by the offender even without going to jail.²⁰ If the cost of incarceration is the same for offenders with different earning capacities, imprisoning those with very high earning capacities is a waste of social capital if the objectives sought to be achieved by incarceration can be achieved through other means. Further, the cost of a conviction can be predicted with sufficient certainty in the case of white-collar criminals by looking at their earnings history, and in many cases this can be a significant sum. Unlike the common criminal who may not have a similarly predictable earning capacity and therefore suffer the same extent of monetary loss from a conviction, this loss ought to serve the deterrence function without the need

¹⁶ To the extent that further action is necessary, there are alternatives to imprisonment: *United States v. Clark*, 195 F.3d 446, 452 (9th Cir. 1999) (probation condition preventing defendant from working in law office or "any institution in the business of providing legal services"); *United States v. Whitlow*, 979 F.2d 1008, 1012 (5th Cir. 1992) (preventing defendant from working in used car industry); *United States v. Burnett*, 952 F.2d 187, 190 (8th Cir. 1991) (preventing defendant from working in business that requires travel or selling vending machines).

¹⁷ *SEC v. Sands*, 142 F.3d 1186; 1998 U.S. App. LEXIS 8093: "The district court has broad-equity powers to order the disgorgement of ill-gotten gains obtained through the violation of the securities laws. Disgorgement is designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable." (internal citations omitted).

¹⁸ Incarceration is extremely costly. As one expert notes, "Between 1982 and 2006, direct expenditures by federal, state, and local governments on corrections jumped from \$9 billion to \$68.7 billion, an increase of over 618%. During the same period, combined criminal justice expenditures (for police, judicial, and corrections activities) by federal, state, county, and municipal governments rose from \$35.7 billion in 1982 to \$214.3 billion in 2006." See, Testimony of Prof. Stephen Saltzburg on Over Criminalization of Conduct and Over-Federalization of Criminal Law before the Subcommittee on Crime, Terrorism and Homeland Security, July 22, 2009, available at <http://judiciary.house.gov/hearings/pdf/Saltzburg090722.pdf>.

¹⁹ A Wall Street Journal compensation survey of CEOs of 35 large U.S. corporations in 2006 showed a median salary and bonus combined of \$ 2,598,284, which included about \$ 1 million in median base salary. See, The WSJ 350A Survey of CEO Compensation, WALL ST. J., Apr. 9, 2007, at R1.

²⁰ For example by bar orders against serving as officers and directors of companies such as those obtained by the SEC in numerous cases.

for the state to spend money imprisoning the offender. In addition to loss of earning capacity, clawing back ill-gotten gains significantly adds to disutility.²¹

The paper is set out as follows: Part II briefly outlines the scope of the wrongs tackled as stemming from the principal-agent relationship in corporate law, and the inability of the law to overcome effectively problems resulting from the collectivization of the principal in that relationship. In Part III, I argue that conviction without imprisonment is a second-best alternative to decriminalization in cases where the conduct is blameworthy, and results in non-consensual harm. Part IV demonstrates the disutility caused by conviction alone to show that the objectives of criminalization can be satisfied without the need for imprisonment. Part V asserts that consequential sanctions like shaming add to the disutility of conviction. Part VI ties the thesis to Skilling's conviction for bad business judgment devoid of moral wrongfulness to illustrate the problems with conflating blame and punishment. Part VII concludes.

II. Scope of the Wrongs Covered

What is white-collar crime and why should it be criminalized? The oft-cited definition proposed by criminologist Sutherland - "those crimes committed by persons of respectability and high social status in the course of their occupations" – is now seen to

²¹ SEC v. Cavanagh, 445 F.3d 105, 117 (2d Cir. 2006) (the purpose is to prevent wrongdoers from unjustly enriching themselves through violations, which has the effect of deterring subsequent fraud. . . . The emphasis on public protection, as opposed to simple compensatory relief, illustrates the equitable nature of the remedy.); Former United Health Group CEO/Chairman Settles Stock Options Backdating Case for \$ 468 Million, Litigation Release No. 20387 (Dec. 6, 2007), available at <http://www.sec.gov/litigation/litreleases/2007/lr20387.htm>; Press Release, U.S. Sec. Exch. Comm'n, Former UnitedHealth Group CEO/Chairman Settles Stock Options Backdating Case for \$ 468 Million (Dec. 6, 2007) (No. 2007-255), available at www.sec.gov/news/press/2007/2007-255.htm. Section 304 of the Sarbanes-Oxley Act provides: "If an issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws, the chief executive officer and chief financial officer of the company shall reimburse the issuer for--(1) any bonus or other incentive-based or equity-based compensation received by that person from the issuer during the 12-month period following the first public issuance or filing with the Commission (whichever first occurs) of the financial document embodying such financial reporting requirement; and (2) any profits realized from the sale of securities of the issuer during that 12-month period.

be severely problematic.²² There is little normative justification for differentiating criminal behavior based upon the offender belonging to the privileged classes rather than the *hoi polloi*.²³ From the standpoint of the victims of the crime, social status of the offender has, at best, marginal relevance for evaluating harm and blameworthiness. Shifting the focus away from the offender's social status to the quality of the behavior itself might be more helpful in formulating a definition. Viewed thus, white collar crime usually involves the behavior itself having the veneer of respectability and is *mala prohibita*²⁴ rather than *mala in se*.²⁵ Frequently, the conduct at issue only invites attention because it was seen to be too aggressive by regulators, when the actors themselves only believed that they were engaging in legitimately risky enterprise.²⁶

This paper only focuses on a sub-set of white-collar offenders – corporate fiduciaries abusing the principal-agent relationship. The core arguments could be extended to other kinds of white-collar crime also because conviction without incarceration would satisfy the objectives of criminalization in many cases. The principal-agent relationship is pregnant with potential for abuse because of its inherently asymmetric nature. Agents are primarily employed in order to make up for the gaps in expertise, skill, and time that prevent principals from accomplishing the delegated tasks on their own. It is these very advantages enjoyed by agents that create problems of adverse selection and moral hazard. To be sure, these problems are addressed by the carrot-and-stick structures created by

²² E. Sutherland & D. Cressey, CRIMINOLOGY 40 (1974). In contrast, the FBI defined it as “[t]hose illegal acts which are characterized by deceit, concealment, or violation of trust and which are not dependent upon the application or threat of physical force or violence...”

²³ See, Stuart Green, Lying, Cheating, 3 (“the strikingly broad range of moral judgments that surrounds such cases has less to do with the identity of individual defendants than with deeper moral ambiguities, confusions, and uncertainties that pervade our understanding of white-collar crime more generally.”)

²⁴ Black's Law Dictionary 956 (defining *malum prohibitum* offenses as those “which are made criminal by statute but which, of themselves, are not criminal”).

²⁵ Black's Law Dictionary 956 (defining *mala in se* offenses as “wrongs in themselves; acts morally wrong; offenses against conscience”).

²⁶ See Marilyn E. Walsh and Donna D. Schram, *The Victim of White-Collar Crime: Accuser or Accused*, in *White Collar Crime: Theory and Research* 32, 36 (Gilbert Geis & Ezra Stotland eds., 1980): “Instead of there being a clear consensus about the unacceptability of the conduct in rape and white-collar crimes, there is a tendency to view the conduct as associated with otherwise acceptable behavior. Thus, rape may be identified as behavior distinguished from approved conduct only by its location on the more aggressive end of a continuum of demonstration of sexual prowess. Similarly, many frauds and larcenies by trick or false pretenses can be viewed as excesses in what is normally accepted, aggressive salesmanship or shrewd economic behavior.”

principals – by keeping a close rein on agents and circumscribing discretion, co-opting the agent into ownership of the enterprise, tying incentives to the principal’s returns, and careful selection of the agent, principals try to ensure that they remain the masters of the relationship. When applied at the corporate level, the collectivization of the principal creates incentives for free-riding and rational apathy. Shareholders might have very different objectives even if they care to monitor management – ranging from the employee union shareholder’s desire to protect jobs, to large institutional investors’ focus on earning profits for investors. When they perceive management to be inadequate most shareholders prefer exit to taking corrective action. All these factors debilitate the monitoring power to a point where the agent is the de facto master of the relationship. Thus, although in theory the shareholders are the principals, it is the management that exercises the greater power, primarily because of real barriers to removal caused by collective action problems, and the deference that corporate law accords to business decisions taken by management. The question that this paper addresses is whether the problems that arise by virtue of agents abusing this relationship should be the subject matter of criminal law with imprisonment as the sanction, or are better suited to civil or social sanctions.²⁷ Criminal sanctions have been used, for example, in the Skilling case, despite the prosecution framing the case in terms that invoke the agency cost problem.²⁸ This resort to criminal law has been justified on the plea that the principals are not the only victims of Skilling’s wrongdoing, but that his conduct engendered wider societal harm. It might also be evidence of the vicious nature of the retributive impulse following loss, even when some of it is the byproduct of consensual risk taking.²⁹ Shareholders, employees, and the wider public feel the urge to punish those at the top for bad bets despite the absence of moral wrongfulness and the criminal law serves an instrumental

²⁷ Larry Ribstein, *Perils of Criminalizing Agency Costs*, 2 (Ill. Law Econ. Working Paper Series, Paper No. LE06-021, 2006), available at www.ssrn.com.

²⁸ See closing argument by the prosecution: “[M]ake no mistake, they got wealthy.... And in exchange for that money, they owed their employees a duty, a duty of good faith and honest services, a duty to be truthful, and a duty to do their job, ladies and gentlemen, to do their job and to do it appropriately.”

²⁹ Epithets used against Skilling included “pig,” “snake,” “evil,” “crook,” “thief,” “fraud,” “asshole,” “criminal,” “bastard,” “scoundrel,” “liar,” “weasel,” and “economic terrorist.” He was described as “dirty,” “deceitful,” “dishonest,” “greedy,” “amoral,” “devious,” “lecherous,” “manipulative,” “unscrupulous,” “despicable,” “equivalent [to] an axe murderer” who has “no conscience,” “stole from employees,” and “swindled a lot of people.” He was condemned as “guilty as sin,” for which “he needs to pay the price,” go to “jail for 20 years,” and “be hanged.” See, Skilling Appeal Brief, 134.

function here.

My arguments do not apply to offenses that involve regular fraudulent behavior with its usual *mens rea* requirements as criminalization is not problematic in those cases. I restrict my case to offenses where the defendants were probably acting in the belief that their conduct was legal. This is particularly plausible in cases involving the interpretation of complex accounting rules or risky business decisions. The problem with criminalizing such behavior is that the traditional purposes of criminal punishment – deterrence, incapacitation, retribution, rehabilitation, restitution – are ill matched with the results that principals seek. Principals’ objectives can be achieved at much lower cost either by social or civil sanctions without the need for the expenditure of state resources. The employment of the criminal law to agency abuses is particularly troubling when alleged offenders are incarcerated without the underlying allegations ever being proven, with the state content to criminalize for alleged obstruction of justice and the like. The cases of Martha Stewart³⁰ and Frank Quattrone³¹ are illustrative of this trend.

III. Moral Ambiguity of White-Collar Crime

1. Crime has to be morally blameworthy

There has to be a fundamental distinction based on the moral blameworthiness of conduct if our distinctions between criminal and civil sanctions are to have any merit.³²

Misapplication of the criminal label to conduct that is not intrinsically wrong is counterproductive to the objectives sought to be achieved by criminalization.³³ As

³⁰ United States v. Stewart, 433 F.3d 273, 280, 319-2(2d Cir. 2006) (affirming conviction).

³¹ Cite.

³² Paul H. Robinson, *The Criminal-Civil Distinction and the Utility of Desert*, 76 B.U. L. Rev. 201 (1996); Stephen J. Schulhofer, *Two Systems of Social Protection: Comments on the Civil-Criminal Distinction, with Particular Reference to Sexually Violent Predator Laws*, 7 J. Contemp. Legal Issues 69 (1996); Louis Michael Seidman, *Points of Intersection: Discontinuities at the Junction of Criminal Law and the Regulatory State*, 7 J. Contemp. Legal Issues 97 (1996); Carol S. Steiker, *Foreword--Punishment and Procedure: Punishment Theory and the Criminal-Civil Procedural Divide*, 85 Geo. L. J. 775 (1997)

³³ Paul H. Robinson, *Moral Credibility and Crime*, Atl. Monthly, Mar. 1995, at 72, 77 “As the label “criminal” is increasingly applied to minor violations of a merely civil nature, criminal liability will increasingly become indistinct from civil and will lose its particular stigma. In short, these critics contend, applying criminal sanctions to morally neutral conduct is both unjust and counterproductive. It unfairly brands defendants as criminals, weakens the moral authority of the sanction, and ultimately renders the penalty ineffective. It also squanders scarce enforcement resources and invites selective, and potentially

Professor Green wrote in a recent work, “[w]hat is interesting and distinctive about [white collar crime] is that, in a surprisingly large number of cases, there is genuine doubt as to whether what the defendant was alleged to have done was in fact morally wrong.”³⁴ This is a major problem, as Green recognizes, because “[w]hen there is a gap between what the law regards as morally wrongful and what a significant segment of society views as such, moral conflict and ambiguity are likely to be the result.”³⁵ This sort of ambiguity severely affects what Professor Andrew Ashworth calls the “principle of fair labeling,” because it fails to ensure “that widely felt distinctions between kinds of offenses and degrees of wrongdoing are respected and signaled by the law, and that offenses should be divided and labeled so as to represent fairly the nature and magnitude of the law-breaking.”³⁶ However, Green argues that white collar crimes correspond well to moral norms of a common-sense sort.³⁷ He writes that “certain fine-grained distinctions in our criminal law are a reflection of equally fine-grained distinctions in our moral thinking, and vice-versa.”³⁸ Thus, white-collar crime doctrine that may at first glance seem puzzling and internally inconsistent can often be explained through reflection on the moral concepts that underlie it. And, by the same token, ostensibly baffling distinctions we make in our everyday moral lives can in some cases be traced to distinctions that first appeared, or are most clearly articulated, in the criminal law.”³⁹ Green, thus distinguishes lying from deception by arguing that, “merely misleading is less wrongful than lying because what I call the principle of caveat auditor, or “listener

discriminatory, prosecution. We should reserve the criminal law--the “heavy artillery” of our legal system ... for conduct that reflects the traditional conception of criminality.”

³⁴ Stuart Green, *LYING, CHEATING, STEALING*, 1 (OUP) 2007. (“a widely felt sense – expressed by judges, jurors, scholars, journalists, and the average citizen – that the law in this area involves a kind of moral uncertainty that distinguishes it from that which governs more familiar ‘core’ cases of crime.) *Id.* at 1.

³⁵ *Id.* at 46.

³⁶ *Id.* at 42.

³⁷ These moral norms, according to him, “are fairly concrete. Although there will be significant disagreement over the precise content and application of such norms, almost every civilized person will have some rudimentary understanding that it is morally wrong, at least in certain core cases, to lie, cheat, steal, ... Even people who have never had occasion to read a single page of moral philosophy are capable of making remarkably fine-grained distinctions about, say, what properly constitutes cheating or stealing.” *Id.* at 45.

³⁸ “The divergent ways in which the offenses of perjury and fraud treat the requirement of deception ... reflect deep-seated and fine-grained distinctions concerning the concept of deception that we make in our everyday moral lives.” *Id.* at 42.

³⁹ Green, at 5.

beware,” applies to cases of merely misleading but does not apply to lying. Like the principle of caveat emptor, which says that a buyer is responsible for assessing the quality of a purchase before buying, the principle of caveat auditor says that, in certain circumstances, a listener is responsible, or partly responsible for ascertaining that a statement is true before believing it.”⁴⁰ Green’s thesis posits that people are able to make moral distinctions between these offenses. He does not elucidate on how this transpires. Green seems to conflate common morality with critical morality in coming to this conclusion. As the Skilling case demonstrates in the following pages, it is unduly optimistic to suppose that public perceptions of moral wrongfulness are nuanced enough to separate conduct that is merely risky from that which is criminal, and the dangers are exacerbated in the context of corporate criminal conduct due to the infiltration of negative emotions like envy and resentment. The popular perception that CEOs and senior corporate executives are greedy and arrogant is probably at the root of the visceral reactions to news reports about alleged acts of wrongdoing. Given this fact, it is hard to see that common morality will be able to set aside these negative emotions when evaluating conduct for criminal sanctions.

There is danger also from the imprecise and ambiguous nature - in terms of moral rightness or wrongness - of the conduct at issue in agency crimes. Given that there is lack of clarity as to what underlying moral norm has been violated by an allegedly criminal act because the precise complexities are hard to understand, there is likely to be a great deal of dissonance about moral wrongfulness and culpability.⁴¹ As Henry Hart writes “[w]hen a criminal enactment proscribes conduct which is *malum in se*, such as murder or manslaughter . . . the moral standards of the community are available always as a guide in the resolution of the indeterminacies, and there is a minimum of unfairness when doubt is resolved against a particular defendant. This guidance is missing when the

⁴⁰ Id. at 78-79.

⁴¹ This is particularly the case with cases like Enron where complicated financial transactions were at issue. It is hard to imagine that the average person is able to appreciate the intricacies of the accounting treatment concerning the Enron Special Purpose Entities (SPEs) and the rules relating to off-balance sheet treatment with regard to the 3% at-risk rule. If the relevant actor believed that the SPEs did not have to be consolidated based on expert advice, where is the moral wrongfulness in the conduct? Besides, are accounting rules moral norms?

proscribed conduct is merely *malum prohibitum*.”⁴² Frequently, the conduct alleged to be wrong involves accounting transactions without any evidence about the offender’s expertise in accountancy. The accounting rules do not often have any moral element, and are explained more as coordination devices rather than as moral guidelines. They are also devices for standardization to facilitate comparison and in many situations are substitutable without moral choices being compromised. To be sure, there might be a minor moral value to adhering to rules without regard to the moral neutrality of those rules. This is particularly plausible when the rules are very precise and leave little to interpretation. The trouble is that when there is significant scope for interpretive leeway and consequent disagreement about what the rules require the moral value to rule obedience in of itself becomes weak. This is exacerbated when the rule obedience norm comes into conflict with competing values like self interest. This might explain the indifference of shareholders to accounting restatements by management as long as there is no negative impact on share prices.

Moral wrongfulness is essential to criminalization for corporate governance offences; otherwise determinations about culpability rest only on ex post loss rather than from clear guidelines for behavior ex ante. As Green acknowledges, “we need to refer to the idea of [moral] wrongdoing not only in distinguishing among various offenses but also in deciding which conduct to criminalize in the first place, how offense elements should be defined, and what defenses should be available.”⁴³ He claims that “without a clearer understanding of the relationship between morality and white-collar criminal law, the retributive principles on which the criminal law is founded are placed in serious jeopardy.”⁴⁴

⁴² Hart supra note __, at 420.

⁴³ Id. at 147.

⁴⁴ Id. at 4 Professor Seigel argues in the same vein, “One of the foundational principles of the American criminal-justice system is that punishment is only appropriate if a person acts voluntarily and with some level of intention. The reasons for this principle stem from the two traditional purposes of punishment, retribution and deterrence. Retribution is the deontological notion that a person who commits a crime deserves to be punished. The converse of this proposition - employing retribution as a limiting principle - is equally true. A person who fails to act voluntarily (such as by way of reflex or subject to duress) simply should not be punished.” Michael Seigel, *Bringing Coherence to Mens Rea Analysis for Securities-Related Offenses*, Wis. L. Rev. 1563, 1566 (2006).

With regard to regulatory offenses, Green does not contend that it is wrong for the state to criminalize conduct that is not morally wrongful. He argues that “if violating such a regulatory statute constitutes rule-breaking intended to obtain an unfair advantage over another with whom one is in a cooperative, rule-bound relationship,” then the violation constitutes the moral wrong of cheating.⁴⁵ Giving the example of insider trading, he writes that it is wrongful because it is essentially cheating, because the trader “(1) violates the SEC rule that one must either disclose material non-public information or abstain from trading; and does so (2) with the intent to obtain an advantage over a second party with whom she is in a cooperative, rule-governed relationship.”⁴⁶ The basis of the abstain-or-disclose rule appears to be that investors must have confidence that the game is being played fairly, and that it is unfair that some traders who have privileged access to information should be allowed to make money off of the information. This is not as clear as Green would like to believe because there is a clear body of scholarship contending that insider trading is actually beneficial to the market because it facilitates more efficient pricing of securities.⁴⁷ Further, it is unlikely that the person who is purchasing the securities from the insider is being taken advantage of in every situation. It is quite likely that the buyer sold the securities also before the information surfaced and caused the stock price to fall. In this case, the buyer is also profiting, rather than being taken advantage of as Green contends. If it is assumed that the argument is that the entire market is being taken advantage of, even that does not suffice as a strong case for criminalization because in many cases the insider’s transactions might be small in relation to the market for securities of the relevant company, with the result that the consequences are de minimis. Further, the chief complaint of the non-insiders is that they also did not have the opportunity to cash in on the non-public information, not that they were cheated. If they had been able to cash in, there would have been no complaint. This, again, illustrates the moral ambiguity of the alleged crime.

⁴⁵ Green, *supra* note __ at 250. However, he qualifies this by writing that “harmfulness without wrongfulness is not supposed to be enough to satisfy the retributive demands of the criminal law. In the absence of a persuasive argument that lawbreaking per se entails some independent form of moral wrongfulness” he doubts that “criminalization can be justified.” *Id.* at 254.

⁴⁶ *Id.* at 240.

Moreover, moral wrongfulness is not an automatic justification for criminalization: several morally wrongful acts might cause no harm in many circumstances involving consent. This is why the state refuses to criminalize such acts in situations involving consensual exchanges. Some scholars like Henry Hart have argued that criminalization should be reserved for conduct that is “intrinsically wrongful.”⁴⁸ Similarly, Kadish has criticized the tendency to criminalize “aggressive business behavior,” claiming that the “stigma of moral reprehensibility does not naturally associate itself with the regulated conduct” in such cases.⁴⁹ This impair[s] the identity of the criminal sanction and its ultimate effectiveness as a preventive sanction, both in the area of economic crimes and in the areas of its traditional application.⁵⁰ The fact that our perceptions about morality are capable of temporal change and that conduct regarded as morally wrongful or harmful during a certain time-frame might be regarded as perfectly acceptable at another time-frame must give us further pause for thought when we see the temptation to criminalize.⁵¹

2. Harm distinguished

Horror stories of families being deprived of their entire savings and retirement plans by the actions of corporate executives has shattered the myth that white collar crime is victim-less, and that it is a different animal from common crimes.⁵² In some cases, it has been alleged that entire cities are victims of corporate criminal conduct.⁵³ The purported economic costs imposed by white collar criminal behavior also have been cited as a

⁴⁷ Henry Manne, *Insider Trading: Hayek, Virtual Markets and the Dog that Did Not Bark*, 31 J. Corp. L. 167 (2005).

⁴⁸ Henry M. Hart, Jr., *The Aims of the Criminal Law*, 23 Law & Contemp. Probs. 401, 417 (1958)

⁴⁹ Sanford H. Kadish, *Some Observations on the Use of Criminal Sanctions in Enforcing Economic Regulations*, 30 U. Chi. L. Rev. 423, 425 (1963).

⁵⁰ *Id.* at 444.

⁵¹ See Harry V. Ball & Lawrence M. Friedman, *The Use of Criminal Sanctions in the Enforcement of Economic Legislation: A Sociological View*, 17 Stan. L. Rev. 197, 221 (1965).

⁵² See, for e.g., Testimony of Janice Farmer, US Senate Hearings “They took more than my money and my dream. They destroyed my pride in my whole career. I am totally ashamed that I worked for Enron.”; Statement of Bradley W. Skolnik, Indiana Securities Commissioner, and Chairman, Enforcement Section, North American Securities Administrators Association, Inc., (“white collar crimes aren’t victimless crimes. Just like street crime, securities fraud ruins lives, destroys families, steals hopes, and kills dreams.”)

⁵³ See Enron Task Force statement at Skilling’s sentencing hearing: “I want to talk a little bit about ... other victims, Your Honor. Vendors who sold their goods and services to Enron suffered. Other businesses who relied on Enron suffered. Local economies where Enron did business suffered. Houston as a community was particularly hit hard by what happened at Enron.”

reason for adopting a hard line against offenders.⁵⁴ Given the harm caused by white collar criminals, some believe that the privileged treatment accorded to them erodes the deterrent power of the criminal law because it signals that society treats criminals from rich backgrounds differently than those from poorer ones. Some prosecutors complain that judges are more sympathetic to pleas by corporate defendants to reduce or avoid incarceration, and that this affects their decisions to bring to trial offences that are more complicated and resource intensive than other crimes.⁵⁵ Observers also claim that this is particularly lamentable because the deterrent objectives of the criminal law are particularly well suited to effective application against corporate defendants because they are usually educated, and commit their crimes after rational thought.⁵⁶ All of these have coalesced to create a growing public opinion that corporate wrongdoers must be equated with ordinary criminals and that incarceration is necessary.⁵⁷

These justifications constitute the harm prevention model of criminalization - it is permissible to criminalize harmful white-collar conduct even if it is not morally wrongful. It is not necessary that the act should have also offended a moral wrong – it suffices that the offender violated a legal ban. Joel Feinberg's harm principle, for example, posits that: “[i]t is legitimate for the state to prohibit conduct that causes serious private harm, or the unreasonable risk of such harm, or harm to important public institutions and practices. In short, state interference with a citizen's behavior tends to be

⁵⁴ One expert stated that the economic value of securities fraud alone is at about \$40 billion, compared with \$10 billion for street crime. See, Testimony of Glenn B. Gainer III, US Senate Hearings, *supra* note 1.

⁵⁵ Statement of Hon. James B. Comey, Jr., United States Attorney, Southern District of New York, New York, US Senate Hearings (“they work to eliminate or reduce that jail time because of the defendant’s civic work or charitable work or his great employment record or his big family or his health problems, or a whole host of factors that the Guidelines say are discouraged...”)

⁵⁶ *Id.* ([white collar criminals are]...more sophisticated than most criminals. They commit their crimes not in a fit of passion or out of addiction or a craving, but with cold and careful calculation. They are, in my experience, the most rational of offenders and are more likely to weigh the risks against the anticipated rewards of committing a crime.); See also, Statement of Hon. Jeff Sessions, U.S. Senator from Alabama, US Senate Hearings, *supra* note 1. (“I was a United States Attorney during the Savings and Loan fraud cases. I prosecuted Federal land bank fraud cases. My office prosecuted those cases that I supervised, and I am going to tell you there is a lot better behavior in banking today because people went to jail over those cases in the past. They lost everything they had, their families were embarrassed, and a lot of people started checking to make sure they were doing their banking correctly.”)

⁵⁷ Statement of Glen B. Gainer, III, West Virginia State Auditor, and Chairman, National White Collar Crime Center, West Virginia, US Senate Hearings (“Our research section has found through our last nationwide study that most Americans view economic crime, or what we would consider white collar crime, to be every bit as important and deserve equal time and prosecution as traditional street crime...”)

morally justified when it is reasonably necessary to prevent harm or the unreasonable risk of harm to parties other than the person interfered with.”⁵⁸ It is important to understand what constitutes harm. As is typically used in the criminal law, “criminal harm” can involve bodily harm,⁵⁹ and social harm involving collective losses.⁶⁰ The first kind is unproblematic and no one seriously disputes the validity of the state criminalizing such conduct. The second might also be acceptable in cases where the harm is non-consensual and involves third parties suffering without the ability to avoid the harm. However, no such necessity exists in situations involving agency problems as the principals have tools at their disposal to control the wrongdoers. There are perfectly adequate civil and social sanctions that can achieve the objectives – incapacitation, retribution, and deterrence - at much lower cost. Principals can act in concert, use regulators like the SEC, or through intermediaries like stock exchanges, and institutional shareholders to do all this without the need for the state to incur imprisonment expenses.

Corporate crimes certainly involve harm – sometimes on a massive scale such as that caused by the bankruptcy of Enron. However, this harm is the price of capitalism and there are other mechanisms that can tackle it more efficiently. I contend that for conduct without the taint of moral wrongfulness, but where non-consensual harm results, criminalization without incarceration is a second-best alternative to decriminalization.

Removing incarceration from the table also separates blameworthiness from punishment. To be sure, the state possesses advantages in determining blame, but its advantages in terms of punishing corporate governance offenders are less clear. If the high cost of incarcerating non-violent offenders outweighs the cost of other kinds of punishment, without corresponding benefits, scaling back the state monopoly on punishment to areas where it enjoys advantages might be advisable. Decoupling blame from punishment also recognizes the reality that conviction alone is sufficient punishment. Assuming further

⁵⁸ Joel Feinberg, *The Moral Limits of the Criminal Law: Harm to Others*, 11 (1984).

⁵⁹ See Robert W. Drane & David J. Neal, *On Moral Justifications for the Tort/Crime Distinction*, 68 Cal. L. Rev. 398, 409-10 (1980).

⁶⁰ Feinberg, *Harm to Others*, supra note __, at 221-32.

punishment is necessary, state-punishment could be restricted to fines and impediments to holding positions involving trust.⁶¹

IV. Conviction as a sufficient sanction: theoretical underpinnings

1. Deterrence

This section undertakes an exploration of the theoretical justifications for the deterrence value of conviction for corporate governance wrongs by comparing and contrasting it with the deterrent value of imprisonment. The most frequently advanced justification for criminalization is deterrence -- offenders will be deterred from committing criminal acts if the benefits from committing those acts do not exceed the probability of being caught multiplied by the cost of punishment following prosecution.⁶² Thus, a rational actor will trade off the expected value of committing the criminal act against two variables -- the probability of being caught, and the punishment after conviction. If the probability of being caught is rather low, the criminal act might confer value even if the punishment is high. The same principle applies if the punishment is low and the probability of being caught is high. These two variables are a function of the resources that the state possesses and determinations as to their optimal allocation. This vein of scholarship draws on work by Gary Becker, whose economics based approach, showed that stringent fines were preferable to imprisonment.⁶³ Subsequent work building on this has important implications for this paper's thesis. In an important article calculating the disutility of imprisonment, Polinsky and Shavell posit that there are three kinds of offenders -- risk-neutral (offenders for whom the severity and probability of imprisonment has equal deterrent value), risk-averse (offenders for whom severity of imprisonment has greater deterrent value than probability of imprisonment), and risk-preferring (those for whom the severity of imprisonment has less deterrent value than the probability of

⁶¹ Gary Becker, *Economics of Crime*, J. POL. ECON. 193 ("probation and institutionalization use up social resources, and fines do not, since the latter are basically just transfer payments, while the former use resources in the form of guards, supervisory personnel, probation officers, and the offenders' own time.")

⁶² Some examples of scholarship in this genre are Gary S. Becker, *Crime and Punishment, An Economic Approach*, 76 J. Pol. Econ. 169, 172 (1968), Richard A. Posner, *An Economic Theory of the Criminal Law*, 85 Colum. L. Rev. 1193 (1985), Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, Duke L.J. 1 (1990), Steven Shavell, *Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent*, 85 Colum. L. Rev. 1232 (1985).

⁶³ Gary S. Becker, *Crime and Punishment, An Economic Approach*, 76 J. Pol. Econ. 16 (1968).

imprisonment).⁶⁴ Unlike them, I focus on disutility of conviction rather than disutility of imprisonment. This allows us to gain an understanding of the calculation that rational offenders might engage in even if there is no imprisonment sanction attached to the conviction. It also facilitates an analysis of the tradeoffs between the relevant variables by slicing the salami even finer than Polinsky and Shavell's study does.

To start our analysis, the probability of conviction is p , the length of imprisonment is l , and the total disutility is u . Total disutility is made up of disutility of conviction c and disutility of imprisonment i . Although other factors like age and social situation can be significant variables in calculating total disutility, for simplicity we exclude those factors and calculate $u = p \times [(l \times i) + c]$. Individuals with a high value for c are reputation-conscious and those with a low value for c are reputation-indifferent. Consider the following scenario: The probability of conviction is 10 percent, the disutility of conviction is 200, and the disutility of any sentence length is 5, and the sentence is 10 years. Then total disutility is $.1 \times [(5 \times 10) + 200] = 25$. Now since the disutility of any sentence length is constant, increasing the sanction to 20 years will increase the total disutility to $.1 \times [(5 \times 20) + 200] = 30$. If, however, the disutility of any sentence length is 0, then total disutility is $.1 \times [(0 \times 10) + 200] = 20$. In this case, increasing the sentence length to 20 does not alter the total disutility at all ($.1 \times [(0 \times 20) + 200] = 20$). It is unlikely that the disutility of any sentence length is 0 for any rational individual; it is possible that the disutility of year 1 is very low at 1 ($u = .1 \times [(1 \times 10) + 200] = 21$), and thereafter declines in some proportion to sentence length to a point where the utility of a life sentence might move into positive territory.⁶⁵ To explain, if an individual is sentenced to undergo

⁶⁴ Mitchell Polinsky and Steven Shavell, *On the Disutility and Discounting of Imprisonment and the Theory of Deterrence*, 28 J. Legal Stud. 1 (1999) (if the disutility from imprisonment rises in proportion to sentence length, then an increase in the magnitude of sanctions has the same effect as an equal percentage increase in the probability of sanctions. However, if disutility rises more than in proportion to the sentence, raising the magnitude of sanctions has a greater effect than increasing their probability by the same percentage amount. Conversely, if disutility rises less than in proportion to the sentence, raising the magnitude of sanctions has a smaller effect than increasing their probability.)

⁶⁵ Professors Robinson and Darley and quote Kahneman to make a similar point: "The well being of prison inmates is likely to improve in the course of their sentence, as they gain seniority and survival skills... Suppose ... that prisoners apply a Peak and End rule in retrospective evaluations of their prison experience. The result would be a global evaluation that becomes steadily less aversive with time in prison, implying a negative correlation between sentence length and the deterrence of individual recidivism. This is surely not

imprisonment for 20 years at the age of 55, even if the disutility of the first year is very high, this declines as the person proceeds further into his sentence and ages because the alternative of being released at an old age, without any prospect of income or caregivers, might be more unpalatable than staying in jail. Similarly, if the sentence is life imprisonment, each year after the first might become more bearable and it might be preferable to die in jail.

Now let us consider the case of reputation-indifferent individuals with a no disutility for conviction alone. Probability of conviction is 10 percent, disutility of conviction is 0, disutility of any sentence length is 5 and the sentence is 10 years. Now total disutility is $.1 \times [(5 \times 10) + 0] = 5$. Increasing the sentence length to 20 years results in a total disutility of $.1 \times [(5 \times 20) + 0] = 10$, doubling with the doubling of sentence length. This has startling implications. It shows that for the state to achieve the same disutility for this individual as the offender with the disutility of conviction of 200 and no disutility of imprisonment, the state has to imprison him for 40 years. Conversely, the offender with the disutility of 200 on conviction but no disutility on imprisonment can be deterred to the same extent even by saving money on prison costs for 40 years. Thus, sending both individuals to jail for identical amounts is a significant waste of money and fails to capture the savings offered by the disutility experienced by conviction alone.

Similarly, tweaking the probability of conviction has the following consequences. Assume that the probability of conviction is 0.025, disutility of conviction is 200, disutility of any sentence length is 0 and sentence length is 10 years. Total disutility is $.025 [(0 \times 10) + 200] = 5$. This means that this offender can be deterred to the same extent as the reputation-indifferent individual who is imprisoned for 10 years with a disutility of 5, at one-fourth the cost of enforcement without even incurring the cost of imprisonment, i.e., by conviction alone. Thus, spending the same amount of money on enforcement for both types of offenders is a waste of money.

a socially desirable outcome.” See, Paul Robinson and John Darley, *The Utility of Desert*, 91 Nw. U.L. Rev. 453, 462 at fn.1(1997).

The above clearly demonstrates the benefits of focusing on the quality of individuals and their disutility of conviction. A policy that takes advantage of this characteristic possessed by individuals can achieve the same deterrence at lower prison cost and lower enforcement cost. Corporate governance offenders are more likely to be reputation-conscious and have a high rate of disutility for conviction alone. This is because their very livelihood is tied to reputation. One study found that “[f]or crimes examined, ranging from insider trading to drug offenses to bank larceny, it is not uncommon to find that the highest income criminals suffer reductions in legitimate income of between eighty and ninety-five percent as a result of conviction.”⁶⁶ If earning capacity is destroyed or substantially diminished, the conviction itself would satisfy the punishment function. It serves to convey information to society about the wrongdoer’s unsuitability to hold responsible corporate positions involving trust. To the extent that further deterrence is needed, it could be combined with other impediments to ensure that he does not have access to opportunities for re-offending.⁶⁷ Conviction also triggers consequential sanctions like shaming by emboldening third parties to enforce social norms on offenders.⁶⁸

Given the high profile of the offenders, the information about conviction is likely to be widely disseminated ensuring that the relevant target group perceives the consequences

⁶⁶ John Lott, Comment, *Optimal Penalties Versus Minimizing the Level of Crime: Does it Matter Who is Correct?* 71 B.U.L. Rev. 439, 442 (1991) (“Collateral penalties imposed upon criminals, including the loss of licenses and the loss of legitimate income after returning to the work force, are significantly more important for white collar criminals than for poor criminals even assuming they have committed the same crime.”)

⁶⁷ See, *SEC v. Victor Posner, Steven N. Posner, and Drexel Burnham Lambert, Inc.*, 6 F.3d 520; 1994 U.S. App. LEXIS 3329. The trial court held that the defendants had committed securities fraud, enjoined them from acting as officers and directors of any public company, and ordered them to disgorge money. On appeal, the court affirmed stating the court's conclusion that the officer and director bar was necessary to protect public investors: “The Posners seem to be shocked by what they see as the draconian remedy of eternal boardroom banishment. We intend our affirmance of Judge Pollack’s judgment in this respect as a sharp warning to those who violate the securities laws that they face precisely such banishment. Of course, as the SEC points out, such bar orders are imposed routinely by consent decree.”

⁶⁸ Alon Harel & Alon Klement, *The Economics of Stigma: Why More Detection of Crime May Result in Less Stigmatization*, 36 J. Leg. Stud. 356, 360 (2007): “Criminal conviction is clearly relevant for both willing stigmatizers and unwilling stigmatizers. The willing stigmatizers use conviction as a proxy for identifying offenders even if their real intended targets are offenders rather than those who have been convicted and punished. In contrast, unwilling stigmatizers do not use stigmatization merely as a proxy; their primary targets are those who have been publicly identified and labeled as offenders—that is, the stigmatized.”

of offending. Since the number of actual and potential wrongdoers subject to these prosecutions is relatively small (when compared to other crimes which can be committed by any member of the population, whereas these crimes can only be committed by corporate fiduciaries) saturating the relevant constituency with deterrent information is feasible and ensures that search costs are not significant. Had the pool of corporate fiduciaries been large, corporations would have had to expend significant resources to detect prior offenders and ensure that they are not given further opportunities to offend. This is not the case. In addition, executive search firms and other gatekeepers like professional licensing agencies already perform the detection function.

To sum up, monetizing the disutility suffered by the white-collar criminal upon conviction offers clarity about the sufficiency of the punishment function served by conviction alone. It also allows for more efficient use of state resources -- the cost of imprisonment might be more effectively utilized on those who cannot be deterred by destruction of earning capacity alone because they have little to lose. Further, the ability to deter without the cost of imprisonment eliminates the social disutility caused by constantly ratcheting up sentences.⁶⁹ It also frees courts from making fine distinctions about appropriate sentence length, with the risk of a jail lottery.⁷⁰

2. Retribution

The case for criminalization of corporate governance offenders appears to be largely motivated by the retributive impulse. I do not undertake an exhaustive review of the literature on retribution here or suggest that retribution should not a factor in determinations about the need for criminal sanctions. The limited claim is that the retributive objective is satisfied by conviction alone given the unique position of corporate governance offenders. As discussed previously, these offenders value group membership, often tied directly to their earning capacity. Conviction frequently

⁶⁹ Kenneth Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, Duke L.J. 1, 14 (1990) (increasing penalties to prevent crime imposes costs on society in the forms of the mistaken punishment of innocent people, deterrence of beneficial but marginally lawful activity, and destruction of marginal incentives for good behavior.)

⁷⁰ 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, 213 (2004).

extinguishes such membership and rings the death knell for a professional career.⁷¹ For example, if the offender is a lawyer, he may lose his bar license.⁷² The SEC may also suspend him from practicing before it.⁷³ If she is the CEO of a company she founded, she has to demit that office.⁷⁴ Following the passage of the Sarbanes-Oxley Act, under section 1105, the SEC has the power without going to court to issue officer and director bars as part of a cease-and-desist proceeding.⁷⁵ The standard for a bar is unfitness.⁷⁶ Caution is necessary in exercising the barring power -- it must be confined to limited time

⁷¹ Id.

⁷² ABA Rules, State Bar Rules.

⁷³ Securities Exchange Act of 1934 15(b)(4), 15 U.S.C. 78o. Section 15(b)(4) authorizes the SEC to censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if, among other things, the broker or dealer has (1) willfully made or caused to be made false material statements in any proceeding before the [SEC] with respect to registration; (2) willfully violated any provisions of the Securities Act or the Exchange Act, among others; or (3) willfully aided and abetted the same. See id. 15(b)(4)(A), (D), (E). See also, *Touche Ross Co. v. Sec. Exch. Comm'n*, 60 F.2d 57 (2d Cir. 1979) (Securities Exchange Commission (SEC) can censure and suspend individuals from practicing before it).

⁷⁴ One example is Martha Stewart. Under the terms of her settlement with the SEC for insider trading, Stewart was forbidden from serving as a company executive or director of any public company for five years. *Landon Thomas, Jr., Stewart Deal Resolves Stock Case*, N.Y. Times, Aug. 8, 2006, at C1. SEC regulations bar any unfit person from serving in an executive position in a publicly held company. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 305, 116 Stat. 745, 778-79.

⁷⁵ Sarbanes-Oxley Act, section 1105. **AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.**-(a) Securities Exchange Act of 1934. - Section 21C of the Securities Exchange Act of 1934 (15 U.S.C. 78u-3) is amended by adding at the end the following:-(f) Authority of the Commission to Prohibit Persons From Serving as Officers or Directors. - In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 10(b) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12, or that is required to file reports pursuant to section 15(d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.-(b) Securities Act of 1933. - Section 8A of the Securities Act of 1933 (15 U.S.C. 77h-1) is amended by adding at the end of the following:-(f) Authority of the Commission to Prohibit Persons From Serving as Officers or Directors. - In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has violated section 17(a)(1) or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of the Securities Exchange Act of 1934, or that is required to file reports pursuant to section 15(d) of that Act, if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.

⁷⁶ Sec. 305. **“OFFICER AND DIRECTOR BARS AND PENALTIES.**-(a) Unfitness Standard. - (1) Securities exchange act of 1934. - Section 21(d)(2) of the Securities Exchange Act of 1934 (15 U.S.C. 78u(d)(2)) is amended by striking substantial unfitness and inserting unfitness.-(2) Securities act of 1933. - Section 20(e) of the Securities Act of 1933 (15 U.S.C. 77t(e)) is amended by striking substantial unfitness and inserting unfitness.-(b) Equitable Relief. - Section 21(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78u (d)) is amended by adding at the end the following:-(5) Equitable Relief. - In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.”

periods rather than lifetime bars, unless there are strong reasons to impose the latter. Given the inherent limitations of any system of predicting future behavior, even taking account of prior misconduct will ensure that some CEOs will be falsely predicted to have the potential for re-offending and will receive unnecessarily long bar orders. These individuals will experience undeserved hardship and there will be a net loss of social welfare. Yet others will be falsely predicted to be low risk of re-offending and will receive short term bars. Such individuals might re-offend and create new victims. Since this category is more likely to be the focus of attention, it might explain the view that white-collar offenders also have a significant rate of recidivism.⁷⁷

To conclude, the principal objective of criminalization is to prevent corporate governance offenders from committing similar offences and to deter others; the first can be achieved by disqualifying them from holding responsible office, the second can be achieved by conviction without imprisonment aided by consequential sanctions.⁷⁸ A third objective is to ensure that they do not retain the fruits of their misconduct. This can be achieved by an order to disgorge and by clawing back ill-gotten gains. Incarceration does not aid any of these purposes. To the extent that retribution is an objective, and is not satisfied by the above sanctions, consequential sanctions that inevitably follow conviction ought to suffice in any civilized society. This has the added advantage of decentralizing the retributive objective and allowing non-state actors to impose punishment.

V. Consequential Sanctions

Conviction inevitably results in consequential sanctions ranging from shaming to legal impediments and denial of privileges. As has been previously argued, this is a significant burden for corporate governance offenders and contributes to their high disutility of conviction alone. If, as can be accepted, one of the objectives of criminalization is to socialize offenders and society at large, the shaming element that inevitably accompanies

⁷⁷ Cite.

⁷⁸ Paul H. Robinson & John M. Darley, *The Utility of Desert*, 91 Nw. U. L. Rev. 453, 471-77 (1997) (stating that law can play a role in socialization).

criminal conviction might meet that objective without the need for incarceration.⁷⁹ The law could stop at conviction without imposing any punishment because the shame might offer sufficient deterrence and retributive advantages.⁸⁰ Corporate governance offenders are likely to experience significant detriment in terms of loss of employment opportunities and social exclusion and might internalize the values sought to be conveyed by the law even without going to jail.⁸¹ Consequential sanctions, which can include shaming, withholding of esteem, shunning, and negative voting by investors and other market participants, can thus modify behavior in desirable ways.⁸² Shame-enforcers frequently seek to attach negative labels to an offender,⁸³ create a reputation as a bad actor,⁸⁴ label actors as being disloyal to shareholders' interests, exclude those actors from other employment involving trust,⁸⁵ cause economic harm to offenders by seeking disgorgement of ill gotten gains, and deprive offenders of any opportunity to hold prestigious positions.⁸⁶ These actions are ultimately aimed at norm internalization by the

⁷⁹ Eric Rasmusen, *Stigma and Self-Fulfilling Expectations of Criminality*, 39 J. L. & Econ. 520 (1996).

⁸⁰ *Id.* at 526. ("the penalty might be zero when there is no trial or only probation is given, however, stigma still arises merely from arrest; criminal conviction itself generates stigma irrespective of the level of sentence.")

⁸¹ *Id.* Some are only satisfied by imprisonment. See, statement of Sen. Byrd: "somebody ought to go to jail, and the doors should be locked and the keys thrown away. Throw away the keys. It really would not be too severe a punishment for some of these four-flushers." 148 CONG. REC. S6603, S6606 (daily ed. July 11, 2002).

⁸² Studies also show that the ability to express punishment has important implications for cooperative behavior. Astrid Hopfensitz & Ernesto Reuben, *The Importance of Emotions for the Effectiveness of Social Punishment* (Tinbergen Institute Discussion Paper No. 05-075/1, July 2005), available at <http://ssrn.com/abstract=775524>, at 17.

("[I]ndividuals who are willing to punish are also willing to keep on cooperating. This guaranties that, as long as these individuals have the opportunity to punish, cooperation can be sustained. Furthermore these kinds of individuals might help cooperation emerge, even if it was initially rare. In addition, the same type of people is necessary to support punishment in the presence of retaliation. If retaliation deters individuals from using the punishment mechanism, cooperation can unravel.")

⁸³ Senator ByrdThe President apparently is so miffed with these corporatewrongdoers that he has elevated them in his rhetoric to a bad-guy level that is almost, but not quite as bad, as al-Qaeda's evildoers. Almost the same level; perhaps not quite. Senate Hearings on PCAOB legislation, See 148 CONG. REC. S6603, S6606 (daily ed. July 11, 2002).

⁸⁴ SEC v. Sands, 142 F.3d 1186; 1998 U.S. App. LEXIS 8093: "Sands, a sophisticated businessman and a lawyer, has engaged in numerous activities in violation of the securities laws and basic notions of right and wrong. We need not sort out whether his principles are just plain wrong, or whether he is afflicted with akrasia."

⁸⁵ See call by AFL-CIO for Kenneth Langone, a director of the NYSE board who defended Richard Grasso's compensation package, to be dropped from the board of GE and four other public companies. Troy Wolverton, *AFL-CIO's Throw-the-Bum-Out Call Gets Cool Reception*, STREET.COM (Sept. 26, 2003), available at <http://www.thestreet.com/stocks/troywolverton/10116076.html>.

⁸⁶ In SEC v. Sands, 142 F.3d 1186; 1998 U.S. App. LEXIS 8093, the defendant argued that the bar against him holding office as director was against the public interest because it would prevent him from serving on

offender and observers. As discussed previously, individuals with high capacity for shame are reputation-conscious and incarceration is a waste of resources for such actors.⁸⁷

Norm-internalization for white-collar offenders is enabled by the significant detriment in terms of loss of employment opportunities and social exclusion experienced (in other words, disutility of conviction). A variant of this idea is captured by Dau-Schmidt, who calls it preference-shaping.⁸⁸ Dau-Schmidt writes that “[p]reference shaping, on an individual, organizational, and societal level, is an important human endeavor. It has been identified as a primary or secondary goal of childrearing, education, religion, advertising, public service announcements, legislation, and criminal punishment. In order to do this, it is essential that the person or group of people who are endeavoring to affect another's preferences have some legitimate claim to authority over the person, or at least have the confidence of the person.”⁸⁹ I have previously suggested that CEOs are particularly suited for desirable behavior modification through the operation of social sanctions because of this very feature -- their dependence on approval from diverse constituencies and the value placed on reputation.⁹⁰

Shaming has salience for corporate governance offenders because of their dependence on group membership. The targets of shaming are members of professional associations, and possess licenses allowing them to carry on certain kinds of economic activity. Frequently, these professional licenses and certifications are privileges that can be taken away by the

the boards of charities. The court responded thus: “Perhaps he is right that charities will not want to place him in positions of high visibility and prestige. If so, and if Sands does have a genuine-interest in doing charitable works, we are certain that he can continue his charitable involvement in a less prestigious, but just as worthy, capacity. We touch on this argument because it underscores the purblindness of Sands...”

⁸⁷ Id.

⁸⁸ Kenneth Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, Duke L.J. 1, 14-15 (1990). (If peoples' preferences are compatible, no one's preferences will be frustrated, and there will be no need to expend resources on precautionary measures.). Id. at 17.

⁸⁹ See also id. at 18. (“By characterizing a behavior as good or bad rather than just inexpensive or expensive, the authority figure indicates need for a fundamental change in the basis upon which the affected person makes decisions.”)

⁹⁰ See, Sandeep Gopalan, *Changing Social Norms and CEO Pay: The Role of Norms Entrepreneurs*, 3 Rutgers L. J. (2008).

relevant authority.⁹¹ Such legal impediments to the offender holding offices involving trust can be finely calibrated to achieve incapacitation in much the same way that jail does.⁹² Even if impediments are not imposed it is unlikely that the individual will be able to find similar employment following conviction. Prestige goods are also likely to be denied in non-professional contexts because these offenders are also members of social groups which view conviction with distaste.⁹³ Membership conditions and interactions after admittance present ideal conditions for deploying shaming as esteem is vital for profitable interactions.⁹⁴ Even if some offenders are not affected by shaming, other observers might see the disutility of the alleged offense and modify their behavior.⁹⁵ Membership in these groups is intrinsically related to the possession of a good reputation, and the gate-keeping function served by these groups might obviate the need for incarceration by delivering the same behavioral change.⁹⁶

⁹¹ SEC v. Sands: “The district court has broad equitable powers to fashion appropriate relief for violations of the federal securities laws, which include the power to order an officer and director bar. In addition to the court’s inherent equitable powers, the Securities Enforcement Remedies and Penny Stock Reform Act of 1999 (Remedies Act) authorizes the court to order an officer and director bar if the person’s conduct demonstrates substantial unfitness to serve as an officer or director. In determining whether to order the bar, a court may consider (1) the ‘egregiousness’ of the underlying securities law violation; (2) the defendant’s ‘repeat offender’ status; (3) the defendant’s ‘role’ or position when he engaged in the fraud; (4) the defendant’s degree of scienter; (5) the defendant’s economic stake in the violation; and (6) the likelihood that misconduct will recur.” (internal citations omitted)

⁹² SEC v. Patel, 61 F.3d 137; 1995 U.S. App. LEXIS 19696: “Although it is not essential for a lifetime ban that there be past violations, we think that it is essential, in the absence of such violations, that a district court articulate the factual basis for a finding of the likelihood of recurrence. We take note of the fact that the governing statute provides that a bar on service as an officer or director that is based on substantial unfitness may be imposed conditionally or unconditionally and permanently or for such period of time as [the court] shall determine. Before imposing a permanent bar, the court should consider whether a conditional bar (e.g., a bar limited to a particular industry) and/or a bar limited in time (e.g., a bar of five years) might be sufficient, especially where there is no prior history of unfitness. We do not think that it would be improper for the district court to take into account any prior punishment that may have been imposed in a criminal proceeding. If the district court decides that a conditional ban or a ban limited in time is not warranted, it should give reasons why a lifetime injunction is imposed.”

⁹³ Cite.

⁹⁴ Jonathan Macey, *Delaware: Home of the World’s Most Expensive Raincoat*, 33 HOFSTRA L. REV. 1131, 1134 (2005) (Directors “do not like to be made the object of public scorn and ridicule.”).

⁹⁵ Dan Kahan, *What do Alternative Sanctions Mean?*, 63 U. CHI. L. REV. 591, 639 (1996). Prof. Kahan argues that shaming has the effect of shaping preferences. If individuals are shamed for contravening a particular asserted norm, other observers will modify their own behavior to fit that asserted norm.

⁹⁶ See Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms and the Unintended Consequences of Independence and Accountability* 25 (Georgetown Law & Econ. Research Paper No. 241,402, Sept. 2000), available at <http://ssrn.com/abstract=241402> (Media coverage makes directors fear liability even more than they ought to: “[H]ypothesis is that under certain predictable circumstances, executives will overestimate the risk of liability. There are a number of possible reasons. One is that newspapers and business periodicals highlight dramatic instances of such suits, and hence the threat of liability.”) See also Alexander Dyck, & Luigi Zingales, *The Corporate Governance Role of the Media*, in

Corporate governance offenders have a variety of agents who can impose shaming and other social sanctions including investors, other directors, employees, the media, politicians, and potential employers. Their position relative to the offender reduces the risk of retaliation by the offender and facilitates internalization.⁹⁷ Indeed, certain shamers like courts are completely immune from retaliation.⁹⁸ They also possess significant advantages over other shamers.⁹⁹ Firstly, they have authority conferred by law. Unlike other shamers, the offender is in a decidedly inferior position to the court at every level. Secondly, the court's findings have certain other positive attributes derived from the legal process.¹⁰⁰ One of these attributes is legitimacy.¹⁰¹ Another is finality. After the appeals process is exhausted, the verdict of the court is final, and any shame that follows cannot be changed.

Shame-targets can respond to shaming with anger and contempt at the shamers.¹⁰² Conviction serves as a focal point for shaming in that it emboldens individuals to impose social sanctions. Collective opinion concretizes around the conviction and holds out the offender as an object of shame. Those who were afraid or hesitant to shame previously draw strength from the conviction. This is because doubt about the guilt of the offender is

THE RIGHT TO TELL: THE ROLE OF THE MEDIA IN DEVELOPMENT (R. Islam ed., The World Bank, Washington DC, 2002) (writing that corporate executives act appropriately because they do not want to be portrayed by the media as "the bad guys").

⁹⁷ Astrid Hopfensitz Ernesto Reuben, *The Importance of Emotions for the Effectiveness of Social Punishment* (Tinbergen Institute Discussion Paper No. 05-075/1, July 2005), available at <http://ssrn.com/abstract=775524>, at 17.

(“If retaliation deters individuals from using the punishment mechanism, cooperation can unravel.”).

⁹⁸ Id.

⁹⁹ Certain shamers like politicians appear to have little effect on those they seek to shame. During the Senate Hearings on the PCAOB, Sen. Byrd said “one finds disconcerting the acute lack of shame--the acute lack of shame--S-H-A-M-E--on the part of some of these corporate executives. Former Enron CEO Jeffrey Skilling told the House Energy and Commerce Oversight Subcommittee that Enron had tight controls on financial risk, but that he could not be expected to oversee everything and 'close out the cash drawers ... every night.' Can you imagine that kind of statement? I think it was Wordsworth who said 'No matter how high you are in your department, you are responsible for what the lowliest clerk is doing...'” See 148 CONG. REC. S6603, S6606 (daily ed. July 11, 2002).

¹⁰⁰ Cite.

¹⁰¹ Cite.

¹⁰² Contempt and indignation by the offender are often counterproductive. For e.g., Sen. Byrd had this to say about Skilling's testimony to a House committee: “here is an individual who tells a House committee he cannot be expected to oversee everything and close out the cash drawers every night...such a stunning, irresponsible, arrogant attitude on the part of a chief executive...” Supra note ____.

largely removed by the court's verdict. Indignation and anger-based responses by the offender are less likely to be tolerated following conviction than before. If the focal point created by the conviction yields effective follow-up shaming by other actors, it serves to reinforce the message and yield sticky norm-internalization.¹⁰³

Shaming meshes neatly with the corporate governance crime debate because it addresses the expressive gap in legal sanctions.¹⁰⁴ Imprisonment and financial sanctions are crude in their application and do not serve to convey the emotions aroused by the actions of corporate offenders. Frequently, for most indirect, non-dangerous offenses, all that society wants is that these emotions be ventilated, and for the offender to be prevented from re-offending, rather than to see the offender go to jail or be made to suffer financial loss. In the Skilling-type case, what is the point of sending the excessively optimistic CEO to jail or imposing a fine? Civilized society recognizes that their conduct is not worthy of jail-time, and that fines are crude matches for their actions. Any sanction, if it has to be meaningful and reflective of a sophisticated system, must match the message that society is trying to convey to the offender, and be proportional to the offense. Imprisoning Skilling for 292 months then is an inappropriate tool for what society really wants to do. Conviction ought to suffice because it serves the expressive function of the law insofar as it tells the offender that he has acted in a way that meets with society's disapproval, and conveys the consequences of such conduct to other observers. It leaves other consequences to individual members to administer.

I have written in previous work about the need for internalization of the underlying norm if shaming is to work.¹⁰⁵ If offenders charged with violating accounting rules do not

¹⁰³ See, Sandeep Gopalan, *Social Norms and CEO Pay: The Role of Norms Entrepreneurs*, 39 Rutgers L. J. (2008).

¹⁰⁴ Chad Flanders, *On Shaming Punishments*, 55 CLEV. ST. L. REV. P.4 (2007): "The law does not exist merely to allocate benefits and burdens; it also *says* things through its actions. . . . It is not as if society punishes by inflicting suffering and then stating in words that it does not approve of the offender's conduct. Rather, the punishment *is* the expression of condemnation: Society gives out harsh punishments for serious crimes because it wants to condemn those crimes in no uncertain terms. This is to say that, conventionally, hard treatment is society's way of expressing disapproval of criminal acts. Words alone are not good enough; the walls of a prison are. "

¹⁰⁵ Sandeep Gopalan, *Changing Social Norms and CEO Pay: The Role of Norms Entrepreneurs*, 39 Rutgers L.J. 1 (2007).

believe that their conduct was wrongful, they are likely to be angered by the imposition of a shame sanction rather than feel remorse. Even if they change their actions following the shaming because they realize the disutility created, this is unlikely to be sustainable. Resentment and anger are likely to motivate them to find new ways to break the rules. This could be partially addressed by incapacitating them from holding similar positions of trust through the use of legal impediments.

I have also discussed, in previous work,¹⁰⁶ the various objections to shaming, and do not regurgitate those arguments here except to address one objection – the lack of process protections.¹⁰⁷ This line of scholarship contends that the lack of process might lead to shame sanctions being imposed on the innocent. Further, there is no architecture to make the amount of shame proportional to the wrong committed by the offender resulting in over-shaming or under-shaming. In some cases, it might inflict too much and irreversible punishment.¹⁰⁸ In addition, those undertaking the shaming are not subject to any accountability mechanisms.¹⁰⁹ While these objections have some merit, they can be overcome to a significant degree here because shaming is consequent upon a determination of blameworthiness by a court. This protects against the political deployment of shame sanctions. Trade unions and employee groups might have self-interested reasons to target CEOs. What is criminal conduct to a left-wing trade union might not be so for many other market participants and the deployment of shame sanctions based on political ideologies could be a threat to their efficacy. Similarly, the media could engage in witch hunts without undertaking significant effort to establish guilt. If, however, shaming follows conviction, or results from a finding of guilt by a

¹⁰⁶ Sandeep Gopalan, *Shame Sanctions and Excessive CEO Pay*, 32 Del. J. Corp. L. 207 (2007).

¹⁰⁷ Seth Kreimer, *Sunlight, Secrets, and Scarlet Letters: The Tension Between Privacy and Disclosure in Constitutional Law*, 140 U. PS. L. REV. 1, 5-12 (1991).

¹⁰⁸ The suicide of a prosecutor who allegedly solicited a person he believed to be 13 years of age following a Dateline NBC sting is a sobering reminder of the dangerous consequences. See, Tim Eaton, *Prosecutor Kills Himself in Texas Raid Over Child Sex*, New York Times, November 6, 2006, available at <http://www.nytimes.com/2006/11/07/us/07pedophile.html?ex=1320555600&en=9a849fc4db0d28ce&ei=5088&partner=rssnyt&emc=rss>.

¹⁰⁹ James Whitman, *What is Wrong with Inflicting Shame Sanctions?*, 107 YALE L.J. 1055, 1088 (1988). (Worrying that shaming confers too much “enforcement power to a fickle and uncontrolled general populace.”)

regulatory agency, professional association or a stock exchange, much of the due process problem can be negated.

VI. Skilling's Case

At the peak of its success, Enron was “The World’s Leading Energy Company,” and an iconic symbol of American capitalism. In just the span of a decade it had undergone enormous transformation - in 1990, Enron was primarily a pipeline company, with 3,000 employees, a market capitalization of \$3 billion, and revenues of about \$5 billion. By 1999, it had 18,000 employees, offices in 30 countries, a market capitalization of \$22 billion, and revenues over \$40 billion— almost 90% of which came from Jeff Skilling’s Wholesale business. During this period of time, Enron’s shareholders received almost 500% return on their investment. This transformation was widely acclaimed. Amongst its many awards, Enron was lauded as *Fortune*’s “Most Innovative Company in America” for four years on the trot.

All this collapsed in an extraordinary sequence of events that was said to epitomize corporate corruption at its worst. Consequences for Enron’s employees and the city of Houston were drastic. On “Black Monday,” over 4,000 Houston Enron employees lost their jobs. Thousands more had to seek other employment during the course of the following months, until the company, once Houston’s largest employer, had only enough employees to administer the bankruptcy. Enron stock plummeted to its nadir, rendering many employees’ 401(k) accounts worthless. Savings accumulated over lifetimes were rendered nought. When the trial of Skilling and Lay commenced, it became apparent that several jurors knew someone—family, friends, neighbors, co-workers, clients, fellow churchgoers—who was harmed by Enron’s collapse.¹¹⁰ Many jurors had suffered financial losses to the tune of thousands of dollars.¹¹¹ In their responses, several jurors noted “the far reaching impact on the business community,” the “extremely negative impact on [Houston’s] charitable and arts organizations,” and the damage to “Houston[’s]

¹¹⁰ Def. Renewed Mot. to Change Venue.

¹¹¹ Id.

real estate market.”¹¹²

Through 1996, Jeff Skilling headed Enron’s Wholesale business, which he founded in 1990 as its first and only employee. In 1997, Skilling became Enron’s President and Chief Operating Officer, and joined the Board of Directors. In February 2001, he was appointed Enron’s CEO. On August 14, 2001, in an end to his meteoric career, he resigned from the company. Skilling was indicted in 2004 along with former Enron Chairman and CEO Ken Lay, and former Enron Chief Accounting Officer Richard Causey. On December 28, 2005, just weeks before trial, Causey pled guilty to one count of securities fraud.¹¹³ Skilling and Lay’s trial began in Houston on January 30, 2006. On May 25, the jury convicted Skilling on 19 counts: one count of conspiracy to commit securities or wire fraud¹¹⁴; 12 counts of securities fraud¹¹⁵; five counts of false statements to auditors¹¹⁶; and one count of insider trading¹¹⁷. He was acquitted on nine counts of insider trading.¹¹⁸ Thereafter, Skilling was sentenced to 292 months in prison, and ordered to pay \$45 million in restitution.¹¹⁹ Crucially to my argument about moral wrongfulness and harm, Skilling was charged not with causing the bankruptcy, but misrepresenting Enron’s financial condition during the 1999-2001 before he stepped down from his position as the CEO.

It is also important to note that unlike the other bete noire, Andrew Fastow, Skilling was not accused of stealing from Enron. Further, the trial showed that Fastow by his own admission had concealed his thefts from Skilling. Given the nature of Skilling’s personality and marriage to Enron’s success, there was no case that Skilling had sabotaged the company’s interests to benefit his own. The Enron Task Force, which had been set up to investigate and bring to justice those who were responsible for Enron’s

¹¹² Id. One juror said: “Was there anyone in Houston not affected in some way?”

¹¹³ Causey has since been sentenced to 5.5 years imprisonment.

¹¹⁴ 18 U.S.C. §371

¹¹⁵ 15 U.S.C. §§78j, 78ff, 17 C.F.R. §240.10b-5.

¹¹⁶ 15 U.S.C. §§78m, 78ff, 17 C.F.R. §240.13b2-2.

¹¹⁷ 15 U.S.C. §§78j, 78ff, 17 C.F.R. §240.10b-5.

¹¹⁸ Skilling judgment at _.

¹¹⁹ Skilling Sentencing Order at ___.

collapse did not deny that Skilling “loved the company,” “was very committed” and “dedicated” to it, and “had the best interests of Enron in mind.”¹²⁰

Despite these facts, the indictment alleged that, starting in late 1999, Skilling spearheaded a massive conspiracy to deceive investors about Enron’s financial health, by manipulating the company’s financial results and lying about the performance of its businesses.¹²¹ The indictment alleged that this conspiracy included almost 125 people from Enron’s senior management to entry level employees to professionals at several establishments in the legal, banking, and finance sectors.¹²² The Task Force contended that the conspiracy’s objective had been to pump up Enron’s stock price artificially—by regularly reporting financial information that met or exceeded Wall Street analysts’ expectations, trumpeting Enron’s successes, and concealing its failures.¹²³

The indictment alleged that Skilling and his co-conspirators engaged in five areas of fraud: 1. LJM: which involved a special purpose entity, whose general partner was Enron CFO Andrew Fastow, where they manufactured earnings and hid losses through fraudulent transactions;¹²⁴ 2. Reserves: where they manipulated reserve accounts allegedly by raiding reserves in one quarter, and taking extra reserves in another, to report earnings that exceeded or met with analysts’ expectations;¹²⁵ 3. Wholesale: where they misrepresented the nature of the business as a “logistics company” that yielded stable, sustainable earnings, when it was really a risky “trading company” whose profits depended on speculative bets on energy prices. The government alleged that spin-doctoring Wholesale as a “logistics company” made a difference to how the market valued it. Allegedly, Skilling was alive to this fact and did tell Ken Rice, EBS’s CEO,

¹²⁰ Cite.

¹²¹ Fastow testified: “at Enron the culture was and the business practice seemed to consistently be to do transactions that maximized the financial reporting earnings as opposed to...maximizing the true economic value of the transaction.” US Appeal Brief, 30, available at <http://online.wsj.com/public/resources/documents/enronskillingappeal.pdf>.

¹²² Govt. Statement in Compliance with Court’s Order Dated Nov. 2, 2004 (Nov. 19, 2004).

¹²³ Government Brief at __.

¹²⁴ Fastow testified that Skilling told him: “I’ll make sure you’re all right on the project,” and “You won’t lose any money.” Fastow opined that Enron’s failure to disclose these supposed “guarantees” made its financial statements false.

that the stock would “get whacked” if the fact that it was a risky trading company was apparent to the market.¹²⁶ The government also alleged that Skilling shifted losses from other divisions to Wholesale in order to convey the appearance that they were financially sound, when they were not, so as to attract further investment¹²⁷ ; 4. Retail/EES (Enron Energy Services): where they concealed the failure of the Retail business by using a “resegmentation” to shift Retail’s losses into Wholesale, then stating EES was “firmly on track.”¹²⁸ EES was created by Enron to sell natural gas to customers in deregulated markets. It belied its initial expectations of being profitable and was struggling financially. The problems were compounded by the distress faced by Californian utility companies which owed EES substantial amounts, and which had already been booked as profits under the mark-to-market accounting rules.¹²⁹ When the utilities did not pay up in late 2000, the government alleges that instead of booking several hundreds of millions in losses pursuant to the accounting rules, Skilling conspired to hide the losses in Wholesale.¹³⁰ This ensured that EES continued to smell of roses. Similarly, in March 2001, EES’s losses were buried in Wholesale following the California energy crisis when the California Public Utilities Commission imposed a surcharge which could not be passed on to customers.¹³¹ This hurt Enron to the tune of hundreds of millions of dollars.¹³² Notwithstanding these machinations, EES’s financial condition did not improve and its losses in 2001 alone exceeded \$700 million;¹³³ and 5. Broadband/EBS: where they allegedly concealed the failure of the Broadband business by falsely stating it was “healthy” and “growing fast”.¹³⁴ As is evident at first blush, the statements at issue

¹²⁵ The Task Force argued that reserves were manipulated to hit earnings targets in three separate quarters: 4Q 1999; 2Q 2000; and 4Q 2000.

¹²⁶ Appeal Judgment at ___.

¹²⁷ Id.

¹²⁸ Id.

¹²⁹ Id.

¹³⁰ Id.

¹³¹ Id.

¹³² Id.

¹³³ The Task Force alleged Skilling concealed the failure of Enron’s relatively new Retail unit, Enron Energy Services, by moving hundreds of millions in alleged losses from Retail to Wholesale. The Task Force also claimed Skilling misled analysts by failing to tell them that the real purpose of the reorganization was to hide losses, instead telling them it was done for efficiency—“to get the best hands working risk management.” Skilling was also told the accounting and disclosures were appropriate.

¹³⁴ The Task Force said Skilling misrepresented the outlook of EBS’s business and the sources of its revenues.

were remarkably like puffery, rather than criminal fraud.¹³⁵ In some cases they were bad business decisions based on hindsight, but were they worthy of imprisonment?¹³⁶

The government also alleged that Skilling made misrepresentations to investors during several conference calls.¹³⁷ The relevant ones are:

January 22, 2001 - Skilling told investors: “the situation in California had little impact on fourth quarter results. Let me repeat that. For Enron, the situation in California had little impact on fourth quarter results.”¹³⁸ Further, “nothing can happen in California that would jeopardize” earnings targets.¹³⁹ The government claimed that at the time of these statements, Skilling knew that the California utilities were not in a position to pay Enron and that a loss of hundreds of millions of dollars would have to be booked.¹⁴⁰ Allegedly, at this call, Skilling was a mute bystander when Mark Koenig, Enron’s Director of Investor Relations, stated that non-core business revenues were a “fairly small” amount of EBS’s earnings.¹⁴¹ The government contends that this was false.¹⁴²

January 25, 2001: Skilling told Enron’s annual analysts conference that EES and EBS had “sustainable high earnings power.”¹⁴³ He also claimed that Wholesale was “not a trading business. We are a logistics company.”¹⁴⁴

March 23, 2001, following news on the market that EBS was in dire straits, and Enron’s

¹³⁵ “In our Bandwidth Intermediation Business, we are making excellent progress in creating a commodity market for bandwidth.”

¹³⁶ Skilling’s testimony is revealing: “I’ll make the last one argument for Broadband because people criticize me about Broadband, and I will take the criticism. We -- certainly, we made a mistake. But it wasn’t big. I mean, it was a billion dollars. We invested a billion dollars in the Broadband business. If it had worked, it could have been worth \$30 billion. It didn’t work. We lost a billion dollars, but if you can make those kinds of bets, that’s the kind of the risk you [should be taking] as a corporation. And if you do a lot of [deals with a] downside of a billion and upside of 30 [billion], you’re doing a good job for your shareholders in the long run, in my opinion. This one didn’t work.”

¹³⁷ Government Brief at _.

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ *Id.*

falling stock price, Skilling convened a special conference call with analysts. He claimed that EBS was “having a great quarter” and that Enron was “highly confident” that EES would meet its earning target.¹⁴⁵ The government alleges that Skilling knew this was not true.¹⁴⁶

April 17, 2001, Skilling told another conference call that the transfer of EES’s risk-management books to Wholesale was because there was “such capacity in our wholesale business that we’re—we just weren’t taking advantage of that in managing our portfolio at the retail side. And this retail portfolio has gotten so big so fast that we needed to get the best—the best hands working on risk management there.”¹⁴⁷ The government alleges that the motivation was to conceal losses. During the call, Skilling also said that the “first quarter results were great” at EES, despite them being down, and with regard to EBS, claimed that there was a very strong development of the marketplace in the commoditization of bandwidth ...we’re feeling very good about the development of this business.”¹⁴⁸

July 17, 2001: Skilling stated that EES “had an outstanding second quarter” and was “firmly on track to achieve” earnings targets, despite EES posting a loss of hundreds of millions of dollars.¹⁴⁹ He again claimed that EES’s reorganization was undertaken for efficiency reasons (not to hide losses as alleged by the government).¹⁵⁰

Skilling also allegedly raided the reserve accounts flush from Wholesale’s profitable second half of 2000 - which had allowed it to put over \$850 million in reserves.¹⁵¹ The government contends that the decision to put the funds into reserves was not based on feared potential liabilities, but rather to use it instrumentally to manipulate earnings.¹⁵² Skilling allegedly used it to hit a specific earnings target to meet Wall Street

¹⁴⁵ Id.

¹⁴⁶ Id.

¹⁴⁷ Id.

¹⁴⁸ Id.

¹⁴⁹ Id.

¹⁵⁰ Id.

¹⁵¹ Id.

¹⁵² Id.

expectations.¹⁵³ The government also argued that Skilling was aware of Enron’s SEC filings containing false statements, including the wrong recognition of money from the Nigerian barges deal as legitimate income despite the fact that it was not really a sale.¹⁵⁴ In addition, it was alleged that Enron misled Arthur Andersen by giving them management-representation letters knowing them to be false, thus undermining the auditing process.¹⁵⁵ In particular, these representations claimed that all related party transactions were disclosed when they were not.¹⁵⁶

In terms of the mental element required for conviction, the conspiracy count required that Skilling “knew the unlawful purpose of the agreement.”¹⁵⁷ The securities fraud counts required that he “knowingly” engaged in a “fraud or deceit.”¹⁵⁸ The false statements to auditors counts required that Skilling “knowingly” made materially false statements or omitted material facts.¹⁵⁹ Finally, the insider trading counts required that he “knowingly employed a device, scheme, or artifice to defraud” by trading on inside information.¹⁶⁰ None of these were directly proved through documentary evidence.

Instead, the prosecution based its case on self-serving testimony provided by witnesses who had everything to gain by pinning blame on Skilling for what were, at worst, bad business judgments.¹⁶¹ During the trial, Skilling’s defense was that he did not break any laws, and that his actions were undertaken as a loyal employee of Enron.¹⁶² He also claimed that he had always relied on competent legal and accounting advice.¹⁶³ With regard to the statements made during the calls to analysts, Skilling claimed that these

¹⁵³ Appeal judgment, 8.

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ Press Release, U.S. DOJ, Former Enron Chief Financial Officer Andrew Fastow Pleads Guilty to Conspiracy to Commit Securities and Wire Fraud, Agrees to Cooperate with Enron Investigation (Jan. 14, 2004), available at <http://www.fbi.gov/dojpressrel/pressrel04/enron011404.htm>; see also, See Kristen Hays, Enron's Top Accountant Gets 5 Years, Fine/Casey's Term Is Third-Harshes, but Less Than Time Sought in Plea Deal, *Hous. Chron.*, Nov. 16, 2006, at A1.

¹⁶² Skilling Brief at _.

¹⁶³ *Id.*

were immaterial. Most importantly, Skilling attacked the reliability of the government's key witnesses - Fastow and Glisan. Fastow's testimony is the most problematic – it claimed that he and Skilling had a secret understanding about Cuiaba and the Nigerian barges — which Fastow referred to as “bear hugs.”¹⁶⁴ Skilling contended that these were self-serving interpretations made by Fastow.¹⁶⁵

Following the trial, in May 2006, the jury found Skilling guilty of nineteen counts: one count of conspiracy, twelve counts of securities fraud, five counts of making false statements, and one count of insider trading. Skilling won a minor victory by being acquitted of nine counts of insider trading.¹⁶⁶ Ken Lay also met a harsh fate and was convicted of every count against him.¹⁶⁷ The district court sentenced Skilling to 292 months' imprisonment, three years' supervised release, and \$45 million in restitution.

As is apparent, the sheer size of a company like Enron necessitates the creation of large sub-structures comprising of several layers of subordinates, governance systems, and internal and outside advisors to ensure the proper structuring and vetting of business transactions and decisions. It is upon these substructures that CEOs and senior executives turn to for most of the decisions that they are required to make. They act upon the basis of the advice provided by these processes, and the success of any company is owed in substantial measure to the efficacy of these decision-making systems. It is indeed rare for CEOs to run companies the size of Enron as personal fiefdoms where every decision is made on their own accord and without consultation with and reliance on advisors, internal and external. It is also not typical that CEOs, actively seek out personal accounting or legal advice in addition to those offered by these substructures. It makes sense then for them to rely on expert advice, and for such reliance to be useful in showing that they did not possess the required knowledge or intent to engage in criminal conduct.

¹⁶⁴ Alexei Barrionuevo and Kurt Eichenwald, What Remains Unanswered at Enron Trial, N.Y. TIMES, May 9, 2006, at C1. (Mr. Fastow said he listed his various side deals in a three-page document he called 'Global Galactic,' which he said Mr. Causey reviewed and initialed. Mr. Skilling denied ever hearing about such a document or making any side deals.)

¹⁶⁵ He also attacked the “Global Galactic” list kept by Fastow.

¹⁶⁶ Skilling Judgment at _.

Enron and Skilling were no different in terms of consultation and reliance. Skilling had been advised that the Raptors transactions,¹⁶⁸ for example, had been reviewed and approved by Andersen’s technical accounting group in Chicago.¹⁶⁹ His decision to support the structures was based on presentations made to him and to the full Board, which had voted to approve them. Skilling’s testimony showed that he was never told that the vehicles were improper.¹⁷⁰ As one senior prosecuting lawyer wrote, [i]n a trial involving allegations of earnings manipulation and disputes over the defendants’ respective understandings of the application of often arcane accounting rules, proof of criminal intent was of critical importance. Assembling such evidence proved challenging, however, as both Skilling and Lay clearly relied on the advice of inside and outside counsel, as well as their auditors.”¹⁷¹ This was to be of no avail.

The Task Force’s case against Skilling was predicated primarily on the testimony of cooperating witnesses, who had all agreed to testify in exchange for leniency and favorable sentencing recommendations.¹⁷² In addition, there is some substance to the feeling that witnesses who could have provided exculpatory testimony for Skilling were intimidated by the Task Force with threats of indictment.¹⁷³ Throughout the trial, there was no other direct evidence that linked Skilling with the alleged crimes.

¹⁶⁷ Cite.

¹⁶⁸ The Raptors were four structured finance transactions used to hedge—or offset the risk in—various Enron investments. Each Raptor was capitalized by \$400 million in Enron stock and a \$30 million investment by LJM. Fastow testified there was a “secret oral side deal”: LJM was to receive its \$30 million investment back, plus \$11 million in profits, before any hedging could begin. Skilling testified that the Raptors were a self-insurance structure that protected the value of the assets hedged by Enron: if Enron’s stock in the Raptors went up, the hedging vehicles (or self-insurance policy) would be capitalized with gains on Enron’s stock; if Enron’s stock went down, Enron’s stock contribution to the vehicles would be protected through the proceeds from the put.

¹⁶⁹ Skilling Brief at __.

¹⁷⁰ Government Appeal Brief, 40: “On June 28, 1999, Skilling and Fastow presented LJM to the Enron Board of Directors for approval. GX 2280 at 6 (Board minutes); R.21232-43. During the discussion, a board member asked if there were risks to Enron from LJM, and he was told that the biggest risk was “‘Wall Street Journal’ risk” because it would “look terrible” if the media found out about LJM. R.21239. At the meeting, the Board granted Fastow a waiver of Enron’s conflict-of-interest rules and approved Enron’s investment in LJM.”

¹⁷¹ John C. Heuston, *Behind the Scenes of the Enron Trial: Creating the Decisive Moments*, 44 Am. Crim. L. Rev. 197, 198 (2007).

¹⁷² *United States v. Fastow*, No. 02-0665 (S.D. Tex. Sept. 27, 2006).

¹⁷³ Skilling Brief at __.

The duplicity of the prosecution can be seen in one simple instance involving document destruction – the very basis for the government ringing the death knell for Arthur Andersen. Skilling had moved for an order requiring the production of the raw interview notes of Andrew Fastow’s examination by the government in order to determine how much of what was produced had been massaged to support their case. In response, the Task Force refused to produce the notes, and in a bizarre move claimed that it had destroyed all the materials including the electronic files from computer hard drives. How was this different from the document destruction engaged in by Arthur Andersen? Clearly, the Task Force had destroyed the electronic copies in an attempt to prevent Skilling from attacking the credibility of Fastow, and in an attempt at gaining an unfair advantage in the trial. The difference between aggressive prosecution and obstruction of justice is equally thin here.

1. Deliberate Ignorance

A further taint on the prosecution was the employment of the “deliberate ignorance” doctrine to get over the minor problem of Skilling believing that his actions were legal.¹⁷⁴ In *United States v. Heredia*, the court justified the use of the doctrine stating that “‘knowingly’ in criminal statutes is not limited to positive knowledge, but includes the state of mind of one who does not possess positive knowledge only because he consciously avoided it.”¹⁷⁵ In another case, the court concluded that to “constru[e] knowingly in a criminal statute to include willful blindness to the existence of a fact is no radical concept in the law.”¹⁷⁶ Key to the doctrine is that the conduct of the defendant “denotes a conscious effort to avoid positive knowledge of a fact which is an element of

¹⁷⁴ The doctrine allows a defendant to be found to have acted knowingly if he knew with high probability that a certain fact existed and acted deliberately to avoid obtaining information that would confirm the fact. The instruction provided to the jury during the trial was: “The word “knowingly,” as that term is used throughout these instructions, means that the act was done voluntarily and intentionally, not because of mistake or accident. You may find that a defendant had knowledge of a fact if you find that the defendant deliberately closed his eyes to what would otherwise have been obvious to him. While knowledge on the part of the defendant cannot be established merely by demonstrating that the defendant was negligent, careless, or foolish, knowledge can be inferred if the defendant deliberately blinded himself to the existence of a fact.” See Appeal judgment, at 25, fn.19.

¹⁷⁵ 483 F. 3d. 913, 918 (9th Cir. 2007).

¹⁷⁶ *United States v. Evans* 559 F. 2d. 244, 246 (5th Cir. 1977).

an offense charged ... choosing to remain ignorant so he can plead lack of positive knowledge in the event he should be caught.”¹⁷⁷ In order to apply the doctrine, the conduct must be “Don’t tell me, I don’t want to know.”¹⁷⁸ Given its broad sweep, courts have repeatedly emphasized that it should only be given “in the “rare” instance where there is significant evidence of deliberate ignorance.”¹⁷⁹ The concern has been that “[b]ecause the instruction permits a jury to convict a defendant without a finding that the defendant was actually aware of the existence of illegal conduct, the deliberate ignorance instruction poses the risk that a jury might convict the defendant on a lesser negligence standard - the defendant should have been aware of the illegal conduct.”¹⁸⁰

This is dangerous territory. There is a clear distinction between failing to ascertain information about a fact, and knowing the fact. If the former equals the latter, there is little sense in requiring the prosecution to prove knowledge. It dilutes the requirements of knowledge to breaking point. As the court noted in *United States v. Mendoza-Medina*, “the deliberate ignorance instruction poses the risk that a jury might convict the defendant on a lesser negligence standard – the defendant should have been aware of the illegal conduct.”¹⁸¹ Even setting aside the serious problems with the doctrine, its application in this case does not satisfy the conditions that are required to be fulfilled. In order to apply the doctrine, two conditions must be satisfied: “1. the defendant was subjectively aware of a high probability of the existence of the illegal conduct; 2. the defendant purposely contrived to avoid learning of the illegal conduct.”¹⁸² Further, subjective awareness of illegal activity and purposeful contrivance to avoid learning of illegal conduct can be inferred from the defendant’s inactivity in the face of a “routine and repeated pattern of suspicious transactions.”¹⁸³ As the 5th circuit court stressed, “where there is no such evidence, a district court should not give the instruction because there is no basis for finding deliberate ignorance. In such a case, it is usually harmful, because it is likely to lead the jury to find that the defendant had the requisite knowledge

¹⁷⁷ *United States v. Lara-Velasquez*, 919 F.2d 946, 951 (5th Cir. 1990).

¹⁷⁸ Skilling Appeal judgment at ___.

¹⁷⁹ *Id.*

¹⁸⁰ *Id.* Quoting *United States v. Lara-Velasquez*, 919 F.2d 946, 951 (5th Cir. 1990).

¹⁸¹ 346 F. 3d. 121, 132 (5th Cir. 2003).

¹⁸² *United States v. Lara-Velasquez*, 919 F.2d. 946 (5th cir. 1995).

¹⁸³ *United States v. Nguyen*, 493 F.3d at 619-22.

when he in fact did not.”¹⁸⁴

Is deliberate ignorance even possible in a corporation the size of Enron with its army of lawyers, accountants and consultants? Expert advice is routinely provided and there is no evidence that Skilling deliberately sought to avoid getting advice when he should have. There are few facts which justify the conclusion that there was a pattern of suspicious transactions that ought to have caused Skilling to act. Skilling’s case had never been that he did not know the facts. His case was that his actions were not illegal. As the 5th circuit put it, “[h]e claims that he “agreed” at trial with the government’s characterization of him as knowing everything that went on at Enron. He maintains that his “defense was not that he was unaware of fraud, but that there was no fraud.”¹⁸⁵ This strikes at the root of the deliberate ignorance ground because if he had full knowledge of the actions but did not believe them to be illegal, there is no case. There is obviously no need to contrive to avoid finding out about legal facts. Having come this far, the 5th circuit gets it horribly wrong: “Even if Skilling is correct that there is little evidence to support a deliberate ignorance instruction, however, any error in the district court’s decision to give the instruction was harmless. This is because the peril to be avoided in cases reversing convictions based on the deliberate ignorance instruction is not present here. By his own admission, Skilling claims that he knew of the allegedly illegal acts, so there is no risk that a jury would rely on the deliberate ignorance instruction to find that he should have known of the acts. Consequently, even if the district court erred in giving the deliberate ignorance instruction in the sense that the instruction was “not supported by evidence,” any such error was necessarily harmless.”¹⁸⁶

This is a terrible travesty. The court completely confuses Skilling’s case – he did not contend that he knew the acts were illegal.¹⁸⁷ Rather, the claim was that he knew of the

¹⁸⁴ Skilling Appeal judgment at ___.

¹⁸⁵ *Id.*

¹⁸⁶ *Id.*

¹⁸⁷ The court quoted from Skilling’s reply brief and said “[t]here were very few instances where [he] denied that the alleged conduct happened—he agreed statements were made, conversations occurred, transactions were approved. Indeed, most were a matter of written record. [His] position was that the conduct was not criminal or wrongful,” but still got it wrong!

acts, which were all legal!¹⁸⁸

Skilling appealed, contending *inter alia*, that the government used an invalid theory of “honest-services fraud” to convict him. The jury had convicted Skilling of one count of conspiracy. The problem was that it did not specify which object of the conspiracy had been used to convict and given that one of them was honest services, Skilling sought to overturn the conviction alleging that this was an invalid theory.¹⁸⁹

2. Honest Services

The government’s case against Skilling under this theory was based on a conspiracy to deceive investors about the true performance of Enron’s businesses by cooking the books to increase reported earnings, reduce reported losses, maintain an investment-grade credit rating, and improve the price of Enron’s stock. In doing so, Skilling allegedly breached his fiduciary duty of “honest services.”¹⁹⁰ The truth is that Skilling’s conviction is founded on no evidence as to when, how, or why the conspiracy was hatched, or anything beyond self-serving testimony from Fastow claiming that he committed any crime. The conviction chillingly demonstrates the need to clarify the “honest services” theory if it is to serve any function in distinguishing risky business behavior from criminal behavior.

In *US v. Brown*,¹⁹¹ the government’s “honest services” theory was rejected by the court in similar circumstances. In *Brown*, Enron and Merrill Lynch employees were alleged to have engaged in a conspiracy to defraud Enron and its shareholders by “parking” the now infamous “Nigerian barges” with Merrill Lynch for six months to artificially boost Enron’s earnings.¹⁹² It was alleged that Merrill paid \$7 million to acquire equity in the barges to help Enron post \$12 million in earnings to meet its forecasts.¹⁹³ The state’s case

¹⁸⁸ Skilling Appeal Brief at 24: “His defense was *not* that he was unaware of fraud, but that there was no fraud. As we told the jury in opening statement: “This is not a case of hear no evil, see no evil. This is a case of there was no evil.”

¹⁸⁹ The prosecution’s case contained three objects of the conspiracy: to commit (1) securities fraud, (2) wire fraud to deprive Enron and its shareholders of money and property, and (3) wire fraud to deprive Enron and its shareholders of the honest services owed by its employees.

¹⁹⁰ See 18 U.S.C. 1346.

¹⁹¹ 459 F.3d 509 (5th Cir. 2006).

¹⁹² *Id.*

¹⁹³ *Id.*

was that this was a sham transaction because Enron executives orally promised Merrill a flat fee of \$250,000 and a guaranteed 15% annual rate of return for the six months that it was required to hold the asset.¹⁹⁴ Further, the government alleged that the transaction was in the nature of a lease rather than a sale because Enron executives promised it would buyback Merrill's interest if no third party could be found.¹⁹⁵ The court was unsympathetic to the government's claims because the facts did not show that the defendants had acted at the expense of the company, or had engaged in bribery and self-dealing.¹⁹⁶ Rather, their actions were to the benefit of Enron. According to the majority, "[w]e do not presume that it is in a corporation's legitimate interests ever to misstate earnings – it is not. However, where an employer intentionally aligns the interests of the employee with a specified corporate goal, where the employee perceives its pursuit of that goal as mutually benefiting him and his employer, and where the employee's conduct is consistent with that perception of the mutual interest, such conduct is beyond the reach of the honest-services theory of fraud as it has hitherto been applied."¹⁹⁷

The test for a deprivation of "honest services" case, which is laid down in *Rybicki*,¹⁹⁸ is that the defendant is secretly acting for his own interest while purporting to act for the employer. This is consistent with the Seventh Circuit's ruling in *United States v. Bloom*.¹⁹⁹

There is no evidence that Skilling engaged in bribery or self dealing. Nor did he act secretly for his own benefit at the expense of Enron. There was no deprivation of "honest services" because, if anything, Skilling's interests were too closely aligned with Enron's. Unless the causal link between Enron's ultimate collapse and Skilling's alleged actions are conclusively established, the harm was not directly caused by Skilling's alleged crimes. In fact, the immediate consequences of Skilling's actions were that Enron and its shareholders benefited. The government sought to distinguish Skilling's case from

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* at 522.

¹⁹⁸ 354 F.3d 124, 141-42 (2d Cir. 2003) (en banc).

¹⁹⁹ 149 F.3d 649, 654 (7th Cir. 1998).

Brown contending that he “violated his fiduciary obligations and his duty to provide Enron and its shareholders with honest services by setting an improper corporate goal – improperly maintaining and increasing Enron’s share price and maintaining its credit rating – and then scheming to achieve that goal by committing, directing, and causing others to commit a series of fraudulent actions that Skilling could not have perceived as being consistent with any legitimate corporate interest.”²⁰⁰ They also allege that in *Brown* the offenders were “low-level” employees who were acting on orders from superiors whereas Skilling was not acting in pursuance of goals imposed on him by those above him.²⁰¹

The 5th circuit analyzed *Brown* as creating the following ingredients for establishing liability: “when an employer (1) creates a particular goal, (2) aligns the employees’ interests with the employer’s interest in achieving that goal, and (3) has higher-level management sanction improper conduct to reach the goal, then lower-level employees following their boss’s direction are not liable for honest-services fraud.”²⁰² The employees in *Brown* were acting both in the corporate interest and at the direction of their employer, justifying the reversal of their conviction. Thereafter, the court manufactured an exception for honest services fraud thus: “In essence, *Brown* created an exception for honest-services fraud where an employer not only aligns its interests with the interests of its employees but also sanctions the fraudulent conduct, i.e., where the corporate decisionmakers, who supervised the employees being prosecuted, specifically authorized the activity.”²⁰³

By their own logic, the employer – Enron - should sanction the fraudulent conduct and the decisionmaker – Skilling – should have specifically authorized the activity. Given the facts of the case, this might be a bridge too far. Nevertheless, the 5th circuit would have none of it: “Skilling misconstrues our holding in *Brown* ... because he fails to recognize

²⁰⁰ Government Appeal Brief, 80.

²⁰¹ *Id.*

²⁰² Skilling Appeal Judgment at _.

²⁰³ *Id.*

the manner in which the court in *Brown* explicitly distinguished *Gray*... *Gray*²⁰⁴ and *Brown* present different facts; in *Gray*, the basketball coaches acted on their own volition, without any direction from their supervisors, while in *Brown*, a lower-level Enron employee acted at the direction of Fastow, who as a decisionmaker had the authority to tell his employee that Enron sanctioned the particular fraud in question. The difference is that in *Brown*, the employee undertook the specific fraud in question at the direction of the employer, while this did not occur in *Gray*. In essence, because the Enron decisionmaker in *Brown* sanctioned the specific fraudulent conduct of its employee, the employee (and the other conspirators) did not deprive Enron of its honest services. Thus, for example, had the basketball coaches in *Gray* showed that the President of Baylor University or other decisionmakers specifically directed their fraudulent conduct, then they would not have been liable for honest-services fraud.”²⁰⁵

Having come up with this sword, the court then foisted Skilling on it. It said, “Skilling’s convictions must stand. First, Enron created a goal of meeting certain earnings projections. Second, Enron aligned its interests with Skilling’s personal interests, e.g., through his compensation structure, leading Skilling to undertake fraudulent means to achieve the goal. Third—and fatally to Skilling’s argument—no one at Enron sanctioned Skilling’s improper conduct. That is, Skilling does not allege that the Board of Directors or any other decisionmaker specifically directed the improper means that he undertook to achieve his goals. Of course, a senior executive cannot wear his “executive” hat to sanction a fraudulent scheme and then wear his “employee” hat to perpetuate that fraud. Therefore, it is not a matter of Skilling setting the corporation’s policy himself. Instead, the question is whether anyone who supervised Skilling specifically directed his actions—such as how Fastow sanctioned the scheme in *Brown*. Skilling never alleged that he engaged in his conduct at the explicit direction of anyone, and therefore he cannot avail himself of the exception from *Brown*.”²⁰⁶

²⁰⁴ 96 F.3d at 775.

²⁰⁵ Appeal Judgment at ___.

²⁰⁶ Appeal judgment at ___. The court also said: “The elements of honest-services wire fraud applicable here are (1) a material breach of a fiduciary duty imposed under state law, 14 including duties defined by the employer-employee relationship, 15 (2) that results in a detriment to the employer. *Brown* sheds light on the employer-employee relationship by creating an exception for when the employer specifically directs the

There is one problem: where is the “fraudulent” action undertaken by Skilling to achieve the corporate goal of achieving earnings? There is too facile an assumption of fraud and impropriety without the evidence to back it up. The application of the honest services theory in cases where bad business decisions caused financial losses dangerously corrodes the very basis of criminal liability by conflating moral wrongfulness with risk taking. It must be clarified if it has to serve the intended purpose. Further, even upon the court’s reasoning, would it not be possible to believe that the board of directors, whose task it was to supervise Skilling, sub silentio directed and approved his actions?

As the above analysis shows, there is little morally wrongful in Skilling’s conduct.²⁰⁷ There was no suggestion that Skilling had anything to gain at the expense of Enron by his alleged crimes. In fact, all the evidence pointed to Skilling working for the success of Enron. His alleged misstatements were in the nature of sales talk, and puffery and there is no evidence that there was any intention to deceive. The Skilling case demonstrates the perils of letting the notion of harm alone dictate criminalization. The enormous harm suffered by people in Houston appears to have colored their perceptions about the moral wrongfulness of Skilling’s actions. If Skilling was indeed responsible for the harm, there were other avenues like civil suits to recover for the harm caused. The criminal law ought to require more than mere harm to deprive individuals of their liberty. If Skilling has to suffer the fate of a murderer who has killed five people (based on his sentence), surely there must be the same degree of moral wrongfulness to his actions?

To sum up, Skilling’s conduct was at worst an aggressive interpretation of existing law. The government did not adduce any evidence that he intentionally committed acts that he knew to be wrong. It is arguable that overly optimistic and egregiously risky actions

fraudulent conduct. Further, it is a sufficient detriment for an employee, contrary to his duty of honesty, to withhold material information, i.e., information that he had reason to believe would lead a reasonable employer to change its conduct. Accordingly, the jury was entitled to convict Skilling of conspiracy to commit honest-services wire fraud on these elements.”

²⁰⁷ As Malcolm Gladwell wrote in the *New Yorker*, “Can anyone explain—in plain language—what it is Jeff Skilling and Co. did wrong? . . . The question is strictly a legal one: according to the way the accounting rules were written at the time, what specific transgressions were Skilling guilty of that merited twenty-four years in prison?” Malcolm Gladwell, *New Yorker*, 2007.

ought not to be viewed kindly by the law and that CEOs who are guilty of these faults should not be allowed to hold similar positions. If, such conduct has to be criminalized upon the justification that non-consenting individuals were harmed, conviction without imprisonment could achieve the purposes of criminalization at lower cost. Skilling would have had his earning capacity destroyed by conviction alone. An order of disgorgement would have reduced him to penury. To the extent that it is necessary, other legal impediments could have been imposed on him by regulatory agencies. In addition, if members of society wanted to impose other consequential sanctions, they could do so upon conviction without sending him to jail.

VII. Conclusion

Criminalizing risky actions undertaken by corporate fiduciaries confuses ex post harm with moral wrongfulness. The scholarly and policy-making communities conflate blameworthiness with imprisonment, explaining the inordinate focus on ratcheting up prison terms. Such a view assumes that physical confinement is essential to achieving the objectives of criminalization when the particular nature of corporate governance offenders facilitates the realization of those objectives without the need for imprisonment. To the extent that criminalization is necessary, the societal goals that the law articulates through the criminal law can be realized through conviction alone without the need for imprisonment. Conviction is sufficiently liberty-depriving for corporate governance offenders insofar as it destroys the ability to hold fiduciary positions eliminating the possibility for further social harm. The disutility caused by conviction alone is a sufficient deterrent. If the law stops at conviction, deterrent objectives can be achieved without the need for the state to bear the cost of imprisonment. The possibility of imposing consequential sanctions satisfies the retributive dimension. Lastly, the incapacitation objective is achieved by legal impediments to holding offices involving trust.

The criminal law is a blunt instrument when applied to problems created by agency costs because of the crudeness of traditional sanctions and their relatively high cost without demonstrable gain. Further, since corporate governance wrongs are not always morally

wrong the criminal law's expressive and coercive powers are seriously undermined by the crude application of criminal sanctions. Stopping at conviction without automatic imprisonment minimizes the erosion of expressive power by facilitating the deployment of consequential sanctions like shaming, which allows for the decentralized enforcement of the asserted norms. Thus, conviction without incarceration offers a second-best alternative to decriminalization.