2019

Principles for State Prosecution of Securities Crime in a Dual-Regulatory, Multi-Enforcer Regime

Wendy Gerwick Couture
University of Idaho College of Law, wgcouture@uidaho.edu

PRINCIPLES FOR STATE PROSECUTION OF SECURITIES CRIME IN A DUAL-REGULATORY, MULTI-ENFORCER REGIME

Wendy Gerwick Couture*

ABSTRACT

This article proposes principles for the exercise of prosecutorial discretion when prosecuting securities crime under state law. Securities transactions in the United States are subject to a dual-regulatory, multi-enforcer regime. Securities are dually regulated by the federal government and the states, with each regulatory scheme including both civil and criminal enforcement provisions. Those laws are multi-enforced at each level by a regulator, private parties, and prosecutors. And yet, the role of state prosecution of securities crime within this regime is undertheorized, and there is little guidance for state prosecutors about how their prosecutorial decisions affect this regime. This article, drawing from the goals of prosecuting securities crime and the implications of this complex regime, provides guidance on states' exercise of prosecutorial discretion therein.

* Wendy Gerwick Couture is the James E. Wilson Distinguished Professor of Law at the University of Idaho College of Law, where she teaches securities regulation, white collar crime, and business associations.

I. INTRODUCTION

Securities transactions in the United States are subject to a dual-regulatory, multi-enforcer regime. Securities are dually regulated by the federal government and the states, with each regulatory scheme including both civil and criminal enforcement provisions. Those laws are multi-enforced at each level by a regulator, private parties, and prosecutors. In this article, I focus on the role of state prosecutors within this complex regime.

States are quite active in prosecuting securities crime. According to the North American Securities Administrators Association ("NASAA"), from 2013 through 2017, states prosecuted an average of 258 securities-related criminal actions per year.[1] During this same time period, federal prosecutors filed an average of 5,306.4 "white collar crime" criminal cases in federal district court.[2] Within the broad category of "white collar

1. *See* N. AM. SEC. ADMIN. ASS'N, 2018 N. AM. SEC. ADMIN. ASS'N ENFORCEMENT REP. BASED ON 2017 DATA 11 (2018) ("U.S. NASAA Member Enforcement Activity 2013-2017") (compiling statistics based on data self-reported by NASAA's members), http://www.nasaa.org/wp-content/uploads/2018/10/2018-Enforcement-Report-Based-on-2017-Data-FINAL.pdf [https://perma.cc/DX28-S2SX]. States prosecuted 255 criminal actions in 2017, 241 criminal actions in 2016, 261 criminal actions in 2015, 271 criminal actions in 2014, and 262 criminal actions in 2013.

2. *See* 2017 U.S. ATT'YS' ANN. STAT. REP. 12 ("Criminal Cases and Defendants in United States District Court") (reporting 4,379 total White Collar Crime cases filed), https://www.justice.gov/usao/page/file/1081801/download [https://perma.cc/Y88M-Y8SH]; 2016 U.S. ATT'YS' ANN. STAT. REP. 12 ("Criminal Cases and Defendants in United States

crime," which includes various non-securities crimes like "bankruptcy fraud" and "federal program fraud," an average of sixty-four per year were subcategorized as "corporate fraud,"[3] an average of approximately 130 per year as "securities fraud,"[4] and an average of eighty-three per year as "other investment fraud."[5] It is likely that other federal securities prosecutions during this time period fell within other subcategories of "white collar crime," such as "insurance fraud" and "mortgage fraud," and within other broad categories, such as "government regulatory offenses." These statistics demonstrate that, although the Department of Justice is the dominant player in the prosecution of securities crime, state prosecutors play a significant role.

And yet, the role of state prosecution of securities crime within this dual-regulatory, multi-enforcer regime is undertheorized, and there is little guidance for state prosecutors about how their prosecutorial decisions affect this regime. In this article, I seek to identify the goals of state prosecution of securities crime and, drawing therefrom, to provide guidance on the exercise of prosecutorial discretion within this regime.

In Part II, I contextualize state prosecution of securities crime within

---

District Court") (reporting 4,791 total White Collar Crime cases filed), https://www.justice.gov/usao/page/file/988896/download [https://perma.cc/NBW7-R5NQ]; 2015 U.S. ATT'YS' ANN. STAT. REP. 12 ("Criminal Cases and Defendants in United States District Court") (reporting 5,233 total White Collar Crime cases filed), at https://www.justice.gov/usao/file/831856/download [https://perma.cc/U87K-YJZQ]; 2014 U.S. ATT'YS' ANN. STAT. REP. 12 ("Criminal Cases and Defendants in United States District Court") (reporting 5,829 total White Collar Crime cases filed), https://www.justice.gov/sites/default/files/usao/pages/attachments/2015/03/23/14statrpt.pdf [https://perma.cc/7YH7-9A M9]; 2013 U.S. ATT'YS' ANN. STAT. REP. 58 ("Criminal Cases and Defendants in United States District Court") (reporting 6,300 total White Collar Crime cases filed), https://www.justice.gov/sites/default/files/usao/legacy/2014/09/22/13statrpt.pdf [https://per ma.cc/3UAC-BU76].

3. 2013-2017 U.S. ATT'YS' ANN. STAT. REP., *supra* note 2, at Table 3A. In fiscal year 2017, 62 criminal cases filed were classified as "corporate fraud." In fiscal year 2016, 54 criminal cases filed were so classified. In fiscal year 2015, 69 criminal cases filed were so classified. In fiscal year 2014, 70 criminal cases filed were so classified. In fiscal year 2013, 66 criminal cases filed were so classified.

4. 2013-2017 U.S. ATT'YS' ANN. STAT. REP., *supra* note 2, at Table 3A. In fiscal year 2017, 93 criminal cases filed were classified as "securities fraud." In fiscal year 2016, 118 criminal cases filed were so classified. In fiscal year 2015, 152 criminal cases filed were so classified. In fiscal year 2014, 132 criminal cases filed were so classified. In fiscal year 2013, 154 criminal cases filed were so classified.

5. 2013-2017 U.S. ATT'YS' ANN. STAT. REP., *supra* note 2, at Table 3A. In fiscal year 2017, 87 criminal cases filed were classified as "other investment fraud." In fiscal year 2016, 97 criminal cases filed were so classified. In fiscal year 2015, 101 criminal cases filed were so classified. In fiscal year 2014, 131 criminal cases filed were so classified. In fiscal year 2013, 119 criminal cases filed were so classified.

this dual-regulatory, multi-enforcer regime. First, because of dual state-federal regulation, every securities transaction is subject to at least two regulatory schemes: federal law and one state's law. Interstate transactions are subject to multiple states' laws, and nationally traded firms are potentially subject to regulation in every state. Second, although federal and state law are largely coextensive, states sometimes criminalize securities-related conduct that is not a federal crime. Third, multiple states, in addition to the federal government, may have criminal jurisdiction to prosecute actors for the same securities-related conduct. Finally, under the dual sovereignty doctrine, successive prosecutions for the same conduct are possible—state and then federal, federal and then state, or one state and then another state.

Next, in Part III, I seek to define the goals of prosecuting securities crime. Drawing from the purposes of the securities laws and enforcement thereof and the theories of criminal punishment, I contend that these goals are multi-faceted and sometimes in tension. On the one hand, securities crime prosecution should promote the following aims: (1) specifically and generally deterring violations of the securities laws; (2) punishing securities law violators, both to further deterrence and to express society's condemnation; and (3) compensating investors who have been harmed by securities violations. On the other hand, securities crime prosecution should aim to further these purposes (1) without incurring unnecessary prosecution or punishment costs and (2) without unduly inhibiting capital formation. Moreover, I argue that, when states are seeking to further these goals by prosecuting securities crime, they should be cognizant that, rather than acting in isolation, they are acting within a dual-regulatory, multi-enforcer regime. Ideally, state securities prosecutions, alongside other federal and state enforcement by public and private parties, would be calibrated so as to balance these sometimes-competing goals.

Against this backdrop, in Part IV, I argue that the exercise of prosecutorial discretion is the appropriate means of calibrating state prosecution of securities crime within this dual-regulatory, multi-enforcer regime. Through the exercise of their discretion, state prosecutors can respond quickly to new data about the benefits and harms of prosecution, as well as to adjustments in other enforcement levers within the regime. Finally, I propose a three-step analysis to guide state prosecutors when exercising their prosecutorial discretion with respect to securities crime. Step One incorporates the multi-faceted goals of prosecuting securities crime, Step Two layers on the multi-enforcer component of that regime, and Step Three incorporates the dual-regulatory aspect of that regime.

II. STATE PROSECUTION OF SECURITIES CRIME WITHIN A DUAL-REGULATORY, MULTI-ENFORCER REGIME

State criminal prosecution is but one enforcement lever within a dual-regulatory, multiple-enforcer regime. Securities are dually regulated at the federal and state levels; and although federal and state securities crimes are largely coextensive, states sometimes criminalize conduct that is not a federal crime. At each level, there are multiple enforcers—public and private, civil and criminal. Moreover, multiple states, in addition to the federal government, may have criminal jurisdiction to prosecute securities-related conduct; and, under the dual sovereignty doctrine, successive prosecutions for the same conduct can be pursued by different sovereigns.

A. Dual Federal-State Regulation

Securities are dually regulated by the federal government and the states. The federal government broadly regulates securities transactions within the United States. For example, the Securities Act of 1933 regulates the offer or sale of securities via "any means or instruments of transportation or communication in interstate commerce or of the mails,"[6] and the Securities Exchange Act of 1934 prohibits manipulative or deceptive devices in connection with the purchase or sale of any security "by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange."[7] When enacting the federal securities laws, Congress included express savings clauses,[8] thus recognizing that each state likewise regulates securities transactions within that state.[9] For example, the Uniform Securities Act, versions of which have been enacted by at least 40 states,[10] regulates the offer or sale of securities[11] and prohibits securities fraud[12] if "the offer to

6. 15 U.S.C. §§ 77e(a)-(c).

7. 15 U.S.C. § 78j.

8. 15 U.S.C. § 77p(a); 15 U.S.C. § 78bb(a).

9. *See* Renee M. Jones, *Dynamic Federalism: Competition, Cooperation and Securities Enforcement*, 11 CONN. INS. L.J. 107, 112 (2005) ("The dual regulatory structure created by Congress was deliberate, and recognized that the states' experience and expertise in the field would be necessary to provide remedies beyond those that the new statutes created.").

10. *See* Carlos Berdejó, *Small Investments, Big Losses: The States' Role in Protecting Local Investors from Securities Fraud*, 92 WASH. L. REV. 567, 586 n.107 (2017) ("At least forty states have adopted some version of the Uniform Securities Act.").

11. *See* UNIF. SEC. ACT § 301 (NAT'L. CONFERENCE OF COMM'RS. ON UNIF. STATE LAWS 2002); *see also* UNIF. SECURITIES ACT § 301 (1956) (amended 1997) ("It is unlawful for any

sell or the sale is made in this State or the offer to purchase or the purchase is made and accepted in this State."[13] As a consequence, every securities transaction within the United States is subject to, at a minimum, two regulatory schemes, while nationally traded securities are potentially subject to fifty-one regulatory schemes.[14]

On certain issues, however, federal law preempts or precludes state law. For example, the National Securities Markets Improvement Act of 1996 preempts state registration or qualification requirements with respect to "covered securities,"[15] including securities that are exempt from federal registration requirements under Rule 506 of Regulation D.[16] As another example, the Securities Litigation Uniform Standards Act of 1998 precludes most securities class actions asserting misrepresentation claims under "the statutory or common law of any State or subdivision thereof."[17]

On other issues, federal law largely defers to state law. For example, in the contexts of limited offerings not exceeding $5,000,000[18] and intrastate securities offerings,[19] federal exemptions from registration

---

person to offer or sell any security in this state unless it is registered under this act.").

12. UNIF. SEC. ACT § 501 (2002); *see also* UNIF. SEC. ACT § 101 (1956) ("It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly to employ any device, scheme, or artifice to defraud.").

13. UNIF. SEC. ACT §§ 610(a) & (b) (2002); *see also* UNIF. SEC. ACT §§ 414(a) & (b) (1956) (amended 1997) (stating that specified sections of the act "apply to persons who sell or offer to sell when (1) an offer to sell is made in this state, or (2) an offer to buy is made and accepted in this state.").

14. *See* Amanda M. Rose, *State Enforcement of National Policy: A Contextual Approach (with Evidence from the Securities Realm)*, 97 MINN. L. REV. 1343, 1383 (2013) [hereinafter Rose, *State*] ("State jurisdiction over securities fraud is not limited to states where the offending firm is headquartered or incorporated. Instead, it typically extends to all states where an offer or sale of the firm's securities has been made. Thus, each of the fifty states could likely assert jurisdiction over a nationally traded firm based on the same alleged misstatement or omission, because at least one resident is likely to have purchased the firm's shares while the misstatement or omission was allegedly distorting the price. A public firm cannot effectively limit the investors who purchase its shares in the secondary market based on state residency, so it has no choice but to expose itself to this level of jurisdictional overlap.").

15. 15 U.S.C. § 77r(a)(1)(A).

16. 15 U.S.C. § 77r(b)(4)(F); 17 C.R.F. § 230.506.

17. 15 U.S.C. § 77p(b); 15 U.S.C. § 78bb(f)(1).

18. *See, e.g.*, 17 C.F.R. § 230.504(b)(i) (providing that the prohibition on general solicitation and advertising and the limitations on resale do not apply to offers and sales that are made "[e]xclusively in one or more states that provide for the registration of the securities, and require the public filing and delivery to investors of a substantive disclosure document before sale, and are made in accordance with those state provisions.").

19. *See* 17 C.F.R. §§ 230.147 & 230.147A ("This section shall not raise any presumption that the exemption provided by section 3(a)(11) of the Act (15U.S.C.

impose few requirements, largely deferring to state offering regulation. Indeed, the SEC declined to impose an offering size limit on Rule 147 and Rule 147A intrastate offerings because "we believe it appropriate that the resident investor protections in intrastate offerings primarily flow from the requirements of state securities law."[20]

With respect to securities crimes, federal law neither preempts state law nor defers to it. Thus, the federal government and the states operate dually, each with full prosecutorial power within the scope of its criminal jurisdiction.

B. Scope of State Securities Crimes

State securities crimes are largely coextensive with federal securities crimes.[21] Most prominently,[22] securities fraud and the offer or sale of unregistered, non-exempt securities are crimes under both federal[23] and state law.[24]

State law sometimes diverges from federal law, however, criminalizing conduct that is not illegal under federal law. For example,

---

77c(a)(11)) is not available for transactions by an issuer which do not satisfy all of the provisions of this section.").

20. Exemptions To Facilitate Intrastate and Regional Securities Offerings, 81 Fed. Reg. 83494, 83509 (to be codified at 17 C.F.R. 200, 230, 239, 240, 249, 270, and 275) (Nov. 21, 2016).

21. *See* Jones, *supra* note 9, at 128 ("Overall then, securities industry participants are guided by uniform legal principles that prohibit them from making false statements or misleading investors.").

22. *See* Stefania A. Di Trolio, *Public Choice Theory, Federalism, and the Sunny Side to Blue-Sky Laws*, 30 WM. MITCHELL L. REV. 1279, 1295 (2004) ("[T]hree distinct types of blue-sky laws remained in effect after 1996: antifraud provisions, provisions requiring the registration or licensing of certain persons engaged in the securities business, and provisions requiring the registration of securities.").

23. *See* 15 U.S.C. §§ 77e(a) & (c) (2011) (prohibiting the offer or sale of unregistered, non-exempt securities); 15 U.S.C. § 77x (2011) (providing for criminal penalties for willfully violating any provision of the Securities Act); 15 U.S.C. § 78j(b) (2011) (prohibiting securities fraud); 15 U.S.C. § 78ff(a) (2011) (providing for criminal penalties for violating any provision of the Exchange Act).

24. *See* UNIF. SEC. ACT § 301 (UNIF. LAW COMM'N 2002) (prohibiting the offer or sale of unregistered, non-exempt securities); UNIF. SEC. ACT § 501 (UNIF. LAW COMM'N 2002) (prohibiting securities fraud); UNIF. SEC. ACT § 508(a) (UNIF. LAW COMM'N 2002) (providing for criminal penalties for willfully violating § 301 and § 501); *see also* UNIF. SEC. ACT § 101 (UNIF. LAW COMM'N 1956) (prohibiting securities fraud); UNIF. SEC. ACT § 301 (amended 1997) (UNIF. LAW COMM'N 1956) (prohibiting the offer or sale of unregistered, non-exempt securities); UNIF. SEC. ACT § 409 (UNIF. LAW COMM'N 1956) (providing for criminal penalties for willfully violating § 101 and § 301).

some states interpret the following elements of securities crimes more broadly than their federal counterpart: (1) the definition of "security"; (2) the requisite mental state about a security's unregistered, non-exempt status when a defendant is charged with offering or selling such a security; (3) the requisite mental state about the false or misleading nature of a statement when a defendant is charged with securities fraud; and (4) the scope of the duty to disclose when a defendant is charged with securities fraud.[25]

1. Definition of "Security"

In order for a transaction to be within the scope of a jurisdiction's securities laws, the interest at issue must qualify as a "security" under the relevant regulatory scheme. Although federal and state securities acts define "security" similarly,[26] state law has a potentially broader reach, particularly with respect to the catch-all category of "investment contracts."

In *SEC v. W.J. Howey Co.*, the Supreme Court held that, under federal law, an investment contract is "a contract, transaction, or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party. . . ."[27] Federal courts are split, however, about what is required to satisfy the common enterprise element. Some courts require horizontal commonality (*i.e.*, a pooling of investors' financial interests), while others interpret this element more expansively as including vertical commonality (*i.e.*, a pooling of the promoter's and at least one investor's interests).[28] Moreover, among those courts that accept vertical commonality, there is a split between a narrow interpretation (requiring that the promoter's and the investor's financial interests be intertwined) and a broad interpretation (merely requiring that the promoter's efforts and the investor's financial interests be intertwined).[29]

For several reasons, state law potentially defines investment contracts

25. These examples are not comprehensive. For example, some states define the element of "materiality" more broadly than under federal law. Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669, 706 (1984).

26. *See* 15 U.S.C. § 77b(a)(1) (2011); 15 U.S.C. § 78c(a)(1) (2011); UNIF. SEC. ACT § 102(28) (UNIF. LAW COMM'N 2002); UNIF. SEC. ACT § 401(m) (amended 1997) (UNIF. LAW COMM'N 1956).

27. S.E.C. v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946).

28. James D. Gordon III, *Defining a Common Enterprise in Investment Contracts*, 72 OHIO ST. L.J. 59, 61 (2011) (summarizing the case law).

29. *Id.*

more expansively than federal law. First, some states have judicially[30] or statutorily[31] adopted variations of the so-called "risk-capital" test,[32] either in addition to[33] or instead of[34] the federal *Howey* test. For example, as the risk-capital test was articulated by the California Supreme Court, an investment contract exists if there is

> an attempt by an issuer to raise funds for a business venture or enterprise; an indiscriminate offering to the public at large where the persons solicited are selected at random; a passive position on the part of the investor; and the conduct of the enterprise by the issuer with other people's money.[35]

As another example, as the risk-capital test was articulated by the Hawaii Supreme Court, an investment contract is created whenever the following elements are present: (1) An offeree furnishes initial value to an offeror, (2) a portion of this initial value is subjected to the risks of the enterprise, (3) the furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise, and (4) the offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise.[36]

---

30. *E.g.*, Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908 (Cal. 1961)(describing how to make a risk capital assessment).

31. *E.g.*, WASH. REV. CODE ANN. § 21.20.005(17)(a) (West 2011) ("'Security' means any . . . investment of money or other consideration in the risk capital of a venture with the expectation of some valuable benefit to the investor where the investor does not receive the right to exercise practical and actual control over the managerial decisions of the venture.").

32. *See* Mark A. Sargent, *Are Limited Liability Company Interests Securities?*, 19 PEPP. L. REV. 1069, 1092 (1992) ("The first point to note about the risk capital test is that there is no single risk capital test. There are different versions in different states.").

33. *E.g.*, People v. Black, 8 Cal. App. 5th 889, 900 (Cal. Ct. App. 2017), *rev. denied* (Cal. 2017) ("It is generally accepted that both the risk capital and federal tests may be applied, either separately or together; a transaction is a security if it satisfies either test."); UTAH CODE ANN. § 61-1-13(1)(s) (West 2016) (defining "investment contract" in the alternative under the *Howey* test and the risk-capital test).

34. *E.g.*, Cunha v. Ward Foods, Inc., 545 F. Supp. 94, 101 (D. Haw. 1982) ("Plaintiffs rightly point out that the question is governed by the Hawaii Supreme Court decision in *State v. Hawaii Market Center, Inc.*, 52 Haw. 642, 485 P.2d 105 (1971). In that case, the court held that, for purposes of the state securities laws, it would not apply the *Howey* test but rather a 'risk capital' test. . . .").

35. Silver Hills Country Club v. Sobieski, 361 P.2d 906, 908 (Cal. 1961) (quoting T.W. Dahlquist, *Regulation and Civil Liability Under the California Securities Act*, 33 CAL. L. REV. 343, 360 (1945)).

36. State v. Hawaii Mkt. Ctr., Inc., 485 P.2d 105, 109 (Haw. 1971) (relying on Ronald

The risk-capital test has the potential to reach more broadly than the *Howey* test. First, it either eliminates *Howey*'s expectation of profits element altogether (as in California)[37] or expands it to include "valuable benefit of some kind" (as in Hawaii).[38] In addition, the risk-capital test replaces *Howey*'s common enterprise element with the more amorphous requirement that the capital be subjected to the risks of the enterprise, which could occur in circumstances in which a common enterprise is not present.[39] In short, states' adoption of the risk-capital test has the potential to bring some interests that are not securities under federal law within the scope of states' securities laws.[40]

Second, some states, albeit while applying the *Howey* test, have interpreted the common enterprise element to include vertical commonality (either narrow or broad), despite the federal court split. For example, the Uniform Securities Act adopts a narrow vertical commonality test: "'[C]ommon enterprise' means an enterprise in which the fortunes of the investor are interwoven with those of either the person offering the investment, a third party, or other investors."[41] The Montana Supreme Court has gone even further, adopting broad vertical commonality: "[W]e conclude that for the purposes of the Act, a common venture can be established by satisfying the elements of any of the above discussed methods—either horizontal, broad vertical, or narrow vertical commonality."[42] Accordingly, some states apply a broader interpretation of

---

J. Coffey, *The Economic Realities of a 'Security': Is There a More Meaningful Formula?*, 18 W. RES. L. REV. 367, 412 (1967)).

37. Silver Hills Country Club v. Sobieski, 361 P.2d 906, 909 (Cal. 1961) (stating that an interest satisfying the risk-capital test is a security "whether or not they [the investors] expect a return on their capital in one form or another").

38. Sargent, *supra* note 32, at 1094 ("The benefits/profits distinction reflects a departure from *Howey*, but its meaning is not all that elusive, and it is of importance only in those exceptional cases in which profits in the narrow sense are not expected.").

39. Sargent, *supra* note 32, at 1095.

40. *See* Jeffrey A. Blomberg & Henry E. Forcier, *But Is It A Security? A Look at Offers from Start-Up Companies*, BUS. L. TODAY, May/June 2005, at 49, 52 ("It is very likely, particularly with respect to the offer and sale of any type of club memberships, that the application of the risk capital test will result in the treatment of such an interest as a security more often than if simply applying the Howey Test."); Richard S. Hardy, *The New Gold Rush: The Last Frontier of the Securities Laws?*, 29 SANTA CLARA L. REV. 359, 374 (1989) ("Subsequent use of the risk capital test by California courts demonstrates the usefulness of the new test in reaching transactions the *Howey* test could not.").

41. UNIF. SEC. ACT § 102(28)(D) (UNIF. LAW COMM'N 2002).

42. Redding v. Montana First Judicial Dist. Court, 281 P.3d 189, 197 (Mont. 2012); *see also* People v. First Meridian Planning Corp., 658 N.E.2d 1017, 1024 (N.Y. 1995) (citations omitted) ("[T]he common enterprise factor can be established by proof that 'the fortunes of

the *Howey* test than is applied by some federal courts.

In sum, on the margins, it is possible for an interest, albeit not a security under federal law, to fall within the scope of a state's securities laws, including its criminal provisions.

2. Mental State About Unregistered, Non-Exempt Status

Offering or selling securities that are neither registered nor exempt from registration violates both federal and state securities law,[43] and, if done with the requisite mental state, such a violation can be criminally prosecuted under both federal and state law.[44] Some states require a lower mental state, however, than federal law.

Under federal law, selling unregistered, non-exempt securities is only a crime if a person acts "willfully."[45] A person "willfully" violates the federal securities laws by "intentionally undertaking an act that one knows to be wrongful."[46] As applied to the sale of unregistered, non-exempt securities, the Government must prove that the defendant knew that the securities were neither registered nor exempt from registration.[47]

---

all investors are inextricably tied to the efficacy [of those seeking the investment or a third party].'").

43. 15 U.S.C. §§ 77e(a) & (c) (2011); UNIF. SEC. ACT § 301 (UNIF. LAW COMM'N 2002); *see also* UNIF. SEC. ACT § 301 (amended 1997) (UNIF. LAW COMM'N 1956)(providing that selling unregistered securities violates state and federal law).

44. 15 U.S.C. § 77x (2011); UNIF. SEC. ACT § 508(a) (UNIF. LAW COMM'N 2002); *see also* UNIF. SEC. ACT § 409 (UNIF. LAW COMM'N 1956) (providing that selling unregistered securities can be criminally prosecuted under state and federal law).

45. 15 U.S.C. § 77x.

46. *See* United States v. Lloyd, 807 F.3d 1128, 1166 (9th Cir. 2015) (finding that this instruction was not reversible error); *see also* United States v. Tarallo, 380 F.3d 1174, 1188 (9th Cir. 2004), *amended by* 413 F.3d 928 (9th Cir. 2005) ("Under our jurisprudence, then, 'willfully' as it is used in § 78ff(a) means intentionally undertaking an act that one knows to be wrongful. . . ."); United States v. Dixon, 536 F.2d 1388, 1395 (2d Cir. 1976) (citations omitted) (defining "willfulness" as "a realization on the defendant's part that he was doing a wrongful act" and that the act "be 'wrongful under the securities laws and that the knowingly wrongful act involve a significant risk of effecting the violation that has occurred'").

47. *See Lloyd*, 807 F.3d at 1166 (finding no reversible error where the instruction required the jury to find that "knowing the securities were not registered and not exempt, the defendant willfully sold or caused them to be sold to the public" but did not require the jury to find knowledge of the registration requirement); United States v. Lindo, 18 F.3d 353, 356 (6th Cir. 1994) (discussing the defendant's argument that, if a good faith reliance on counsel instruction had been given, "the government could not have borne its burden of proving that he willfully caused shares, which he knew to be neither registered nor exempt from registration, to be sold to the public"); *see also* WHITE COLLAR CRIME BUSINESS AND

Many states criminalize the offer or sale of unregistered, non-exempt securities with a lower mental state. In the majority of states, the offer or sale of unregistered, non-exempt securities must be "willful," but willfulness merely requires the defendant to have offered or sold the securities of his or her own volition.[48] These states do not require proof of any mental state regarding the unregistered or non-exempt status of the securities.[49] In California, it is a crime to sell an unregistered, non-exempt security if the defendant "was criminally negligent in failing to know that the security was not exempt."[50] Criminal negligence "refers to a higher degree of negligence than is required to establish negligent default on a mere civil issue. The negligence must be aggravated, culpable, gross, or reckless."[51] Thus, unlike under federal law, a defendant can potentially be convicted under state law of selling unregistered, non-exempt securities even if he or she did not know that the securities were unregistered and non-exempt.

3. Mental State About False or Misleading Nature of Statement

Securities fraud is a crime under federal and state law,[52] but some states require a lower mental state regarding the false or misleading nature of the fraudulent statement than is required under federal law.

The federal crime of securities fraud is usually prosecuted under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.[53] Section 32(a), which criminalizes the violation of Section 10(b), requires a different mental state depending on how the alleged misrepresentation was communicated.[54] If the alleged misrepresentation was contained in a registration statement or mandatory SEC filing, the

---

REGULATORY OFFENSES § 12.02 (citing *Lloyd*) ("To obtain a conviction . . . for unlawful sale of unregistered securities, the government must prove . . . 'that knowing the securities were not registered and not exempt, the defendant willfully sold or caused them to be sold to the public. . . .'"); MODERN FEDERAL JURY INSTRUCTIONS-CRIMINAL § 485-57-3 (Matthew Bender & Co., Inc. 2018).

48. *See* JOSEPH C. LONG, MICHAEL J. KAUFMAN & JOHN M. WUNDERLICH, 12A BLUE SKY LAW § 10:15 (2019) ("Intent—Majority view that intent need not be shown for nonregistration violation.") (citing authority).

49. *Id.*

50. People v. Salas, 127 P.3d 40, 48 (Cal. 2006).

51. Stark v. Superior Court, 257 P.3d 41, 59 (Cal. 2011) (citing authority).

52. 15 U.S.C. § 78j(b); 15 U.S.C. § 78ff(a); UNIF. SEC. ACT § 501 (2002); UNIF. SEC. ACT § 508(a) (2002); *see also* UNIF. SEC. ACT § 101 (1956); UNIF. SEC. ACT § 409 (1956).

53. 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

54. 15 U.S.C. § 78ff(a).

Government must prove that the defendant knew that the misrepresentation was false or misleading.[55] If the alleged misrepresentation was oral or in a document not filed with the SEC, the Government must prove that the defendant was at least reckless with respect to truth or falsity.[56] Of note, some misrepresentations can also be prosecuted under Section 17(a)(2) of the Securities Act.[57] To convict under that provision,[58] the Government must prove that the defendant was at least reckless with respect to truth or falsity.[59]

Under state law, however, a defendant can potentially be prosecuted for misrepresentations with a lower mental state about the false or misleading nature of the statement. For example, under New York's securities statute, the Martin Act, a defendant can be criminally convicted for making a false statement if he or she "(i) knew the truth; or (ii) with reasonable effort could have known the truth; or (iii) made no reasonable effort to ascertain the truth; or (iv) did not have knowledge concerning the representation or statement made."[60] In other words, as recognized by a number of commentators, a defendant who is merely negligent about the false or misleading nature of a statement can potentially be convicted of a crime under New York law.[61]

4. Scope of the Duty to Disclose

Under both federal and state law, it is a crime to materially mislead investors by remaining silent in the face of a duty to disclose.[62] The scope

55. *Id.*; *see* Wendy Gerwick Couture, *Prosecuting Securities Fraud Under Section 17(a)(2)*, 50 LOY. U. CHI. L.J. 669, 686 (2019) [hereinafter Couture, *Prosecuting*] (citing authority).

56. 15 U.S.C. § 78ff(a); *see* Couture, *Prosecuting*, *supra* note 55, at 686–87 (citing authority).

57. 15 U.S.C. § 77q(a)(2).

58. 15 U.S.C. § 77x.

59. *See* Couture, *Prosecuting*, *supra* note 55, at 688 (citing authority).

60. N.Y. GEN. BUS. LAW §§ 352-c(1)(c) & 359-g(2) (McKinney 1996).

61. *See* Wendy Gerwick Couture, *White Collar Crime's Gray Area: The Anomaly of Criminalizing Conduct Not Civilly Actionable*, 72 ALB. L. REV. 1, 18 (2009) [hereinafter Couture, *White Collar*] ("[A] defendant who negligently makes a false statement could be held criminally liable under the Martin Act, despite the fact that the same conduct neither implicates federal criminal liability nor affords a civil remedy."); Johnathan Mathiesen, *Dr. Spitzlove or: How I Learned to Stop Worrying and Love "Balkanization,"* 2006 COLUM. BUS. L. REV. 311, 316 (noting that the Martin Act "affords extraordinary leverage as a prosecutorial weapon in part from its lack of a scienter requirement.").

62. *See* Basic Inc. v. Levinson, 485 U.S. 224, 239, n.17 (1988) ("Silence, absent a duty to disclose, is not misleading under Rule 10b–5."); Frank C. Razzano, *The Martin Act: An*

of the duty to disclose is sometimes more expansive under state law than under federal law, however.

Under federal law, there is not a duty to disclose all material information.[63] Rather, there is a duty to speak only if mandated by positive law.[64] First, if other statements are rendered misleadingly incomplete without additional disclosure, there is a duty to disclose.[65] Additional sources of a duty to speak include mandatory SEC disclosure rules[66] and fiduciary duties.[67]

Some states impose broader duties to disclose, however. For example, the Texas Securities Act criminalizes securities fraud, which it defines as including "an intentional failure to disclose a material fact."[68] In other words, it imposes a duty to disclose all material facts.[69]

Overview, 1 J. BUS. & TECH. L. 125, 129 (2006) ("A showing of neither intent nor scienter is required to prove a violation of the Act and sustain civil liability or criminal culpability, unless a felony is charged. The purpose of the Act is to allow the Attorney General to prosecute acts and practices beyond intentional fraud.").

63. *See* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27, 44 (2011) ("[I]t bears emphasis that § 10(b) and Rule 10b–5(b) do not create an affirmative duty to disclose any and all material information."); *In re* Time Warner Inc. Sec. Litig., 9 F.3d 259, 267 (2d Cir. 1993) ("But a corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts.").

64. *See* Gallagher v. Abbott Labs., 269 F.3d 806, 808 (7th Cir. 2001) ("[F]irms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose.").

65. 17 C.F.R. § 240.10b–5(b) (imposing a duty to disclose if necessary "to make . . . statements made, in the light of the circumstances under which they were made, not misleading").

66. *See* Stratte-McClure v. Morgan Stanley, 776 F.3d 94, 100 (2d Cir. 2015) (concluding that "failure to make a required Item 303 disclosure in a 10-Q filing is indeed an omission that can serve as the basis for a Section 10(b) securities fraud claim"); *but see* In re NVIDIA Corp. Sec. Litig., 768 F.3d 1046, 1054 (9th Cir. 2014) (holding that a violation of Item 303's disclosure duty is not actionable under Section 10(b) and Rule 10b-5).

67. *See* Dirks v. SEC., 463 U.S. 646, 661 (1983) ("In determining whether a tippee is under an obligation to disclose or abstain, it thus is necessary to determine whether the insider's 'tip' constituted a breach of the insider's fiduciary duty.").

68. TEX. REV. CIV. STAT. ANN. art. 581-4(F) (West 2003); TEX. REV. CIV. STAT. ANN. art. 581–29(C)(1) (Vernon Supp. 2007).

69. *See* Bridwell v. State, No. 05-07-00258-CR, 2008 WL 467271, at *5 (Tex. App. Feb. 23, 2008) ("The purpose of the Texas Securities Act is to require sellers of securities to be truthful and provide investors with all material facts, allowing them to make informed decisions.").

C. Multiple Enforcers

In addition to being dually-regulated at the federal and state levels, securities laws are multi-enforced at each level by a regulator, private parties, and prosecutors. At the federal level, the Securities and Exchange Commission civilly enforces the securities laws via administrative proceedings or civil enforcement actions.[70] In addition, to the extent that federal law provides a private right of action, either express or implied, private litigants may also enforce federal securities laws.[71] Finally, the Department of Justice ("DOJ") criminally enforces federal securities laws.[72] Likewise, at the state level, each state's securities regulator civilly enforces the state's securities laws via administrative proceedings or civil actions.[73] In addition, to the extent that state law provides a private right of action, private litigants enforce the state's securities laws.[74] Finally, state prosecutors, either state-level or local,[75] criminally enforce the state's securities laws.[76]

Thus, assuming that a securities transaction is within the scope of only one state's securities laws, there are potentially five enforcers with respect to that securities transaction: the SEC, the state securities regulator, private parties asserting claims under federal and/or state law, the DOJ, and the state's prosecutors. If a securities transaction is within the scope of

---

70. 15 U.S.C. §§ 77t & 77u (2017); 15 U.S.C. §§ 78u, 78u-1, 78u-2 & 78u-3 (2017).

71. *E.g.*, 15 U.S.C. § 77k ("Civil liabilities on account of false registration statement"); 15 U.S.C. § 771 (2017) ("Civil liabilities arising in connection with prospectuses and communications"); 15 U.S.C. § 78j(b)(2017) ("It shall be unlawful for any person . . . To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."); Superintendent of Ins. of State of N. Y. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971) ("It is now established that a private right of action is implied under § 10(b).").

72. 15 U.S.C. § 77x (2017); 15 U.S.C. § 78ff(a) (2017).

73. UNIF. SEC. ACT §§ 603 & 604 (UNIF. LAW COMM'N 2002).

74. UNIF. SEC. ACT § 509 (UNIF. LAW COMM'N 2002); *see also* UNIF. SEC. ACT § 410 (1956, as amended in 1986) ("Civil liabilities.").

75. Rachel E. Barkow, *Federalism and Criminal Law: What the Feds Can Learn from the States*, 109 MICH. L. REV. 519, 548 (2011) ("In addition, state-level prosecutors typically handle business and white collar crimes, including antitrust and sometimes securities violations, either exclusively or concurrently with local prosecutors.").

76. *See* UNIF. SEC. ACT § 508(a) (2002); *see also* UNIF. SEC. ACT § 409 (1956) ("Any person who willfully violates any provision of this act . . . shall upon conviction be fined not more than $5,000 or imprisoned not more than three years, or both.")

multiple states' securities laws, the number of potential enforcers increases accordingly.

D. Potential for Multiple States to Have Criminal Jurisdiction

In general, states exercise territorial jurisdiction to prosecute crimes.[77] This includes not only conduct within the state's territory, but also out-of-state conduct with in-state territorial effects.[78]

Many state securities laws include specific jurisdictional provisions, which likewise extend the state's criminal jurisdiction to out-of-state conduct directed to the state. For example, the Uniform Securities Act's jurisdictional provision "applies to all types of proceedings specified by the Act–administrative, civil, and criminal."[79] Pursuant thereto, the Act's prohibition on the offer or sale of unregistered, non-exempt securities and the Act's prohibition on securities fraud apply to any person who offers to sell, sells, offers to purchase, or purchases securities within the state.[80] The Act defines in-state offers as (1) offers originating from within the state or (2) offers directed to and received at a place in the state.[81] Thus, "a person may violate the law of a particular state without ever being within the state."[82]

As a consequence, in an interstate securities transaction, it is possible for multiple states to have criminal jurisdiction to prosecute the parties

---

77. *E.g.*, MODEL PENAL CODE § 1.03 (AM. LAW INST., Proposed Official Draft 1962) (Describing the conditions that would be sufficient to punish an individual in a given state for their or another's conduct, the Model Penal Code suggests that a state's jurisdictional reach is broad and reaching, even outside their geographically defined territory).

78. *E.g.*, MODEL PENAL CODE § 1.03(1)(a) (AM. LAW INST., Proposed Official Draft 1962) ("[A] person may be convicted under the law of this State of an offense committed by his own conduct or the conduct of another for which he is legally accountable if either the conduct that is an element of the offense or the result that is such an element occurs within this State.").

79. *See* UNIF. SEC. ACT § 610 cmt. 1 (2002); *see also* UNIF. SEC. ACT § 414 cmt. 1 (1956, as amended in 1997) ("Section 414 and its appendages . . . determine the scope of the Act for all kinds of proceedings—civil, criminal, injunctive, and administrative.").

80. *See* UNIF. SEC. ACT §§ 610(a)-(b) (2002); *see also* UNIF. SEC. ACT § 414(a)-(b) (1956, as amended in 1997)("Scope of the act and service of process.").

81. *See* UNIF. SEC. ACT § 610(c) (2002); *see also* UNIF. SEC. ACT § 414(c) (1956, as amended in 1997) ("For the purposes of this section, an offer to sell or to buy is made in this state, whether or not either party is then present in this state, when the offer (1) originates from this state or (2) is directed by the offeror to this state and received at the place to which it is directed (or at any post office in this state in the case of a mailed offer).").

82. *See* UNIF. SEC. ACT § 610 cmt. 1 (2002); *see also* UNIF. SEC. ACT § 414 cmt. 1 (1956, as amended in 1997) ("Interstate transactions.").

involved. For example, if an unregistered, non-exempt or fraudulent offer originates from State A and is directed to State B, both State A and State B potentially have criminal jurisdiction to prosecute the offeror.[83] At the extreme, "each of the fifty states could likely assert jurisdiction over a nationally traded firm based on the same alleged misstatement or omission, because at least one resident is likely to have purchased the firm's shares while the misstatement or omission was allegedly distorting the price."[84]

E. Potential for Multiple Prosecutions

Not only are the parties to a securities transaction subject to the criminal jurisdiction of the federal government and of at least one state, they can potentially be subject to multiple prosecutions for the same conduct. These prosecutions could proceed in any order—state and then federal, federal and then state, or one state and then another state.

Under the dual-sovereignty doctrine, a defendant can be subject to successive prosecutions by different sovereigns for the same conduct without implicating the Double Jeopardy Clause of the Fifth Amendment. The Double Jeopardy Clause prohibits multiple prosecutions for "the same offence."[85] But, as the Supreme Court recently reaffirmed in *Gamble v. United States*, crimes under different sovereigns' laws are not "the same offence."

> We have long held that a crime under one sovereign's laws is not "the same offence" as a crime under the laws of another sovereign. Under this "dual-sovereignty" doctrine, a State may prosecute a defendant under state law even if the Federal Government has prosecuted him for the same conduct under a federal statute. Or the reverse may happen, as it did here.[86]

This doctrine "honors the substantive differences between the interests that two sovereigns can have in punishing the same act."[87]

---

83. *See* Lintz v. Carey Manor Ltd., 613 F. Supp. 543, 550 (W.D. Va. 1985) ("[S]o long as there is some territorial nexus to a particular transaction, the laws of two or more states may simultaneously apply.") (citing Louis Loss, *The Conflict of Laws and the Blue Sky Laws*, 71 HARV. L. REV. 209, 242 (1957)).

84. Rose, *State, supra* note 14, at 1383.

85. U.S. CONST. amend. V

86. Gamble v. United States, 139 S. Ct. 1960, 1964 (2019); *see also* United States v. Lanza, 260 U.S. 377, 382 (1922) ("It follows that an act denounced as a crime by both national and state sovereignties is an offense against the peace and dignity of both and may be punished by each.").

87. *Gamble*, 139 S. Ct. at 1966.

The dual-sovereignty doctrine applies, not only to successive federal-state and state-federal prosecutions, but also to successive prosecutions by different states.[88] Indeed, in an *amicus curiae* brief arguing for a broad interpretation of the Uniform Securities Act's jurisdiction provision, the North American Securities Administrators Association recognized that multiple states could engage in successive prosecutions of securities crimes: "Under criminal statutes such as the KUSA [Kansas Uniform Securities Act], if an illegal act transpires over several states, each state can assert jurisdiction over the entire scope of the criminal conduct. This does not violate the principle of double jeopardy because each state is a separate sovereign."[89]

Critics of the dual sovereignty doctrine argue that it undercuts the basic premise of the Double Jeopardy Clause that a "free society does not allow its government to try the same individual for the same crime until it's happy with the result."[90] They contend that federalism, which was meant to limit the power of government, should not be used to expand the government's power.[91] Finally, they note that the "expansion of federal criminal law has exacerbated the problems created by the separate-sovereigns doctrine."[92]

In partial response to these critiques, the DOJ has a policy that limits successive federal prosecutions. Under the so-called "*Petite* policy,"[93] the

88. Heath v. Alabama, 474 U.S. 82, 88 (1985) ("The dual sovereignty doctrine, as originally articulated and consistently applied by this Court, compels the conclusion that successive prosecutions by two States for the same conduct are not barred by the Double Jeopardy Clause.").

89. Brief of the North American Securities Administrators Association, Amicus Curiae in Support of the Securities Commissioner of the State of Kansas at 6, State v. Lundberg, 53 Kan. App. 2d 721 (Kan. Ct. App. 2017), No. 15-114897-A (citations omitted).

90. *Gamble*, 139 S. Ct. at 1996 (Gorsuch, J., dissenting).

91. *See id.* at 2000 (Gorsuch, J., dissenting) ("When the 'ONE WHOLE' people of the United States assigned different aspects of their sovereign power to the federal and state governments, they sought not to multiply governmental power but to limit it.").

92. *Id.* at 1994 (Ginsburg, J., dissenting); *accord* Thomas White, *Limitations Imposed on the Dual Sovereignty Doctrine By Federal and State Governments*, 39 N. KY. L. REV. 173, 188 (2011) ("Given the increasing overlap between state and federal criminal laws, many scholars argue that, even though the dual sovereignty doctrine may have once served a useful purpose when federal criminal law was limited to conduct pertaining distinctly to the national government, this is no longer the case with the increasing federalization of criminal law.").

93. *See* Petite v. United States, 361 U.S. 529, 530–31 (1960) ("[I]t is the general policy of the Federal Government 'that several offenses arising out of a single transaction should be alleged and tried together and should not be made the basis of multiple prosecutions, a policy dictated by considerations both of fairness to defendants and of efficient and orderly law enforcement.' The Solicitor General on behalf of the Government represents this policy

DOJ will not pursue a successive federal prosecution "based on substantially the same act(s) or transaction(s)" unless (1) the matter involves "a substantial federal interest"; (2) the prior prosecution "left that interest demonstrably unvindicated"; (3) the government believes "that the defendant's conduct constitutes a federal offense, and that the admissible evidence probably will be sufficient to obtain and sustain a conviction by an unbiased trier of fact"; and (4) the prosecution is "approved by the appropriate Assistant Attorney General."[94] At oral argument before the *Gamble* Court, the government estimated that it authorizes only "about a hundred" such prosecutions per year.[95] Of note, the *Petite* policy is merely a voluntary exercise of prosecutorial discretion; it cannot be invoked by a defendant as a bar to federal prosecution.[96]

Moreover, many states, either via state constitutional provision or statute, prohibit successive prosecutions for the same offense if the prior prosecution was resolved on the merits by the federal government or by another state.[97] For example, California has enacted the following statutory prohibition on successive prosecutions:

> [W]hen an act charged as a public offense is within the jurisdiction of the United States, or of another state or territory of the United States, as well as of this state, a conviction or acquittal thereof in that other jurisdiction is a bar to the prosecution or indictment in this state.[98]

Thus, the potential for a successive prosecution depends on the identity of the successive sovereign. If the federal government is the successive sovereign, the prosecution is subject to the *Petite* policy. If a

---

as closely related to that against duplicating federal-state prosecutions, which was formally defined by the Attorney General of the United States in a memorandum to the United States Attorneys.").

94. Dept. of Justice, Justice Manual § 9–2.031(A) (rev. July 2009).

95. *Gamble*, 139 S. Ct. at 1995 (Ginsburg, J., dissenting) (quoting Tr. of Oral Arg. 54).

96. *See* Dept. of Justice, Justice Manual § 9–2.031(F) (rev. July 2009) (citing authority) ("All of the federal circuit courts that have considered the question have held that a criminal defendant can not invoke the Department's policy as a bar to federal prosecution."); *see also* Ellen S. Podgor, *Department of Justice Guidelines: Balancing "Discretionary Justice,"* 13 CORNELL J.L. & PUB. POL'Y 167, 179 (2004) (hereinafter Podgor, *Department*) (citing authority) ("Although the government has discretion to dismiss cases when its Petite policy is violated, defendants are not afforded this same opportunity.").

97. *See Gamble*, 139 S. Ct. at 1995 (Ginsburg, J., dissenting) (citing Brief for Criminal Defense Experts as Amici Curiae 4–5, and n. 2 & Brief for State of Texas et al. as Amici Curiae 28–30, and nn.6–15) ("And more than half the States forbid successive prosecutions for all or some offenses previously resolved on the merits by a federal or state court.").

98. CAL. PENAL CODE § 793 (West).

state is the successive sovereign, it depends whether the state has prohibited successive prosecutions. If not, then the decision whether to re-prosecute resides in the discretion of the state prosecutor.

III. THE GOALS OF PROSECUTING SECURITIES CRIMES

Drawing from the policy reasons for enacting and enforcing securities laws and theories of criminal punishment, I contend that the goals of prosecuting securities crime are multifaceted, sometimes in tension, and must be analyzed against the backdrop of the above-described dual-regulatory, multi-enforcer regime.

A. Purposes of the Securities Laws and Enforcement Thereof

The fundamental purpose of the federal securities laws is "to insure honest securities markets and thereby promote investor confidence."[99] At the same time, however, the federal securities laws are intended to promote "efficiency, competition, and capital formation."[100] Sometimes, such as when increased regulatory burdens are placed on issuers for the benefit of investors, these purposes are in tension.

State securities laws share the same purposes of protecting investors and promoting capital formation. For example, the Uniform Securities Act states that, when a state regulator is considering whether to cooperate and coordinate with other regulators, the administrator

> shall, in its discretion, take into consideration in carrying out the public interest the following general policies: (1) maximizing effectiveness of regulation for the protection of investors; (2) maximizing uniformity in federal and state regulatory standards; and (3) minimizing burdens on the business of capital formation, without adversely affecting essentials of investor protection.[101]

Securities enforcement, whether public or private, promotes these goals by deterring violations of the securities laws and by compensating

99. Chadbourne & Parke LLP v. Troice, 571 U.S. 377, 390 (2014) (quoting U.S. v. O'Hagan, 521 U.S. 642, 658 (1997)).

100. 15 U.S.C. § 77b; *see also* Chadbourne & Parke LLP, 571 U.S. at 390 ("The dissent correctly points out that the federal securities laws have another purpose, beyond protecting investors. Namely, they also seek to protect securities *issuers*, as well as the investment advisers, accountants, and brokers who help them sell financial products, from abusive class-action lawsuits.").

101. UNIF. SEC. ACT § 608(b) (2002).

injured investors while ensuring that enforcement does not unduly inhibit capital formation.[102] The balance among these sometimes-competing considerations has played out most notably in the regulation of private securities litigation, including the enactment of the Private Securities Litigation Reform Act of 1995 ("PSLRA").[103]

B. Theories of Criminal Punishment

Criminal prosecution is but one lever within the overall enforcement landscape, and it serves specific purposes therein. The criminal law plays a unique role because "conviction for crime is a distinctive and serious matter—a something, and not a nothing."[104] For this reason, criminalization is generally[105] (although not always[106]) reserved for a subset

---

102. *See* Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007) ("This Court has long recognized that meritorious private actions to enforce federal antifraud securities laws are an essential supplement to criminal prosecutions and civil enforcement actions brought, respectively, by the Department of Justice and the Securities and Exchange Commission (SEC).").

103. *See* Joint Explanatory Statement of the Committee of Conference, H.R. CONF. REP. § 104-369, 31-32, 1995 U.S.C.C.A.N. 730, 0-731 ("Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. . . . the investing public and the entire U.S. economy have been injured by the unwillingness of the best qualified persons to serve on boards of directors and of issuers to discuss publicly their future prospects, because of fear of baseless and extortionate securities lawsuits.").

104. Henry M. Hart, Jr., *The Aims of the Criminal Law*, 23 LAW & CONTEMP. PROBS. 401, 404 (1958).

105. *See* John C. Coffee, Jr., *Paradigms Lost: The Blurring of the Criminal and Civil Law Models--And What Can Be Done About It*, 101 YALE L.J. 1875, 1887 (1992) ("The overall structure this relationship points toward is a penumbra of civil penalties around an inner core of fundamental moral precepts enforced by sanctions."); *see also* John C. Coffee, Jr., *Does "Unlawful" Mean "Criminal"?: Reflections on the Disappearing Tort/Crime Distinction in American Law*, 71 B.U. L. REV. 193, 201 (1991) (hereinafter Coffee, *Reflections*) ("The relationship of the civil and criminal law here is sequentially interactive: the civil law experiments with a standard, but at some point it may 'harden' into a community standard that the criminal law can enforce."); *see also* Stephen Marks, *Utility and Community: Musings on the Tort/Crime Distinction*, 76 B.U. L. Rev. 215, 233 (1996) (positing that tort law encompasses both prohibited and conditionally permissible acts and that criminal law encompasses only prohibited acts, thus implying that criminal law is a subset of tort law).

106. *See* Couture, *White Collar*, *supra* note 61, at 2 ("Substantive and procedural differences between criminal and civil treatment of conduct sounding in securities fraud combine to cause the following anomaly: certain false statements to investors may be actionable criminally--subjecting individual defendants to imprisonment--but not civilly--leaving victims without remedy."); *see also* Gerard E. Lynch, *The Role of Criminal Law in*

of the conduct that is civilly actionable.

Two classic theories seek to demarcate the conduct that should be criminalized: a utilitarian theory and a retributive theory. Under the utilitarian theory, behavior that is socially inefficient, because its harms exceed its benefits[107] or because it bypasses a market transaction,[108] should be deterred when the costs of deterrence do not exceed the benefits thereof. Because criminal conviction imposes a higher social cost than civil liability,[109] criminalization is only appropriate when the monetary damages necessary to deter an actor's inefficient conduct are higher than the actor could pay[110] and when "gains in crime reduction are greater than the costs of punishment policy."[111] In short, the utilitarian theory focuses on the role

---

Policing Corporate Misconduct, 60 LAW & CONTEMP. PROBS. 23, 29 (1997) ("There is a distinct oddity here, from the standpoint of traditional distinctions between criminal and civil law: Historically, we have expected the criminal law to be narrower and more precise than the law of civil wrongs, but in interpreting RICO, the courts have been distinctly more comfortable with broad interpretations in criminal cases, and correspondingly more hostile to civil applications.").

107. *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 172 (1968) ("Usually a belief that other members of society are harmed is the motivation behind outlawing or otherwise restricting an activity.").

108. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 208 (4th ed. 1992) ("These [intentional] torts and the corresponding list of crimes involve not a conflict between legitimate (productive) activities but a coerced transfer of wealth to the defendant in a setting of low transaction costs.") (hereinafter Posner, ECONOMIC ANALYSIS); *see also* Richard A. Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1195 (1985) ("The major function of criminal law in a capitalist society is to prevent people from bypassing the system of voluntary, compensated exchange--the 'market,' explicit or implicit--in situations where, because transaction costs are low, the market is a more efficient method of allocating resources than forced exchange.").

109. *See* POSNER, ECONOMIC ANALYSIS, *supra* note 108, at 222 & 227 (stating that tort remedies are less costly than criminal fines and that criminal fines are less costly than imprisonment); *see also* Steven Shavell, *Criminal Law and the Optimal Use of Nonmonetary Sanctions as a Deterrent*, 85 COLUM. L. REV. 1232, 1235 (1985) ("The imposition of monetary sanctions will be assumed to involve lower social costs than the imposition of nonmonetary sanctions.").

110. *See* POSNER, ECONOMIC ANALYSIS, *supra* note 108, at 222 ("Where tort remedies are an adequate deterrent because optimal tort damages, including any punitive damages, are within the ability to pay of the potential defendant, there is no need to invoke criminal penalties . . . .").

111. Darryl K. Brown, *Criminal Law Theory and Criminal Justice Practice*, 49 AM. CRIM. L. REV. 73, 74 (2012); *see also* Peter J. Henning, *Is Deterrence Relevant in Sentencing White-Collar Criminals?*, 61 WAYNE L. REV. 27, 40 (2015) (citing Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968)) ("Deterrence, which is an expression of utilitarianism, is a determination that a particular punishment will be sufficient to create a benefit to society by preventing future misconduct over the costs of investigating, prosecuting, and (where necessary) incarcerating.").

of the criminal law in deterring inefficient behavior.[112]

Under the retributive theory, the criminal law is reserved for morally repugnant behavior, with criminal conviction expressing the moral condemnation of the community.[113] The criminal punishment of this behavior "demonstrates the community's disapproval of the conduct, so what is communicated to the defendant, and society at large, is the extent of disapprobation—and even indignation or anger—at what the person did and how others suffered because of the misconduct."[114] In short, the retributive theory focuses on the role of the criminal law in punishing morally repugnant behavior.[115]

The two theories, although with different orientations, interrelate. First, the socially inefficient behavior to be deterred under the utilitarian theory aligns with "generally accepted moral principles."[116] Indeed, under either theory, "there is little disagreement that desert is *necessary* to justify punishment."[117] Second, the expression of society's moral condemnation under the retributive theory has deterrent effects,[118] even if proponents of

---

112. *See* Richard S. Frase, *Limiting Excessive Prison Sentences Under Federal and State Constitutions*, 11 U. PA. J. CONST. L. 39, 43 (2008) ("Utilitarian (or consequentialist) purposes of punishment focus on the desirable effects (mainly, future crime reduction) which punishments have on the offender being punished, or on other would-be offenders, and on the costs and undesired consequences of punishments."); *see also* Darren Bush, *Law and Economics of Restorative Justice: Why Restorative Justice Cannot and Should Not Be Solely About Restoration*, 2003 UTAH L. REV. 439, 450 (2003) ("[T]he goal of criminal law, according to economists, should be prevention of the harm from taking place in the first instance where undertaking the harm would be socially inefficient.").

113. *See* Alan C. Michaels, *"Rationales" of Criminal Law Then and Now: For a Judgmental Descriptivism*, 100 COLUM. L. REV. 54, 57 (2000) ("[T]he dominant view today sees an essential link between punishment and moral wrongdoing.").

114. Henning, *supra* note 111, at 41–42.

115. *See* Michele Cotton, *Back with a Vengeance: The Resilience of Retribution as an Articulated Purpose of Criminal Punishment*, 37 AM. CRIM. L. REV. 1313, 1317 (2000) ("Retribution, on the other hand, assumes that the criminal should be hurt, and that the injury caused by the criminal offense calls for a like infliction of injury on the criminal as a moral penalty.").

116. *See* POSNER, ECONOMIC ANALYSIS, *supra* note 108, at 261 ("[O]n balance it would seem that adherence to generally accepted moral principles increases the wealth of society more than it reduces it"); *see also* Alvin K. Klevorick, *Legal Theory and the Economic Analysis of Torts and Crimes*, 85 COLUM. L. REV. 905, 908 (1985) ("The law-and-economics explanation of the criminal sanction presupposes the existence of a transaction structure . . . .But explaining a particular society's transaction structure requires an understanding of societal values—a conception of how a society legitimates its transaction structure.").

117. Brown, *supra* note 111, at 76.

118. *See* Jayme Herschkopf, *Morality and Securities Fraud*, 101 MARQ. L. REV. 453, 461 (2017) ("And indeed, scholars point out that retributive and condemnatory punishment

the moral theory do not view those effects as a primary goal of criminalization. As such, these theories can be melded into a "mixed theory," whereby "criminal law is justified both by a commitment to punishing offenders based on their desert and a commitment that criminal law should serve some instrumental function, typically crime (or harm) prevention or preservation of order."[119]

And in practice, both theories inform modern criminal law and punishment, which incorporate both deterrence and retribution rationales.[120] For example, the United States Sentencing Commission, when drafting the Federal Sentencing Guidelines, acknowledged the theoretical debate[121] but declined to resolve it "because in most sentencing decisions the application of either philosophy will produce the same or similar results."[122] As another example, the principles of prosecutorial discretion in the Justice Manual incorporate utilitarian considerations (*e.g.*, "the deterrent effect of prosecution") as well as moral ones (*e.g.*, "the nature and seriousness of the offense" and "the person's culpability in connection with the offense").[123]

Finally, with the rise of restitution as a component of criminal sentencing under federal and state law,[124] the criminal law now serves as a means of compensating at least some victims, even though compensation was traditionally the province of civil rather than criminal law.[125] This

---

can have utilitarian results, such as reinforcing respect for the law and thus encouraging general adherence.").

119. Brown, *supra* note 111, at 88.

120. Brown, *supra* note 111, at 75 ("Anglo-American criminal justice institutions draw on both instrumental and deontological commitments for their lawmaking, enforcement, and punishment policies.").

121. *See* U.S. SENTENCING GUIDELINES MANUAL § 1A1.1(3)(U.S. SENTENCING COMM'N 2005)("Some argue that appropriate punishment should be defined primarily on the basis of the principle of 'just deserts.' Under this principle, punishment should be scaled to the offender's culpability and the resulting harms . . . Others argue that punishment should be imposed primarily on the basis of practical 'crime control' considerations. Defendants sentenced under this scheme should receive the punishment that most effectively lessens the likelihood of future crime, either by deterring others or incapacitating the defendant.").

122. *Id.*

123. U.S. DEP'T OF JUSTICE, JUSTICE MANUAL § 9-27.230 (2019), https://www.justice.gov/jm/jm-9-27000-principles-federal-prosecution#9-27.230 [https://perma.cc/6TMA-YSBN].

124. *See* Adam S. Zimmerman & David M. Jaros, *The Criminal Class Action*, 159 U. PA. L. REV. 1385, 1390 (2011) ("Recently, another body of law--criminal law--has begun to assume the same compensatory role as the large private lawsuit. Since 2003, federal prosecutors increasingly have sought to settle charges with corporate defendants in exchange for multimillion dollar victim restitution funds--or what we call 'criminal class actions.'"); *see also id.* at 1393 n.33 ("Criminal class actions occur in the state system as well.").

125. *See* Coffee, *Reflections*, *supra* note 105, at 231 ("[T]ort law and criminal law are

compensation goal sometimes aligns with deterrence and retribution rationales by forcing defendants to "bear more of the social cost of the harm,"[126] and it sometimes works at cross purposes because "imprisoning a defendant undermines any efforts towards restitution."[127]

Thus, in practice, modern criminal law, including securities crime, serves utilitarian, retributive, and compensatory goals, albeit sometimes furthering one purpose over another.

C. Goals of Prosecuting Securities Crime

Drawing from the purposes of the securities laws and enforcement thereof and the theories of criminal punishment, I contend that the goals of prosecuting securities crime are multi-faceted and sometimes in tension. On the one hand, securities crime prosecution should promote the following aims: (1) specifically and generally deterring violations of the securities laws; (2) punishing securities law violators, both to further deterrence and to express society's condemnation; and (3) compensating investors who have been harmed by securities violations. On the other hand, securities crime prosecution should aim to further these purposes (1) without incurring unnecessary prosecution or punishment costs and (2) without unduly inhibiting capital formation.

Moreover, when states are prosecuting securities crimes, they should recognize that, rather than acting in isolation, they are acting within the above-described dual-regulatory, multi-enforcer regime. Ideally, state securities prosecutions, alongside other federal and state enforcement by public and private parties, would be calibrated so as to balance appropriately these sometimes-competing goals.[128] Many scholars have

---

institutionally segregated so that one focuses principally on compensation and the other principally on deterrence."); Lynch, *supra* note106, at 27 ("The traditional rough distinction between criminal and civil matters has been that criminal actions are brought by the sovereign to punish and deter violations of social norms, while civil actions are brought by private parties (or occasionally by the government in a proprietary or administrative capacity) to compensate those who have suffered damage or to prevent harms from occurring.").

126. Zimmerman & Jaros, *supra* note 124, at 1412.

127. J. Kelly Strader, *White Collar Crime and Punishment: Reflections on Michael, Martha, and Milberg Weiss*, 15 GEO. MASON L. REV. 45, 102 (2007).

128. *See* Geraldine Szott Moohr, *The Balance Among Corporate Criminal Liability, Private Civil Suits, and Regulatory Enforcement*, 46 AM. CRIM. L. REV. 1459, 1478 (2009) ("Ideally, the three enforcement mechanisms, regulatory, civil, and criminal, work in tandem to prevent business misconduct through a system of graduated penalties . . . In sum, a comprehensive strategy would provide several sources of intervention, offer remedies

argued, however, that enforcement within this dual-regulatory, multi-enforcer regime is not appropriately calibrated. For example, scholars have debated whether private securities litigation is too expansive or too constrained;[129] whether the SEC is under-enforcing or over-enforcing;[130] whether state civil enforcement of securities laws is too aggressive or too lax,[131] and whether federal prosecutors are over- or under-prosecuting securities crime.[132]

---

scaled to wrongdoing, and send a single deterrent message that strengthens business norms to support law-abiding behavior.").

129. *E.g.*, Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2201–02 (2010) (hereinafter Rose, *Multienforcer*) ("Private enforcers could not be expected to use their discretion to balance concerns for underdeterrence and enforcement costs the way our idealized public enforcer could."); Michael J. Kaufman & John M. Wunderlich, *The Judicial Access Barriers to Remedies for Securities Fraud*, 75 LAW & CONTEMP. PROBS. 55, 91 (2012) ("As a result of access barriers that largely substitute the district judge as the fact-finder on a motion to dismiss, class certification, and summary judgment, injured investors face significant obstacles to recovery under Rule 10b-5.").

130. *E.g.*, John C. Coffee, Jr. & Hillary A. Sale, *Redesigning the SEC: Does the Treasury Have A Better Idea?*, 95 VA. L. REV. 707, 729 (2009) ("This marked variation in enforcement intensity leads to an obvious policy debate: Does the United States overenforce? Or, does the rest of the world underenforce?").

131. *E.g.*, Rose, *Multienforcer*, *supra* note 129, at 2228 ("In light of these observations, there is no reason to accept the current allocation of enforcement authority in the United States as sacrosanct. Rather, we should give thoughtful consideration to consolidating enforcement authority in a single federal regulator, such as the SEC, while at the same time adopting reforms to align the federal enforcer's incentives more closely with the public interest (so as to offset any increased risk of underdeterrence this change might introduce)."); David Zaring, *Litigating the Financial Crisis*, 100 VA. L. REV. 1405, 1464–65 (2014) ("The states have generally not stepped in where the federal agencies have feared to tread, though this is often thought to be a potential check on failure to regulate on the national level.").

132. *E.g.*, Sandeep Gopalan, *Skilling's Martyrdom: The Case for Criminalization Without Incarceration*, 44 U.S.F. L. REV. 459, 504 (2010) ("The criminal law is a blunt instrument when applied to problems created by agency costs because of the crudeness of its sanctions and their relatively high cost without demonstrable gain. Further, since white-collar wrongs are not always morally wrong, the criminal law's expressive and coercive powers are seriously undermined by the crude application of criminal sanctions."); Zaring, *supra* note 131, at 1410 ("But the handling of this crisis suggests that the government has changed its approach from one seeking prison time to one satisfied with corporate fines, usually extracted through settlements paired with so-called deferred prosecution agreements ('DPAs'), which are commitments by the companies that settle to change their internal practices in a way that limits the potential for future law breaking.").

IV. PRINCIPLES FOR STATE PROSECUTION OF SECURITIES CRIME

Against this backdrop, I focus on an oft-ignored lever within this dual-regulatory, multi-enforcer regime: state prosecution of securities crimes. Rather than proposing a more directive solution, I propose principles of prosecutorial discretion designed to guide state prosecutors when balancing the multi-faceted and competing goals of prosecuting securities crimes within this regime.

A. The Importance of States' Prosecutorial Discretion When Prosecuting Securities Crimes

Prosecutors must "make decisions regarding which cases *will* be prosecuted out of the many which *could* be prosecuted."[133] According to former prosecutor Kenneth J. Melilli, "[t]he decision to charge an individual with a crime is the most important function exercised by a prosecutor."[134]

As recognized by the Supreme Court, prosecutors have "'broad discretion' as to whom to prosecute."[135] "[S]o long as the prosecutor has probable cause to believe that the accused committed an offense defined by statute, the decision whether or not to prosecute, and what charge to file or bring before a grand jury, generally rests entirely in his discretion."[136] The prosecutor's exercise of discretion is limited only by "constitutional constraints."[137]

Principles of prosecutorial discretion are an important tool to promote uniformity and accountability in charging decisions,[138] lest non-uniform prosecutorial decisions "reduce[] the public's perception that the legal system employs a fair and ethical process."[139] Accordingly, the American

133. Roger A. Fairfax, Jr., *Prosecutorial Nullification*, 52 B.C. L. Rev. 1243, 1244 (2011).

134. Kenneth J. Melilli, *Prosecutorial Discretion in an Adversary System*, BYU L. REV. 669, 671 (1992).

135. Wayte v. United States, 470 U.S. 598, 607 (1985) (quoting United States v. Goodwin, 457 U.S. 368, 380, n. 11 (1982)).

136. *Id.* (quoting Bordenkircher v. Hayes, 434 U.S. 357, 364 (1978)).

137. *Id.* at 608 (quoting United States v. Batchelder, 442 U.S. 114, 125 (1979)).

138. *See* Bruce A. Green & Fred C. Zacharias, *Prosecutorial Neutrality*, 2004 WIS. L. REV. 837, 871 ("Requiring prosecutors to follow neutral principles empowers the public to evaluate the bases for prosecutorial conduct and to assess whether a prosecutor has correctly and consistently applied the principles in particular cases.").

139. Ellen S. Podgor, *The Ethics and Professionalism of Prosecutors in Discretionary Decisions*, 68 FORDHAM L. REV. 1511, 1514 (2000) [hereinafter Podgor, *Ethics*].

Bar Association ("ABA") Criminal Justice Standards for the Prosecution Function state that "[e]ach prosecutor's office should seek to develop general policies to guide the exercise of prosecutorial discretion, and standard operating procedures for the office."[140] For example, at the federal level, the Justice Manual contains principles for the exercise of prosecutorial discretion, including the aforementioned *Petite* policy.[141]

Principles of prosecutorial discretion generally begin with high-level objectives. For example, the ABA Criminal Justice Standards for the Prosecution Function state that the "objectives of such policies and procedures should be to achieve fair, efficient, and effective enforcement of the criminal law within the prosecutor's jurisdiction."[142] Similarly, the Justice Manual's principles of prosecutorial discretion are intended to "promote the reasoned exercise of prosecutorial authority and contribute to the fair, evenhanded administration of the federal criminal laws."[143]

But, in order for principles of prosecutorial discretion to be effective,[144] they must also include specific subprinciples,[145] potentially even statute-specific ones.[146] As recognized by the Supreme Court, relevant specific factors include "the strength of the case, the prosecution's general deterrence value, the Government's enforcement priorities, and the case's relationship to the Government's overall enforcement plan."[147] Other relevant factors include the theoretical underpinnings of criminal law,[148] the availability of civil enforcement as an alternative to criminal

140. ABA STANDARDS FOR CRIMINAL JUSTICE: PROSECUTION AND DEFENSE FUNCTION, 4TH ED., § 3-2.4(A) (2015).

141. DEP'T OF JUSTICE MANUAL § 9-27.001 *ET SEQ.*

142. ABA STANDARDS FOR CRIMINAL JUSTICE: PROSECUTION AND DEFENSE FUNCTION, 4TH ED., § 3-2.4(A) (2015).

143. DEP'T JUSTICE MANUAL § 9-27.001 (UPDATED FEB. 2018).

144. *See* Green & Zacharias, *supra* note 138, at 896 ("Standing alone, they [first-order principles] are of dubious value precisely because they are so broad and overarching.").

145. *See* Green & Zacharias, *supra* note 138 at 896 ("These [principles] likely will apply more narrowly, but also may focus more specifically on the factors that society wishes prosecutors to implement or ignore."); James Vorenberg, *Decent Restraint of Prosecutorial Power*, 94 HARV. L. REV. 1521, 1562–63 (1981) ("At the core of a system limiting discretion should be prosecutors' own guidelines indicating how they will make charging and bargaining decisions. These should be specific enough to provide genuine guidance when applied to a particular set of facts.").

146. *See* Podgor, *Ethics*, *supra* note 139, at 1517 ("In not providing guidance that is specific to a case, or at least to particular statutes, consistency in the decision-making process is not achieved.").

147. Wayte v. United States, 470 U.S. 598, 607 (1985).

148. *See* Jeffrey Standen, *An Economic Perspective on Federal Criminal Law Reform*, 2 BUFF. CRIM. L. REV. 249, 275 (1998) ("Prosecutors in charging and plea bargaining, much

prosecution (particularly in the context of white collar crime),[149] and the opportunity cost of expending resources on one prosecution over another.[150]

Prosecutors also take into account broader societal considerations when exercising their discretion,[151] including whether the criminal law is overly broad,[152] unduly punitive,[153] or out-of-step with current societal views.[154] On the positive side, a prosecutor's consideration of broader societal values can "serve as a much needed safety valve for when an otherwise justified prosecution does not serve societal needs."[155] On the negative side, however, it can usurp the role of the legislature[156] and relieve

---

like judges in sentencing, presumably are motivated by a disparate mixture of philosophies and aims, including deterrence, retribution or just desserts, incapacitation, and rehabilitation.").

149. Podgor, *Ethics*, *supra* note 139, at 1519 ("The prosecutor's discretionary is magnified in the white collar crime context, where the characterization of conduct as criminal instead of tortious may be within the prosecutor's realm of decision-making.").

150. Fairfax, *supra* note 133, at 1257 ("Prosecutors often must decide not to pursue one matter (or category of matters) in order to have the investigative or prosecutorial capacity to prosecute other matters deemed to be of higher priority."); *see also* John C. Coffee, Jr., *The Metastasis of Mail Fraud: The Continuing Story of the "Evolution" of A White-Collar Crime*, 21 AM. CRIM. L. REV. 1, 19 (1983) [hereinafter Coffee, *Metastasis*] ("Desirable as it may be to punish the wicked, one cannot ignore that the supply of such persons vastly exceeds available prosecutorial resources."); *see also* Vorenberg, *supra* note 145, at 1542–43 ("Funding levels determine how many cases can be brought and inevitably force prosecutors' offices to give little or no attention to many chargeable crimes.").

151. Melilli, *supra* note 134, at 674 ("If discretion to charge is justified, then that justification necessarily extends to the discretion not to charge. And that discretion justifies not only eliminating unprovable cases but also protecting citizens from charges that do not advance societal interests."); *see also* Stanley Z. Fisher, *In Search of the Virtuous Prosecutor: A Conceptual Framework*, 15 AM. J. CRIM. L. 197, 250 (1988) (arguing that, when making decisions absent "adversary system safeguards," prosecutors should act with "impartial, judge-like neutrality" and incorporate a "moral point of view").

152. Podgor, *Department*, *supra* note 96, at 173 (citing the Department of Justice's guidelines on RICO prosecutions as an example of "offer[ing] internal constraints to overly broad statutes").

153. *See* Melilli, *supra* note 134, at 674 (noting that prosecutorial discretion includes "decisions to charge felony sales of small quantities of controlled substances as misdemeanor possessions").

154. Fairfax, *supra* note 133, at 1260 ("Some criminal laws remain on the statute books but are not enforced because they no longer comport with modern societal values."); *see* Melilli, *supra* note 135, at 674 (noting that prosecutorial discretion includes "decisions not to enforce anachronistic penal laws like adultery").

155. Fairfax, *supra* note 133, at 1274.

156. Coffee, *Reflections*, *supra* note 105, at 241 ("Yet, for prosecutors to decide systematically not to prosecute what the legislature has deemed criminal is also a politically dangerous act, one that seems to undermine the legislature's position as the sovereign lawmaker.").

the pressure on the legislature to reform outdated, unduly punitive, or overly broad laws.[157]

State prosecutors' exercise of prosecutorial discretion is an important lever within the overall dual-regulatory, multi-enforcer securities regime because "[h]ow the law is enforced can influence behavior as much as, and sometimes even more than, how the law is written."[158] Certainly, parties "bargain in the shadow of the law,"[159] and thus the laws on the books affect parties' conduct. Yet, as explained by Amanda M. Rose, "[t]he particular misconduct that enforcers choose to target, their investigative methods, the type and level of sanctions that they seek to have imposed (whether judicially or through settlement), and the frequency at which they choose to prosecute can powerfully affect the behavior of regulated parties."[160] In other words, the laws on the books are weaponized or neutralized via prosecutorial discretion, for good or for ill.[161]

Moreover, relying on prosecutorial discretion to calibrate state criminal prosecution within this dual-regulatory, multi-enforcer regime is nimbler than more directive approaches like amending state securities laws or preempting state criminal enforcement thereof. State prosecutors can respond quickly to new data about benefits and harms of prosecution, as well as to adjustments in other enforcement levers within the regime, such as changes in the scope of private civil liability or in federal enforcement priorities.[162]

Admittedly, relying on principles of prosecutorial discretion to

157. Fairfax, *supra* note 133, at 1274–75; Vorenberg, *supra* note 145, at 1552 ("Not only is the prosecutor overruling the legislature's judgment; he may be preempting as well the only method for bringing home to the legislature the impact of its tough stance.").

158. Rose, *State*, *supra* note 14, at 1353.

159. Coffee, *Metastasis*, *supra* note 150, at 9 n.41 ("So long as the parties bargain in the shadow of the law, the full impact of a statutory change cannot be assessed simply by looking at those who are prosecuted.").

160. Rose, *State*, *supra* note 14, at 1353; *see also* Margaret H. Lemos & Alex Stein, *Strategic Enforcement*, 95 MINN. L. REV. 9, 10 (2010) ("Violators know that they will avoid punishment if their violations do not stand out as rampant relative to what other violators do. This knowledge motivates violators to reduce the intensity of their unlawful activity from the high-end zone to the inconspicuous level.").

161. Brown, *supra* note 111, at 82 ("Charging discretion in the Anglo-American system lets enforcement officials substantially shape criminal law's priorities, a task more often taken on by legislatures and trial adjudication in systems that lack such discretion.").

162. *See* Rose, *Multienforcer*, *supra* note 129, at 2196–97 (arguing for a single federal enforcer) ("[T]he enforcer could respond to new information regarding the social costs from fraud and overdeterrence in real time by ratcheting up or down its enforcement efforts or by changing the amount or type of sanctions it pursues. Similarly, it could alter the types of frauds and defendants it prosecutes most aggressively.").

channel state prosecution within this dual-regulatory, multi-enforcer regime assumes an idealized version of the state prosecutor. In short, this ideal state prosecutor is a "rational bureaucrat,"[163] is not captured by industry,[164] is not seeking free-rider benefits,[165] is not succumbing to political pressure,[166] is not seeking self-aggrandizement,[167] is not "chickenshit" about losing cases,[168] is not caught up in a fervor to indict "someone for

163. *See* Coffee, *Metastasis*, *supra* note 150, at 22 ("One could sketch a model of the prosecutor as a rational bureaucrat, who considers whether the product of each additional increment of time and effort will exceed its marginal cost. Such model would, of course, be overly idealized, because such perfect efficiency is never obtainable.").

164. *See* Max Minzner, *Should Agencies Enforce?*, 99 MINN. L. REV. 2113, 2137 (2015) ("If the public is the principal, acting through the government as its agent, capture occurs when the agent stops seeking to serve the goals of the principal and instead pursues the ends of a third party. For administrative agencies, the key third parties are regulated entities–agencies get captured when they become controlled by those industries they regulate."); Moohr, *supra* note 128, at 1478 ("Regulatory agencies charged with monitoring business financial conduct are beset with inherent barriers to effective enforcement and are swept by political winds, often resulting in weak enforcement."); Mark Totten, *The Enforcers & the Great Recession*, 36 CARDOZO L. REV. 1611, 1658 (2015) ("When federal regulators are captured and fail to take necessary actions to protect consumers, at least a few states are likely to enter the enforcement gap. . . . No individual state AG is per se resistant to capture—and a recent investigative report has documented the previously unrecognized influence of lobbying on the state AG world—but understood collectively it is likely that at least a few states will act.").

165. *See* James J. Park, *Securities Enforcement in Extraordinary Times: A Comment on Rose and Leblanc's Policing Public Companies*, 63 FLA. L. REV. F. 1, 3 (2011) ("Multiple suits are most troubling when one enforcer is a free-rider, bringing a concurrent suit based on another enforcer's investigation, to obtain significant benefits for itself."); Rose, *State*, *supra* note 14, at 1402 ("Nothing formally prevents a state regulator from free-riding on the investigative efforts of the SEC, the private bar, or other state regulators by filing a follow-on suit to recover a quick fine for the state fisc, while adding little to the deterrence mix. . . . One would hope that a general concern for the national welfare on the part of state regulators keeps this sort of strategic activity to a minimum.").

166. *See* Rose, *Multienforcer*, *supra* note 129, at 2223 ("Voter preferences might also lead state officials to favor excessive enforcement, if being responsive to voters happens to be officials' political support-maximizing strategy. As explained above, because fraud is more salient than overdeterrence, voters are likely to overweigh underdeterrence costs relative to enforcement costs.").

167. *See* Coffee, *Metastasis*, *supra* note 150, at 21 ("Second, careerist motives may encourage the individual prosecutor to stalk the 'big kill'—typically, a highly visible business or political figure—even if the evidence ultimately obtained shows misconduct that is relatively modest in proportion to other violations by less notable persons. Successful prosecution of a highly visible defendant can significantly advance a prosecutor's career."); Vorenberg, *supra* note 145, at 1545 ("Human nature being what it is, people rarely give up power voluntarily, and thus the capacity of self-regulation to remove prosecutorial abuse and arbitrariness from the criminal justice system is limited.").

168. JESSE EISINGER, THE CHICKENSHIT CLUB: WHY THE JUSTICE DEPARTMENT FAILS TO

something,"[169] is capable of considering the benefits and harms of prosecution holistically,[170] and is willing to consider his or her role within the overall national scheme of securities regulation.[171]

Yet, without principles of prosecutorial discretion responsive to the dual-regulatory, multi-enforcer regime of securities regulation, even such an ideal prosecutor may make missteps.[172] Thus, I seek to provide that guidance, both to inform state prosecutors and to serve as a benchmark to assess states' prosecutorial decisions. If those decisions fall short, perhaps there is room for a more directive solution, even though it would not be as nimble.

Of note, when applied to the state prosecution of securities crime, principles of prosecutorial discretion usually apply at two levels–at the agency level when the state securities regulator is considering whether to make a criminal referral and at the prosecutor level upon receiving such a referral.[173] But, state prosecutors can charge securities crimes without such

---

PROSECUTE EXECUTIVES, xiv-xv (2017) (recounting that then-U.S. Attorney for the Southern District of New York, James Comey, characterized prosecutors who had never lost a case as members of the "Chickenshit Club.").

169. *See* Coffee, *Metastasis*, *supra* note 150, at 21 ("The momentum to indict someone for something can often be irresistible."); *see also* Fisher, *supra* note 151, at 206 (discussing how "[t]he internal climate of prosecution agencies may also promote 'conviction psychology'").

170. *See* Minzner, *supra* note 164, at 2145 ("Enforcement targets will always see cases holistically, aggregating the direct and collateral costs in determining how to proceed. In comparison, enforcement agencies cannot take a holistic approach. Almost by definition, only the direct consequences of an agency enforcement action are within its control. The collateral consequences lie outside its jurisdiction.").

171. *See* Rose, *Multienforcer*, *supra* note 129, at 2206 ("No individual state would fully capture the benefits of designing an 'optimal' liability regime for deterring fraud in the national securities markets, as those benefits would spill over to the national economy."); Rose, *State*, *supra* note 14, at 1353–54 ("Federal and state enforcers are likely to have differing policy perspectives for a variety of reasons. For example, federal enforcers should be concerned with maximizing national welfare, whereas state enforcers should be concerned with maximizing the welfare of their particular state. This may lead states to pursue actions that are in their parochial interest, but which are not in the best interest of the nation as a whole.").

172. *See* Strader, *supra* note 127, at 98 ("Prosecutorial discretion may seem a thin reed upon which to hang hopes of reforming white collar criminalization. Much has been written on prosecutorial discretion, but so far no principled system has been implemented for preventing abuse of discretion. . . . Yet, at least at the federal level, there is some cause for hope. The prosecutorial guidelines set forth in the *U.S. Attorneys Manual* attempt to provide some principled restraints on the exercise of prosecutorial discretion.").

173. *See* Minzner, *supra* note 164, at 2122–23 ("Enforcers must first decide the scope of liability. This initial charging decision requires a choice about which defendants to pursue and which defendants to ignore. As a practical matter, every enforcement agency sees more

a referral.[174] As such, these principles of prosecutorial discretion are broadly drafted to apply both to state regulators when making criminal referrals and to state prosecutors when deciding whether to pursue criminal charges, whether pursuant to a referral or not.

B. Proposed Principles for State Prosecution of Securities Crime

I propose a three-step analysis to guide state prosecutors when exercising their prosecutorial discretion with respect to securities crime. The three steps should be applied sequentially to reach a final charging decision. Step One incorporates the multi-faceted goals of prosecuting securities crime into general principles of prosecutorial discretion,[175] ignoring the dual-regulatory and multi-enforcer regime in which a state prosecutor operates. Step Two layers on the multi-enforcer component of that regime, and Step Three incorporates the dual-regulatory aspect of that regime.

Step One: Assuming that this potential criminal charge would be the only enforcement of any kind and assuming that the conduct is also criminalized under federal law, consider the benefits and harms of prosecution. Only if the benefits exceed the harms should the state prosecute.

Discussion of Step One

In this step, prosecutors should engage in a comprehensive analysis of the benefits and harms of prosecution, in light of the goals of prosecuting securities crime. For purposes of this step, prosecutors should not consider any concurrent enforcement against this perpetrator, and prosecutors should assume that state law is coextensive with federal law. Below are the key benefits and harms of prosecuting securities crime.

---

violations than it can charge, so some potential defendants will be allowed to escape. These decisions are perhaps the classic example of prosecutorial discretion by public enforcers. This choice belongs to the enforcement agency alone. Both in the civil and criminal context, decisions not to charge are effectively unreviewable.").

174. *See* UNIF. SEC. ACT § 508(B) (2002) ("The [Attorney General or the proper prosecuting attorney] with or without a reference from the administrator, may institute criminal proceedings under this [Act].").

175. Brown, *supra* note 111, at 74 ("[P]rosecutors (and also, to various degrees, police and regulatory officials) weigh a set of familiar considerations: harm, blameworthiness, deterrent effects, alternative remedies or policy options, and resource constraints.").

Benefits

Deterrence

The first potential benefit of prosecution is deterring similar conduct in the future, both by this perpetrator and by others. In order to appreciate the potential deterrent effects of prosecution, it is necessary to consider (1) the harms to society if this conduct were to reoccur; (2) the potential impact of criminal prosecution on deterring this perpetrator from similar conduct in the future (*i.e.*, specific deterrence); and (3) the potential impact of criminal prosecution on deterring others from similar conduct in the future (*i.e.*, general deterrence).

First, the societal harm flowing from the conduct depends on the type of securities crime at issue. For example, securities fraud hurts defrauded investors by depriving them of accurate information to make investment decisions, potentially resulting in the loss of the invested funds themselves, as well as the lost opportunity to invest in honest investments that might perform better than the one influenced by fraud. Securities fraud harms society more broadly by diverting scarce investment funds from honest investments into fraudulent ones.[176] Securities fraud also harms society because other investors, in response to markets in which fraud is present, may require a so-called "fraud discount" or exit the markets altogether, thus raising the cost of capital and limiting its flow.[177] As another example, the offer or sale of unregistered, non-exempt securities potentially harms the investors who participate in the offering because the registration and exemption rules attempt to ensure that the information provided to investors correlates with their level of financial sophistication and risk tolerance.[178] Thus, investors who participate in unregistered, non-exempt offerings may participate in unsuitable investments without appreciating

176. *See* Merritt B. Fox, *Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1358 (1999) ("Ideally, society would want to implement all proposed projects in rank order of their risk-adjusted expected returns (based on all available information, including what is known by the managers proposing each project).").

177. *See* Rose, *Multienforcer*, *supra* note 129, at 2180 ("By successfully deterring fraud, it would bring skittish investors back to the capital markets, reduce the 'fraud discount' they may otherwise be inclined to charge, and generally improve corporate governance. Allocative distortions would thereby be minimized, and the cost of capital reduced.").

178. *See* S.E.C. v. Ralston Purina Co., 346 U.S. 119, 124–25 (1953) ("The design of the statute is to protect investors by promoting full disclosure of information thought necessary to informed investment decisions. The natural way to interpret the private offering exemption is in light of the statutory purpose. . . . An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'").

the risks thereof.

Second, criminal prosecution may further specific deterrence. Relevant to this inquiry is the likelihood that the perpetrator, if not prosecuted, will reoffend. The perpetrator's history of prior securities violations is especially relevant here, as there is data to suggest that there is a subset of so-called "securities fraud recidivists."[179] A criminal conviction for a securities-related crime, even if not accompanied by imprisonment, bars people from participating in many securities-related industries, thus potentially preventing the perpetrator from reoffending.[180]

In addition, white collar offenders are especially sensitive to the potential for imprisonment,[181] potentially increasing the deterrent effect of a criminal prosecution.

Third, criminal prosecution will likely further general deterrence. A securities-related prosecution is likely to scare other potential violators, especially white collar ones,[182] enhancing its general deterrence impact. Although some potential offenders are unlikely to be deterred by the prospect of prosecution,[183] a subset will adjust their conduct in response to criminal prosecution.[184]

---

179. *See* Jayne W. Barnard, *Securities Fraud, Recidivism, and Deterrence*, 113 PENN ST. L. REV. 189, 191–92 (2008) ("[P]opulation of offenders who engage repeatedly in retail securities fraud—securities fraud recidivists" will often "receive two, three, or even more sequential civil sanctions before the Department of Justice initiates criminal prosecution."); *see also* Sally S. Simpson, *Making Sense of White-Collar Crime: Theory and Research*, 8 OHIO ST. J. CRIM. L. 481, 485 (2011) ("Although most scholarship in the field tends to be more conceptual and qualitative in nature, the few systematic quantitative studies that have been conducted have produced some uniform findings: . . . a large percent of offenders are recidivists.").

180. *See* 15 U.S.C. §§ 78c(a)(39)(F) & 78o(b)(4)(B) (disqualifying any person from membership in a self-regulatory organization if, within the past ten years, the person has been convicted of any offense involving the purchase or sale of any security).

181. *See* Strader, *supra* note 127, at 55 ("[T]he vast majority of white collar defendants would undoubtedly prefer fines and other civil sanctions to jail time and the taint of being branded a felon. There is simply no doubt that defendants in parallel administrative, civil, and criminal proceedings consider criminal sanctions to be of a qualitatively different order than civil and administrative sanctions.").

182. Strader, *supra* note 127, at 55.

183. Barnard, *supra* note 179, at 192 (suggesting that "[M]any individuals who engage in securities fraud—and especially securities fraud recidivists—may be 'hard-wired' to engage in fraudulent schemes.").

184. *See* Henning, *supra* note 111, at 35 ("[P]eople who operate in the white-collar world seem to be the likeliest candidates to be aware of a prison sentence imposed on someone in the same industry, and to respond by avoiding future misconduct, even for actions that may appear to be typical in the modern business environment.").

Retribution

The second potential benefit of prosecution is retributive—expressing society's approbation of immoral conduct. The degree to which this potential benefit is implicated depends on the facts of the securities crime at issue. For example, some species of securities fraud—such as Ponzi schemes—likely involve immoral conduct, while others—such as reckless financial statements—may not.[185] Relevant factors include: (1) whether the fraud involved an abuse of trust; (2) whether the fraud involved especially vulnerable victims, such as the elderly; (3) the perpetrator's mental state; and (4) the scope of the loss, if any, to victims. The sale of unregistered, non-exempt securities is less likely to involve immoral conduct than securities fraud, unless the above factors suggest that the conduct was unusually brazen.

Compensation

The third potential benefit of criminal prosecution is compensatory. Relevant factors include: (1) the scope of the loss; (2) whether the perpetrator has assets that could be used to accomplish restitution; and (3) whether the victims are identifiable.

Harms

Costs of Prosecution and Punishment

The first potential harm of criminal prosecution is the diversion of resources to prosecute and punish this perpetrator as opposed to other perpetrators.[186] Securities crime cases are often document-intensive, may require expert witnesses, and may require greater time to prepare and try than other cases.[187] In addition, as with any criminal prosecution that may

185. *See* Henning, *supra* note 111, at 55 ("[M]any white-collar offenses do not provoke the type of moral opprobrium attached to a crime like murder or assault, so individuals may not comprehend how their conduct can be viewed as criminal or subject them to a conviction rather than, at most, a civil penalty. And when the violation revolves around the application of technical rules, one can readily see how a defendant might reasonably conclude that there was no criminal conduct involved.").

186. *See* Rose, *Multienforcer*, *supra* note 129, at 2184 ("*Direct* enforcement costs include the resources consumed in detecting, prosecuting, defending, and adjudicating securities fraud cases.").

187. *See* John Hasnas, *Foreword to Corporate Criminality: Legal, Ethical and Managerial Implications*, 44 AM. CRIM. L. REV., 1269, 1269–70 (2007). ("Considerable investigation may be required to even establish that a crime has been committed, and a great deal of legal and accounting sophistication may be required to unravel the deception. Prosecuting such cases is necessarily an expensive and time-consuming task.").

result in imprisonment, the cost of incarceration is a factor.

Over-Deterrence Costs

The second potential harm of criminal prosecution is the risk of over-deterrence costs. Such costs are imposed when other actors, in response to an enforcement action and out of fear of being subject to enforcement themselves,[188] over-correct their own conduct in a way that is not socially beneficial. For example, other actors could respond to a securities fraud prosecution by over-investing in precautionary measures, thus increasing the cost of capital, or over- or under-disclosing, thus reducing share price accuracy.[189] Professor Rose summarized the potential over-deterrence costs associated with securities fraud prosecutions as follows:

> The risk of these sorts of mistaken fraud prosecutions can produce over-deterrence costs that look very much like the under-deterrence costs the system is meant to prevent. If regulators aggressively pursue forecasts and other opinions, it may prompt even honest individuals to disclose less of this type of information, impeding share price accuracy. Conversely, the aggressive pursuit of omissions might cause individuals to spend too much firm money in the production of information, or to flood the market with trivial information—which can likewise impede share price accuracy. Less accurate share prices mean, in turn, less allocative efficiency in the economy and a higher cost of capital. The risk of erroneous fraud liability might also lead firms to spend more money scrubbing documents for accuracy

188. *See* Coffee, *Metastasis*, *supra* note 150, at 9 ("Yet, by introducing the threat of criminal sanction, there is an impact not only on those who are guilty of misconduct, but also on those who are risk averse and insist on arranging their affairs so as to avoid any chance of entanglement with the criminal law.").

189. *See* Rose, *Multienforcer*, *supra* note 129, at 2184 ("[O]verdeterrence produces some of the very same social costs as securities fraud itself: it can increase the cost of capital (e.g., if fear of liability causes companies to overinvest in precautionary measures or causes financial intermediaries to charge more for their services) and upset the allocative efficiency of the economy (e.g., if fear of liability causes companies to reduce disclosure of truthful information or, conversely, to disclose too much trivial information, thereby impeding share-price accuracy)."); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 652 (1996). ("[T]here are significant costs associated with precaution in the face of excessive liability. Accounting and legal fees are higher. Managers will tend either to disclose too much (which is at least costly, often contrary to the company's business interests, and perhaps misleading by virtue of the dilution effect) or to say little or nothing at all when they want to keep secrets for fear of the uncertain consequences of addressing a subject in the first place given the dimly illuminated margins of the half-truth doctrine and the duty to update.").

> than is socially optimal. In addition, financial intermediaries might charge firms more for their services as compensation for the risk of erroneous aiding and abetting liability. Finally, when vicarious liability is a feature of the system, excessive sanctions might cause firms to overinvest in measures to prevent fraud and misrepresentation, even absent a risk of legal error.[190]

Similarly, other actors could respond to a prosecution for offering or selling unregistered, non-exempt securities in two costly ways: (1) over-complying with an exemption (such as by refraining from selling to any non-accredited investors even if a limited number of such sales are permitted by the exemption), thus increasing the cost of capital; or (2) refraining from selling securities altogether, thus restricting the growth of the economy.[191] Because all other regulated parties may respond to a single prosecution, the over-deterrence costs from a single prosecution can be exponential.[192]

However, not all crimes, including securities crimes, pose the risk of over-deterrence costs. There are two prerequisites in order for over-deterrence costs to be a concern: (1) the law must be murky or subject to legal error;[193] and (2) the conduct at issue must be "priced" rather than "prohibited" via criminalization.[194]

First, over-deterrence costs only pose a risk if regulated parties are unsure about how to comply with the law or fear that they will be mistakenly found not to have complied. If the law is clear and unlikely to be applied in error, "[r]egulated parties can avoid sanction with confidence. . . ."[195] For example, there are unlikely to be over-deterrence costs associated with prosecuting the perpetrator of a Ponzi scheme or someone selling securities via the internet without attempting to satisfy an

190. Rose, *State*, *supra* note 14, at 1381.

191. *See* John Herbert Roth, *The Effective Counselor*, 77 ALA. LAW. 188, 192 (2016). ("[L]awyers and compliance professionals tend to be more risk averse because we are trained to spot and plan for the worst possible outcomes. In simplified terms, we see the landscape as being covered with landmines, at least one of which is expected to explode.").

192. *See* Rose, *Multienforcer*, *supra* note 129, at 2184 ("*[A]ll* regulated parties may potentially produce overdeterrence costs. Lawmakers should therefore pay close attention to these costs lest the securities fraud deterrence regime ends up doing more harm to the economy than good.").

193. *See* Rose, *State*, *supra* note 14, at 1365 ("If the law identifies the behavior to be proscribed with specificity, and the risk of legal error and misguided prosecution is low (which is likely to be the case with a very specific law), unleashing multiple enforcers is less worrisome.").

194. Coffee, *Reflections*, *supra* note 105, at 196.

195. Rose, *State*, *supra* note 14, at 1365.

exemption from registration that permits general solicitation or advertising.[196] On the other hand, there is a risk of over-deterrence costs if prosecuting someone who spoke recklessly or negligently, rather than knowingly or intentionally; who sold interests that qualify as securities only under an expansive interpretation of "investment contract;" or who sold securities via a word-of-mouth network that just crossed the line into "general solicitation or advertising."[197]

Second, over-deterrence costs only pose a risk if the conduct is "priced" rather than "prohibited" by criminalization.[198] As John C. Coffee, Jr. has explained, the modern criminal law serves both roles.[199] For conduct that has no social value, the criminal law prohibits it.[200] In this scenario, there is no risk of over-deterrence because the conduct is so contrary to community standards that society wants potential perpetrators to avoid it at all costs.[201]

Examples of "prohibited" conduct in the securities context are so-called "true crimes"[202] or "real frauds"[203] like Ponzi schemes[204] and pump-

196. *See* Langevoort, *supra* note 189, at 658–59 ("Given scienter's slippery character, it is appropriate to distinguish between those frauds that are truly deliberate (having something like malice aforethought) and those where there is a more significant risk of judicial error or legitimate cause for uncertainty on matters such as materiality or duty. Drawing this distinction reduces the risk of overprecaution: there is far less cause for concern with respect to the truly deliberate scheme.").

197. *See* Rose, *Multienforcer*, *supra* note 129, at 2193 ("[T]he overdeterrence risks discussed above are all traceable to a single source: *regulated parties' fear of falsely positive scienter determinations*.").

198. *See* Minzner, *supra* note 164, at 2129 ("In this framework, enforcers can set the penalties either to require the violator to internalize the costs caused by the violation or deter it completely.").

199. *See* Coffee, *Reflections*, *supra* note 105, at 239 ("Ideally, criminal legislation might therefore distinguish two grades of the crime of toxic dumping: the higher grade requiring a subjective perception by the defendant of the serious risk of harm to others, and the lower grade not. The former might be 'prohibited,' and the latter 'priced.'").

200. *See* Coffee, *Reflections*, *supra* note 105, at 239 ("Generally, society seeks to prohibit (rather than price) those activities that violate fundamental community standards.").

201. *See* Coffee, *Reflections*, *supra* note 105, at 195 ("Because society has refused on moral grounds to recognize the legitimacy of the benefit to the defendant in these cases, then by definition the benefits of the crime to the individual can never exceed the costs it imposes on society. Thus, the criminal law threatens the defendant with a much sharper, more discontinuous jump in the costs that the defendant will incur for its violation than does tort law, because the criminal law has little reason to fear overdeterrence (that is, the chilling of socially valuable behavior) within its appropriate domain.").

202. *See* Coffee, *Reflections*, *supra* note 105, at 195 (arguing that "'true' crimes" are those that "society wishes to prohibit, not price").

203. *See* Urska Velikonja, Behind the Annual SEC Enforcement Report: 2017 and Beyond, Part I (Nov. 22, 2017), https://wp.nyu.edu/compliance_enforcement/2017/11/22/be

and-dump schemes.[205] For conduct that has social value but also poses the risk of social harm, the criminal law "prices" the conduct, thus forcing actors to internalize the social cost of their conduct.[206] In this scenario, there is a risk of over-deterrence costs if the potential criminal penalty exceeds the social harm of the conduct.[207] Examples of "priced" conduct in the securities context are negligent misrepresentations and the negligent failure to comply with an exemption from registration. This prerequisite merges with the first because conduct is more likely to be "priced" rather than "prohibited" if the law is unclear,[208] and often the dividing line depends on the applicable mental state.[209]

---

hind-the-annual-sec-enforcement-report-2017-and-beyond-part-i/ [https://perma.cc/EX5U-VRAT] ("In the second half of 2017, the SEC moved aggressively against offering fraud, pump-and-dump schemes, and the like—the sorts of cases that Chair Clayton has described as 'real frauds.' Cases such as these have always been the bread and butter of SEC enforcement. They are not just securities violations but crimes; the SEC usually joins forces with prosecutors who file a criminal case against the same defendant(s), often on the same day.").

204. *See* Samuel W. Buell, *What Is Securities Fraud?*, 61 DUKE L.J. 511, 539 (2011) ("Everyone knows operating a billion-dollar Ponzi scheme is not only fraudulent, but wrongful.").

205. *See id.* at 529 ("Core frauds require everything needed to establish a misrepresentation, plus something more that, in general, is highly significant in law: the actor's level of mental state, fault, culpability, or moral blameworthiness.").

206. *See* Coffee, *Reflections*, *supra* note 105, at 228 ("The negligent defendant is frequently engaged in activities that have social utility and, indeed, is the same person with whom the law of torts regularly deals. Hence, to the extent that these forms of misbehavior are considered 'crimes,' the law should 'price' the misbehavior—that is, seek to force the defendant to internalize the costs it imposes on others.").

207. *See id.* ("All arguments have their logical limits, and the claim that the criminal law should prohibit rather than price misbehavior has its doctrinal boundaries also. Normally, when we think of the criminal law, we visualize it punishing intentional actions willfully engaged in by the defendant. Yet, the criminal law also can be used to punish negligent acts, to impose strict liability, and to hold persons vicariously liable for the acts of others. In such circumstances, the statement that the criminal law should treat the defendant's conduct as lacking social utility (and therefore should impose high penalties without concern for overdeterrence) makes little sense.").

208. *See id.* ("The mere fact that conduct is in violation of a known and valid legal standard is insufficient, because sometimes society may wish only to price such violations. . . . Ultimately, pricing is necessary on moral as well as economic grounds when sufficiently clear partitions cannot be erected between the unlawful behavior and closely related lawful behavior to justify a prohibitory policy. Unfortunately, this condition holds true throughout much of the 'white collar' criminal context.").

209. *See id.* ("Put simply, the existence or non-existence of criminal intent supplies a traditional jury issue that also furnishes the most practical breakpoint at which to shift from pricing to prohibiting.").

Step Two: Determine whether the perpetrator is subject to another enforcer (public or private, civil or criminal). If not, then skip this step. If so, however, revisit Step One, considering only the *marginal* benefits and harms of prosecution. Only if the marginal benefits exceed the marginal harms should the state prosecute.

Discussion of Step Two

This step incorporates the multi-enforcer aspect of the securities regulation regime. In this step, prosecutors should first assess whether another enforcer is pursuing, or is likely to pursue, this perpetrator. Possibilities include criminal prosecution by the federal government or another state; civil enforcement by the SEC, by this state's securities regulator, or by another state's securities regulator; and a private civil action under federal or state law by injured investors. Just because another enforcement is theoretically possible does not mean that it will occur. On the public side, regulators[210] and prosecutors[211] are selective in pursuing enforcement. On the private side, even if investors have a theoretically viable claim for damages, they may not pursue it because the costs of litigation may exceed the expected recovery.[212] Although the class action mechanism may enable some of these negative-value claims to proceed, "smaller issuers are relatively immune to class actions, significantly reducing any deterrence or compensation value of such mechanism."[213]

If no other enforcement is likely, prosecutors should skip this step of the analysis. If at least one other enforcer is pursuing, or is likely to pursue, this perpetrator, however, prosecutors should revisit Step One's benefits-harms analysis, this time considering only the marginal benefits and harms of criminal prosecution in light of the goals of prosecuting

210. *See* Di Trolio, *supra* note 22, at 1306 ("Another reason for state enforcement is that federal government enforcement is selective.").

211. *See id.* at 1311 ("Moreover, the existence of prosecutorial discretion necessarily means that overlapping jurisdiction does not necessarily result in duplicative enforcement.").

212. *See* Carlos Berdejó, *Small Investments, Big Losses: The States' Role in Protecting Local Investors from Securities Fraud*, 92 WASH. L. REV. 567, 579–80 (2017) ("But investors who have a valid claim under the securities laws will not necessarily bring a lawsuit to assert their rights. . . . Arguably, the costs and risks associated with bringing a lawsuit are likely to present a more formidable barrier to investors who have suffered relatively small losses."); *see also* Zimmerman & Jaros, *supra* note 124, at 1436 ("When claims are less marketable, private parties and attorneys may lack resources or incentives to pursue individual litigation.").

213. *See* Berdejó, *supra* note 212, at 581.

securities crime. As in Step One, prosecutors should continue to assume that state law is coextensive with federal law.

Marginal Benefits

Deterrence & Compensation

Private securities litigation furthers both deterrence and compensation goals.[214] However, for several reasons, criminal prosecution might nonetheless have a marginal impact.[215] For one, substantive and procedural restrictions on securities litigation, most of which are contained in the PSLRA, allow some perpetrators to escape liability.[216] For example, the discovery stay, which applies to federal securities claims pending in federal court, stays discovery until resolution of the defendant's motion to dismiss.[217] In order to survive a motion to dismiss a securities fraud action, plaintiffs must plead a strong inference of scienter.[218] This heightened pleading standard is often unachievable without the benefit of discovery, even if the perpetrator actually possessed scienter.[219] As another example, the safe harbor for forward-looking statements, which applies to private civil securities actions under federal law, insulates from liability certain

214. *See* Moohr, *supra* note 128, at 1478 ("Private civil suits not only provide compensation to those injured, they also enlarge scrutiny of corporate conduct and deter other firms from engaging in similar conduct."); see *Joint Explanatory Statement of the Committee of Conference*, H.R. CONF. REP. 104-369, 31, 1995 U.S.C.C.A.N. 730, 731 ("Private securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.").

215. *See* Zimmerman & Jaros, *supra* note 124, at 1435–36 ("We argue that prosecutors should seek large-scale compensation only when there is strong evidence that neither a civil class action nor individual private litigation will hold defendants accountable, efficiently resolve multiple claims, or equitably distribute victim compensation."); *see also* Coffee, *Reflections*, *supra* note 105, at 238 ("First, tortious conduct can impose enormous externalities upon society, and in some of the new areas where the criminal sanction is being used—worker safety, toxic dumping, securities fraud—existing tort and regulatory remedies are generally believed not to have produced adequate deterrence.").

216. *See* Moohr, *supra* note 128, at 1478 ("Private plaintiffs no longer have ready access to courts to obtain civil redress for securities fraud, and the scrutiny provided by private attorneys general has been forsaken.").

217. 15 U.S.C. § 77z-1(b)(1); 15 U.S.C. § 78u-4(b)(3)(B).

218. 15 U.S.C. § 78u-4(b)(2)(A).

219. *See* Geoffrey P. Miller, *Pleading After Tellabs*, 2009 WIS. L. REV. 507, 530 (2009) ("The intersection of these rules puts a plaintiff in a vise: the pleading rules require particularized allegations and a strong inference of scienter, while the discovery stay deprives the attorney of the conventional means to develop this information.").

forward-looking statements that are identified as such and accompanied by meaningful cautionary language, regardless of the speaker's mental state.[220]

In addition, if the private litigation is proceeding as a class action, there is a risk that class counsel might agree to an unduly low settlement, undercutting the deterrent and compensatory effects of the private suit. Class action litigation poses the risk of agency costs because "substantial conflicts of interest between attorney and client can arise."[221] As explained by Professor Coffee, these conflicts arise because "plaintiff's attorneys have more at stake than their clients;"[222] "the attorney/entrepreneur has more reason to desire an early settlement than the client;"[223] and "because plaintiff's fee awards are typically a declining percentage of the recovery, the attorney benefits less from an increase in the recovery than does his or her clients."[224] Thus, "[t]he classic agency cost problem in class actions involves the 'sweetheart' settlement, in which the plaintiff's attorney trades a high fee award for a low recovery."[225] Although the PSLRA sought to limit agency costs in securities class actions, such as by imposing a rebuttable presumption that the investor with the largest financial interest be appointed lead plaintiff[226] and by imposing a "reasonable percentage" restriction on class counsel's attorneys' fees and expenses,[227] conflicts of interest remain.[228] Of course, prosecutors are not immune from principal-agent problems,[229] but they can potentially further deterrence and

220. 15 U.S.C. § 77z-2(c)(1)(A)(i); 15 U.S.C. § 78u-5(c)(1)(a)(i).

221. John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 883 (1987) [hereinafter Coffee, *Regulation*].

222. *See* John C. Coffee, Jr., *Accountability and Competition in Securities Class Actions: Why "Exit" Works Better Than "Voice"*, 30 CARDOZO L. REV. 407, 413 (2008) [hereinafter Coffee, *Accountability*] ("When one adds these two amounts--the expenses that the attorney must bear and the attorney's expected contingent fee--the attorney has far more at stake than any individual class member.").

223. *See id.* ("[T]ime is money, and delay for class counsel means additional costs and expenses that the attorney alone bears.")

224. *Id.*

225. Coffee, *Regulation*, *supra* note 221, at 883.

226. 15 U.S.C. § 77z-1(a)(3)(B); 15 U.S.C. § 78u-4(a)(3)(B).

227. 15 U.S.C. § 77z-1(a)(6); 15 U.S.C. § 78u-4(a)(6).

228. *See* Coffee, *Accountability*, *supra* note 222, 417 (2008) ("When institutional investors exit the class and sue individually, they appear to do dramatically better--by an order of magnitude!").

229. *See* Zimmerman & Jaros, *supra* note 124, at 1416 ("At first blush, prosecutors seem to present less of a principal-agent problem than private class counsel. Prosecutors have no independent financial stake in the final settlement. . . . Principal-agent problems exist, however, even when public officials are charged with representing victims' interests.").

compensation goals under circumstances where securities class actions fall short.

Further, even if the defendant were held liable in damages to injured investors, criminal prosecution might nonetheless further deterrence. For one, being convicted of a crime carries with it a stigma that is different in degree and in kind than civil liability. Additionally, even if damages liability would, in theory, serve as an adequate deterrent, it might fall short in practice if the perpetrator and other potential perpetrators were judgment-proof.[230] For example, if a $10 million judgment would, in theory, serve as an adequate deterrent, it would lose its deterrent impact if the perpetrator lacked the resources to pay the judgment.

Finally, a state criminal prosecution might actually affect the outcome of concurrent private litigation, increasing the deterrence value of the private litigation. In other words, the mere fact that the state is pursuing criminal charges might increase the value of the civil suit.[231]

Likewise, civil enforcement by a state or federal regulator and criminal prosecution by another state or by the federal government can further both deterrence and compensation goals.[232] For several reasons, however, state criminal prosecution might have a marginal impact. First, as discussed above, if the other enforcement is civil rather than criminal, the heightened stigma associated with criminal prosecution may marginally increase deterrence.

Second, the state criminal prosecution might be more effective than the other public enforcement, whether civil or criminal. Because of capture[233] or insufficient resources,[234] the other enforcer might be too

230. *See* POSNER, ECONOMIC ANALYSIS, *supra* note 108, at 224 ("Where tort remedies are an adequate deterrent because optimal tort damages, including any punitive damages, are within the ability to pay of the potential defendant, there is no need to invoke criminal penalties. . . .").

231. *See* Rose, *Multienforcer*, *supra* note 129, at 2223 (citing James D. Cox & Randall S. Thomas with the assistance of Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 777 (2003)) ("Empirical studies show that Rule 10b-5 class actions are likely to settle more quickly, and for more money, if the government has brought a parallel action against the defendant.").

232. *See* Kokesh v. S.E.C., 137 S. Ct. 1635, 1643, 198 L. Ed. 2d 86 (2017) ("[I]t has become clear that deterrence is not simply an incidental effect of [SEC] disgorgement."); Strader, *supra* note 127, at 102 ("There is substantial evidence that white collar defendants are strongly deterred by civil/administrative sanctions, including debarment. The public humiliation and loss of status that attend such sanctions create their own deterrent effect.").

233. *See* Totten, *supra* note 164, at 1659 (explaining the incentives that "can make state AGs an effective counterbalance to a captured federal regulator"); Minzner, *supra* note 164, at 2119 ("If enforcement is centralized in a single federal agency, capture can produce underenforcement and underdeterrence. Additional enforcers can counteract capture by

lenient in charging decisions, especially with respect to charging individuals,[235] or in negotiating a settlement or plea agreement.[236] In addition, because of greater agility[237] or access to resources or information,[238] the state prosecutor might be better situated to achieve a conviction. Finally, to the extent that a second criminal prosecution would increase media coverage, it could have a marginal impact on general deterrence.

Retribution

Finally, state criminal prosecution might have a marginal impact on retribution goals. If the other enforcement is civil—either public or private—it is unlikely to express the weight of society's disapproval to the

---

bringing their resources to bear and competing with the primary public enforcer. Decentralization thus allows other entities to supplement the enforcement efforts of the primary administrative agency."); Jones, *supra* note 9, at 124 ("Maintaining multiple levels of regulation provides an antidote to regulatory capture.").

234. *See* Berdejó, *supra* note 10, at 585 ("Due to limited resources, the SEC cannot investigate all alleged securities violations brought to its attention."); Jones, *supra* note 9, at 126-27 ("Because the SEC lacks adequate resources to effectively police the national securities market, supplemental enforcement is essential to achieve an appropriate level of deterrence.").

235. *See* Jean Eaglesham & Anupreeta Das, *Wall Street Crime: 7 Years, 156 Cases and Few Convictions*, WALL ST. J. ONLINE (May 27, 2016), https://www.wsj.com/articles/wall-street-crime-7-years-156-cases-and-few-convictions-1464217378 ("The Wall Street Journal examined 156 criminal and civil cases brought by the Justice Department, Securities and Exchange Commission and Commodity Futures Trading Commission against 10 of the largest Wall Street banks since 2009. In 81% of those cases, individual employees were neither identified nor charged. A total of 47 bank employees were charged in relation to the cases. One was a boardroom-level executive, the Journal's analysis found.").

236. *See* Brandon L. Garrett, *The Corporate Criminal As Scapegoat*, 101 VA. L. REV. 1789, 1799 (2015) ("That problem grew worse over the past decade, however, since far more of the truly important corporate prosecutions now do not result in a conviction, but rather in alternatives to a conviction called deferred prosecution agreements (in which a case is initially filed but stayed on a judge's docket pending compliance with its terms), and non-prosecution agreements (in which no criminal case is filed in court).").

237. *See* Totten, *supra* note 164, at 1655–56 ("States will often have the ability to respond to emerging harms more swiftly than their federal counterparts because of the nature of their offices and the type of law they enforce. The first reason is straightforward: AGs have less bureaucracy. In the vast majority of states, the AG is a separately elected, constitutional officer and, therefore, does not report to any higher authority. Sprawling federal regulators can have multiple layers of review that mean delay when states are nimble.").

238. *See id.* at 1653–54 ("The states often have distinct information advantages because of their proximity to the harms and the type of laws they enforce, which facilitate more responsive enforcement.").

same degree as a criminal prosecution.[239] In addition, because civil cases are more likely to settle, courts are less likely to play "any expressive role in highlighting unacceptable forms of misconduct."[240] Even if the other enforcement is criminal, a second criminal prosecution could nonetheless have a marginal impact, especially if the other prosecutor is too lenient in charging decisions or plea negotiations or if the other prosecution is less likely to achieve a conviction.

Marginal Harms

The marginal harms of a state prosecution, including the marginal costs of enforcement and imprisonment and the marginal over-deterrence costs, should be weighed against the aforementioned marginal benefits.

Costs of Prosecution and Punishment

Because of the potential for coordination or cooperation among enforcers, the marginal costs of a state prosecution might be lower than if proceeding in a regime without multiple enforcers. For example, in a 2009 executive order, President Obama established the Financial Fraud Enforcement Task Force, and in a 2018 executive order, President Trump replaced that task force with the Task Force on Market Integrity and Consumer Fraud.[241] Both task forces were established in order to "strengthen the efforts of the Department of Justice, in conjunction with Federal, State, tribal, territorial, and local agencies," to investigate and prosecute financial fraud.[242] President Obama's order sought to enhance "coordination" with states,[243] while President Trump's order sought to enhance "cooperation" with states.[244] Regardless, if federal regulators or prosecutors were willing to share information with state prosecutors, it

239. *But see* Herschkopf, *supra* note 118, at 455 ("This Article argues that we should regard liability for civil securities fraud as a pronouncement of moral blameworthiness.").

240. Zaring, *supra* note 131, at 1471.

241. Executive Order 13844, Establishment of the Task Force on Market Integrity and Consumer Fraud (July 11, 2018), Fed. Reg. vol. 83, no. 136, at 33115; Executive Order 13519, Establishment of the Financial Fraud Enforcement Task Force (Nov. 17, 2009), Fed. Reg. vol. 74, no. 222, at 60123.

242. Executive Order 13844, Establishment of the Task Force on Market Integrity and Consumer Fraud (July 11, 2018), Fed. Reg. vol. 83, no. 136, at 33115; Executive Order 13519, Establishment of the Financial Fraud Enforcement Task Force (Nov. 17, 2009), Fed. Reg. vol. 74, no. 222, at 60123.

243. Executive Order 13519, Establishment of the Financial Fraud Enforcement Task Force (Nov. 17, 2009), Fed. Reg. vol. 74, no. 222, at 60124, § 3(c).

244. Executive Order 13844, Establishment of the Task Force on Market Integrity and Consumer Fraud (July 11, 2018), Fed. Reg. vol. 83, no. 136, at 33116, § 4(c)(ii).

could lessen the marginal costs of a state prosecution.

Second, because of the potential for concurrent sentencing, the marginal costs of imprisonment might be lower than if the state prosecutor were the only enforcer. In particular, if another state or the federal government has primary jurisdiction over the defendant,[245] and if this state's sentence were to run concurrently with that sentence,[246] this state's incarceration costs could be decreased.[247] (Of note, the marginal deterrence and retributive impacts of a concurrent sentence would likely be lower than of a consecutive one, thus affecting the marginal benefits analysis above.)

Over-Deterrence Costs

Finally, if the conduct at issue implicates concerns about over-deterrence,[248] the marginal over-deterrence costs of state prosecution must be taken into account.[249] In particular, if the other enforcement is civil rather than criminal, the over-deterrence costs of a state criminal prosecution could be significant.[250]

---

245. *See* Erin E. Goffette, *Sovereignty in Sentencing: Concurrent and Consecutive Sentencing of a Defendant Subject to Simultaneous State and Federal Jurisdiction*, 37 VAL. U. L. REV. 1035, 1055 (2003) ("The court that gains custody of a defendant first, as determined by careful review of the facts of the arrest, enjoys 'primary jurisdiction' over the defendant.").

246. *See id.* at 1050 ("Most states grant the trial court the authority to decide whether multiple sentences will be consecutive or concurrent.").

247. *See* Henry J. Sadowski, Interaction of Federal and State Sentences When the Federal Defendant is Under State Primary Jurisdiction, at 5 (July 7, 2011), https://www.bop.gov/resources/pdfs/ifss.pdf [https://perma.cc/UG6M-Q2JK] ("The jurisdiction which is the primary custodian is responsible for the cost of incarceration. When the federal authorities are the primary custodian of the prisoner, the United States bears the costs of incarceration.").

248. *See supra* text accompanying notes 188–209 (discussing the complexities surrounding the over-deterrence costs of criminal prosecution).

249. *See* Minzner, *supra* note 164, at 2118–19 ("Multiple enforcement actions by state or federal regulators (or a private class action following a public enforcement action) will produce multiple sanctions. Without careful coordination, these multiple sanctions might well exceed the optimal level of punishment for a given violation. In this way, decentralization can produce overpunishment and overdeterrence.").

250. *See* POSNER, ECONOMIC ANALYSIS, supra note 108, at 224 ("[A] savage penalty will induce people to forgo socially desirable activities at the borderline of criminal activity."); Kenneth G. Dau-Schmidt, *An Economic Analysis of the Criminal Law as a Preference-Shaping Policy*, 1990 DUKE L.J. 1, 14 (1990) ("High criminal penalties will deter people from desirable, but only marginally lawful, activity because they are uncertain whether they will be convicted of a crime.").

Step Three: Determine whether the conduct is criminalized under federal law. If so, then skip this step. If not, however, then determine whether the conduct was intrastate or interstate and, based thereon, incorporate any resultant *additional* benefits and harms of prosecution into the above analysis under Step One or Step Two, whichever was most recently applied.

Discussion of Step Three

This step incorporates the dual-regulatory aspect of the securities regulation regime. In this step, prosecutors should first assess whether the conduct is criminalized under federal law. If so, then prosecutors should skip this step. If not, however, prosecutors should determine whether the conduct at issue was intrastate or interstate, considering any additional benefits and harms of prosecution accordingly.

In order for the conduct to qualify as intrastate, all affected parties (including the issuer and the investors) must reside in this state and all of the issuer's relevant communications must have been limited to this state. For example, an offering satisfying the Rule 147 intrastate offering exemption—which requires that all offers and sales be made to residents of the state in which the issuer is resident[251]—would likely qualify as intrastate conduct. If, however, the issuer resides in another state, any investor resides out of the state, or any relevant communication was directed to residents of another state, then the conduct qualifies as interstate.

Additional Benefits

Intrastate Conduct

If the conduct at issue was intrastate, then prosecution under state securities law that is more expansive than federal law could provide the additional benefit of serving as a so-called "laboratory of experimentation." As famously expressed by Justice Brandeis, "[i]t is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[252] States have the potential to "respond rapidly and in a variety of ways to perceived market and regulatory needs."[253] Accordingly, "[s]hould a state create a more

251. 17 C.F.R. § 230.147.

252. New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

253. Thomas M. Jorde, *Antitrust and the New State Action Doctrine: A Return to Deferential Economic Federalism*, 75 CAL. L. REV. 227, 232–33 (1987).

effective system than that of another state, or of the federal government, the latter jurisdictions can benefit by adapting their own systems to make them more effective."[254]

Interstate Conduct

If the conduct at issue was interstate, however, then the experiment would fail because the prosecution would affect regulated parties' out-of-state conduct,[255] thus rendering the results of any such state experiment "impossible to discern."[256] In other words, contrary to the vision expressed by Justice Brandeis, the prosecution could pose a "risk to the rest of the country."[257]

Additional Harms

Interstate Conduct

If the conduct at issue was interstate, there is an increased risk of additional harm from so-called "Balkanization," which refers to the potential that states' differing standards as applied to one regulated party "will result in a confusing patchwork of conduct standards throughout the nation."[258] At the extreme, these standards could conflict, rendering it impossible for a regulated party to comply with all applicable standards.[259] More likely in the context of securities crime, parties in a Balkanized landscape would face increased costs of doing business.[260]

In addition, if the conduct at issue was interstate, prosecution under state securities law that is more expansive than federal law risks disrupting national policy. Because "regulated parties will conform their behavior to

254. Di Trolio, *supra* note 22, at 1313.

255. *See* Michael A. Perino, *Fraud and Federalism: Preempting Private State Securities Fraud Causes of Action*, 50 STAN. L. REV. 273, 326 (1998) ("As a practical matter, because issuers cannot prevent the residents of particular states from buying their securities on impersonal national exchanges, corporations will have no choice but to subject themselves to the laws of all states. Under these conditions, there can be little or no competition in any meaningful sense and states have little or no incentive to adopt efficient rules.").

256. *See* Rose, *Multienforcer*, *supra* note 129, at 2210; *see also* Perino, *supra* note 255, at 324 ("Viewed from this perspective, it is apparent that a competitive market for state fraud causes of action, at least as that market is currently structured, cannot exist for issuers whose securities trade on national markets.").

257. *New State Ice Co.*, 285 U.S. at 311 (Brandeis, J., dissenting).

258. Jones, *supra* note 9, at 127.

259. *See* Mathiesen, *supra* note 61, at 313 ("The cacophony of many different and possibly conflicting sets of rules would impose great compliance costs and inject uncertainty into the securities market. The efficiency loss would be tremendous.").

260. Rose, *State*, *supra* note 14, at 1353.

meet the demands of the strictest regulator with authority over them,"[261] the state securities law would become the de facto law of the land.[262] There is the potential that, as a consequence, other national policies that were crafted to dovetail with federal law could be disrupted.[263] Of course, disruption of national policy is not harmful if the state is filling a federal regulatory vacuum.[264] In that scenario, however, the prosecutor should be explicit about the federal gap that is being filled and should recognize that the decision to prosecute is likely to affect national policy.

Intrastate Conduct

If the conduct at issue was intrastate, however, there is a lessened risk of additional harms from Balkanization or the disruption of national policy. First, if the regulated conduct was intrastate, the regulated party would be subject to, at most, two regulatory schemes, the federal scheme and the state scheme, rather than a cacophony. Second, if the conduct at issue was intrastate, then other parties engaged in interstate conduct or conduct wholly within another state would not fear prosecution under this state's

261. Rose, *Multienforcer*, *supra* note 129, at 2210.

262. *See* Rose, *State*, *supra* note 14, at 1353 ("Policy distortion can result from mere lack of coordination and communication between enforcers. But it can also result when different enforcers have different views on what the appropriate policy should be. When this occurs, the more aggressive enforcer's viewpoint will always win out, creating a one-way ratchet as regulated parties adjust their behavior to conform to the demands of the strictest enforcer with jurisdiction over them.").

263. *See* Mathiesen, *supra* note 61, at 328 ("Actual balkanization would see state attorneys general attempting to restructure the securities market with 'reforms' that would in reality prove deleterious to the integrity and efficiency of a national market system."); Stephen M. Cutler, Director, Division of Enforcement, U.S. Sec. and Exch. Comm'n, Remarks *at the F. Hodge O'Neal Corporate and Securities Law Symposium Washington University School of Law*, 81 WASH. U. L.Q. 545, 550 (2003) ("Our mutual goal should be to avoid re-balkanizing (to paraphrase Chairman Donaldson) the securities markets, and effectively, undoing the work Congress has done. We, as public servants and policy makers, should ask ourselves how the actions we contemplate taking as federal or state actors would promote or detract from Congress' vision of a truly national market system.").

264. Rose, *State*, *supra* note 14, at 1367 ("For example, if captured federal agencies can engage in rulemaking that undesirably restricts the scope of federal law, state enforcement of state law can serve as a counterweight whereas state enforcement of federal law could not."); Di Trolio, *supra* note 22, at 1314 ("States do have an important role to play in the enforcement of securities laws because of the limitations placed on the federal government by the public choice theory. An alternative method of enforcement is needed for the following scenarios: 1) instances in which federal regulation is too lax, and 2) instances in which state action can highlight gaps in federal enforcement either because gaps exist in the regulations themselves, or because the federal government is not aware of certain abuses of the market.").

law, thus avoiding the potential for this prosecution to disrupt national policy by becoming the de facto law of the land.[265]

V. CONCLUSION

In this article, I have sought to make several contributions. First, I have contextualized state prosecution of securities crime within a dual-regulatory, multi-enforcer regime. Second, I have argued that the goals of prosecuting securities crime are multi-faceted and sometimes in tension and that they must be analyzed against the backdrop of this regime. Finally, I have proposed principles of prosecutorial discretion to guide state prosecutors when deciding whether to prosecute securities crime, in light of the goals of prosecuting securities crime and the complex regime of securities regulation in the United States.

265. *See* Rose, *State*, *supra* note 14, at 1366 ("It also presents greater potential costs in terms of federal policy distortion, because it allows for greater state level deviation from federal policy goals (assuming, importantly, that the relevant state laws are not restricted to primarily intrastate activities).").