Written Testimony
United States Senate Subcommittee on Crime and Drugs of the Committee on the Judiciary
"Wall Street and Fiduciary Duties: Can Jail Time Serve as an Adequate Deterrent for Willful Violations?"
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Mr. Andrew Weissmann
Partner, Jenner & Block LLP

Good morning Chairman Specter, Ranking Member Graham, and members of the Committee and staff. I am Andrew Weissmann, a partner at the law firm of Jenner & Block in New York. I served for 15 years as an Assistant United States Attorney in the Eastern District of New York and had the privilege to represent the United States as the Director of the Department of Justice's Enron Task Force and Special Counsel to the Director of the FBI. I also am an adjunct Professor of Law at Fordham Law School, where I teach Criminal Procedure. I am here testifying today on my own behalf.

As the former Director of the Enron Task Force, I see certain parallels between the period following the Enron scandal and the present period following the financial crisis. Now, as then, we have learned that:

- the stability of the institutions we regard as most robust may be illusory;
- sometimes the very complexity of sophisticated financial practices can serve as a cover for blatant fraud;
- the interconnectedness of the global economy may magnify the effects of misconduct, causing collateral damage throughout the system; and
- some of the institutions charged with monitoring and investigating misconduct have failed to see what, in hindsight, can look very clear.

And now, as then, we face the question of what measures we might undertake to better prevent the kinds of conduct that caused such damage to the economy and the public.

To the extent that the current financial crisis can be blamed on willful conduct unburdened by concern for law and ethics, I am in agreement with Senator Specter that it should be recognized as criminal and prosecuted no differently than criminal behavior that occurs apart from Wall Street. I also agree that the threat of civil liability for individuals can sometimes be no substitute for the prospect of jail time or, more broadly, for the retributive moral effect of the imposition of criminal responsibility.

I am not convinced, however, that all -- or even the core -- of the conduct that we find most troubling on Wall Street at this juncture is properly considered criminal. While it is tempting to think that we have not learned the lessons from Enron, we have yet to see the kind of systemic fraud that occurred in that institution. Moreover, to the extent that there is misconduct at play here -- and inevitably there will be some, since Wall Street is not immune from crime -- there are strong and abundant tools already at the government's disposal, if it were to choose to use them. Thus, even if the prescription for the current crisis is in part to impose jail time for

certain Wall Street misconduct, that goal does not necessitate creating additional federal crimes. In short, in my view neither Enron nor the current Wall Street conduct that causes us concern and even outrage were preventable but for the dearth of federal criminal laws.

I will make three main points.

I. The Current Federal Criminal Statutes Provide Adequate Tools to Prosecute and Punish Financial Crime.

The advisability of criminalizing the breach of fiduciary duties owed by financial institutions to clients must be examined in the context of the federal criminal statutes that are already available. Much has been written about the sheer number of federal criminal statutes on the books, and without repeating those compendiums, it suffices to note the enormous growth of federal crimes, including so-called white collar crimes.[1] Most relevant here is the breadth of some existing federal criminal statutes that apply to financial fraud, specifically the mail and wire fraud statutes.[2]

For example, Chapter 63 of the Title 18 of the United States Code contains eleven different provisions criminalizing different forms of mail and wire fraud. To win a conviction under the broadest of these sections, a prosecutor needs only to show (beyond a reasonable doubt, of course) that the defendant used the mails or the wires as part of a scheme to defraud. In our technological and bureaucratic age, almost every action taken by someone at a financial institution satisfies this jurisdictional hook -- any email or SEC filing can suffice. The simplicity and breadth of these statutes is widely recognized; prosecutors of financial fraud almost always bring charges under one of these provisions along with whatever other statutes are more narrowly tailored to the particular crime at issue. One anecdote is illustrative: when I switched from prosecuting organized crime bosses in New York City to going after financial fraud on Wall Street and sought advice on the workings of the intricate securities fraud criminal statutes, a senior white-collar prosecutor told me that the mail and wire fraud statutes were the only ones I would ever really need to know; everything else I might charge was gravy.

The basic mail and wire fraud statutes can be supplemented by myriad others. Indeed, given the breadth of the federal criminal statutes currently available to prosecutors of white-collar crime, it is unclear what conduct that we would think should be a crime does not already come within the current statutory regime. Where a material misstatement or omission regarding an investment is intentionally made, criminal liability is already provided under the mail and wire fraud statutes, as well as the federal laws criminalizing securities fraud. *See* 18 U.S.C. sections 1341, 1343 and 1348 and 15 U.S.C. section 78. Even if one were to expand the scope of the fiduciary duties of financial institutions and their employees, it is hard to see how a breach of fiduciary duty would not involve a misstatement or omission of some kind. Where the

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[1] *See, e.g.,* William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505, 514-15 (2001); Susan A. Ehrlich, *The Increasing Federalization of Crime*, 32 ARIZ. ST. L.J. 825, 825-26 (2000); Am. Bar Ass'n, Criminal Justice Section, Task Force on the Federalization of Criminal Law, *The Federalization of Criminal Law* 7, 51 (1998).

[2] *See* Stuntz, *supra* note 1, at 516-17.

misstatement is not material or the intent not willful, it is not evident that the conduct could be, much less should be, considered criminal. That leads me to my next point.

II. A Statute Criminalizing Breaches of Newly Defined Fiduciary Duties Could Prove Impermissibly Vague.

Even in the civil context, the definition of the scope of fiduciary duties can prove a challenge. Even after centuries of cases analyzing the duties of fiduciaries in different contexts, the inquiry into the exact nature of a fiduciary's obligation in a particular case is often highly fact-specific.[3] Moreover, courts have been hesitant to apply fiduciary duties so broadly so as to change the default rule of caveat emptor.[4]

The poorly defined nature of whether and when there is a fiduciary duty would have particular resonance in the criminal context, where issues of vagueness and notice take on constitutional dimension.[5] The Supreme Court is presently considering the scope of this constitutional dimension in three cases involving challenges to the so-called honest services statute, 18 U.S.C. section 1346, which criminalizes using the mail or the wires to execute a scheme to deprive someone of "the intangible right of honest services."[6] Justice Scalia has long been an ardent critic of this statute, which he recently criticized by saying, "It is simply not fair to prosecute someone for a crime that has not been defined until the judicial decision that sends him to jail."[7] In addition to the concern regarding the lack of notice, the federal courts have recognized other serious issues with that statute ranging from the lack of consistency with which it is applied[8] to its effect of transforming internal company policies into a legal obligation

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[3] *See, e.g.*, *DeKwiatkowski v. Bear, Stearns, & Co.*, 306 F.3d 1293, 1306 (2d Cir. 2002) (collecting instances in which existence of fiduciary duty between broker and investor depended on facts distinguishing situation from the "ordinary case"); *In re Daisy Systems Corp*., 97 F.3d 1171, 1178 (9th Cir. 1996) (rejecting conclusion that relation between investment banker and client is not a fiduciary one, as "existence of a fiduciary relation is a question of fact which properly should be resolved by looking to the particular facts and circumstances of the relationship at issue").

[4] *See, e.g.*, *DeKwiatkowski*, 306 F.3d at 1307-08 (collecting cases refusing to find an ongoing fiduciary duty between broker and investor absent special circumstances or contract to do so); *cf. United States v. Dial*, 757 F.2d 163, 168 (7th Cir. 1985) (Posner, *J.*) (stating that principal "trusts the fiduciary to deal with him as frankly as he would deal with himself" because he or she has "bought candor").

[5] *See Bouie v. City of Columbia*, 378 U.S. 347, 350, 84 S.Ct. 1697, 12 L.Ed.2d 894 (1964) (stating that it is a "basic principle that a criminal statute must give fair warning of the conduct that it makes a crime").

[6] *See Black v. United States*, No. 08-876 (argued Dec. 8, 2009) (concerning whether a conviction under 18 U.S.C. s. 1346 for private conduct requires finding that the defendant reasonably anticipated economic harm); *Weyhrauch v. United States*, No. 08-1196 (argued Dec. 8, 2009) (concerning whether 18 U.S.C. s. 1346 "mandates the creation of . . . a federal common law defining the disclosure obligations of state government officials"); *Skilling v. United States*, No. 08-1394 (argued Mar. 1, 2010) (concerning whether 18 U.S.C. s. 1346 is unconstitutionally vague if it does not require proof that defendant's conduct was intended to advance private gain instead of the employers' interests).

[7] *Sorich v. United States*, 129 S. Ct. 1308, 1310 (2009) (Scalia, *J.*, dissenting from the denial of certiorari).

[8] *See, e.g.*, *United States v. Rybicki*, 354 F.3d 124, 163 (2d Cir. 2003) (Jacobs, *J.*, dissenting) (surveying the lack of uniformity among the circuits in application of s. 1346).

enforced by criminal liability.[9] That statute has been said to criminalize both defrauding a client and an employee wrongly calling in sick for a day. Imposition of criminal liability for a breach of one's fiduciary duties would pose similar risks: whether a defendant had a "fiduciary duty" and what constitutes a breach would be exceedingly ill-defined. For instance, would every breach of duty of care become a federal crime, such that a broker's failure to read diligently all prospectuses or to call a client with updated financial prognoses every day could subject her to criminal sanction? Better to regulate the conduct at issue directly if there is a perceived problem than to use the criminal law to impose a vague stricture that would leave the government with unwarranted discretion and the public without the certainty of clear rules.

Whatever conclusions the Supreme Court reaches in the three cases before it about the constitutionality of the honest services statute will undoubtedly bear directly on the permissible scope of a federal statute criminalizing breaches of fiduciary duties by brokers or others on Wall Street. It would be wise to wait for the Supreme Court to set constitutional standards in this area before initiating the creation of a new federal criminal statute that could well run afoul of the law.

But there are other reasons not to leap to criminalizing conduct that is not now the subject even of civil liability. First, the line separating criminal conduct from all other is society's starkest boundary between right and wrong. It has been reserved, and should continue to be reserved, for the most egregious misconduct. Second, prior to imposition of criminal liability for new fiduciary duties, it would be preferable to first define the scope of specific fiduciary duty obligations in the civil context. It may be that new civil regulation will be sufficient to discourage the problematic practices. Even if it does not succeed, the experience of applying any new fiduciary duty in the civil context will give shape and content to the duty, thus lessening the fairness and notice concerns if the breach of the duty is ultimately criminalized.

III. Additional Protection Against Misconduct Could Be Remedied by Increasing Enforcement of Existing Statutes and Removing Roadblocks to Civil Liability.

While it is true that a corporation may incorporate the costs of lawsuits and civil judgments into the cost of doing business, civil liability nevertheless has a role to play in discouraging misconduct on Wall Street. Regulatory agencies have at their disposal numerous serious civil sanctions. For example,

- individuals, executives, and brokers can be barred from the industry by the SEC;
- corporations can lose their license to sell securities or the privilege of contracting with the government; and
- corporations' profits can be wiped out by both the SEC and DOJ; and they can face not just hefty fines, but also the assignment of federal monitors.

For a corporation, these civil sanctions can be far more painful than a criminal indictment. Moreover, the lower standard of proof for these forms of non-criminal sanction should enable the SEC and civil prosecutors to readily bring and make cases if the conduct is in fact wrongful, as

[9] *See Sorich*, 129 S. Ct. at 1310 (Scalia, *J.*, dissenting from the denial of certiorari).

they need only establish their cases by a preponderance of the evidence. As the SEC's actions in the auction rate securities context demonstrate, the SEC is capable of taking action that protects tens of thousands of investors and punishes wrongdoers. To the extent that one believes that the SEC, in spite of some contrary examples, has been a toothless tiger, the remedy is to encourage the SEC and the civil division of the DOJ to make greater use of their civil enforcement authority, not to rush to criminalize new conduct.

In sum, it is admirable that Congress would take up the issue of what can be done to learn from history. Prior to the imposition of new criminal liability, however, the prudent and fair thing to do -- as well as perhaps the most efficacious -- is to examine the current tools at hand and less Draconian measures that can be taken to assist the public in reducing the risk that they will again be the victims of corporate misconduct.