RULE 10B-5 AND THE "UNFITNESS" QUESTION

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I. INTRODUCTION

A key provision of the Sarbanes-Oxley Act (Sarbanes-Oxley or "the Act")[1] creates a new standard for the imposition of a lifetime bar order against a defendant found liable for violations of the federal securities laws. Under the Act, any person who is found to have violated the antifraud provisions of either the Securities Act of 1933 or the Securities Exchange Act of 1934 may be barred from serving as an officer or director of a public company, "if the person's conduct demonstrates unfitness to serve."[2]

The Act, of course, was an effort to restore public confidence in the securities markets after a series of scandals that began with Enron's implosion in the fall of 2001 and continued with shocking announcements at Global Crossing, Adelphia, WorldCom, Tyco, and Xerox in the spring and summer of 2002. At the heart of the Act are provisions designed to ensure accuracy and transparency in financial reporting,[3] timeliness in disclosure of insider transactions,[4] the

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1. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

2. Securities Act of 1933 § 20(e), 15 U.S.C. § 77t(e) (Supp. 2002); Securities Exchange Act of 1934 § 21(d)(2), 15 U.S.C. § 78u(d)(2) (Supp. 2002).

3. *See* 15 U.S.C. § 7241 (2004) (requiring certification of financial statements by an issuer's CEO and CFO).

elimination of insider loans,[5] and increased oversight of corporate activities by directors and other gatekeepers.[6] In other words, the Act represents a comprehensive effort to improve corporate executives' accountability to their shareholders and to stimulate those shareholders to continue to invest in the capital markets.[7] Through its forfeiture provisions[8] and enhanced criminal penalties,[9] the Act also seeks to punish those executives who violate the law. The provision permitting debarment of officers and directors is a part of this potent legislative mix.

The question that underlies the debarment provision is what conduct demonstrates "unfitness to serve?" Does *every* Rule 10b-5 violation satisfy the "unfitness" standard? No, it does not.[10] So how can courts meaningfully identify those violators who are deserving of a lifetime bar order? Stated another way, how can courts determine when a Rule 10b-5 violator is "unfit"?

This Article sets out a useful test for courts to employ in deciding the "unfitness" question. It draws on case law developed under a predecessor statute to Sarbanes-Oxley.[11] It also considers the issue of executive unfitness as it has developed in bankruptcy law, employment law, banking law, and the regulation of securities professionals.[12]

The Article considers what is meant by "unfitness" specifically as it is applied to top corporate executives. Is an executive who orchestrates a violation of the securities laws any more "unfit to serve" than an executive who orchestrates a violation of the antitrust laws? The environmental laws? Health and safety laws? Congress apparently believes the answer is "yes." But what is it precisely about a violation of the securities laws—and about the violator himself—that renders the violator "unfit to serve"? I suggest that a matrix of factors, described in detail below, can be helpful in answering that question.

Before setting out the matrix, however, this Article will do three things. It will briefly review the legislative and judicial history that preceded enactment of

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4. *See id.* § 78p(a)(2)(C) (requiring filing of Form 4s (Statement of Changes of Beneficial Ownership) within forty-eight hours).

5. *See id.* § 78m(k) (prohibiting the extension of credit to officers or directors).

6. *See id.* § 78j-1(m) (establishing standards for members of the audit committee and rules of professional responsibility for lawyers, respectively).

7. See John J. Huber & Julie K. Hoffman, *The Sarbanes-Oxley Act of 2002 and SEC Rulemaking*, in 1 THE PRACTITIONER'S GUIDE TO THE SARBANES-OXLEY ACT (John J. Huber et al., eds. 2004), at I-4 ("In short, the Act is intended to be a comprehensive and permanent solution to management malfeasance, with the ultimate goal of re-establishing investor confidence in the integrity of corporate disclosures and financial statements.").

8. 15 U.S.C. § 7243.

9. *See* Frank O. Bowman III, *Pour encourager les autres? The Curious History and Distressing Implications of the Criminal Provisions of the Sarbanes-Oxley Act and the Sentencing Guidelines Amendments That Followed*, 1 OHIO ST. J. CRIM. L. 373 (2004) (describing the new enhanced penalties).

10. *See infra* note 68 and accompanying text.

11. *See infra* Section II.B.

12. *See infra* Section III.

the Sarbanes-Oxley Act in July, 2002;[13] it will survey the law of executive unfitness in several disciplines that are germane to the Sarbanes-Oxley inquiry;[14] and it will consider the utility of the Federal Sentencing Guidelines in structuring an inquiry under the Act.[15] In Section V of the Article, I will set out a roadmap for deciding the question of executive unfitness.

Context is important here. A finding of unfitness is unquestionably stigmatizing. It also may have profound economic consequences. But there is more to a lifetime bar order than merely enjoining misbehavior or assessing a fine—even a substantial fine. A lifetime bar order goes to the heart of fundamental issues of identity. Corporate executives uneasily refer to a lifetime bar order as a kind of "death penalty." Pete Rose has poignantly described his lifetime exclusion from baseball as a "prison without bars."[16]

Blacklisting of any sort imposes profoundly transformative limitations on people who, in many cases, regard their work as their life. Memoirs of writers and actors who were blacklisted in the 1950s, for example,[17] repeatedly recount stories of ruined marriages, substance abuse, depression, anger, and despair.[18] Studies of white-collar layoffs during the 1980s and 1990s similarly report the trauma and pain experienced by executives when they cannot find work commensurate with their skills.[19]

I am not suggesting that serious offenders ought not to answer for the harm that they do. Of course they should, through the full panoply of criminal and civil proceedings available under the securities laws. Nor am I suggesting that there is a "right" to executive employment that is somehow infringed upon by the

13. *See infra* Section II.

14. *See infra* Section III.

15. *See infra* Section IV.

16. PETE ROSE (WITH RICK HILL), MY PRISON WITHOUT BARS (2004).

17. *See, e.g.*, NORMA BARZMAN, THE RED AND THE BLACKLIST: THE INTIMATE MEMOIR OF A HOLLYWOOD EXPATRIATE (2003); WALTER BERNSTEIN, INSIDE OUT: A MEMOIR OF THE BLACKLIST (1996); ALVAH BESSIE, INQUISITION IN EDEN (1965); BRUCE COOK, DALTON TRUMBO (1977); JOHN HENRY FAULK, FEAR ON TRIAL (1964); BERNARD GORDON, HOLLYWOOD EXILE, OR, HOW I LEARNED TO LOVE THE BLACKLIST: A MEMOIR (Thomas Schatz ed., 1999); LILLIAN HELLMAN, SCOUNDREL TIME (1976); RING LARDNER, JR., I'D HATE MYSELF IN THE MORNING: A MEMOIR (2000); PATRICK MCGILLIGAN & PAUL BUHLE, TENDER COMRADES: A BACKSTORY OF THE HOLLYWOOD BLACKLIST (1997); VICTOR S. NAVASKY, NAMING NAMES (2003); JEAN ROUVEROL, REFUGEES FROM HOLLYWOOD: A JOURNAL OF THE BLACKLIST YEARS (2000).

18. In fairness, these memoirs also contain many stories of resourcefulness in working around the blacklist, by relocating families to Mexico or Europe, or using pseudonyms or "fronts" in writing screenplays. For those (like actors) who could not work around the blacklist, these memoirs also describe the adaptive strategies used to find success in other careers.

19. *See, e.g.*, STEPHEN FINEMAN, WHITE COLLAR UNEMPLOYMENT: IMPACT AND STRESS 36–61 (Iain Manghan ed., (1983) (detailing the negative impact of sudden unemployment on white collar employees); CARRIE R. LEANA & DANIEL C. FELDMAN, COPING WITH JOB LOSS: HOW INDIVIDUALS, ORGANIZATIONS, AND COMMUNITIES RESPOND TO LAYOFFS 45–77 (Arthur P. Brief & Benjamin Schneider eds., 1992) (describing studies on responses to job loss, including among professionals).

Sarbanes-Oxley Act.[20] I merely seek to emphasize that the lifetime bar order is a severe sanction.[21] Given that fact, and remembering that a lifetime bar order is a creature of civil enforcement, not criminal prosecution, courts should approach the question of "unfitness" guided by principle and with humility. What follows is an effort to shape that process.

II. A BRIEF HISTORY OF THE LIFETIME BAR PROVISION

A. Lifetime Bar Orders Prior to 1990

Prior to 1990, the SEC's Enforcement Division often sought lifetime bar orders in its complaints for relief in civil enforcement actions. In many of the cases that were settled by the Commission, defendants consented to a lifetime bar order.[22] Oddly, though, only one published opinion included a lifetime bar order.[23] Still, the Commission was confident that it was empowered, even in the absence of express legislative authority, to seek lifetime bar orders as a form of "ancillary relief." This authority was finally recognized by the U.S. Court of Appeals for the Second Circuit in 1994.[24] Ironically, though, the court did not issue its opinion until well after the passage of the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the "Remedies Act"),[25] which expressly authorized the Commission to seek lifetime bar orders in litigated proceedings.

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20. I am not, for example, trying to relitigate the issue of whether a lifetime bar order is the kind of punishment that may only be imposed in a criminal proceeding. Courts have repeatedly held that a lifetime bar order is a "remedy," not a "punishment." *See, e.g.*, Hudson v. United States, 522 U.S. 93, 117 (1997) (holding that an administrative debarment of banking officials does not constitute punishment); Cox v. CFTC, 138 F.3d 268, 272–74 (7th Cir. 1998) (holding that an administrative sanction barring a commodities trader from trading in the commodities markets does not constitute punishment); United States v. Merriam, 108 F.3d 1162, 1165 (9th Cir. 1997) (holding that a disciplinary sanction barring a brokerage firm employee from associating with any National Association of Securities Dealers member firm does not constitute punishment).

21. *See* Marketlines, Inc. v. SEC, 384 F.2d 264, 267 (2d Cir. 1967). Courts have also characterized lifetime bar orders as "harsh," "draconian," and "punitive" in nature. *See, e.g.*, Kenny v. SEC, 87 Fed. Appx. 608, 609 (8th Cir. 2004) ("harsh"); Proffitt v. FDIC, 200 F.3d 855, 861 (D.C. Cir. 2000) ("punitive"); Kim v. OTS, 40 F.3d 1050, 1055 (9th Cir. 1994) ("draconian"); Doolittle v. Nat'l Credit Union Admin., 992 F.2d 1531, 1538 (11th Cir. 1993) ("harsh").

22. *See* Jayne W. Barnard, *The Securities Law Enforcement Remedies Act of 1989: Disenfranchising Shareholders in Order to Protect Them*, 65 NOTRE DAME L. REV. 32, 54 n.158 (1989) [hereinafter Barnard, *Disenfranchising Shareholders*] (listing settled cases); Jayne W. Barnard, *When is a Corporate Executive "Substantially Unfit to Serve"?*, 70 N.C. L. REV. 1489, 1509 n.101 (1992) [hereinafter Barnard, *Substantially Unfit*] (same).

23. SEC v. Techni-Culture, Inc., [1973–1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,501, at 95,759 (D. Ariz. Apr. 2, 1974).

24. SEC v. Posner, 16 F.3d 520, 522 (2d Cir. 1994), *cert. denied*, 513 U.S. 1077 (1995).

25. Securities Enforcement Remedies and Penny Stock Reform Act of 1990, Pub. L. No. 101-429, 104 Stat. 931 (1990).

B. The Remedies Act Formulation

As enacted, the Remedies Act provided that:

> [Where a defendant is found to have violated certain of the securities laws], the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated [the applicable provisions] from acting as an officer or director [of a public company] if the person's conduct demonstrates substantial unfitness to serve as an officer or director . . . .[26]

There was very little legislative history for the "substantial unfitness" provision,[27] though it seemed to be designed primarily for recidivists and perpetrators of "egregious" forms of fraud.[28] Thus, the field was ripe for some classic statutory construction.

1. The Operative Inquiry (or the "Six-Factor" Test)

The first court to consider the issue of "substantial unfitness" was the U.S. District Court for the Southern District of New York in *SEC v. Shah.*[29] The *Shah* case involved a defendant who had engaged in insider trading in the shares of a pharmaceutical company of which he was a senior executive. The inside information upon which Shah traded was that he had been paying bribes to examiners for the Food & Drug Administration. When the bribery scheme was disclosed, the company's share price dropped. Shah pleaded guilty in the bribery scheme and was fined $125,000. He was also permanently barred from working for a pharmaceutical company and barred from employment by any government contractor for a period of three years. Shah also paid $35,000 to settle a private lawsuit alleging insider trading.

The SEC then brought a civil enforcement action against him, seeking further disgorgement of profits, an injunction against future violations of the securities laws, a civil penalty, and a lifetime bar order under the Remedies Act.

After granting the SEC's first three requests, the court turned to the lifetime bar issue. The court first articulated six items that would govern its consideration of the demand for a lifetime bar order:

> (1) the "egregiousness" of the underlying securities law violation;
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> (2) the defendant's "repeat offender" status;
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> (3) the defendant's "role" or position when he engaged in the fraud;
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> (4) the defendant's degree of scienter;

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26. 15 U.S.C. § 78u(d)(2) (2001).

27. SEC v. Shah, No. 92-CIV1952, 1993 WL 288285, at *7 (S.D.N.Y. July 28, 1993) ("The statutes do not define 'substantial unfitness,' and the legislative history is not instructive as to what Congress intended this term to mean." (internal citations omitted)).

28. Barnard, *Substantially Unfit*, *supra* note 22, at 1510 (citing legislative history).

29. No. 92-CIV1952, 1993 WL 288285 (S.D.N.Y. July 28, 1993).

(5) the defendant's economic stake in the violation; and

(6) the likelihood that misconduct will recur.[30]

The court then walked through each of these factors, noting particularly that Shah's degree of scienter seemed low (he had not engaged in "clandestine trading, such as tipping, purchasing stock in the names of other people, or trading in a secret account"),[31] and the likelihood of future misconduct on his part appeared "relatively slight."[32] Taking into account the totality of the circumstances, and the fact that Shah had been punished elsewhere, the court declined to enter a lifetime bar order.[33]

In a related case decided shortly after *Shah*, the U.S. Court of Appeals for the Second Circuit modified the six-factor test somewhat. In *SEC v. Patel*,[34] the court recognized the six-factor test in *Shah* as "useful in making the unfitness assessment." [35] It went on, however, to caution:

> [W]e do not mean to say that [the six factors articulated in *Shah*] are the only factors that may be taken into account or even that it is necessary to apply all these factors in every case. A district court should be afforded substantial discretion in deciding whether to impose a bar to employment in a public company.[36]

The heart of the *Patel* decision was the court's emphasis on the "likelihood of future misconduct" requirement of the *Shah* six-factor test. The court insisted that, as is true in any case in which the government seeks a forward-looking injunction, a likelihood of future misconduct is "always an important element in deciding whether [to order] a lifetime ban."[37] As importantly, the court said, in the absence of a record of recidivism or defiance of previous injunctive orders by the defendant, the district court must "articulate the factual basis for a finding of the likelihood of recurrence"[38] before it may enter a suspension or bar order. In addition, the district court must consider the hierarchy of remedies authorized by the Remedies Act and impose the least restrictive available remedy:

> [T]he 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 of for such period of time as [the court] shall determine." We take these

30. This "six-factor test" came from that suggested in Barnard, *Substantially Unfit*, *supra* note 22, at 1492–93.

31. *Shah*, 1993 WL 288285, at *7.

32. *Id.*

33. This is one of only two reported decisions in which any district court declined to enter any type of suspension or bar order where such an order was sought by the SEC. The other is *SEC v. Pace*, 173 F. Supp. 2d 30 (D.D.C. 2001) (holding that the defendant could be enjoined from engaging in the type of conduct proven in this case but that the Commission had failed to establish that he should be barred).

34. 61 F.3d 137 (2d Cir. 1995).

35. *Id.* at 141.

36. *Id.*

37. *Id.*

38. *Id.* at 142.

> provisions to suggest that, 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. . . . 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.[39]

Having set out this framework, the court remanded for a determination of whether Patel was a suitable candidate for a lifetime bar order.[40]

In the run-up to the enactment of the Sarbanes-Oxley Act, Stephen M. Cutler, the Director of the SEC Enforcement Division, disparaged the *Patel* decision as creating "a burdensome and overly restrictive test"[41] and "an unreasonably high"[42] burden for the Commission to have to meet. Cutler was particularly disgusted by a district court's refusal, following *Patel*, to enter a lifetime bar order where the defendant had been convicted of insider trading and sentenced to 18 months in federal prison.[43] In the SEC's parallel civil proceeding, the court declined to grant a lifetime bar order against the defendant, finding that a lesser sanction would suffice to protect the public:

> Based upon the record, a permanent officer or director bar is not appropriate. Farrell's securities violations were serious and he did engage in fraudulent conduct in the hopes that his illegal activities would not be discovered. However, upon release from prison, he should not be barred from holding any other officer or director positions. Farrell is a talented executive and a permanent bar would effectively prevent him from using those talents to rebuild his life. *However, in view of Farrell's offenses, he is permanently barred from holding an officer/director position with any banking or financial institutions*.[44]

Referring to this and a similar case,[45] Cutler suggested "when it comes to O and D bars, the courts have simply lost their way."[46]

2. *Lifetime Bar Orders Against Defendants Who Were Officers or Directors at the Time of Their Misconduct*

Most of the lifetime bar orders entered under the Remedies Act were entered against officers or directors of public companies who had utilized their

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39. *Id.*

40. The case was later settled, with Patel accepting a lifetime bar order in exchange for paying a lower fine.

41. Stephen M. Cutler, Remarks at the Glasser Legal Works 20th Annual Federal Securities Institute (Feb. 15, 2002), *at* www.sec.gov/news/speech/spch538.htm.

42. *Id.*

43. SEC v. Farrell, Fed. Sec. L. Rep. (CCH) ¶ 99,365 (W.D.N.Y. Nov. 6, 1996).

44. *Id.* (emphasis added) (internal citations omitted).

45. SEC v. McCaskey, Fed. Sec. L. Rep. (CCH) ¶ 91,747 (S.D.N.Y Mar. 26, 2002) (prohibiting the defendant from serving as an officer or director of a public company for a period of six years).

46. Cutler, *supra* note 41.

position to engage in fraudulent activities. In some of the cases, recidivism was a salient factor. For example, in *SEC v. Chester Holdings, Ltd.*,[47] a lifetime bar order was entered against Joseph Pignatiello, the Chairman and CEO of a company found to have overstated its value in public filings by $11.7 million. Noting that Pignatiello was not a first-time offender, but that he had previously been "restrained, censured, fined, and even imprisoned for prior securities violations,"[48] the court concluded a lifetime bar order was appropriate.

Other cases focused on self-enrichment. In *SEC v. First Pacific Bancorp*,[49] a lifetime bar order was entered against Leonard Sands, the chairman and CEO of a bank holding company (and a lawyer) who misdirected the proceeds of two public offerings and also orchestrated several other transactions "which greatly and artificially inflated the value of the Bank."[50] Sands also "milked" the company and "received substantial personal benefit from the infusion of the illegally obtained proceeds."[51]

In *SEC v. Softpoint, Inc.*,[52] a lifetime bar order was entered against Ronald G. Stoecklein who, as president, chief operating officer, and director of a software company had created millions of dollars in fictitious sales in order to enhance his company's financial statements. "Coincident with his activities on behalf of Softpoint, Stoecklein enriched himself through insider trading in Softpoint common stock."[53]

Other cases resulting in a lifetime bar order against senior executives involved significant falsification of financial records,[54] orchestration of a stock manipulation scheme from which the executive benefited personally,[55] and insider trading in the employer's stock.[56] In each of these cases, the fact that the defendant

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47. 41 F. Supp. 2d 505, 531 (D.N.J. 1999).

48. *Id.* at 530.

49. 142 F.3d 1186 (9th Cir. 1998), *cert. denied*, 525 U.S. 1121 (1999).

50. *Id.* at 1193.

51. *Id.* at 1191.

52. 958 F. Supp. 846 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998).

53. *Id.* at 862. A similar case is SEC v. Solucorp Indus., 274 F. Supp. 2d 379 (S.D.N.Y. 2003) (officers and directors sold stock at inflated prices while falsifying the company's financial statements).

54. SEC v. Scorpion Techs., Inc., Litigation Release No. 17634, 2002 SEC LEXIS 1914 (July 29, 2002) (former Comptroller barred); SEC v. Hollywood Trenz, Inc., Litigation Release No. 17204, 2001 SEC LEXIS 2224 (Oct. 25, 2001) (former Chairman, President, CEO and CFO (all the same person) barred); SEC v. Sudikoff, Litigation Release No. 16663, 2000 SEC LEXIS 1774 (Aug. 28, 2000) (former Chairman and CEO and former president barred); SEC v. Safronchik, Litigation Release No. 15833, 1998 SEC LEXIS 1649 (Aug. 5, 1998) (former CEO barred); SEC v. Monus, Litigation Release No. 14716, 1995 SEC LEXIS 3095 (Nov. 9, 1995) (former President and former COO barred).

55. SEC v. Leung, Litigation Release No. 17458, 2002 SEC LEXIS 840 (April 4, 2002) (former chairman and president barred); SEC v. Zubkis, Litigation Release No. 17050, 2001 SEC LEXIS 1254 (June 25, 2001) (former president and CEO barred).

56. SEC v. Matus, No. 4:01CV359-PB, 2002 U.S. Dist. LEXIS 14225 (E.D. Tex. June 24, 2002) (former Senior Vice President of Investor Relations barred); SEC v. Vertucci, Litigation Release No. 16565, 2000 SEC LEXIS 1055 (May 25, 2000) (former CEO barred).

had been an officer or director of a public company and had abused the privileges of that position to advance the scheme (and usually to enrich himself) played a central role in the determination of the sanction.

Looking at any of these cases, few would question the finding of "substantial unfitness." Similarly, few would question the sanction selected based upon that finding.[57] I think that one can comfortably conclude that these cases, or a majority of them, were decided as Congress intended.

3. Lifetime Bar Orders Against Others

Occasionally, lifetime bar orders under the Remedies Act were entered against defendants who either were not officers or directors of any company, or were officers or directors of non-public companies at the time of their wrongdoing. In the latter category, one might consider Carl Robinson, the promoter of a company claiming to be engaged in the sale of "mobile wireless digital personal security alarm systems for cars, RV's and homes."[58] Robinson orchestrated a sale of unregistered stock over the internet that the court characterized as "nothing but a polite form of theft."[59] Even though Robinson had surely never served as an officer or director of a public company, and was unlikely to be asked to do so anytime soon, the magistrate judge recommended entry of a lifetime bar order.[60] The recommendation focused on Robinson's refusal to recognize that he had violated the law, and also on the "flagrant, indeed one might say outrageous" nature of his misrepresentations to investors.[61]

On at least three other occasions, lifetime bar orders were entered under the Remedies Act against defendants who were not public company officers or directors at the time of their wrongdoing and had no apparent history of ever having served in such a position. These defendants included a promoter who sold shares in an ostrich-breeding scheme without registering the shares,[62] organizers of two boiler room operations that netted them $3.7 million in a pump-and-dump scheme,[63] and organizers of an internet scheme involving the sale of $1.47 million in bogus securities.[64]

None of these cases resulted in a written decision and none were subject to appellate review. It is therefore difficult to assess the reasoning behind the imposition of a lifetime bar order in these cases. But it seems to me these decisions make little sense. In the words of criminologists David Weisburd and Elin Waring,

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57. Congress offered a range of sanctions upon a finding of "substantial unfitness." *See infra* Part IV, Figure 1 and accompanying text.

58. SEC v. Robinson, Fed. Sec. L. Rep. (CCH) ¶ 91,948 (S.D.N.Y. July 16, 2002).

59. *Id.*

60. *Id.*

61. *Id.*

62. SEC v. Trans-Am. Ostrich Traders, Inc., Litigation Release No. 15437, 1997 SEC LEXIS 1630 (Aug. 11, 1997).

63. SEC v. Tanner, Litigation Release No. 17790, 2002 SEC LEXIS 2631 (Oct. 17, 2002).

64. SEC v. Am. Healthcare Providers, Inc., Litigation Release No. 17530, 2002 SEC LEXIS 1359 (May 22, 2002).

these defendants were "flim-flam artists,"[65] not sophisticated or worldly men. They had never served as an officer or director of a public company and, more importantly, had little prospect of ever doing so, with or without the imposition of a lifetime bar order.

One might argue, of course, that the defendants in these cases were in fact "substantially unfit to serve" in the sense that no reasonable person would select them to be an officer or director. Their education, skill set, social class, lack of professional contacts, and inexperience in the mainstream business world all would work against them in the market for high-level corporate appointments. So would the federal disclosure requirements that would compel disclosure of their prior bad acts.[66] Thus, one might argue, the bar order was nothing more to these defendants than a harmless indignity or an act of "expressive justice."[67]

Are these decisions, however, really what Congress had in mind when it passed the Remedies Act? The use of lifetime bar orders in these cases suggests that *every* Rule 10b-5 violator could be found "substantially unfit" to serve as an officer or director of a public company, a conclusion that Congress could easily have reached and written into the Remedies Act but—significantly—did not.[68]

C. The Sarbanes-Oxley Act Formulation

The Sarbanes-Oxley Act altered the provisions of the Remedies Acts in two important respects. First, in addition to being authorized to seek suspension bar orders in federal court proceedings, the SEC was given authority to enter

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65. DAVID WEISBURD & ELIN WARING, WHITE-COLLAR CRIME AND CRIMINAL CAREERS 80 (2001).

66. *See* SEC Regulation S–K, Item 401(f), 17 C.F.R. § 229.401(f) (2004) (requiring disclosure of legal proceedings brought against a director, nominee, or executive officer, within the past five years); *id.* Item 401(e), § 229.401(e) (requiring disclosure of business experience); SEC Rule 408, 17 C.F.R. § 230.408 (2004) (requiring disclosure of other material information).

67. Dan M. Kahan, *Social Influence, Social Meaning and Deterrence,* 83 VA. L. REV. 349, 383 (1997).

68. There are several federal statutes which automatically bar a person from specific occupations, upon a finding that they violated a federal statute. *See, e.g.*, 5 U.S.C. § 8902a(b)(1) (2004) (foreclosing health care providers "convicted . . . of a criminal offense relating to fraud, corruption, breach of fiduciary responsibility, or other financial misconduct in connection with the delivery of a health care service" from participation in the Medicare program); 21 U.S.C. 335a(a) (2004) (foreclosing individuals convicted of an FDA-related felony from seeking approval for a generic drug product); 21 U.S.C. § 467 (2004) (permitting denial of food inspection services to anyone who has been convicted within the previous ten years of a felony related to food handling or distribution); 29 U.S.C. § 504(a)(5) (2003) (establishing that the conviction for robbery, bribery, extortion, embezzlement, grand larceny, burglary, arson, violation of narcotics laws, or violent crimes bars the offender from serving as an officer, director, trustee, member of any executive board, business manager, or representative of any labor organization for at least three years); 29 U.S.C. § 1111(a)(3) (2003) (establishing that the conviction for robbery, bribery, extortion, embezzlement, grand larceny, burglary, arson, violation of narcotics laws, or violent crimes bars the offender from serving as an officer, director, trustee, custodian, counsel, agent, employee or representative in any capacity of an employee benefit plan for at least three years).

suspension and bar orders in cease-and-desist proceedings conducted internally.[69] Second, the standard for entering a suspension or bar order was amended from "substantial unfitness" to "unfitness."[70] Regrettably, there is no legislative history to suggest what Congress may have meant by "unfitness."[71] Nor is there much useful guidance from the use of the term "unfitness" in other federal statutes.[72] One thing is clear—the term "unfitness" was intended to suggest a lower standard of proof than the previous standard under the Remedies Act. To date, however, no court has had occasion to interpret the new "unfitness" standard.[73] That is why this Article exists—to provide guidelines for federal courts that inevitably will be called upon to do so.[74]

III. WHAT CONDUCT CHARACTERIZES THE "UNFIT" DEFENDANT?

Now that Congress has indicated an intention to permit the imposition of a lifetime bar order where a defendant can be shown to be unfit to serve, the critical question is what constitutes "unfitness"? In the absence of any legislative guidance on this issue, or any understanding that "unfitness" is a term that may be construed with reference to other federal statutes,[75] courts must turn to analogous areas of the law. This section explores four such areas, in which questions of executive unfitness—though not always characterized specifically in that

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69. 15 U.S.C. § 77h-1(f) (2004); 15 U.S.C. § 78u-3(f) (2004).

70. 15 U.S.C. § 77t(e) (2004); 15 U.S.C. § 78u(d)(2) (2004).

71. *See* Jayne W. Barnard, *SEC Debarment of Officers and Directors After Sarbanes-Oxley*, 59 BUS. LAW. 391, 407–08 (2004) (noting the dearth of legislative history).

72. The term "unfit" or "unfitness" is used in several federal statutes, covering such items as grain, livestock, railroad equipment, river steamboats, sailing vessels, medals and lapel buttons, paper currency, buildings, cars, milk, food products, medical supplies, spirits and wines, horses and mules, stamps, and military personnel.

73. One reason for this dearth of case law is the Commission's preference for seeking suspension and bar orders through a cease-and-desist proceeding rather than having to go to court. *See* Barnard, *supra* note 71, at 401–02 (explaining why this is more attractive to the Commission). Another reason is the high rate of settlements in SEC civil cases.

74. Two commentators have already suggested ways of interpreting the "unfitness" provision. Professor Langevoort has suggested that "the new statutory language should be read in a way that presumes the propriety of a bar order from any finding of serious, intentional securities fraud." Donald C. Langevoort, *Managing the "Expectations Gap" in Investor Protection: The SEC and the Post-Enron Reform Agenda*, 48 VILL. L. REV. 1139, 1158 (2003).

A recent student note suggests that courts may construe "unfitness" in one of two ways:

> On one hand, courts could completely reject the six-part test from Patel II and allow the SEC to issue officer and director bars almost any time securities laws have been violated. On the other hand, courts could interpret the change to be only a slight adjustment, and thus continue to apply the existing test with only a slight increase in strictness.

Philip F.S. Berg, Note, *Unfit to Serve: Permanently Barring People From Serving as Officers and Directors of Publicly-Traded Companies After the Sarbanes-Oxley Act*, 56 VAND. L. REV. 1871, 1888 (2003).

As is obvious from what follows in the balance of this Article, I believe the issue is a little more complex than either Professor Langevoort or Mr. Berg suggests.

75. *See supra* note 72.

language—have been at issue. It is fair to say that these bodies of decisional law share some common themes: misuse of corporate resources, personal enrichment, stealth and concealment, arrogance and grandiosity, and lack of contrition.

What follows is a brief survey of these areas of the law, designed to illustrate these themes. None of the cases alone define unfitness as one might assume Congress intended in the Sarbanes-Oxley Act. Taken together, however, these cases suggest the kinds of behaviors that might form the basis for a judicial finding of unfitness.

A. Bankruptcy Law

Questions of executive unfitness arise under federal bankruptcy law when a corporation has filed in Chapter 11, and the court considers whether incumbent management should be replaced by a court-appointed trustee. The grounds for an appointment include "fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management."[76] The presumption is always *against* appointment of a trustee.[77]

Courts have concluded that the criteria for removing the debtor's executives and replacing them with a trustee are satisfied where the executives are found to have looted the company by accepting payment of kickbacks from vendors,[78] where they have enriched themselves personally by the unauthorized receipt of corporate funds,[79] and where they have misdirected corporate funds, largely to support their extravagant lifestyles.[80] The criteria have also been satisfied where executives have authorized excessive compensation for themselves and borrowed substantial funds from the debtor for their own use,[81] where executives have authorized loan forgiveness for themselves and used corporate funds for purely personal expenses,[82] and where executives have orchestrated complex transactions that benefit themselves at the creditors' expense.[83] In each of these cases, the implicit finding has been that, due to the improper exploitation of their executive positions for personal gain, the incumbent managers should be replaced.

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76. 11 U.S.C. § 1104(a)(1) (2004).

77. *See In re* Marvel Entm't Group, Inc., 140 F.3d 463, 471 (3d Cir. 1998) (noting that there is a "strong presumption" against appointing an outside trustee).

78. *In re* Bibo, Inc., 76 F.3d 256 (9th Cir. 1996) (affirming appointment of a trustee).

79. *In re* Am. Res., Ltd., 54 B.R. 245, 246–47 (Bankr. D. Haw. 1985) (finding cause for appointment of a trustee).

80. *In re* La Sherene, Inc., 3 B.R. 169 (Bankr. N.D. Ga. 1980) (finding cause for appointment of a trustee).

81. *In re* N. Am. Communications, Inc., 138 B.R. 175 (Bankr. W.D. Pa. 1992) (finding cause for appointment of a trustee).

82. *In re* Intercat, Inc., 247 B.R. 911 (Bankr. S.D. Ga. 2000) (finding cause for appointment of a trustee).

83. *In re* Sharon Steel Corp., 871 F.2d 1217 (3d Cir. 1989) (affirming appointment of a trustee where, among other actions, the day before the Chapter 11 petition was filed, management transferred $3.7 million to another corporation under management's control and the record reflected numerous pre-petition transfers of that "amounted at best to voidable preferences and at worst to fraudulent conveyances").

B. Employment Law

Questions of executive unfitness arise in employment law cases when a high-level employee is fired or demoted and sues for wrongful termination. Typically, the defense is that the employee was fired "for cause" under the terms of her contract. Whether the employee's termination was in fact "for cause" often has implications for her access to stock options, severance benefits, retirement benefits, health care coverage, and future job possibilities.

The question of what constitutes "cause" for termination is often determined by the text of the employment contract. Sometimes the contract leaves unfortunate loopholes.[84] Generally, however, behavior like accepting gratuities in violation of company policy,[85] utilizing employees, equipment and assets in furtherance of personal, extra-corporate activities,[86] borrowing money from the company and then refusing to repay it,[87] "deceptive conduct" regarding conflicts of interest,[88] and misappropriation of corporate funds[89] all support a "for cause" finding. As in the bankruptcy cases, the employment cases focus on self-enrichment at the company's expense, as well as behavior one might characterize as "clandestine."

C. Banking Law

Questions of executive unfitness arise under federal banking law when regulatory officials determine that a banking official should be removed from office and prohibited from serving as an officer or director at *any* insured depository institution. This body of law has special application to the unfitness inquiry under the Sarbanes-Oxley Act because, unlike the bankruptcy law and employment law cases, which are company-specific, the banking law cases apply industry-wide.

The standard for an order of prohibition has multiple elements. First, there must have been a direct or indirect violation of a statute, administrative order, or contractual agreement with the bank regulatory agency.[90] In the alternative, the defendant must have engaged in unsafe or unsound lending

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84. *See, e.g.*, Fields v. Thompson Printing Co., 363 F.3d 259 (3d Cir. 2004) (holding that a continuation of benefits provision in an executive's contract did not include a "conduct-related exception," so that he was entitled to receive his salary, health and pension benefits notwithstanding multiple allegations of sexual harassment against him).

85. Welland v. Citigroup, Inc., No. 00 CIV.738, 2003 WL 22973574 (S.D.N.Y. Dec. 17, 2003) (characterizing termination of vice-president's employment as meeting the "for cause" standard and granting summary judgment to the defendant).

86. Ruzicka v. Hart Printing Co., 21 S.W.3d 67, 71 (Mo. Ct. App. 2000) (characterizing termination of vice-president and chief operating officer's employment as meeting the "for cause" standard).

87. Bono v. Chicago Sun-Times, Inc., 707 F. Supp. 363, 368 (N.D. Ill. 1989) (finding vice-president's discharge to have been "for cause").

88. O'Connor v. Certainteed Corp., No. CIV.A.87-3866, 1990 U.S. Dist. LEXIS 1683 (E.D. Pa. Dec. 17, 1990) (finding grounds for a "for cause" dismissal).

89. Sim v. Bauregard Elec. Coop, Inc., 322 So. 2d 410, 417 (La. Ct. App. 1975) (finding manager's discharge to have been "for cause").

90. 12 U.S.C. § 1818(e)(1)(A)(i) (2004).

practices or “committed or engaged in any act, omission, or practice which constitutes a breach of [that person’s] fiduciary duty.”[91] Second, the action must have caused financial loss or other damage to the banking institution or resulted in a financial gain to the defendant.[92] Third, the action must have involved “personal dishonesty” or “demonstrate willful or continuing disregard by [the person] for the safety or soundness of [the banking institution].”[93] These elements are known, respectively, as “misconduct,” “effect,” and “culpability” and all must be proven in order to support the entry of a prohibition order against a banking official.[94] The process does *not* purport to assess the defendant’s current competence or whether he presents a current risk of harm.[95]

Misconduct that is merely “technical” or “inadvertent” is insufficient to support a prohibition order.[96] So are mere “accounting irregularities.”[97] The general rule is that, to support a prohibition order, the bank regulatory agency must show something more than “merely stating that [the defendant] violated a law or regulation or breached his fiduciary duty.”[98] It must also show the defendant acted with “personal dishonesty,” either by making affirmative misrepresentations to other banking officials or the government or by withholding material information.[99] These requirements are strictly construed.[100]

Courts have been sensitive to the fact that Congress is wary of prohibition orders against banking executives.[101] Even so, most prohibition orders have been

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91. *Id.* § 1818(e)(1)(A)(ii), (iii).

92. *Id.* § 1818(e)(1)(B).

93. *Id.* § 1818(e)(1)(C). A parallel statute, applicable to the Farm Credit System, appears at *id.* § 2264(a).

94. Oberstar v. FDIC, 987 F.2d 494, 500 (8th Cir. 1993).

95. Proffitt v. FDIC, 200 F.2d 855, 865 (D.C. Cir. 2000). *See also* United States v. Stoller, 78 F.3d 710, 723 (1st Cir. 1996) (“[A] debarment order may properly be said to work rough remedial justice without a detailed prognostication regarding the probable extent of the wrongdoer’s future misconduct, if unchecked.”).

96. *Oberstar*, 987 F.2d at 502.

97. Doolittle v. Nat’l Credit Union Admin., 992 F.2d 1531, 1537 (11th Cir. 1993).

98. *Id.* at 1539.

99. *See* Van Dyke v. Bd. of Governors, 876 F.2d 1377, 1379 (8th Cir. 1989) (noting that “personal dishonesty” does not require proof of civil fraud. Rather, “personal dishonesty” “could encompass a broad range of conduct,” including “misrepresentation of facts and deliberate deception by pretense and stealth”). Backdating documents may satisfy the “personal dishonesty” requirement. Hendrickson v. FDIC, 113 F.3d 98, 103 (7th Cir. 1997). So may paying or receiving bribes. Cousin v. OTS, 73 F.3d 1242, 1252 (2d Cir. 1996).

100. *See* Kim v. OTS, 40 F.3d 1050, 1055 (9th Cir. 1994) (vacating prohibition order for failure to show personal dishonesty).

101. *See In re* Seidman, 37 F.3d 911, 926 n.18 (3d Cir. 1994) (citing legislative history to the effect that “[t]he power to suspend or remove an officer or director of a bank or savings and loan association is an extraordinary power, which can do great harm to the individual affected and to his institution and to the financial system as a whole. It must be strictly limited and carefully guarded.”); Anonymous v. FDIC, 619 F. Supp. 866, 871 (D.D.C. 1985) (“[B]oth a reading of the statutory language and an examination of the

upheld, particularly in times of stress in the banking industry.[102] Most prohibition orders today are entered by consent.[103]

Prohibition orders have been sustained against banking officials where a bank officer misled the bank's board about the nature of a funding scheme that he characterized as likely to help the bank, while in fact it was an exercise in "self dealing" and "for the good of [the defendant] at the expense of [the bank]";[104] where a bank officer falsified bank records to conceal an unlawful bonus he had received;[105] and where a bank officer engaged in a check-kiting scheme to disguise his significant overdrafts.[106] Prohibition orders have also been sustained where two bank directors authorized loans to partnerships controlled by them without making appropriate disclosures to other board members,[107] and where a bank CEO directed payments to himself through use of the bank's "miscellaneous expense" account and then misrepresented the use of that account in reports to the federal government.[108] In one case, a prohibition order was sustained where a bank director repeatedly borrowed funds in excess of the bank's lending limits, even in the face of directives from bank examiners that he must repay the loans.[109] These cases suggest that, as in the bankruptcy and employment law cases, the key factors in the banking law cases are self-enrichment and non-disclosure. The banking cases also raise issues of fraud, corruption, and outright defiance of the law.

D. Securities Law

Questions of executive unfitness arise under the federal securities laws when an executive in a brokerage firm, an investment company, or an investment advisory firm is barred for life from associating with any such firm. The typical ground for entry of a lifetime bar order is that the employee "willfully violated" a provision of the federal securities laws[110] or "willfully filed" misleading

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legislative history indicate that Congress intended that the FDIC's power to remove or suspend bank officers be carefully limited.").

102. *See, e.g.*, *Hendrickson*, 113 F.3d at 104 (noting the recent history of mismanagement of federally insured depository institutions).

103. E-mail from Ronald G. Schneck, Director for Special Supervision, Office of Comptroller of the Currency, to Jayne W. Barnard (July 13, 2004) (on file with Author); e-mail from John Henrie, Chief, Risk Management Applications Section, FDIC, to Jayne W. Barnard (Sept. 10, 2004) (on file with Author).

104. Landry v. FDIC, 204 F.3d 1125, 1130 (D.C. Cir. 2000), *cert. denied*, 531 U.S. 924 (2000) (internal quotations omitted).

105. Jameson v. FDIC, 931 F.2d 290, 291 (5th Cir. 1991).

106. Van Dyke v. Bd. of Governors, 876 F.2d 1377, 1380 (8th Cir. 1989).

107. Greenberg v. Bd. of Governors, 968 F.2d 164, 170 (2d Cir. 1992).

108. Magee v. Greenspan, 808 F. Supp. 847, 850 (D.D.C. 1991).

109. Grubb v. FDIC, 34 F.3d 956 (10th Cir. 1994). The defendant in this case "often treated the Bank's resources as if they were his personal purse which he might employ without regard to regulatory constraints." *Id.* at 961.

110. 15 U.S.C. § 80a-9(b)(2) (2004) (permitting lifetime bar of persons associated with investment companies).

documents with the Commission.[111] In considering whether to sanction a defendant, the SEC typically considers several factors:

> [T]he egregiousness of the defendant's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the defendant's assurances against future violations, the defendant's recognition of the wrongful nature of his conduct, and the likelihood that the defendant's occupation will present opportunities for future violations.[112]

In reality, though, the SEC must establish only two things to withstand a challenge to a lifetime bar order: first, that the defendant's violation of the securities laws was "willful"[113] and, second, that the Commission's choice of sanction was not an abuse of discretion.[114]

Given this standard, and the high degree of deference typically accorded to the Commission's decisions,[115] lifetime bar orders against securities professionals have generally been upheld by the federal courts. Arguments that the defendant was a first-time offender,[116] or that he relied on advice of counsel,[117] or

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111. *Id.* § 78*o*(b)(4)(D) (permitting lifetime bar of persons associated with a brokerage firm); *id.* § 80a-9(b)(1) (permitting lifetime bar of persons associated with investment companies); *id.* § 80b-3 (permitting lifetime bar of persons associated with investment advisers).

112. *In re* Jett, Securities Act Release No. 8395, 2004 SEC LEXIS 504 (Mar. 5, 2004). The factors considered by the NASD in its disciplinary proceedings against securities professionals are similar:

> 1) prior or other similar misconduct; 2) attempts to conceal conversion, misappropriation, or misuse; 3) forgery of documentation or customer's signature; 4) duration of the period the securities or funds were converted; 5) essentially stealing versus mistaken belief of authority to use; 6) value of converted, misappropriated or misused funds or securities (loss to customer); 7) prompt and voluntary restitution, clear evidence that the funds or securities were returned to the customer; 8) other aggravating or mitigating factors.

Otto v. SEC, 253 F.3d 960, 966 (7th Cir. 2001).

113. "Willfulness" in this context means intentionally or recklessly committing an act that constitutes a violation of the securities laws. The defendant need not be aware that he is violating a specific Act or rule. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000).

114. Lowry v. SEC, 340 F.3d 501, 504 (8th Cir. 2003) ("The court's role is to decide only whether, under the applicable statute and the facts, the agency made 'an allowable judgment in its choice of the remedy.'" (quoting Jacob Siegel Co. v. FTC, 327 U.S. 608, 612 (1946))); Svalberg v. SEC, 876 F.2d 181, 185 (D.C. Cir. 1989) ("The main point is that a court should not second-guess the judgment of the Commission in connection with the imposition of sanctions, unless the [Commission] has acted contrary to law, without basis in fact or in abuse of discretion."); Tager v. SEC, 344 F.2d 5, 9 (2d Cir. 1965) ("Failing a gross abuse of discretion, the courts should not attempt to substitute their untutored views as to what sanctions will best accord with the regulatory powers of the Commission.").

115. *See, e.g.*, *Otto*, 253 F.3d at 964 (describing the court's review of the SEC's findings as "highly deferential").

116. O'Leary v. SEC, 424 F.2d 908, 909 (D.C. Cir. 1970).

117. *Wonsover*, 205 F.3d at 415.

that he cooperated with the government and deserves a second chance,[118] or that investors did not lose any money[119] all have failed to persuade the courts to reverse the entry of a lifetime bar order. Not surprisingly, courts have refused to consider whether similar conduct has given rise to lesser sanctions in other cases.[120] Perhaps more surprisingly, they have refused to require the Commission to demonstrate that a lifetime bar order is the least restrictive means of protecting the investing public.[121] That is, even though lesser sanctions (such as a finite-term suspension or a requirement of supervision) are available under the applicable statute, the Commission is not required to calibrate its sanctions. The upshot of all this decisional law is that many securities professionals—street-level brokers, their supervisors, and investment advisers—now accept a lifetime bar order by consent.[122]

In contested cases, lifetime bar orders have been upheld against executives of brokerage or advisory firms where the vice-president of a brokerage firm churned customers' accounts and doctored records prepared for his firm's compliance officers,[123] where the owner of an advisory firm promoted investments that benefited him personally without making appropriate disclosure to his clients,[124] and where the president and vice president of a brokerage firm engaged in manipulation through nominee accounts that inured to their personal benefit.[125] Two factors—secrecy and stubbornness—play an important role in these cases. Secrecy appears in cases involving practices designed to avoid detection by

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118. *Tager*, 344 F.2d at 7–8.

119. Jones v. SEC, 115 F.3d 1173, 1184 (4th Cir. 1997).

120. Geiger v. SEC, 363 F.3d 481, 488 (D.C. Cir. 2004); Lowry v. SEC, 340 F.3d 501, 507 (8th Cir. 2003); Hiller v. SEC, 429 F.2d 856, 858 (2d Cir. 1970). Courts may, however, consider all kinds of unrelated misconduct in determining whether a securities professional should be permitted to continue in the securities business. *See, e.g.*, Marketlines, Inc v. SEC, 384 F.2d 264, 267 (2d Cir. 1967) (finding that a decade-old disbarment was "quite relevant to a determination as to whether it is in the public interest for [the defendant] to continue as an investment adviser").

121. Rizek v. SEC, 215 F.3d 157, 161 (1st Cir. 2000).

122. *See, e.g.*, *In re* Nichols, Admin. Proc. File No. 3-11534, 83 SEC Docket 449 (July 1, 2004) (noting that the defendant had consented to an order barring him from association with any broker, dealer or investment adviser); *In re* Hawkesworth, Admin. Proc. File No. 3-11531, 83 SEC Docket 573 (June 30, 2004) (noting that the defendant had consented to an order barring him from association with any broker or dealer); *In re* Farnell, Admin. Proc. File No. 3-11510, 82 SEC Docket 3461 (June 4, 2004) (same); *In re* Fine, Admin. Proc. File No. 3-11520, 83 SEC Docket 47 (June 15, 2004) (noting that the defendant had consented to an order barring him from association with any broker or dealer).

123. *Rizek*, 215 F.3d at 162 ("While his customers lost $195,000, Rizek received about $125,000 in commissions.").

124. *Lowry*, 340 F.3d at 503. A similar case resulting in a suspension rather than a bar order is Vernazza v. SEC, 327 F.3d 851, 858–59 (9th Cir. 2003) ("[P]etitioners made materially false statements when they claimed not to recommend securities in which they had an ownership or sales interest, not to receive economic benefits in connection with giving advice to clients, and not to recommend securities in which they had a financial interest.").

125. Pagel, Inc. v. SEC, 803 F.2d 942 (8th Cir. 1986).

compliance officers and regulators.[126] Stubbornness appears where the defendant refuses to admit he violated the law.[127]

The cases involving senior-level brokerage officials, like the banking cases, suggest that a finding of unfitness may be appropriate where the defendant has used her role and expertise to secure personal gain, and also where the defendant has withheld material information under circumstances requiring her to be forthcoming.

E. How These Cases Can Help Us Think About the "Unfitness" Inquiry Under the Sarbanes-Oxley Act

The foregoing cases present some common themes. If one were to look only at these cases, it might be reasonable to conclude that the elements of "unfitness" under the Sarbanes-Oxley Act should be the following:[128] misuse of corporate resources; affirmative misrepresentations; stealth and concealment; arrogance or grandiosity; personal enrichment; and lack of contrition.

Applying only these factors, one might argue that persons who orchestrate financial reporting violations while selling their shares at inflated prices,[129] persons who engage in insider trading in the companies they lead through

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126. Reddy v. CFTC, 191 F.3d 109, 125 (2d Cir. 1999) (upholding revocation of commodities trader's registration where the challenged transactions were "difficult to detect").

127. *See, e.g.*, *In re* First Jersey Sec., Admin. Proc. File No. 3-8699, 67 SEC Docket 650 (May 29, 1998) (entering a lifetime bar order where the defendant "evidenced no remorse for the massive losses he caused to unsuspecting investors"); *In re* Ialeggio, Admin. Proc. File No. 3-8925, 67 SEC Docket 471 (May 27, 1998), *aff'd*, 1999 U.S. App. LEXIS 10362 (9th Cir. May 20, 1999) (affirming the NASD's disciplinary sanction, where the defendant "displayed neither the understanding that his conduct . . . was improper, nor remorse for his actions"); *In re* Osborne, Admin. Proc. File No. 3-9008, 65 SEC Docket 505 (Aug. 18, 1997) (entering a lifetime bar order where the defendant "displayed no remorse or appreciation of his misconduct"); *In re* Johnston, Admin. Proc. File No. 3-7528, 51 SEC Docket 1403, at *36–37 (June 23, 1992) (entering a lifetime bar order against one defendant where "he ha[d] no remorse for what he did, [and had] not acknowledged any wrongdoing," while imposing only a thirty-day suspension on another defendant who "showed remorse for her actions" and was found by the Administrative Law Judge to be a "smart, honest person who is much wiser today than she was during the relevant period"); *In re* Elliott, Admin. Proc. File No. 3-7280, 47 SEC Docket 728 (Oct. 24, 1990), *aff'd* 36 F.3d 86 (11th Cir. 1994) (entering a lifetime bar order where the defendant maintained his innocence in spite of the fact that the sentencing judge in his criminal case found that he had participated in a "typical Ponzi scheme" and "a massive fraud"); *see also* Jones v. SEC, 115 F.3d 1173, 1184 (4th Cir. 1997) (upholding a twelve-month suspension where the defendant insisted that "he had done nothing wrong"); CFTC v. Heffernan, 274 F. Supp. 2d 1375, 1381 (S.D. Ga. 2003) (affirming an injunction where the defendant "persist[ed] in his belief that he [had] done no wrong"); Abdo v. United States, 234 F. Supp. 2d 553, 566 (M.D.N.C. 2002) (entering lifetime bar order against a tax preparer who "continued to assert his frivolous and unrealistic positions" and "continu[ed] to steadfastly deny any culpability or wrongdoing").

128. In fact, this list, though helpful, is incomplete, as I will discuss more fully in Section V.B.

129. *See* SEC v. Henke, 275 F. Supp. 2d 1075, 1086 (N.D. Cal. 2003) (former chairman and CEO of public company is barred, following guilty plea to criminal charges of

the use of nominee or offshore accounts,[130] and persons who, having misused their positions as corporate officers or directors, refuse to acknowledge the nature of their wrongdoing,[131] may reasonably be found unfit to serve under Sarbanes-Oxley. On the other hand, one could conclude that persons swept up in financial reporting violations but who do not personally profit therefrom,[132] persons who engaged in garden-variety insider trading (trading in the stock of somebody else's company based on a social or familial tip),[133] and persons who confess the error of their misconduct, assist the government and demonstrate their contrition should not be found unfit to serve.

Approaching "unfitness" using only these six considerations would eliminate the need for courts to make a finding that the defendant presents a

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insider trading, in light of the fact that "[he] was aware of and actively participated in the accounting fraud resulting in an inflated stock price"); SEC v. Rice, Litigation Release No. 18815, 2004 SEC LEXIS 1652 (July 30, 2004) (former CEO of Enron Broadband agrees to be barred where he orchestrated dissemination of misleading information then "sold large amounts of Enron stock at the inflated levels, at a time when he knew that [his prior] statements were false and misleading and . . . was in possession of material non-public information concerning the true status of EBS' technology and commercial success"); SEC v. Delainey, Litigation Release No.18435, 2003 SEC LEXIS 2592 (Oct. 30, 2003) (former Enron executive agrees to be barred, following guilty plea to criminal charges of insider trading from which he received some $4.26 million in unlawful proceeds). In private securities litigation, plaintiffs state a cause of action where they can allege that "defendants sold their own shares while at the same time misrepresenting corporate performance in order to inflate stock prices." *In re* Loral Space & Communications Ltd., Sec. Litig., Fed. Sec. L. Rep. (CCH) ¶ 92,696, at 18 (S.D.N.Y. Feb. 27, 2004).

130. *See* SEC v. Waksal, Litigation Release No. 18026, 2003 SEC LEXIS 570 (March 11, 2003) (former Imclone CEO agrees to be barred, after having directed his family members to sell their Imclone shares in advance of an adverse FDA ruling and also purchased put option contracts through his own Swiss brokerage account).

131. *See* SEC v. First Pac. Bancorp, 142 F.3d 1186, 1193–94 (9th Cir. 1998) (affirming lifetime bar order where the defendant "utterly failed to recognize the wrongful nature of his conduct"); SEC v. Robinson, No. 00 CIV.7452, 2002 U.S. Dist. LEXIS 12811 (S.D.N.Y. July 16, 2002) (recommending a lifetime bar order where the defendant "continues to deny wrongdoing in the face of overwhelming evidence, preferring instead to claim that the SEC's entire investigation was the product of racial bias"); SEC v. Softpoint, Inc., 958 F. Supp. 846, 867 (S.D.N.Y. 1997) (entering a lifetime bar order where the defendant "adamantly maintain[ed] that his involvement in Softpoint's financial manipulations was entirely legitimate or unknowing. He depict[ed] himself as an unwitting participant in schemes concocted by . . . other Softpoint officers.").

132. A case in point is Jamie Olis, former Senior Director—Tax Planning for Dynegy, Inc. Olis was involved in Project Alpha, a scheme for which he was recently sentenced to twenty-four years in federal prison. It is widely understood that Olis did not profit personally from the scheme. Interestingly, the SEC in its civil action did not seek a lifetime bar against Olis, or even a finite-term suspension order. (It did seek a permanent injunction, a disgorgement order and a civil penalty.) SEC v. Foster, Litigation Release No. 18188, 2003 SEC LEXIS 1416 (June 12, 2003).

133. *See, e.g.*, SEC v. Sargent, 329 F.3d 34, 40 (lst Cir. 2003) (affirming the denial of an injunction and civil penalties for a defendant who received a tip of non-public information and bought stock, in light of the fact that the violation was "isolated and unsophisticated," the trader (a dentist) was "unlikely to be privy to inside information" in the future, and he acknowledged "the wrongfulness of his conduct").

“likelihood of future misconduct” in the role of public company officer or director. That is, as is now done in the banking law cases,[134] district courts might take a largely backward-looking approach to the question of unfitness rather than trying to predict the future. Certainly such an approach would make sense since predicting white-collar recidivism is so difficult and unreliable. Criminologists, who have spent their careers studying recidivism, can offer little in the way of predictive markers.

We do know that, among defendants convicted of securities fraud in a criminal proceeding, fewer than one-quarter are ever again arrested for *any* offense, including relatively common offenses such as drunk driving and non-payment of taxes.[135] As compared to other white-collar offenders, this rate of re-offending is low.[136] We also know that defendants convicted of securities fraud who do later recidivate often violate laws other than the securities laws. They are not, in criminological terms, “specialists” in securities fraud. The “securities fraud specialist” category is, in fact, quite small.[137]

There is a simple explanation for this low rate of recidivism: the majority of securities law violators are not “career criminals.” As Professor Langevoort has pointed out, many securities law violations are situational and not the product of a corrupt or criminal character.[138] They occur because senior level executives put

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134. *See supra* note 95.

135. WEISBURD & WARING, *supra* note 65, at 29 tbl. 2.2 (noting that, of 155 defendants convicted of securities fraud between 1976 and 1978, only 24.5% were ever arrested following the criterion offense). In a more recent study, only 16.9% of defendants convicted of fraud in FY 1992 were rearrested. U.S. SENTENCING COMM’N, MEASURING RECIDIVISM: THE CRIMINAL HISTORY COMPUTATION OF THE FEDERAL SENTENCING GUIDELINES: A COMPONENT OF THE FIFTEEN YEAR REPORT ON THE U.S. SENTENCING COMMISSION’S LEGISLATIVE MANDATE 13 (May 2004) [hereinafter MEASURING RECIDIVISM], *available at* http://www.ussc.gov/publicat/recidivism_General.pdf. Such offenders are “overall the least likely to recidivate.” *Id.*

136. For example, of the 119 defendants convicted of credit fraud between 1976 and 1978, 45.4% were arrested following the criterion offense. The figure for mail fraud defendants was 39.2%. WEISBURD & WARING, *supra* note 65, at 29 tbl. 2.2. Of the 968 defendants convicted of *any* white collar crime between 1976 and 1978, 31.3% were arrested following the criterion offense. *Id.* at 28 tbl. 2.1.

137. In fact, we know very little about specialization of white collar offenders. Studies have shown that white collar offenders “are somewhat more likely to specialize in white-collar crimes than common offenders [are likely to specialize in common offenses], but also display versatility in their offending.” Michael L. Benson & Elizabeth Moore, *Are White Collar and Common Offenders the Same? An Empirical and Theoretical Critique of a Recently Proposed General Theory of Crime*, 29 J. RES. CRIME & DELINQ. 251, 262 (1992). The most recent study of white collar offenders concludes only that “securities offenders are more likely than others to be exclusively involved in white-collar crime . . . .” WEISBURD & WARING, *supra* note 65 at 46.

138. Donald C. Langevoort, *Technological Evolution and the Devolution of Corporate Financial Reporting*, 46 WM. & MARY L. REV. 1, 3 (2004) (noting the situational nature of many securities frauds in the 1990s). Professor Baucus has described the kinds of situational influences that often lead to misconduct by corporate employees—pressure from superiors, opportunity, and the corporate culture (which she calls “predisposition”). Melissa

pressure on subordinates to bend or ignore the rules,[139] because employees want to be seen as "good soldiers" and "team players" so go along with their bosses' illegal practices,[140] and because executives become committed—sometimes irrationally—to maintaining the appearance of their company's success.[141] Contrary to popular folklore, these defendants frequently are driven as much by loyalty (or fear) as they are by greed.[142] It should therefore not be surprising that the rate of re-offending by securities law violators is so low.[143]

S. Baucus, *Pressure, Opportunity and Predisposition: A Multivariate Model of Corporate Illegality*, 20 J. MGMT. 699 (1994).

139. *See HealthSouth Executive Pleads Guilty in Fraud Case*, N.Y.TIMES, Nov. 25, 2003, at C3 (reporting that Catherine Fowler, a former cash manager and vice president of HealthSouth, had hidden a twenty-seven million dollar transaction at the request of the company's chief financial officer); Susan Pulliam, *Over the Line: A Staffer Ordered to Commit Fraud Balked, Then Caved—Pushed by WorldCom Bosses, Accountant Betty Vinson Helped Cook the Books—A Confession at the Marriott*, WALL ST. J., June 23, 2003, at A1 (describing how a senior manager in WorldCom's accounting department was directed by her boss to transfer $828 million from a reserve account, in violation of accounting rules, then later was directed to make another $771 million transfer).

140. *See* Peter Grant, *Adelphia Insider Tells of Culture of Lies at Firm—Government's Star Witness Says Manipulation of Reports Began Soon After Company Went Public*, WALL ST. J., May 19, 2004, at C1 (noting that executives "regularly fabricated statistics on the number of subscribers, cash flow, cable-system upgrades and other closely followed metrics"). The company's former vice president of finance testified that he lied to investors, lied in public filings and lied regularly in press releases, in part, because of his close personal friendship with the firm's chief financial officer, Tim Rigas. *Id.*

141. *See Former CEO Indicted in WorldCom Scandal*, SEATTLE TIMES, March 3, 2004, at El (noting that, in pleading guilty to securities fraud, WorldCom CFO Scott Sullivan told the court "I took these actions, knowing that they were wrong, in a misguided effort to preserve the company to allow it to withstand what I believed were temporary financial difficulties."). The 1990s saw many efforts designed to make companies' quarterly earnings figures look better than they really were. *See* ALEX BERENSON, THE NUMBER: HOW THE DRIVE FOR QUARTERLY EARNINGS CORRUPTED WALL STREET AND CORPORATE AMERICA (2003).

142. *See* Langevoort, *supra* note 138, at 6 (noting that executives at Enron and WorldCom had motives other than maintaining the value of their stock or stock options).

> The fact that so many of the executives in these scandals sold only portions of their portfolios before the collapse of their stock prices strongly suggests that the frauds that occurred were not mainly about personal wealth maximization. They were betting that the illusions could indeed become self-fulfilling—that the immediate competitive gains from shading the truth would more than compensate for any harms flowing from a loss of credibility were the truth eventually to be discovered. Many of these bets were predictably over-optimistic. But most were probably made with the sense at the time that they were aggressively consistent with the firm's interests.

Id. at 6–7.

143. There are several other reasons for the low rate of specialized recidivism amongst securities defrauders: (1) securities fraud usually requires a good deal of time to set up the scheme; (2) securities fraud requires specialized—and usually firm-specific—skills; and (3) the current disclosure regime discourages firms and institutions from placing violators in positions of trust.

Still, there is that subset of defrauders who do recidivate, and a smaller subset of that group who engage in new fraudulent schemes in violation of the securities laws. How can we segregate this small group of bad actors from the larger population of once-in-a-lifetime offenders? We know that white-collar defendants with high-level attainments and a history of family stability are less likely to recidivate than other white-collar defendants with a lower level of education and a history of family dysfunction.[144] There is also some evidence that white-collar defendants who were at the top of the corporate hierarchy at the time of their crime may be less likely to recidivate than those at lower levels of management.[145]

Criminal history, gender, age at sentence, race and ethnicity, a stable employment record, educational attainment, marital status, and a history of drug abuse all tell us something about the likelihood of recidivism.[146] The reality, however, is that our capacity to predict who is likely to recidivate—especially among white-collar offenders—is meager. In the absence of a history of repeated misconduct under the securities laws, or a history of abusing one's professional position, sorting out *which* securities law violators are more likely than others to recidivate—which ones present a "likelihood of future misconduct"—is really little more than an exercise in guesswork.

So rather than urging the court to try to predict a defendant's future behavior, as the court in *Patel* required,[147] it might be wiser to ask the court to employ a backward-looking approach to the issue of "unfitness," using parameters like those set out above. Measuring unfitness by evaluating what the defendant *has done* rather than what she *might do* is consistent both with criminological theory[148] and with a common sense view of just how well judges are likely to predict the future.

There is a problem, though, with an exclusively backward-looking approach to the unfitness issue. A lifetime bar order is expressly designed to be remedial,[149] *and* to protect the public against future harm.[150] It is, the courts tell us,

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144. WEISBURD & WARING, *supra* note 65, at 54, tbl.3.1.

145. *Id.* at 30.

146. MEASURING RECIDIVISM, *supra* note 135. Reviewing these items, women recidivate at a lower rate than men; recidivism rates decline as age at sentencing increases; people of color are more likely than whites to recidivate; those with stable employment in the year prior to the criterion offense are less likely to recidivate than those who were unemployed; offenders with college degrees are less likely to recidivate than those with lower levels of education, and married offenders are less likely to recidivate than those who have never married. *Id.* at 11–12. Offenders who receive credit for cooperating with the government have a lower recidivism rate than those who do not. *Id.* at 14.

147. SEC v. Patel, 61 F.3d 137, 142 (2d Cir. 1995).

148. Here, I refer to desert-based, rather than utilitarian (deterrence-based) theories of punishment. *See generally* ANDREW VON HIRSCH, CENSURE AND SANCTIONS (1993) (discussing these approaches to punishment).

149. *See*, *e.g.*, United States v. Merriam, 108 F.3d 1162, 1165 (9th Cir. 1997) (holding that lifetime bars are "remedial"); United States v. Furlett, 974 F.2d 839, 845 (7th Cir. 1992) (holding that a revocation of the defendant's registration with the CFTC, together with a bar on trading, "is designed to serve remedial purposes").

not “punishment.”[151] If that is the case, then looking backward exclusively, without making some estimate of the likelihood of some future harm, is inconsistent with the ostensible purpose of the sanction.[152] In Section V, I will return to this conundrum: courts cannot reasonably predict future misconduct, but without such a prediction, cannot justify imposing the Sarbanes-Oxley sanction.

IV. WHEN IS A LIFETIME BAR ORDER APPROPRIATE?

Making a finding of “unfitness” under the Sarbanes-Oxley Act is just the first of a two-part process. Once a finding of “unfitness” has been made, the court must then determine the appropriate sanction. Doing so requires recognition of the context in which civil sanctions are imposed.

Let us assume, for example, that a defendant has been found liable for a Rule 10b-5 violation. The court at that point has a number of remedial options. Of course, it may enter a damage award.[153] It may also impose a significant civil penalty.[154] The court may also enter some type of injunction: a don’t-do-it-again injunction,[155] a categorical injunction,[156] or even a wide-ranging “obey-the-law” injunction.[157] Then, if the court makes a finding of unfitness, it may also impose a

150. *See Furlett*, 974 F.2d at 844 (noting that such orders “can be seen as an action to ensure the integrity of the markets and protect them from people like [the defendant]”).

151. *See supra* note 20.

152. Courts have recognized in a number of contexts, that, in the absence of some genuine risk of future misconduct, a forward-looking sanction is inappropriate. *See, e.g.*, SEC v. Pros Int’l, Inc., 994 F.2d 767, 769 (10th Cir. 1993) (affirming the district court’s denial of the SEC’s request for an injunction against an accountant where “there [was] no evidence that future violations [were] likely”); SEC v. Happ, 295 F. Supp. 2d 189, 196–97 (D. Mass. 2003) (refusing to enter injunction where the Commission failed to establish a “reasonable likelihood of future violations”—the defendant’s violation (insider trading) was not egregious, he did not act “with conscious disregard to the securities law,” and was retired and no longer serving as a director of any public company); SEC v. Parks, 222 F. Supp. 2.d 1124, 1131 (C.D. Ill. 2002) (same, where the defendant’s acts were isolated, he expressed remorse, and he had worked without problems for a registered investment adviser for four years after the violation); SEC v. Enter. Solutions, Inc., 142 F. Supp. 2d 561, 579 (S.D. N.Y. 2001) (same, where defendant had “no history of criminal violations, fraud, or other misconduct, and this [was] his first experience in running a public company”).

153. *See, e.g.*, SEC v. The Better Life Club, 995 F. Supp. 167, 179 (D.D.C. 1998) (ordering defendants in a “Ponzi scheme” to provide restitution totaling twenty-five million dollars).

154. *See, e.g.*, SEC v. United Energy Partners, Inc., 88 Fed. Appx. 744 (5th Cir. 2004) (affirming the imposition of a $110,000 “third tier” civil penalty against each of the individual defendants); SEC v. Palmisano, 135 F.3d 860, 863 (2d Cir. 1998) (affirming a $500,000 civil penalty).

155. *See, e.g.*, SEC v. First City Fin. Corp., 890 F. 3d 1215, 1229 (D.C. Cir. 1989) (affirming an injunction against further violations of section 13(d)).

156. *See, e.g.*, SEC v. Poirier, 140 F. Supp. 2d 1033, 1047 (D. Ariz. 2001) (enjoining the defendant from future violations of sections 17(a) and 5(c) of the Securities Act of 1933, sections 7(f) and 10(b) of the Securities Exchange Act of 1934, Rule 10b-5 and Regulation X).

157. *See, e.g.*, SEC v. Chester Holdings, Ltd., 41 F. Supp. 2d 505, 530 (D.N.J. 1999) (prohibiting future violations of the securities laws).

finite-term suspension order.[158] In the most egregious cases, it may impose a lifetime bar order.[159] Figure 1 illustrates this hierarchy, placing the lifetime bar order at the top.

Lifetime bar order
Finite-term suspension order
Injunction against any violation of the securities laws
Injunction against a category of misconduct
Injunction against specific misconduct
Civil penalty
Damage award/disgorgement

Figure 1. Remedy Hierarchy

In the next section, I will argue that this process of "stacking" remedies in civil cases is much like the process of sentence enhancement in criminal cases, and that the Federal Sentencing Guidelines provide useful guidance for determining the appropriate sanction under Sarbanes-Oxley. The Sentencing Guidelines can also shed light on the question of "unfitness."

A. The Sentence Enhancement Analogy

Although the lifetime bar provision of the Sarbanes-Oxley Act applies only in civil cases,[160] it is appropriate to note some obvious parallels to the

158. *See, e.g.*, SEC v.McCaskey, No. 98 CIV. 6153, 2001 WL 1029053 (S.D.N.Y. Sept. 6, 2001) (ordering the defendant be barred from serving as an officer or director of a public company for six years).

159. *See, e.g.*, SEC v Softpoint, Inc., 958 F. Supp. 846, 867 (S.D.N.Y. 1997) (imposing a lifetime bar order).

criminal law. In criminal cases, the Federal Sentencing Guidelines establish a base offense level that may be adjusted upward or downward depending on the presence of certain facts or circumstances. When the necessary conditions are present, a court may "enhance" a criminal sentence, typically by increasing the fine or the amount of prison time to be served.[161] Sentence enhancements reflect certain aspects of the crime that permit the imposition of a greater-than-normal penalty. For example, a sentence may be enhanced where: (1) the violator was an officer or director of a public company at the time of the crime;[162] (2) the offense involved 50 victims or more;[163] (3) the scheme involved "sophisticated means";[164] (4) the violator "was an organizer or leader of a [scheme] that involved five or more participants or was otherwise extensive";[165] (5) the violator engaged in an abuse of trust or "used a special skill, in a manner that significantly facilitated the commission or concealment of the offense";[166] or (6) the violator engaged in obstruction of justice.[167] A court may depart upward, in addition, where the fraud is thought to be "outside of the heartland" of conventional frauds.[168]

The process of sentence enhancement in criminal cases is similar to the process of determining that a defendant in a civil case merits an enhanced remedy. That is to say, the counterpart in civil cases to the base offense level in criminal cases is the damage award. Anything on top of that—a civil penalty, an injunction, or a suspension or lifetime bar order—like a sentence enhancement, must be based on findings in addition to the fact that the defendant violated the law. Thus, the Sentencing Guidelines, and the enhancement factors that the Guidelines employ, may be useful in thinking about the circumstances in which a lifetime bar order is, or is not, appropriate for a defendant found to be "unfit."

1. The Defendant's Role as an Officer or Director of a Public Company

Under the Sentencing Guidelines, a court is permitted to increase an offense level by four levels where the offense involves a violation of the securities laws and "at the time of the offense, the defendant was . . . an officer or a director of a publicly traded company."[169] This provision is a product of the Sarbanes-Oxley Act[170] and expresses a Congressional desire to visit special punishment on

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160. This includes civil enforcement actions and cease-and-desist proceedings.

161. The Guidelines have, of course, recently been declared "advisory" rather than mandatory. United States v. Booker, 125 S. Ct. 738 (2005). It is important to note that the *Booker* decision does not challenge the substance—or wisdom—of the Guidelines themselves.

162. U.S. SENTENCING GUIDELINES MANUAL ("U.S.S.G.") § 2B1.1(b)(15) (2004) (increasing offense level by four).

163. *Id.* § 2B1.1(b)(2)(B) (increasing offense level by four). Crimes involving 250 victims or more result in a six-level sentence enhancement. *Id.* § 2B1.1(b)(2)(C).

164. *Id.* § 2B1.1(b)(9)(C) (increasing offense level by two).

165. *Id.* § 3B1.1(a) (increasing offense level by four).

166. *Id.* § 3B1.3 (increasing offense level by two).

167. *Id.* § 3C1.1 (increasing offense level by two).

168. *Id.* § 5K2.0 (granting discretion to depart upwards).

169. *Id.* § 2B1.1(b)(15)(A)(i).

170. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 1104, 116 Stat. 745, 808 (2002).

defendants who abuse their prestigious and lucrative positions to take advantage of the investing public. This provision also suggests that, in civil cases, persons who violated the securities law while an officer or director of a public company will be more suitable candidates for a lifetime bar order than persons who did so while serving in other capacities.

2. More Than Fifty Victims

Under the Sentencing Guidelines, a court is permitted to increase an offense level by four levels where the offense involved fifty victims or more[171] and by six levels where the offense involved 250 victims or more.[172] Though the issue of which victims count for this calculation has not yet been litigated, this provision suggests that, in civil cases, persons involved in schemes that impact a large number of victims—accounting fraud in public companies, deliberate misstatements in corporate filings and press releases, Ponzi schemes, and fraudulent public offerings—will be more suitable candidates for a lifetime bar order than rogue brokers, sellers of businesses, and most inside traders, who engaged in one-on-one frauds.

3. Sophisticated Means

Under the Sentencing Guidelines, a court is permitted to increase an offense level by two levels where the scheme involved "sophisticated means."[173] "Sophisticated means" is described as "especially complex or especially intricate offense conduct pertaining to the execution or concealment of an offense."[174] It may include conduct "such as hiding assets or transactions, or both, through the use of fictitious entities, corporate shells, or offshore financial accounts."[175]

The "sophisticated means" adjustment has been applied to a multinational investment scheme engineered by parties located in London, Switzerland, and the Caribbean,[176] to an embezzlement scheme involving diversion of corporate funds into multiple secret bank accounts,[177] and to a tax evasion scheme in which a CEO created fictitious business entities and falsified and destroyed corporate records.[178]

The "sophisticated means" provision suggests that, in civil cases, persons involved in schemes in which scores of complex transactions are required to hide off-balance sheet financing, or that involve exotic use of derivatives, will be more

171. U.S.S.G. § 2B1.1(b)(2)(B).
172. *Id.* § 2B1.1(b)(2)(C).
173. *Id.* § 2B1.1(b)(9)(C).
174. *Id.* § 2B1.1, cmt. n.8(B).
175. *Id.*
176. United States v. Anderson, 439 F.3d 568, 570 (8th Cir. 2003) (affirming a six-level upward adjustment).
177. United States v. Janecek, 86 Fed. Appx. 215, 217 (8th Cir. 2003) (affirming a two-level upward adjustment).
178. United States v. Furkin, 119 F.3d 1276, 1278 (7th Cir. 1997) (affirming a two-level upward adjustment).

suitable candidates for a lifetime bar order than persons involved in less complex forms of fraud.[179]

4. Aggravating Role

Under the Sentencing Guidelines, a court is permitted to increase an offense level by four levels if the defendant "was an organizer or leader of a criminal activity that involved five or more participants or was otherwise extensive."[180] This so-called "kingpin" provision allows for sentence enhancement for those defendants who orchestrate complex and far-reaching schemes, particularly those into which they have recruited other wrongdoers[181] or, even worse, unwitting accomplices.[182]

The kingpin provision has been applied to a corporate executive who involved several of his employees in frauds against the public,[183] to a bank president who organized a scheme involving numerous players both inside and outside the bank,[184] and to a CEO who misappropriated funds from his companies' retirement plans with the assistance of lawyers who prepared phony documents to help conceal the scheme.[185] The kingpin provision has also been used against leaders who "inherited" a scheme from others, or who "[chose] to actively participate in [an ongoing] scheme rather than put a stop to it."[186] The essence of the kingpin provision is the use of position and power to corrupt others and also the concept of "scope" of the fraud.[187]

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179. There is a limit to this concept. For example, the fraud in WorldCom—the recharacterization of ordinary business expenses as capitalized items—might easily be described as a "garden variety" fraud, but its magnitude—eleven billion dollars—puts it into an entirely different category from small-time earnings management or other alterations of a company's financial statements. *See infra* Section IV.A.6. (frauds outside of the heartland).

180. U.S.S.G. § 3B1.1(a).

181. *See, e.g.*, United States v. Kubick, 205 F.3d 1117, 1126–27 (9th Cir.1999) (affirming a four-level upward adjustment where the defendant had put together a scheme that involved lawyers, friends, accountants, his daughter and his wife).

182. *See, e.g.*, United States v. Rose, 20 F.3d 367, 375 (9th Cir. 1994) (affirming a four-level upward adjustment where the defendant had recruited more than sixty employees—most of them unwitting—to assist in his fraud and money laundering scheme).

183. United States v. Lopez-Lopez, 295 F.3d 165, 170 (1st Cir. 2002) (affirming a four-level upward adjustment where the owner of a firm oversaw the adulteration of milk products over a seven-month period, with the unwitting assistance of chemists, employees, and "milk industry people").

184. United States v. Colon-Munoz, 318 F.3d 348, 364 (1st Cir. 2003) (affirming a four-level upward adjustment).

185. United States v. Helbling, 209 F.3d 226, 250 (3d Cir. 2000) (affirming a four-level upward adjustment).

186. United States v. DeRiggi 72 F.3d 7, 9 (2d Cir. 1995).

187. "Scope" is an issue when five or more participants cannot definitively be identified. *See, e.g.*, United States v. Bennett, 161 F.3d 171, 194 (3d Cir. 1998) (finding that largest charitable fraud in history qualifies as "otherwise extensive"); United States. v. Rostoff, 53 F.3d 398, 413 (10th Cir. 1995) (finding that a three-year bank fraud involving 140 loans and millions of dollars qualifies as "otherwise extensive"); United States v. Stouffer, 986 F.2d 916, 927 (5th Cir. 1993) (finding that scheme involving 2,000 investors and eleven million dollars was "otherwise extensive").

The kingpin provision suggests that, in civil cases, persons who engage the services of subordinates, or involve gatekeeping professionals, to facilitate their schemes will be more suitable candidates for a lifetime bar order than persons who execute their schemes alone and without assistance. Also, persons who preside over multi-entity or multi-venue schemes will be more suitable candidates for a lifetime bar order than persons who engage in small-time local frauds.

5. Abuse of Trust or Use of a Special Skill

Under the Sentencing Guidelines, a court is permitted to increase an offense level by two levels if "the defendant abused a position of public or private trust, or used a special skill, in a manner that significantly facilitated the commission or concealment of the offense."[188] The "abuse of trust" provision has been applied to a CEO who exploited her ability to authorize payments and issue orders to subordinates to implement an embezzlement scheme,[189] to a President and a CFO who exploited their "special access to and control of [corporate] checking accounts" to implement a three-year long check-kiting scheme,[190] and to a President/COO who exploited his control over the company's mail system to divert customer payments to his personal account.[191] It has also been applied to a CEO who falsified his company's financial statements in order to secure funds from his business partner, which he then converted to his personal use.[192]

The core principle of the "abuse of trust" cases seems to be that a defendant, who exploits her position of authority for wrongful purposes (and especially to divert funds intended for others to her own use), should be punished with an upward adjustment to her sentence. The use of her position is significant—the "abuse of trust" provision is not intended to be used for street-level employees.[193]

The "use of special skill" provision has a different focus. It asks not what position or title the defendant held at the time of the wrongdoing but what skills she employed to execute the scheme. Often, a fraud can only occur because people rely on the apparent expertise of the defendant or have no means of detecting misconduct. Both the "abuse of trust" and the "use of special skill" provisions have

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188. U.S.S.G. § 3B1.3 (2004).

189. United States v. Freeman, 86 Fed. Appx. 35 (6th Cir. 2003) (affirming a two-level "abuse of trust" sentence enhancement). *See also* United States v. Cameron, No. 03-1511, 2004 WL 77914 (7th Cir. Jan. 7, 2004) (affirming a two-level "abuse of trust" sentence enhancement for an Executive Director of a non-profit corporation who embezzled funds).

190. United States v. Reid, No. CRIM.A.3:04CR00013, 2004 WL 1261454 (W.D. Va. May 18, 2004) (overruling defendant's objections to a two-level "abuse of trust" sentence enhancement).

191. United States v. Bhagavan, 116 F.3d 189, 193 (7th Cir. 1997).

192. United States v. Schneider, 72 Fed. Appx. 369 (6th Cir. 2003) (affirming a two-level "abuse of trust" sentence enhancement).

193. U.S.S.G. § 3B1.3, cmt. n.1 ("This adjustment does not apply in the case of an embezzlement or theft by an ordinary bank teller . . . ."). Because of the potential for overlap, where the post-Sarbanes-Oxley "officer or director of a public company" adjustment applies, the "breach of trust" adjustment is not available. *Id.* § 2B1.1, cmt. n.14(C).

been applied to lawyers,[194] accountants,[195] securities professionals,[196] and senior financial executives.[197]

The breach of trust and use of special skills provisions suggest that, in civil cases, persons whose frauds depend on their ability to direct the preparation of false and misleading documents by others, or whose frauds depend on the unique nature of their professional skills in a business setting will be more suitable candidates for a lifetime bar order than persons who lack discretion in their job, or persons who lack credentials.

6. Conduct Outside the "Heartland" of Conventional Frauds

Under the Sentencing Guidelines, a sentencing judge may depart upward from the Guidelines if the judge finds that "there exists an aggravating . . . circumstance of a kind, or to a degree, not adequately taken into consideration by the Sentencing Commission in formulating the guidelines . . . ."[198] Though typically applied in cases that result in severe psychological, as well as financial, harm to victims,[199] the upward departure provision has also been applied in fraud cases where the victims not only lost money but suffered damage to their professional reputations.[200] In one case, the court departed upward where the defendant (a lawyer) disgraced his partners and his profession.[201]

Upward departures also have been imposed when the defendant's crime extended over a multi-year period and consisted of "literally hundreds of

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194. *See, e.g.*, United States v. Harris, 38 F.3d 95, 99 (2d Cir. 1994) (applying the "use of special skill" adjustment to a lawyer); United States v. Foster, 868 F. Supp. 213, 217 (E.D. Mich. 1994) (same).

195. *See, e.g.*, United States v. Fritzson, 979 F.2d 21, 22–23 (2d Cir. 1992) (applying the "use of special skill" adjustment to an accountant); United States v. Ellis, No. CRIM.A.95-435-4, 1997 WL 297080 (E.D. Pa. May 22, 1997) (same); *see also* United States v. Kay, 83 F.3d 98, 102 (5th Cir. 1996) ("An accountant is a prime example of a person with a special skill.").

196. *See, e.g.*, United States v. Hirsch, 239 F.3d 221, 226–28 (2d Cir. 2001) (applying the "abuse of trust" provision to a stockbroker); United States v. Yeaman, 194 F.3d 442, 465 (3d Cir. 1999) (noting that the "use of special skills adjustment" may be used "in some circumstances" where a defendant's skills developed as a broker were used in the commission of a securities fraud).

197. *See, e.g.*, United States v. Moskowitz, 215 F.3d 265, 272–73 (2d Cir. 2000) (applying the "abuse of trust" provision to the chief financial officer of a public company).

198. 18 U.S.C. § 3553(b) (2004).

199. *See, e.g.*, United States v. Jarvis, 258 F.3d 235, 240 (3d Cir. 2001) (affirming a five-level upward departure where the victims of the scheme were retirees who had lost all their savings); United States v. Helbling, 209 F.3d 226, 251 (3d Cir. 2000) (affirming a two-level upward departure where "the district court found, both through testimony and its own observation, that the victims' health suffered after they lost their life savings").

200. United States v. Taylor, 60 Fed. Appx. 429 (4th Cir. 2003) (affirming an eight-level upward departure).

201. United States v. Moskal, 211 F.3d 1070, 1074–75 (8th Cir. 2000) (affirming a two-level upward departure).

transactions,"[202] or where the defendant defrauded the government of tens of millions of dollars over a period of more than twenty years.[203]

What these cases all have in common is the notion that some forms of misconduct are simply so audacious that they warrant an increased penalty. The concept of "outside the heartland" suggests that, in civil cases, persons who engage in affinity fraud (including fraud on one's own employees)[204] or whose schemes last for years or generate monumental damages will be more suitable candidates for lifetime bar orders than persons whose schemes are conducted at arms length and whose reach in terms of duration or dollars is limited.

7. Obstruction of Justice

Defendants who obstruct or impede the administration of justice are subject to a two-level increase in their base offense level.[205] The obstruction of justice provision has been applied where a defendant destroys documents,[206] lies to investigating agents,[207] launders funds,[208] hides assets,[209] or induces others to lie.[210]

The obstruction of justice provision suggests that, in civil cases, defendants who thwart the investigative process, destroy or hide documents, or conceal the fruits of their scheme will be more suitable candidates for a lifetime bar order than defendants who do not.

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202. United States v. Morberg, 863 F. Supp. 511, 517 (W.D. Mich. 1994) (authorizing an eight-level upward departure).

203. United States v. Garrison, 133 F.3d 831, 853 (11th Cir. 1998) (authorizing a two-level upward departure).

204. *See* Lisa M. Fairfax, *"With Friends Like These . . . .": Toward a More Efficacious Response to Affinity-Based Securities and Investment Fraud*, 36 GA. L. REV. 63, 64–65 (2001) (defining affinity fraud).

205. U.S.S.G. § 3C1.1 (2004).

206. United States v. Thompson, 367 F.3d 1045, 1046 (8th Cir. 2004) (affirming a two-level upward adjustment).

207. United States v. Luca, 183 F.3d 1018, 1023 (9th Cir. 1999) (affirming upward adjustment where defendant gave false documents to state officials); United States v. Ancheta, 38 F.3d 1114, 1118 (9th Cir. 1994) (affirming upward adjustment where defendant made false statements to DEA agents); United States v. Benitez, 34 F.3d 1489, 1497 (9th Cir. 1994) (affirming upward adjustment where defendant gave false date and place of birth and withheld information from pretrial service officers).

208. United States v. Dowdell, 272 F. Supp. 2d 583, 590 (W.D. Va. 2003) (applying a two-level upward adjustment).

209. United States v. Case, 180 F.3d 464, 468 (2d Cir. 1999) (affirming a two-level upward adjustment where defendant withheld information regarding $1.2 million certificate of deposit); United States v. Wu, 81 F.3d 72, 73–74 (7th Cir. 1996) (affirming a two-level upward adjustment where defendant maintained offshore accounts).

210. United States v. Duranseau, 26 F.3d 804, 810 (8th Cir. 1994) (affirming a two-level upward adjustment where defendant suborned perjury).

8. Factors in Mitigation

Defendants who plead guilty and cooperate with the government sometimes receive a *downward* adjustment in their sentence.[211] Cooperation (or "substantial assistance") typically includes providing documents, testifying at trial, and assisting prosecutors in preparing their case against others.[212]

The substantial assistance provision suggests that, in civil cases, persons who settle and cooperate with the government may escape the imposition of a lifetime bar order and may be subject instead to a finite-term suspension order[213] or even to no remedy-enhancement at all.

B. Why the Sentencing Guidelines Matter

I have digressed in this section from the "unfitness" inquiry for two reasons: first, it is important to put the "unfitness" inquiry into context, and second, a discussion of the factors that should influence the ultimate sanctioning decision can also illustrate some of the factors that may influence the determination of "unfitness." For many courts, the "unfitness" inquiry and the determination of an appropriate sanction will overlap and may, in fact, be one and the same. Reviewing the Sentencing Guidelines not only helps shape the process of deciding an appropriate sanction for Rule 10b-5 violators; it may also help shape the process of determining unfitness.

V. HOW SHOULD COURTS APPROACH THE UNFITNESS QUESTION?

So far this Article has considered ways in which federal district courts (or the SEC in a cease-and-desist proceeding) might approach the two questions posed by the Sarbanes-Oxley Act: when is a Rule 10b-5 violator "unfit to serve" and when is an unfit defendant properly subject to a lifetime bar order as opposed to some shorter term of disqualification? In this section, I will again focus directly on the question of "unfitness."

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211. *See* U.S.S.G. § 3E.1.1 (2004) (permitting a downward adjustment for acceptance of responsibility); *id.* § 5K1.1 (permitting a downward adjustment where the government certifies that the defendant has provided substantial assistance to the government); *see also* United States v. Awad, 371 F.3d 583, 586–88 (9th Cir. 2004) (vacating sentence where district court failed to account for all of the defendant's cooperation with the government).

212. *See, e.g.*, United States v. Washington, 293 F. Supp. 2d 930, 934–35 (E.D. Wisc. 2003) (granting an eight-level downward adjustment where the defendant actively participated in a sting operation, making drug buys and testifying at sentencing proceedings); United States v. Graye, No. 02 CR.336, 2003 U.S. Dist. LEXIS 1831 (S.D.N.Y. Feb. 10, 2003) (noting that the defendant had provided critical documents and testimony in an unrelated prosecution); United States v. Feeny, No. 00 CR.91-09, 2002 U.S. Dist. LEXIS 20752 (S.D.N.Y. Oct. 28, 2002) (noting that the defendant had helped the prosecution build its case against five co-defendants).

213. *See, e.g.*, SEC v. Quattrone, Litigation Release No. 18534, 2004 SEC LEXIS 25 (Jan. 7, 2004) (imposing a lifetime bar order on the individual defendants "with the exception of Christensen, who [will] be subject to a ten-year suspension in recognition of his level of cooperation").

First, I will consider the standard of proof necessary to support a determination of unfitness.[214] Then I will sketch out the matrix of factors that courts should apply in assessing a defendant's unfitness.[215] I will then briefly touch on the need for specific factual findings in support of a determination of unfitness.[216] I will conclude by exploring the importance of revisiting the unfitness question after a suitable passage of time.[217]

In this section, I will also attempt to resolve the fundamental problem posed by the Sarbanes-Oxley Act: if the lifetime bar order (or a shorter-term suspension order) is designed to forestall future harm to the public, and not merely to punish the defendant for her past acts, then how can courts determine which defendants are most likely to present a genuine risk of harm to the public? One answer is that they should do so with great caution.

A. The Government Should Be Required to Prove All the Elements by Clear and Convincing Evidence

Sarbanes-Oxley says nothing about the standard of proof by which unfitness must be shown. There is a background, however, to this issue in securities law enforcement. The first case addressing the standard of proof issue was *Collins Securities Corp. v. SEC*,[218] a case involving the revocation of Collins Securities' registration as a broker-dealer and investment adviser. The evidence adduced by the Commission staff was circumstantial, and its argument that Collins Securities had engaged in market manipulation was largely based on inference. Still, the Commission found against Collins Securities, utilizing a preponderance of the evidence standard. On appeal, the U.S. Court of Appeals for the D.C. Circuit noted the high stakes involved. It described the revocation of the firm's license as a "drastic sanction[] which in effect amount[s] to a deprivation of livelihood for the sanctioned parties."[219] Given these stakes, and the allegations of fraud underlying the disciplinary action, the court concluded that clear and convincing, rather than preponderance of the evidence, was the appropriate standard of proof for revocation.[220] The court remanded the case with the instruction "that *all alleged violations* must be proved by the Commission with clear and convincing evidence."[221]

The same court shortly thereafter decided *Whitney v. SEC*,[222] in which the question before the D.C. Circuit Court was whether the defendant had properly received a nine-month suspension that prohibited him from associating with any broker or dealer. Refusing to authorize a lower standard of proof in suspension cases than the standard of proof applicable to revocation cases, the court

214. *See infra* Section V.A.
215. *See infra* Section V.B.
216. *See infra* Section V.D.
217. *See infra* Section V.E.
218. 562 F.2d 820 (D.C. Cir. 1977).
219. *Id.* at 823.
220. *Id.*
221. *Id.* at 827 (emphasis added).
222. 604 F.2d 676 (D.C. Cir. 1979).

reaffirmed its view that any incapacitation-type sanction of this sort "must be sustained by clear and convincing evidence."[223]

The next case, *Steadman v. SEC*,[224] involved a defendant appealing an order by the Commission barring him permanently from associating with any investment adviser, prohibiting his affiliation with any registered investment company, and suspending him for one year from associating with any broker or dealer.[225] His primary argument was that the Commission had employed a preponderance of the evidence standard rather than a clear and convincing standard in assessing the claims against him. The U.S. Court of Appeals for the Fifth Circuit rejected Steadman's argument and affirmed the bar order against him, thereby creating a circuit split. The Fifth Circuit took the position that "[i]f the burden of proof imposed on the Commission is too high, its ability to police the industry is impaired."[226]

A divided U.S. Supreme Court affirmed *Steadman*.[227] The Court noted first that,

> Where Congress has not prescribed the degree of proof which must be adduced by the proponent of a rule or order to carry its burden of persuasion in an administrative proceeding, this Court has felt at liberty to prescribe the standard, for "[i]t is the kind of question which has traditionally been left to the judiciary to resolve."[228]

It then concluded that, in the case of Commission proceedings against regulated professionals, Congress *had* prescribed a standard of proof in the text of the Administrative Procedure Act[229] and that the appropriate standard of proof was preponderance of the evidence. Therefore, "many of [Steadman's policy-based] arguments [were] simply inapposite."[230] Justices Powell and Stewart dissented, arguing in part that the Administrative Procedure Act had been enacted several years after the securities laws upon which Steadman's disqualification was based and consequently "should have no bearing on the proof burden in this case."[231]

Steadman might be cited for the proposition that all lifetime bar cases should be governed by a preponderance of the evidence standard. In fact, however, the *Steadman* decision is inapplicable to judicial proceedings under the Sarbanes-Oxley Act. That is, the *Steadman* decision was based on specific statutory language not present in Sarbanes-Oxley and applicable only to administrative

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223. *Id.* at 681.
224. 603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981).
225. *Id.* at 1128.
226. *Id.* at 1139.
227. Steadman v. SEC, 450 U.S. 91 (1981).
228. *Id.* at 95 (alteration in original) (quoting Woodby v. INS, 385 U.S. 276, 284 (1966).
229. *Id.* at 96. The Act provided that "[a] sanction may not be imposed . . . except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with reliable, probative, and substantial evidence." 5 U.S.C. § 556(d) (2004).
230. *Steadman*, 450 U.S. at 96 n.10.
231. *Id.* at 106.

proceedings.[232] Also, *Steadman* held only that *the underlying violations* must be proved by a preponderance of the evidence. That is a very different issue than whether "unfitness to serve" must be proved by a preponderance of the evidence or some higher standard of proof, *or* whether the need for a lifetime bar order must be proved by a preponderance of the evidence or some higher standard of proof.

Courts have long recognized that in circumstances like this—in which the defendant faces both stigma and a loss of some liberty (economic or otherwise)—the appropriate standard of proof is clear and convincing:

> [The Supreme Court] has mandated an intermediate standard of proof—"clear and convincing evidence"—when the individual interests at stake in a state proceeding are both "particularly important" and "more substantial than mere loss of money."[233]

Accordingly, *all three* elements of the Sarbanes-Oxley inquiry—the underlying violation, the question of "unfitness," and the issue of an appropriate remedy—should all be required to be proved by clear and convincing evidence.

1. The Underlying Violation

The most useful analogy to the lifetime bar order is the revocation of a professional license.[234] In these cases, courts have commonly held that the underlying claims must be proved by clear and convincing evidence. For example, charges necessary to sustain the revocation of a teacher's license,[235] charges necessary to support the revocation of a physician's license,[236] charges necessary to support the revocation of other professional licenses,[237] and charges necessary to support the disbarment of a lawyer[238] all must be proved by clear and convincing evidence.

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232. *See supra* note 229.

233. Santosky v. Kramer, 455 U.S. 745, 756 (1982).

234. Similarly, the most useful analogy to a finite-term suspension order under the Sarbanes-Oxley Act is a suspension of a professional license.

235. Ferris v. Turlington, 510 So. 2d 292, 294 (Fla. 1987).

236. Nguyen v. State, 29 P.3d 689, 708 (Wash. 2001); Webb v. W. Va. Bd. of Med., 569 S.E.2d 225, 231 (W. Va. 2002).

237. *See, e.g.*, Am. Legion Post #134 v. Miss. Gaming Comm'n, 798 So. 2d 445, 456 (Miss. 2001) (applying a clear and convincing standard to the revocation of a bingo license); Nims v. Bd. of Registration, 53 P.2d 52, 55 (Wash. Ct. App. 2002) (requiring that grounds for revoking an engineer's license be established by clear and convincing evidence); *see also In re* Hammermaster, 985 P.2d 924, 934 (Wash. 1999) (applying a clear and convincing standard to discipline of a sitting judge). *But see* Coleman v. Anne Arundel County Police Dep't, 797 A.2d 770, 795 (Md. 2002) (concluding that a preponderance of the evidence standard is sufficient for terminating a police officer's contract); Pretzer v. Motor Vehicle Bd., 125 S.W.3d 23, 39 (Tex. Ct. App. 2003), *aff'd* in part and *rev'd* in part, 138 S.W.3d 908 (Tex. 2004) (holding that standard for revocation of a license to sell motor vehicles is only a preponderance of the evidence).

238. Burton v. Mottolese, 835 A.2d 998, 1024 (Conn. 2003); N.C. State Bar v. Talford, 556 S.E.2d 344, 349 (N.C. Ct. App. 2001) ; *In re* Crosland, 577 S.E.2d 214, 214 (S.C. 2003).

License revocation, however, is not the only appropriate analogy. Courts have recognized that, where a remedy is proposed *in a civil case* that will limit a defendant's personal autonomy, a clear and convincing standard of proof is required. For example, where a defendant faces civil commitment,[239] or is at risk of losing his citizenship status,[240] or where the state seeks to declare a defendant a sexually violent predator,[241] the applicable standard of proof in each case is clear and convincing. And even where the issue is "merely" money, the standard of proof for an enhanced damage award—such as punitive damages—is often clear and convincing and not just a preponderance of the evidence.[242] Taken together, these cases suggest that, to support any form of occupational incapacitation, the SEC should be held to an enhanced standard of proof in presenting the elements of the underlying offense.

2. "Unfitness"

A defendant who has violated Rule 10b-5 may or may not be unfit to serve as an officer or director of a public company. That is, when the Commission is seeking a lifetime bar order, a finding of unfitness is a separate element in the case, requiring separate evidence. "Unfitness" is a state encompassing moral and professional failings of the defendant. Allegations of unfitness must therefore be proved by clear and convincing evidence.

In this case too, analogies are helpful. For example, a parent's "unfitness" to retain parental rights in her children,[243] an executive's "unfitness" to remain in control of a debtor-in-possession in the course of a bankruptcy proceeding,[244] and a bar applicant's "unfitness" to practice law[245] are all governed by the clear and convincing standard of proof. So are allegations of "actual malice,"[246] civil contempt,[247] and "bad faith,"[248] all of which embody some sense of moral

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239. Addington v. Texas, 441 U.S. 418, 425–33 (1979).

240. Federenko v. United States, 449 U.S. 490, 504 (1981); *see also* United States v. Lindert, 907 F. Supp. 1114 (N.D. Ohio. 1995) (upholding defendant's citizenship status where the government failed to meet its burden by clear and convincing evidence).

241. Commonwealth v. Williams, 832 A.2d 962, 966 (Pa. 2003).

242. *See, e.g.*, White v. Burlington N. & Santa Fe Ry., 364 F.3d 789, 823–25 (6th Cir. 2004) (noting in an appendix that, as of 2004, thirty-one states have adopted a clear-and-convincing standard of proof for an award of punitive damages).

243. *See, e.g.*, Santosky v. Kramer, 455 U.S. 745, 747–48 (1982) (holding that a clear and convincing standard is necessary to protect the parents' due process rights)*; In re* D.C., 807 N.E.2d 472 (Ill. 2004) (holding that it is necessary to find, by clear and convincing evidence, that the parent is unfit with respect to *each* child, before parental rights to that child may be terminated).

244. *See, e.g.*, *In re* G–I Holdings, Inc., 295 B.R. 502, 507 (D.N.J. 2003) (noting that "[i]n every motion to appoint a trustee . . . , the movant must prove the need for a trustee by clear and convincing evidence").

245. *See, e.g.*, *In re* Triffin, 701 A.2d 907, 913 (N.J. 1997) (holding that "unless evidence of unfitness is clear and convincing, . . . 'admission to the bar should be allowed'").

246. New York Times Co. v. Sullivan, 376 U.S. 254, 285–86 (1964) (holding that actual malice must be shown with "convincing clarity").

247. FTC v. Kuykendall, 371 F.3d 745, 754 (10th Cir. 2004) (holding that proof of contempt must be shown by clear and convincing evidence).

shortcoming. Unfitness to serve as an officer or director should be subjected to the same high standard of proof and for the same reasons: a finding of unfitness implicates a person's reputation, not just his pocket-book;[249] the potential for an erroneous judgment is high;[250] and the interests at stake are significant.

3. The Need for a Lifelong Sanction

The use of a clear and convincing standard is not merely prudential. It is constitutionally-mandated. The appropriate standard of proof is determined by the Due Process Clause, taking into account the magnitude of what is at stake for the defendant. For example, a preponderance of the evidence standard may suffice to support the entry of a simple damage award.[251] A beyond a reasonable doubt standard is required when the interest at stake is the defendant's freedom.[252] In between these extremes is an intermediate standard of proof—clear and convincing. This is the standard that courts must apply when something more than money (or even a job) is at stake.[253]

The function of a standard of proof is to "instruct the fact-finder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication."[254] A clear and convincing standard ensures that the court recognizes the gravity of the decision before it, and approaches that decision with an appropriate level of caution. It also ensures that the court does not place undue emphasis on "a few isolated instances of unusual conduct [or] . . . idiosyncratic behavior."[255]

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248. Pape v. Local 390, 315 F. Supp. 2d 1297, 1313 (S.D. Fla. 2004) (holding that claims that a trusteeship imposed by the international union was imposed in bad faith must be proved by clear and convincing evidence).

249. Note that, for this reason, allegations of fraud often must be proved by clear and convincing evidence. Illinois *ex rel.* Madigan v. Telemarketing Assocs., 538 U.S. 600, 620 (2003) (applying Illinois law).

250. *See* Barnard, *Substantially Unfit*, *supra* note 22, at 1520 (discussing why courts in deciding questions like "unfitness" are far more likely to sanction defendants for whom incapacitation is unnecessary ("false positives") than to fail to sanction defendants for whom it is appropriate ("false negatives")).

251. *See, e.g.*, Ferguson v. Lieff, Cabraser, Heimann & Bernstein, 69 P.3d 965 (Cal. 2003) (distinguishing between the burden of proof for punitive damages—clear and convincing evidence—and the burden of proof for compensatory damages—preponderance of the evidence).

252. *See, e.g.*, *In re* Winship, 297 U.S. 358, 364 (1970) (noting that a defendant may not be convicted "except upon proof beyond a reasonable doubt of every fact necessary to constitute the crime with which he is charged").

253. *See, e.g.*, Nguyen v. State, 29 P.3d 689, 697 (Wash. 2001) ("[Revocation of a medical license involves] much more than the loss of a specific job. It involves the professional's substantial interest to practice within his profession, his reputation, his livelihood, and his financial and emotional future. [That is why] the constitutional minimum standard of proof in a professional disciplinary proceeding for a medical doctor must be something more than a mere preponderance [of the evidence].").

254. Addington v. Texas, 441 U.S. 418, 423 (1979) (quoting *In re* Winship, 397 U.S. 358, 370 (1970).

255. *Id.* at 427.

The decision under the Sarbanes-Oxley Act, once the court has found that the defendant is "unfit," is whether the defendant should be barred from competing for thousands of well-paying job opportunities for the remainder of his lifetime.[256] Just as in the license revocation cases, it is fair to argue as a matter of due process that the standard of proof that such a sanction is necessary should be clear and convincing. There may even be an equal protection claim for a defendant subjected to a preponderance of the evidence standard when other professionals (like doctors and lawyers) are protected by a clear and convincing standard.[257]

B. Courts Should Consider Several Factors in Evaluating Unfitness

So far in this Article, we have considered the nature of "unfitness," both as a matter of substance (for example, under banking law) and as a matter of process (requiring proof by clear and convincing evidence). We have also looked at how the penalty-enhancement regime of the Federal Sentencing Guidelines might suggest a way in which courts should approach the remedy-enhancement provisions of Sarbanes-Oxley. Taking all of these factors into account, we will now turn to the task of setting out a framework for making the unfitness inquiry.

My prescription—one that focuses on the issues and experiences underlying Sarbanes-Oxley and also takes into account the societal judgments embodied in the Federal Sentencing Guidelines—involves the following nine factors:[258] (1) the nature and complexity of the scheme; (2) the defendant's role in the scheme; (3) the use of corporate resources in executing the scheme; (4) the defendant's financial gain (or loss avoidance) from the scheme; (5) the loss to investors and others as a result of the scheme; (6) whether the scheme represents an isolated occurrence or a pattern of misconduct; (7) the defendant's use of stealth and concealment; (8) the defendant's history of business and related misconduct; and (9) the defendant's acknowledgment of wrongdoing and the credibility of his contrition. This list is not exhaustive, and none of these factors is dispositive.[259]

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256. Currently, there are over 16,000 reporting companies. Douglas M. Branson, *Enron—When All Systems Fail: Creative Destruction or Roadmap to Corporate Governance Reform?*, 48 VILL. L. REV. 989, 990 (2003). If each has four officers (probably a low estimate) and five non-officer directors, this represents over 140,000 jobs that are off-limits to barred defendants.

257. Painter v. Abels, 998 P.2d 931, 940–41 (Wyo. 2000) (holding, under Wyoming law, that a physician is entitled to application of the same clear and convincing standard of proof as is applied to dentists, nurses, pharmacists, optometrists, veterinarians, attorneys, architects, land surveyors, and engineers).

258. A similar list governs the debarment of tax preparers. *See* Abdo v. IRS, 234 F. Supp. 2d 553, 565 (M.D.N.C. 2002) (noting that, in deciding whether such an order is appropriate, courts assess the following factors: "(1) the gravity of harm caused by the offense; (2) the extent of the defendant's participation and his degree of scienter; (3) the isolated or recurrent nature of the infraction and the likelihood that the defendant's customary business activities might again involve him in such transactions; (4) the defendant's recognition of his own culpability; and (5) the sincerity of his assurances against future violations" (internal quotations omitted)).

259. *See* SEC v. Patel, 61 F.3d 137, 141 (2d Cir. 1995) ("[W]e do not mean to say that the enumerated factors are the only factors that may be taken into account or even that it is necessary to apply all these factors in every case. A district court should be afforded

1. The Nature and Complexity of the Scheme

Some Rule 10b-5 violations are straightforward; other violations are more elaborate. For example, assume that a business executive passes along some useful information to an intimate friend, with the expectation that she will trade on that information.[260] By contrast, assume that a business executive engages in an elaborate accounting scheme, utilizing dozens of corporate shells, hundreds of transactions and sophisticated (and non-transparent) off-balance sheet financing techniques, from which he profits personally by some forty million dollars.[261] Although both courses of conduct are Rule 10b-5 violations and both involve scienter, the first scheme might not lead to the conclusion that the defendant is unfit to serve as an officer or director of a public company.[262] The second scheme seems unquestionably deserving of a lifetime bar order.[263]

One difference between the schemes, of course, is the isolated nature of the first defendant's (illegal) indiscretion and the ongoing, protracted (and cynical) nature of the second defendant's scheme. Another distinction, however, is between the simplicity of the first scheme and the complexity of the second. Complexity should play an important role in unfitness determinations. The more complex a securities fraud scheme, the more one may reasonably conclude that the defendant acted with a high degree of scienter. Complexity may also rely upon the defendant's sophistication and use of special skills. Complexity also fosters concealment and obfuscation. As a proxy for many of the most harmful aspects of a securities law violation, *complexity should be the primary factor in any unfitness inquiry*. Schemes that involve scores of people, dozens of entities, and deliberate falsification of thousands of records[264] should reasonably lead to a finding of unfitness, especially when some of the other factors listed below are present.

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substantial discretion in deciding whether to impose a bar to employment in a public company.").

260. *See In re* Thayer, Litigation Release No. 10746, 1985 SEC LEXIS 1597 (May 7, 1985). This case involved former LTV Corp. Chairman Paul Thayer.

261. *See* SEC v. Fastow, Litigation Release No. 18543, 2004 SEC LEXIS 75 (Jan. 14, 2004). According to the complaint, Andrew Fastow, former CFO of Enron Corporation, "participated in a series of fraudulent transactions. Three of the transactions . . . were part of an alleged scheme to hide Fastow's interest in and control of certain entities in order to avoid consolidating those entities in Enron's financial statements. This was done, according to the complaint, for self-enrichment and to mislead analysts, rating agencies, and others about Enron's true financial condition."

262. After serving nineteen months in prison, Paul Thayer joined the boards of two public companies. William P. Barrett, *Picking Up the Pieces*, FORBES, Aug. 10, 1987, at 113.

263. Fastow has been sentenced to ten years in prison, and has consented to the entry of a lifetime bar order.

264. *See, e.g.*, SEC v. Colwell, Litigation Release No. 18403, 2003 SEC LEXIS 2400 (Oct. 9, 2003) (barring the former Chief Accounting Officer of Enron North America) ("As alleged in the complaint, Colwell, along with others at Enron, engaged in a wide ranging scheme to defraud by manipulating Enron's publicly reported earnings through a variety of devices designed to produce materially false and misleading financial results. This scheme included the misuse of reserve accounts, concealment of losses, inflation of asset values, and deliberate use of improper accounting treatment for transactions."); SEC v.

2. The Defendant's Role in the Scheme

When it comes to the question of the defendant's role in a Rule 10b-5 violation, the court must address two subsidiary questions: did the defendant participate in the scheme in her capacity as an officer or director of a public company, and was the defendant the organizer or leader of the scheme?

The first question focuses on whether the defendant exploited her position as an officer or director of a public company in order to orchestrate the fraud. Often, the answer is no. Accountants, lawyers, stockbrokers, business promoters, and others are often defendants in Rule 10b-5 cases. For them, the presumption should be that they are neither "unfit to serve as an officer or director" nor suitable candidates for a lifetime bar order. This presumption may be rebutted where the defendant's role in the scheme was similar to that of an officer or director—she was the organizing force behind the scheme, she directed and recruited other people into the scheme, and she employed multiple competencies in executing the scheme; she has the educational and professional background that would render her suitable for an officer or director's position; and a limited-term suspension order (or "cooling-off period") is insufficient to protect the public.

As for those who *were* an officer or director of a public company at the time they violated Rule 10b-5, that fact alone should not compel a finding of unfitness. As noted above, Congress could easily have written a law that automatically triggered such a finding—but it did not.[265] A defendant's status as an officer or director, however, is an important factor to consider in a Rule 10b-5 case, both because it suggests an abuse of a position of trust and also because it often suggests that the defendant acted as a "kingpin" in the scheme.

The second aspect of the "role" inquiry—regardless of whether the defendant was an officer or director—is the question of leadership in the scheme. The Sentencing Guidelines (through the kingpin provision)[266] recognize that persons who orchestrate frauds are more blameworthy than persons who merely follow directions, even if the subordinates know their actions are wrong. Thus, a junior level executive who is directed by his superiors to alter a corporation's financial statements in order to deceive investors may reasonably be punished for having done so, and certainly will be challenged in the marketplace for managerial employment, but there is little need—subject to the other factors set out in this Article—to conclude that such a person is unfit.[267] A senior level executive who

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Kopper, Litigation Release No. 17692, 2002 SEC LEXIS 2159 (Aug. 21, 2002) (barring a former high ranking executive at Enron Corporation) ("As alleged in the complaint, starting in at least early 1997, Kopper and others used complex structures, straw men, hidden payments, and secured loans to create the appearance that certain entities that Kopper and others at Enron funded and controlled were independent of Enron. This allowed Enron to move its interests in these entities off its balance sheet when, in fact, those interests should have been consolidated into Enron's financial statements.").

265. *See supra* note 68 and accompanying text.

266. *See supra* Section IV.A.4.

267. Note that the SEC did not seek a lifetime bar order against Betty Vinson, the accountant who altered $1.5 billion worth of transactions in WorldCom's financial statements and did not seek *any* relief against Catherine Fowler, the vice-president who

directs subordinates to engage in unlawful conduct, on the other hand, should be a much stronger candidate for a finding of unfitness.[268]

3. The Use of Corporate Resources in Executing the Scheme

Misusing corporate resources should be an important feature of the unfitness inquiry. Not every corporate employee who participates in a fraud does so on company time or through the use of corporate information. The same is true of corporate officers and directors.[269] When such persons violate the securities laws in a manner that is entirely coincidental to their institutional positions, there would seem little need—save a symbolic one—to subject them to a lifetime bar order.

The government might argue that the Sentencing Guidelines impose an enhanced penalty on defendants who engage in securities law violations while officers or directors of public companies, without regard to whether their crime involved an abuse of their corporate position.[270] The Sentencing Guidelines in that regard are overbroad, in my view. Violations that are coincidental to a defendant's position as an officer or director, and that do not involve a breach of fiduciary duties, should not be punished to the same degree as violations that depend on the privileges of office. Stated another way, the mere fortuity that the defendant is a highly-placed executive should not necessarily result in a penalty-enhancement, any more than would be the case if the defendant were a doctor or schoolteacher.

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altered twenty-seven million dollars worth of transactions in HealthSouth's financial statements. Vinson did, however, consent to be barred from appearing before the Commission under Rule 102(e). SEC v. Vinson, Litigation Release No. 17883, 2002 SEC LEXIS 3119 (Dec. 6, 2002) (suspending Vinson from appearing or practicing before the Commission as an accountant).

268. *See* SEC v. Harris, Litigation Release No. 18700, 2004 SEC LEXIS 951 (May 10, 2004) (entering a lifetime bar order against the former group vice president of HealthSouth Corporation, where he "directed HealthSouth employees to make false accounting entries to inflate reported operating results"); SEC v. Sullivan, Litigation Release No. 18605, 2004 SEC LEXIS 493 (Mar. 2, 2004) (entering a lifetime bar order against former CFO of WorldCom, where he "instructed subordinates to book certain fraudulent adjustments and entries in WorldCom's general ledger"); SEC v. Martin, Litigation Release No. 18339, 2003 SEC LEXIS 2152 (Sept. 10, 2003) (entering a lifetime bar order against a former CFO of HealthSouth, where he "directed lower level accounting personnel to make false entries to HealthSouth's accounting books and records"); SEC v. Allaire, Litigation Release No. 18174, 2003 SEC LEXIS 1352 (June 5, 2003) (entering a lifetime bar order against former CFO of Xerox Corpration, where he "directed or allowed lower ranking defendants in Xerox's financial department to make accounting adjustments to results reported from operating divisions to accelerate revenues and increase earnings").

269. A good example is Martha Stewart, who is alleged by the SEC to have engaged in insider trading in Imclone stock. There is no allegation that she utilized the resources of Martha Stewart Living Omnimedia, Inc. in making that trade. Still, the Enforcement Division is seeking a lifetime bar order against her serving as a director of any public company, and a bar limiting her activities as an officer of MSLO. SEC v. Stewart, Litigation Release No. 18169, 2003 SEC LEXIS 1333 (June 4, 2003).

270. *See supra* note 169 and accompanying text.

Similarly, the fact that a securities law violator was an officer or director at the time of the violation may be a legitimate factor to consider in determining "unfitness" under the Sarbanes-Oxley Act. That fact alone, however, is not enough to warrant a remedy-enhancement. The Commission's current practice of routinely seeking lifetime bar orders against corporate executives in civil cases may make sense as a matter of expressive justice, but would seem, in the absence of other factors set forth in this Article, to be an exercise in overreaching.

4. The Defendant's Financial Gain (or Loss Avoidance) from the Scheme

In all the cases we looked at in Section III, a common theme running throughout was self-enrichment. Thus, and not surprisingly, self-enrichment should be a key factor in any unfitness inquiry. Self-enrichment is contrary to basic concepts of agency, undermines investors' confidence in corporate leadership, and—without full and timely disclosure—violates the compact between managers and owners.

Not all securities law violators profit from their wrongdoing, of course. Pumping up a company's financial statements without accompanying reward does occur. So does tipping without a quid pro quo. But in most Rule 10b-5 cases, violators achieve a measurable profit (or avoid a measurable loss), which is usually subject to an order of disgorgement. The rule of thumb should be, the greater the benefit unlawfully extracted from the scheme, the more likely the defendant is to be found "unfit."

5. The Loss to Investors and Others as a Result of the Scheme

A key element of the "unfitness" inquiry under the Remedies Act was how much harm the defendant had caused in the marketplace.[271] The concept of harm was not well-developed in the case law under the Remedies Act, nor will it be here. Suffice it to say that harm is disputable territory, raising issues both of loss causation (as construed in the Rule 10b-5 cases)[272] and "actual loss" (as construed under the Federal Sentencing Guidelines).[273] All other things being equal, however, a big-ticket scheme should more frequently lead to a finding of

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271. *See, e.g.*, SEC v. Chester Holdings, Ltd., 41 F. Supp. 2d 505, 517 (D.N.J. 1999) (entering a lifetime bar order where the defendant had orchestrated an asset restatement totaling $11.9 million); SEC v. Softpoint, Inc., 958 F. Supp. 846, 851 (S.D.N.Y. 1997), *aff'd*, 159 F.3d 1348 (2d Cir. 1998) (entering a lifetime bar order where the defendant's conduct "involved fraud, deceit, manipulation, and deliberate disregard of regulatory requirements, and because his conduct created a significant risk of substantial losses to others").

272. *See generally* John F. X. Peloso & Francis S. Chaplowski, *Loss Causation: Who Was Responsible for the Market Bubble?*, N.Y.L.J., Aug. 21, 2003, at 3 (exploring recent loss causation cases). *See also* Broudo v. Dura Pharm., Inc., 339 F.3d 933 (9th Cir. 2003), *cert. granted*, 124 S. Ct. 2904 (June 28, 2004).

273. *See generally* Mary Kreiner Ramirez, *Just In Crime: Guiding Economic Crime Reform After the Sarbanes-Oxley Act of 2002*, 34 LOY. U. CHI. L.J. 359, 402-03 (2003) (tracing the development of a workable definition of "actual loss" for sentencing purposes); Frank O. Bowman, III, *The 2001 Federal Economic Crime Sentencing Reforms: An Analysis and Legislative History*, 35 IND. L. REV. 5, 38–39 (2001) (same).

unfitness than a small scheme. A scheme that imposes harm on a wide range of victims is a more suitable predicate for a finding of unfitness than a scheme with a single victim.

6. Whether the Defendant's Conduct Represents an Isolated Act or a Pattern of Misconduct

Certainly, recidivism is an important factor in determining whether a defendant is unfit. Indeed, the problem of recidivism was the primary motivator for the enactment of the Remedies Act in 1990 and an essential element in a number of lifetime bar orders entered under that Act.[274] It is fair to say that, where an executive defendant has a history of significant violations of the securities laws, a finding of unfitness will almost always be appropriate. The harder question will be how to deal with first offenders, a question to which we will return when we consider the difficult problem of prediction.[275]

7. The Defendant's Use of Stealth and Concealment

Just as all frauds involve some abuse of trust,[276] all frauds involve some degree of stealth and concealment. Still, some forms of stealth are more significant than others. Certainly, falsification of documents (either during or in order to conceal the fraud), suborning perjury by employees and others, lying to the government, expatriating proceeds to offshore accounts, and lying to employees about the nature of their actions should all be positive factors in a finding of unfitness. Defendants whose conduct over an extended period of time evidences their intention to deceive others and cover up their wrongdoing should be strong candidates for a finding of unfitness.[277]

8. The Defendant's History of Business Misconduct

In deciding whether a defendant is unfit, the court may reasonably inquire into issues going beyond the immediate complaint. In this context, there is nothing inappropriate about the admission of extrinsic evidence.[278] The court may wish to

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274. *See, e.g.*, *Chester Holdings Ltd.*, 41 F. Supp. 2d 505, 531 (D.N.J. 1999) (entering a lifetime bar order after noting that the defendant "[had] been restrained, censured, fined, and even imprisoned for prior securities violations and is currently facing criminal charges); SEC v. First Pac. Bancorp, 142 F.3d 1186, 1193 (9th Cir. 1998) (entering a lifetime bar order after noting that the defendant had been a recidivist).

275. *See infra* Section V.C.

276. *See* United States v. Buck, 324 F.3d 786, 792–93 (5th Cir. 2003).

277. *See* Mark Maremont, *Rite-Aid's Ex-CEO Sentenced to 8 Years for Accounting Fraud*, WALL ST. J., May 28, 2004, at A3 (describing the actions of Martin L. Grass, former CEO of Rite-Aid). "[Grass] directed a two-year conspiracy to cover up his misdeeds. Among other things, . . . the former chief executive 'persuaded a cadre of witnesses' to commit perjury, submitted false evidence to investigators and created a bogus, backdated document to cover up a self-dealing land purchase." *Id.* In a parallel civil proceeding, Grass has accepted a lifetime bar order. SEC v. Bergonzi, Litigation Release No. 18728, 2004 SEC LEXIS 1094 (May 27, 2004).

278. *See* Barnard, *Substantially Unfit*, *supra* note 22, at 1504–05 (suggesting that "a broad inquiry into the defendant's overall behavior" is appropriate in the remedies phase of a civil case).

gather "character" evidence about the defendant, as well as evidence about the defendant's conduct in other business and professional settings.

This kind of evidence can be quite illuminating. Ivan Boesky, for example, had a history of deception and questionable business dealings.[279] Sam Waksal, too, was revealed to have engaged in a pattern of corner-cutting and duplicity throughout his scientific and professional career.[280] Some might even say that Martha Stewart has evidenced unsavory character traits—imperiousness, ambition, and an obsession with detail.[281] (Ironically, the very same characteristics have been ascribed to Jack Welch, who has been lionized as one of America's finest CEOs.) It is entirely legitimate for courts to consider evidence of this nature, for it goes to the very heart of the question of "unfitness."

9. The Defendant's Acknowledgment of Wrongdoing and the Credibility of His Contrition

Embedded in any finding of unfitness is an inevitable moral judgment. Whatever else is on the table, a finding of unfitness involves at least an intuition that the defendant is a sufficiently bad person that she should be incapacitated or else she will generate further social harm. One means of countering that intuition is to persuade the fact-finder that the defendant appreciates the wrongfulness of her conduct, sincerely regrets it, and will not repeat it. Courts may call this "remorse," "contrition," or "acceptance of responsibility," but it is a concept familiar to federal district judges. They often reward "substantial and meaningful contrition" by reducing the monetary penalties in civil cases.[282] They may also reward acceptance of responsibility by reducing the sentences in criminal cases.[283]

Experienced judges know what to look for when assessing a defendant's expression of contrition and remorse.[284] The focus of the inquiry should be

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279. See JESSE KORNBLUTH, HIGHLY CONFIDENT: THE CRIME AND PUNISHMENT OF MICHAEL MILKEN 68 (1992) ("Boesky sat on SEC panels when he was committing his most outrageous crimes. He did nothing to discourage his guests at the Harvard Club from believing he had spent years in Cambridge. He charged his investors high management fees and then defrauded them by making some of his most profitable trades through an entity that siphoned their gains to his account; later, in order to pay his lawyers, he may have defrauded his employees by draining $5 million to $10 million out of their salary-and-bonus account. He listed himself as an adjunct professor at Columbia University's Graduate School of Business when he was no more than a guest lecturer.").

280. *See* ALEX PRUD'HOMME, THE CELL GAME: SAM WAKSAL'S FAST MONEY AND FALSE PROMISES—AND THE FATE OF IMCLONE'S CANCER DRUG (2004).

281. *See* CHRISTOPHER M. BYRON, MARTHA, INC.: THE INCREDIBLE STORY OF MARTHA STEWART LIVING OMNIMEDIA (2002); JERRY OPPENHEIMER, MARTHA STEWART: JUST DESSERTS: THE UNAUTHORIZED BIOGRAPHY (2003).

282. *See, e.g.*, SEC v. Inorganic Recycling Corp., Fed. Sec. L. Rep. ¶ 92,269, at 14 (S.D.N.Y. Aug. 23, 2002) (concluding that the appropriate civil penalty for a defendant who demonstrated "substantial and meaningful contrition" was "zero").

283. *See, e.g.*, United States v. Weeks, No. 00-CR.91-21, 2003 U.S. Dist. LEXIS 20277, *41 (S.D.N.Y. Nov. 12, 2003) (reducing the base offense level by three levels where the defendant "has shown recognition of responsibility for the offense").

284. Two critics have recently argued that the issue of remorse is particularly subject to bias and favoritism on the part of judges. Stephanos Bibas & Richard

whether the defendant "has accepted responsibility for his conduct in a moral sense,"[285] and not just given lip service to the concept. Contrition alone should not avoid a finding of unfitness, but sincere contrition may mitigate other positive factors from the preceding list.

C. The Problem of Prediction

The reader will note that none of the nine factors listed so far goes directly to the question whether, if left unimpeded, the defendant is likely to engage in future violations of Rule 10b-5. I have deliberately avoided including such findings in the proposed test for "unfitness" for two reasons: first, many courts' a finding of a "likelihood of future misconduct" are really a measure of the severity of the defendant's prior misconduct, rather than a sincere effort to predict the future; and second, even sincere efforts to predict the future often involve little more than guesswork. I am reluctant to invite courts to engage in this kind of prognostication, even though it frequently occurs in injunction cases.[286] Predictions are particularly difficult in the case of first offenders.

We know, for example, that first offenders have demonstrably lower recidivism rates than other offenders, regardless of the nature of their crime.[287] Recidivism is particularly rare for first offenders whose offense is some type of fraud.[288] This pattern would suggest that first offenders should almost never be subject to a finding of a likelihood of future misconduct. There is a problem, though, with that approach. Many of the most notorious offenders whose activities

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Bierschbach, *Integrating Remorse and Apology Into Criminal Procedure*, 114 Yale L.J. 85 (2004). Still, "a district court's assessment of witness credibility [on such matters as remorse] is quintessentially a judgment call and virtually unassailable on appeal." United States v. Causor-Serrato, 234 F.3d 384, 390 (8th Cir. 2000).

285. United States v. Bosque, 312 F.3d 313, 316 (7th Cir. 2002).

286. *See, e.g.*, CFTC v. Hunt, 591 F.2d 1211, 1220 n.4 (7th Cir. 1979) (reversing and remanding lower court's denial of an injunction against the offspring of W.H. and N.B. Hunt, even though they had never traded in commodities, where "[i]t is not unlikely that they, either personally or with the advice of the Hunt family financial counselors, will be in a position to violate the regulation in the future"); SEC v. Berger, 244 F. Supp. 2d 180,193 (S.D.N.Y. 2001), *aff'd*, 322 F.3d 187 (2d Cir. 2003) (entering a permanent injunction where "because of his history and experience in the securities markets, there is reason to believe that [the defendant] might attempt to return to investment activity in the future").

287. MEASURING RECIDIVISM, *supra* note 135, at 15. In a recent study, the recidivism rate for offenders with zero criminal history points prior to their criterion offense was 11.7%, compared to 22.6% for offenders with only one criminal history point and 36.5% for offenders with two or more points. U.S. SENTENCING COMM'N, RECIDIVISM AND THE "FIRST OFFENDER": A COMPONENT OF THE FIFTEEN YEAR REPORT ON THE U.S. SENTENCING COMMISSION'S LEGISLATIVE MANDATE 13–14 (May, 2004) [hereinafter RECIDIVISM AND THE "FIRST OFFENDER"]. For those offenders who had never experienced even a single arrest, the recidivism rate was only 6.8%. *Id.* at 14.

288. Among defendants convicted of fraud, the rate of recidivism for defendants who, prior to their fraud offense, were in Criminal History Category (CHC) I (essentially first offenders) was 9.3%. For defendants in CHC II, the rate of recidivism was 26.3%, for Category III, the rate was 33.8%, for Category IV, the rate was 42.3%, for Category V, the rate was 51.2% and for Category VI, the rate was 53.4%. MEASURING RECIDIVISM, *supra* note 135, at 30, exhibit 11.

gave rise to the passage of the Sarbanes-Oxley Act were first offenders.[289] These are precisely the people, it would seem, at whom the lifetime bar provisions of the Act were directed. Should the fact that these men and women are first offenders, or the fact that there may be no legitimate basis for predicting future misconduct on their part, preclude the entry of a lifetime bar order? I think not.

Some Rule 10b-5 violators may seem like unlikely candidates for a lifetime bar order because they are in jail; they are so tarnished and notorious that they are unlikely to be placed in a position where they can do much more harm; or they have grown too old to be viable candidates in the market for executive employment. As a practical matter, there might be no need for a lifetime bar order in these cases to ensure that these offenders will not become an officer or director or orchestrate a significant fraud in that capacity. But refusing to find these defendants "unfit to serve" because they are unlikely to be hired as an officer or director cannot be the right result in these cases. Defendants in the past have argued that a pending term in prison, or a change in jobs, or the defendant's advanced age should excuse them from prospective sanctions in civil proceedings. Courts in those cases have correctly rejected those arguments.[290]

Still, we must remember that occupational incapacitation orders are intended to be remedial, not punitive, and exist to protect the public.[291] There must be some justification for incapacitating a defendant beyond the mere fact that she has recently broken the law.

I therefore suggest an alternative to the "likelihood of future misconduct" test. For first offenders, I suggest the following: a first offender whose fraud has been "outside the heartland" of conventional frauds, either because of its

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289. Consider Andrew Fastow, for example, who is about to go away for ten years in prison.

290. *See, e.g.*, SEC v. Youmans, 729 F.2d 413, 416 (6th Cir. 1984), *cert. denied*, 469 U.S. 1034 (1984) (reversing denial of an injunction, where the district court erroneously relied on defendant's change of occupation as a controlling factor); SEC v. Bonastia, 614 F.2d 908, 913 (3d Cir. 1980) (same); SEC v. Koracorp Indus., Inc., 575 F.2d 692, 698 (9th Cir. 1978), *cert. denied*, 439 U.S. 953 (1978) (holding that "neither changing jobs nor deterioration of health, in and of itself, or in combination with the cessation of illegal activities and proclaimed reformation, provides a complete defense to an injunction suit"); SEC v. Dimensional Entm't Corp., 518 F. Supp. 773, 775–76 (S.D.N.Y. 1981) (entering a permanent injunction against the defendant, even though he had more than six years of a prison sentence yet to serve); SEC v. Falstaff Brewing Corp., 629 F. 2d 62, 80 n.34 (D.C. Cir. 1980) (affirming the entry of a permanent injunction, notwithstanding that the defendant was in his mid-seventies).

291. *See, e.g.*, United States v. Merriam, 108 F.3d 1162, 1164 (9th Cir. 1997) (asserting that a lifetime bar on associating with a brokerage firm was imposed "to protect the investing public against . . . manipulative activity by those in the securities industry who have a fiduciary obligation to their customers"); *see also* Hudson v. United States, 522 U.S. 93, 104 (1997) (asserting that a prohibition order against a banker serves "to promote the stability of the banking industry"); Cox v. CFTC, 138 F.3d 268, 273 (7th Cir. 1998) (asserting that a lifetime bar on trading in commodities "primarily serves the civil goal of protecting the integrity of the public markets"); *cf.* Smith v. Doe, 538 U.S. 84, 88 (2003) (noting that a statute requiring sex offenders to register with local law enforcement authorities serves "the non-punitive purpose of 'public safety'").

magnitude or its impact on investors, in which he has been the driving and organizing force (or "kingpin"), and for which he expresses no credible contrition or remorse, may be a suitable candidate for a finding of unfitness.[292] A first offender whose fraud is more limited, in which he has been just one of several low-level players, and for which he offers credible remorse, should not be found unfit to serve.

What though, of those first offenders who fall in between the kingpin and "just-following-orders" ends of the spectrum? Here, courts should consider whether the defendant's behavior represents a one-time act of opportunism or a more committed act of lawlessness. Historically, this distinction has been characterized as one between an "isolated act" and a "pattern of wrongdoing."[293]

Criminologists frame the issue somewhat differently, however, distinguishing between "crisis responders," "opportunity takers," "opportunity seekers," and "chronic offenders," each being less blameworthy than the next.[294] Courts in the context of a Sarbanes-Oxley inquiry should attempt to make the same distinction and sanction only those defendants who, by their conduct and attitude both in business and before the court, have demonstrated that they are "opportunity seekers" or worse. Factors that might bear on the question of whether a first offender is an "opportunity seeker," and is therefore a more suitable candidate for a finding of unfitness than someone who is merely an "opportunity taker," are: the complexity and duration of the scheme; the defendant's position in the hierarchy of

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292. An example might be Kenneth Lay, former Chairman of Enron. After finally being charged in connection with Enron's collapse (eleven counts of conspiracy and fraud) in July, 2004, Lay immediately called a press conference in which he "firmly reject[ed] any notion that [he] engaged in any wrongful or criminal activity." *Enron's Ken Lay: Cuffed But Confident*, USA TODAY, July 9, 2004, at 1B. While taking responsibility for his failure to save the company, he insisted his conduct "does not equate to a crime." Kara Scannell & Rebecca Smith, *Former Enron CEO Makes His Case on Television*, WALL ST. J., July 9, 2004, at B1. Another example may be Richard Scrushy, former Chairman of HealthSouth, Inc., who appeared on *60 Minutes* to proclaim his innocence and also created a website in which he insists he is "absolutely not guilty." *See* Richard Scrushy, News Service: Setting the Record Straight, *at* http://www.richardscrushy.com.

293. *Compare* CFTC v. Wall Street Underground, Inc., 281 F. Supp. 2d 1260, 1273 (D. Kan. 2003) (entering injunction where defendant's conduct was "not founded on a single incident, but [was] systematic and integral to defendant's business"), *with* SEC v. Globus Group, Inc., 117 F. Supp. 2d 1345, 1347 (S.D. Fla. 2000) (refusing to enter injunction where SEC action was based on "isolated, as opposed to recurrent, violations of the securities laws"). *See also* SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 19 (2d Cir. 1977) (affirming denial of injunction where the defendant's inappropriate disclosure was "merely one instance of misconduct not likely to recur").

294. WEISBURD & WARING, *supra* note 65 at 58. A "crisis responder" is someone who responds to a personal or professional crisis by resorting to crime. *Id.* at 59. An "opportunity taker" commits a crime because a sudden or unusual opportunity arises that is too good to pass up. *Id.* at 64. An "opportunity seeker" spends considerable time imagining and engineering fraudulent schemes. *Id.* at 78. A "chronic offender" is a person who has a demonstrated record of recidivism. *See id.* at 53, 74. S*ee also* Alex R. Piquero et al., *The Criminal Career Paradigm*, 30 CRIME & JUST. 359, 464 (2003) (noting the distinction between "desistors" (those with relatively low recidivism possibilities) and "persisters" (those with relatively high recidivism probabilities)).

the scheme; the defendant's role as an initiator of the scheme; the degree of stealth and concealment involved; and the defendant's lack of contrition.

Looking to identify "opportunity seekers" is less exacting, perhaps, than the *Patel* court's insistence on a specific finding of a likelihood of future misconduct.[295] It is more exacting, however, than the banking cases' exclusive reliance on backward-looking observations.[296] And it seems at least minimally consistent with the courts' desire to ensure market integrity[297] or market stability[298] and to protect the public[299] when they have entered lifetime bar orders in the past. Distinguishing between opportunity seekers (who may be unfit because they are likely to continue to look for ways to abuse or disrupt the capital markets) and opportunity takers (whose wrongs are situational and unlikely to be repeated) may not be a perfect solution to the problem of prediction, but it seems to be the best a court can hope to do.

D. Courts Should Enter Specific Findings Supporting a Conclusion of Unfitness

No matter how the specific facts break down under the "unfitness" test I have proposed in this Article, the court should make written findings to support any ultimate finding of unfitness.[300] The U.S. Court of Appeals for the Second Circuit insisted on such findings under the Remedies Act.[301] Certainly, when the finding of unfitness is made by an administrative agency, that agency should be required to "specify how [the defendant's] conduct demonstrated his unfitness to serve as an officer or director."[302] It must "provide some explanation of why [the defendant] is unfit to serve."[303]

The reasons for insisting that courts document the basis for a finding of unfitness are easy to understand. First, it disciplines the trial court to consider carefully whether its conclusion is based on something more than retributive impulse. It also provides a record upon which a reviewing court may test the reasonableness of the trial court's conclusion.[304]

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295. *See supra* note 37 and accompanying text.

296. *See supra* note 95 and accompanying text.

297. Cox v. CFTC, 138 F.3d 268, 273 (7th Cir. 1998); Jones v. SEC, 115 F.3d 1173, 1179 (4th Cir. 1997).

298. Hudson v. United States, 522 U.S. 93, 104 (1997).

299. United States v. Merriam, 108 F. 3d 1162, 1164 (9th Cir. 1997).

300. *See* FED. R. CIV. P. 52(a) (requiring courts to prepare findings of facts).

301. Taking into account the "loss of livelihood and the stigma attached to permanent exclusion from the corporate suite," the Court of Appeals required the district court to "articulate the factual basis for a finding of substantial unfitness." SEC v. Patel, 61 F.3d at 137, 142 (2d Cir. 1995).

302. Doolittle v. Nat'l Credit Union Admin., 992 F.2d 1531, 1538 (11th Cir. 1993).

303. *Id.*

304. *See* Armstrong v. CFTC, 12 F.3d 401, 403 (3d Cir. 1993) (noting that the purposes for requiring written finding in administrative agency adjudications are "to prevent arbitrary agency decisions, provide parties with a reasoned explanation for those decisions, settle the law for future cases, and [to furnish] a basis for effective judicial review").

E. Courts Should Be Open to Revisiting the Unfitness Question

The Sarbanes-Oxley Act provides no provision for the trial court to revisit the question of unfitness. By contrast, both the federal banking laws[305] and the laws governing securities professionals[306] each provide a mechanism for amending or revoking a lifetime bar order.[307] So do statutes similar to Sarbanes-Oxley in the United Kingdom and Australia.[308]

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305. *See, e.g.*, 12 U.S.C. § 1818(e)(7)(B) (2004) (permitting the lifting of a prohibition order where the regulatory agency consents).

306. *See, e.g.*, 15 U.S.C. § 80a-9(c) (the investment company statute) (providing that a person debarred from serving as an employee, officer or director of an investment company may seek an exemption from such an order upon a showing that the sanction is "unduly or disproportionately severe" or that "the conduct of such person has been such as not to make it against the public interest or protection of investors to grant such an application").

307. These statutes are rarely, but occasionally, invoked. *See, e.g.*, *In re* Wien, Exchange Act Release No. 49000, 2003 SEC LEXIS 3087 (Dec. 29, 2003) (vacating a 1982 order barring the defendant from associating with any broker, dealer, investment company, investment adviser or municipal securities dealer); *In re* Cozzolino, Exchange Act Release No. 49001, 2003 SEC LEXIS 3083 (Dec. 29, 2003) (vacating a 1974 order barring the defendant from associating with any broker or dealer except as a supervised employee in a non-supervisory capacity).

> The factors to be considered in reviewing a petition to lift a bar order against a securities professional include (1) the nature of the misconduct at issue in the underlying matter (more serious and extensive allegations militate against relief); (2) the time that has passed since issuance of the administrative bar; (3) the compliance record of, and any regulatory interest in, the petitioner since issuance of the administrative bar; (4) the age and securities industry experience of the petitioner, and the extent to which the Commission has granted prior relief from the administrative bar; (5) whether the petitioner has identified verifiable, unanticipated consequences of the bar; (6) the position and persuasiveness of the Division of Enforcement as expressed in response to the petition for relief; and (7) whether there exists any other circumstance that would cause the requested relief from the administrative bar to be inconsistent with the public interest or the protection of investors.

In re Wien, Exchange Act Release No. 49000, 2003 SEC LEXIS 3087 (Dec. 29, 2003).

As for banking cases, see *In re* Chu, 2003 FDIC Enf. Dec. LEXIS 12 (Feb. 28, 2003) (terminating a prohibition order entered in 1999), and *In re* Feinberg, 1998 FDIC Enf. Dec. LEXIS 42 (July 7, 1998) (terminating a prohibition order entered in 1974).

The factors to be considered in reviewing a petition to terminate a prohibition order are: (1) the applicant's current fitness to participate in the banking industry; (2) whether the applicant's participation would pose a risk to an institution's safety and soundness; and (3) whether the applicant's participation would erode public confidence in an institution. *In re* Lawson, 2003 FDIC Enf. Dec. LEXIS 127 (Sept. 8, 2003).

308. *See, e.g.*, Company Directors Disqualification Act, 1986, ch. 46, § 1(1) (U.K.) (permitting the court to grant leave to a disqualified person to serve as director or administrator of a company or to "take part in the promotion, formation, or management of a company"); Corporations Act, 2001, § 206G (Austl.) (permitting the court to grant leave to certain disqualified persons to manage a particular corporation, a particular class of corporations, or any corporation). Leave is sometimes granted at the time the bar order is entered, and sometimes following a period of rehabilitation. *See In re* China Jazz

The existence of these models might support an argument that, if Congress had wanted to create a mechanism to re-open unfitness determinations in litigated proceedings, it surely could have done so, but deliberately chose not to. One might counter, however, that defendants subject to a lifetime bar order have an inherent right to request a revisitation of the question of their unfitness, perhaps on the theory that an irrebuttable presumption of unfitness denies the defendant due process[309] or perhaps on some other due process theory.[310] Certainly, there is an existing right for litigants to seek review of the terms of *any* court-ordered injunction. An injunction may be lifted when "it is no longer equitable that the injunction should have prospective application."[311]

I am not suggesting that it should be easy to lift the bar. For example, a period of good behavior should not be enough, on its own, to lift the bar.[312] Something more, like an extended period of exemplary performance in a business setting, payment of restitution to known victims, and a strong showing of peer support and confidence may be required.[313] But it should be possible, after a

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Worldwide Plc, 2003 WL 23145273 (Ch. D.) (leave granted immediately); *In re* Realisations Ltd., 1999 WL 1142774 (leave granted after passage of several months).

309. *See, e.g*., Windy City Meat Co. v. USDA, 926 F.2d 672, 678, 680 (7th Cir. 1991) (suggesting that a *per se* rule that would result in termination of meat inspection services without affording the defendant a chance to adduce mitigating evidence may violate the due process clause); *but see* Black v. Snow, 272 F. Supp. 2d 21, 29, 33 (D.D.C. 2003) (holding that statute barring all convicted felons from possessing firearms does not violate the irrebuttable presumption doctrine and that "recent developments in constitutional law have significantly limited, if not altogether abrogated, the irrebuttable presumption doctrine").

310. One case suggesting such an argument was dismissed on procedural grounds under the Rooker-Feldman doctrine. In *Czura v. Supreme Court*, 813 F.2d 644 (4th Cir. 1987), a disbarred attorney challenged the denial of his petition for readmission and, by inference, a state statute that prohibited readmission after disbarment. He argued that the statute violated his rights to due process and equal protection, "including his rights to be rehabilitated and to practice his profession." Apart from procedural roadblocks, substantive law also presents some challenges in this area. *See, e.g.*, Demore v. Kim, 538 U.S. 510 (2003) (upholding a statute requiring the detention of deportable aliens, notwithstanding petitioner's claim that the scheme's failure to permit him to prove that he is neither a danger to society nor a flight risk deprives him of rights under the due process clause); Connecticut v. Doe, 538 U.S. 1 (2003) (upholding a sexual offender registration statute, notwithstanding petitioner's claim that the scheme's failure to permit him to prove that he is not "currently dangerous" deprives him of rights under the due process clause); Ruggiero v. FCC, 317 F.3d 239 (D.C. Cir. 2003) (upholding an order barring a person who had engaged in the unlicensed operation of a radio station from receiving a low-power FM radio license, notwithstanding petitioner's claim that treating former "pirates" differently than other license applicants with different types of FCC violations in their past constituted a denial of equal protection).

311. FED. R. CIV. P. 60(b)(5). In order to invoke this rule, the movant must show a significant change in factual conditions. Life Techs., Inc. v. Promega Corp., 189 F.R.D. 334, 336 (D. Md. 1999).

312. SEC v. Advance Growth Capital Corp., 539 F.2d 649, 652 (7th Cir. 1976).

313. A similar burden is imposed on lawyers seeking readmission to the bar. *See generally* Kimberly A. Lacey, Note, *Second Chances: The Procedure, Principles, and*

reasonable period of time, for a person barred from serving as an officer or director to demonstrate her ability and desire to serve with honor. The burden for her will be to persuade the court, by clear and convincing evidence, that she is no longer "unfit to serve."[314] It would be fair, in addition, to suggest that "the more egregious the misconduct [underlying the bar order], the heavier an applicant's burden to prove his or her present fitness . . . .[315]

The chance to revisit the unfitness question after a reasonable passage of time not only reflects a recognition of the possibility of rehabilitation and reintegration—a classic American ideal[316]—it also may prove very advantageous for investors in the long run. Consider Michael Milken, who, following his imprisonment on multiple counts of securities fraud in 1990,[317] went on to lead with distinction several non-profit and for-profit organizations.[318] Or consider Ilan Reich, who pleaded guilty to insider trading in 1987, spent seven months in federal prison, and was disbarred. He later was reinstated to the bar and has since become the chief executive officer of two successful public companies.[319] Even Barry Minkow, who spent seven years in federal prison for orchestrating an elaborate fraud at ZZZZ Best Company as a young man, is now consulting with the FBI to help ferret out others engaged in frauds much like the one he concocted in the late 1980s.[320] There are hundreds of stories of wrongdoers who have been

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Problems With Reinstatement of Attorneys After Disbarment, 14 GEO. J. LEGAL ETHICS 1117 (2001).

314. *See, e.g.*, Fla. Bd. of Bar Exam'rs re: L.H.H., 660 So. 2d 1046, 1048 n.2 (Fla. 1995) (applying a clear and convincing standard of proof to disbarred attorney's petition for reinstatement); *In re* Pier, 561 N.W.2d 297, 299 (S.D. 1997) (same); *see also In re* Lawson, 2003 FDIC Enf. Dec. LEXIS 127 (Sept. 8, 2003) (noting that "[a]n applicant seeking modification or termination or an order of prohibition bears a 'strong burden' of proof as to his or her current fitness"); Mohr v. White, 756 N.E.2d 434 (Ill. App. Ct. 2001) (applying a clear and convincing standard of proof to driver's petition for reinstatement of driving privileges).

315. *In re* Robbins, 836 P.2d 965, 966 (Ariz. 1992).

316. In his 2004 State of the Union Address, President George W. Bush declared "America is the land of [the] second chance." President George W. Bush, State of the Union Address (January 20, 2004), *available at* http://www.whitehouse.gov/news/releases/2004/01/20040120-7.html.

317. The specific charges were conspiracy with Ivan Boesky; aiding and abetting the filing of false statements; aiding and abetting the evasion of net capital rules (all these counts had to do with stock "parking" for Boesky); securities fraud for concealing the ownership of MCA stock; mail fraud; and assisting the filing of a false tax return. JAMES B. STEWART, DEN OF THIEVES 436 (1991).

318. *See* Greg Burns, *The Boss: Back in the Game*, CHI. TRIB., June 13, 2004, at C1 (describing the public policy work of the Milken Institute); Michael Olesker, *Michael Milken's Second Act Will Be a Tough One to Top*, BALT. SUN, June 15, 2004, at 1B (recounting Milken's philanthropies and his leadership of Knowledge Universe, "a mix of companies specializing in early childhood education"); Rita Rubin, *Now Just Call Him Mr. Philanthropist*, U.S. NEWS & WORLD REP., Dec. 25, 1995, at 90 (describing his role as founder and leader of the Association for the Cure of Cancer of the Prostate).

319. Steven Brill, *Redemption?*, AM. LAW., Mar. 1996, at 4 (reporting on Reich's life ten years after his insider trading was discovered).

320. Jeff D. Opdyke, *Former White-Collar Felon's Insights Reap Redemption*, WALL. ST. J., Aug. 25, 2003, at C1. According to the former federal prosecutor who handled

rehabilitated—some are reinstated to the bar,[321] some go on to a life of community service,[322] and some even get elected to public office.[323] The point is, rehabilitation is possible and the prospect of removal from the SEC's blacklist in recognition of that rehabilitation could be a powerful motivator for good.

As it is now, barred persons often circumvent lifetime bar orders by serving as "senior advisors"[324] or other euphemisms in lieu of serving as an officer or director. If they have value to add in the marketplace, however, and are playing roles similar to officers or directors, they ought to be given the opportunity to do so openly and legally. Permitting them to serve as officers and directors would also subject them to enforceable fiduciary duties and disclosure requirements, whereas now they are subject only to the terms of their contracts. In this respect, lifting the bar has the potential to serve investors and protect shareholder value.

VI. CONCLUSION

The record of the SEC Enforcement Division, both before and since the adoption of the Sarbanes-Oxley Act, reveals the view that any Rule 10b-5 violator can be declared "unfit" if the Division says so and that every defendant the Division declares "unfit" should be barred for life from serving as an officer or director of a public company.

This Article advances a different view. First, it sets out a framework for approaching the "unfitness" question under Sarbanes-Oxley. It uses terms and concepts with which federal judges are already familiar. More importantly, it sets out a principled and systematic set of nine factors designed to help courts distinguish between those Rule 10b-5 violators whose conduct justifies the conclusion that they are unfit to serve as an officer or director and those offenders (a far greater number) whose conduct does not merit the draconian sanction of debarment.

Minkow's case, "Barry appears to be one of those people who truly turned their life around." *Id.*

321. *See, e.g.*, Fla. Bd. of Bar Exam'rs re P.T.R., 662 So. 2d 334, 338 (Fla. 1995).

322. *See, e.g.*, Marc Mauer, *A Policy Whose Time Has Passed?*, HUMAN RIGHTS, Winter, 2004 (noting the story of a former felon—originally sentenced to a term of life in prison—who was recently named Citizen of the Year by the Montgomery, Alabama, Bar Association).

323. *See, e.g.*, New America Foundation, Events: The State of Statehouse Democracy: A Discussion of a Recent Run for a Low Visibility Public Office, *at* http://www.newamerica.net/index.cfm?pg=event&eveID=234 (last visited Dec, 8, 2004) (noting the recent election of a candidate who had been disbarred as a lawyer and had his real estate license revoked). One of Chicago's greatest mayors, Harold Washington, was elected even though his lawyer's license had been suspended for five years as a result of his failure to file federal income tax returns.

324. *See* Mara Der Hovanesian, *Fred Joseph is Back in Business*, BUS. WK., July 14, 2003, at 84 (noting that, after being barred from serving as an officer of a financial services company, Joseph served as a "senior adviser" to such a company).