Laxity at the Gates: The SEC's Neglect to Enforce Control Person Liability

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LAXITY AT THE GATES: THE SEC’S NEGLECT TO ENFORCE CONTROL PERSON LIABILITY

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The U.S. Securities and Exchange Commission (SEC) emphasizes the importance of holding gatekeepers accountable in order to help effectuate law compliance and sound corporate governance practices. This Article shows that the SEC’s assertions, with respect to individuals at the large enterprises, is mere “jawboning.” This inaction is puzzling as the SEC, from a civil enforcement perspective, has greater statutory authority than does even the U.S. Department of Justice in promoting compliance with the rule of law.

This Article examines the SEC’s refusal to pursue enforcement actions premised on control person and failure to supervise liability against allegedly culpable executives, directors, and other subject persons. This failure is seen most recently by the Commission’s refusal to institute enforcement actions against corporate insiders in the aftermath of the financial collapse of 2008. Instead, allegedly blameworthy publicly-traded companies have paid huge monetary penalties—a punishment which directly harms innocent shareholders—while allegedly culpable insiders largely have avoided government scrutiny.

In this Article, we will explain that by invoking the control person and failure to supervise provisions, the SEC would incentivize subject individuals to fulfill their statutory obligations. In undertaking this

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task, the Article: (1) discusses the legal authority granting the Commission the authority to utilize these statutory provisions; (2) explains the advantages that these provisions provide over those normally employed by the SEC; (3) addresses recent alleged misconduct resulting in huge monetary settlements with several major financial institutions; (4) sets forth possible rationales explaining why the SEC has declined to invoke these provisions against individuals at the "big player" enterprises; and (5) proposes an enforcement framework that would promote sound corporate governance practices and compliance with the rule of law.

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The public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.”¹
President Franklin D. Roosevelt, March 29, 1933

“Wall Street executives who pursued reckless products and activities they did not understand brought our financial system to this crisis. Many of the boards that were supposed to look out for shareholders’ interests failed at this most basic of jobs.”²
Senator Jack Reed, Hearing Regarding Dodd-Frank Act of 2010

“Seven years later. No admission of guilt. No individuals are going to jail. A payment that’s barely a fraction of the billions investors lost—and the trillions our economy lost—because of this fraud... That’s not justice—it’s a white flag of surrender.”³
Senator Elizabeth Warren, January 15, 2016

I. INTRODUCTION

The federal securities laws were born out of a mistrust of corporate insiders.⁴ Indeed, a major justification of the Securities Acts of 1933 and 1934 was the absence of a practical means to impose liability on those

² Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing on Examining the Improvement of Corporate Governance for the Protection of Shareholders and the Enhancement of Public Confidence Before the Subcomm. on Sec., Ins., & Inv. of the H. Comm. on Banking, Hous., & Urban Affairs, 111th Cong. 1 (2009) (statement of Sen. Jack Reed, Chairman, Subcomm. on Sec., Ins., & Inv.).
individuals who were responsible for the collapse of the stock market in 1929.5 Unfortunately, in the wake of the largest financial crisis since the Great Depression,6 this objective has been largely forgotten by the Securities and Exchange Commission ("SEC" or "Commission"). The corporate insiders principally responsible for the financial collapse of 2008 have, for the most part, escaped with little discipline. Even in light of criticism over the lack of individual accountability, the SEC continues its refusal to call out fiduciaries who have a duty to help ensure that their respective enterprises comply with the law.7

Instead, allegedly blameworthy publicly-traded companies have paid huge monetary penalties8—a punishment which directly harms their innocent shareholders9—while culpable executives who turned a blind eye to

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5 See Landis, supra note 4, at 30 ("It indicted a system as a whole that had failed miserably in imposing those essential fiduciary standards that should govern persons whose function it was to handle other people's money. Investment bankers, brokers and dealers, corporate directors, accountants, all found themselves the object of criticism so severe that the American public lost much of its faith in professions that had theretofore been regarded with a respect that had approached awe.").

6 E.g., John Hilsenrath, Serena Ng & Damian Paletta, Worst Crisis Since '30s, with No End Yet in Sight, WALL ST. J., (Sept. 18, 2008), http://www.wsj.com/articles/SB122169431617549947.

7 See, e.g., Aruna Viswanatha, Crisis-Era Case Has Oddball Ending, WALL ST. J., Aug. 25, 2016, at C1 (reporting settlement of SEC case against former Fannie Mae CEO Daniel Mudd, stating that “[t]he deal... requires essentially nothing of Mr. Mudd” with “the government paying itself $100k to end the case”); see also Deutsche Bank Whistle-Blower Spurns $8 Million SEC Award, 48 SEC. REG. & L. REP. (BNA) 1660 (2016) (reporting that whistleblower refused over $8 million bounty award because, while Deutsche Bank paid a $55 million penalty, “top executives retired with their multi-million bonuses intact”).


9 See Brandon Garrett, The Corporate Criminal as a Scapegoat, 101 VA. L. REV. 1789, 1790 (2015) ("The corporation appears to be a kind of a scapegoat: perhaps not entirely blameless, as in the traditional concept, but literally impossible to actually jail—yet capable of receiving the brunt of blame and punishment, while the individual culprits go free."); Margaret H. Lemos & Max Mintzer, For-Profit Public Enforcement, 127 HARV. L. REV. 853, 899 (2014) ("[D]efendants in government actions—as in private suits—may prefer to pay financial awards if the alternative is to engage in lengthy remediation or submit to other forms of injunctive relief. Even hefty financial penalties may amount to a proverbial slap on the wrist for well-heeled defendants."). For a discussion of the rationale against imposing large money penalties on public companies, see B. Seth McNew, Money Penalties Against Publicly Held Companies: A Proposal for Restraint, 37 SEC. REG. L.J. 48 (2009); see also Gretchen Morgenson, Making Them Pay (and Confess), N.Y. TIMES (Jan. 27, 2013), http://www.nytimes.com/2013/01/27/business/at-the-sec-a-chance-to-get-tougher-on-
In the fallout since, critics have called for the pursuit of criminal penalties against Wall Street perpetrators. While some have labeled widespread criminal prosecutions as impractical or too harsh, a readily available civil enforcement remedy is at the SEC’s disposal: the initiation of enforcement actions against control persons of publicly-held companies.

The federal securities laws provide for control person liability pursuant to Section 15 of the Securities Act and Section 20(a) of the Securities Exchange Act. Under these provisions, a person who controls another who violates the federal securities laws will be held jointly and severally liable for the controlled person’s acts, unless the control person establishes that he or she acted in good faith and did not induce the underlying violation. Therefore, control persons are subject to liability under these provisions even if they themselves did not perpetrate the prohibited conduct. While Section 15 of the Securities Act focuses on control person liability in the private securities litigation context, Section 20(a) of the Securities Exchange Act encompasses control person liability in the private as well as the SEC enforcement setting. Indeed, pursuant to the Dodd-Frank Act of 2010, Congress made clear that

settlements.html? r=0 (noting that most financial penalties are paid by shareholders or corporate insurance carriers and are thus not much of a deterrent).

See sources cited supra note 9.


E.g., Daniel C. Richman, Corporate Headhunting, 8 HARV. L. & POL’Y REV. 265 (2014) (outlining in greater detail some of the legal impracticalities of bringing such criminal prosecutions).


15 U.S.C. § 77o; 15 U.S.C. § 78t(a); Maher v. Durango Metals, 144 F.3d 1302, 1305 n.7 (10th Cir. 1998) (“Although worded differently, the control person provisions of § 15 and § 20(a) are interpreted the same.”).

15 U.S.C. § 77o; 15 U.S.C. § 78t(a); Maher, 144 F.3d at 1305 n.7; see also SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 812–13 (2d Cir. 1975) (“We find it plain, therefore, that the ‘controlling person’ provisions were enacted to expand, rather than restrict, the scope of liability under the securities laws. Control was defined in a broad fashion . . . to reach prospective wrongdoers . . . .”).


the SEC has the authority to utilize Section 20(a) in its enforcement actions,\textsuperscript{20} embracing the majority view held by the lower federal courts.\textsuperscript{21} Without adequate explanation, however, the SEC has declined to invoke this attractive enforcement tool against corporate executives who, as fiduciaries, oversaw the misconduct of their respective companies.

In view of the SEC's tough rhetoric,\textsuperscript{22} it is inexplicable why the SEC declines to focus on this manifestly clear statutory remedy to address the blatant misconduct that transpires. This Article will examine the Commission's refusal to pursue enforcement actions premised on control person liability against corporate executives, directors, and other culpable persons. It will seek to determine why the SEC has neglected to bring enforcement actions based on control person liability against executives of Wall Street's biggest miscreants.

\textsuperscript{20} The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. Law No. 111-203, § 929P(c), 124 Stat. 1865 (2010) (amending 15 U.S.C. § 78t(a): "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.") (emphasis added); cf. 15 U.S.C. § 78t(a) (as amended Dec. 21, 2000).

\textsuperscript{21} See discussion infra notes 26–29 and accompanying text; see also SEC v. Hawk, No. 03:05-CV-00172-LRH-VPC, 2007 U.S. Dist. LEXIS 57414, at *6 (D. Nev. Aug. 3, 2007) ("[T]he majority of courts have concluded that an SEC enforcement action can be brought pursuant to Section 20(a)").

\textsuperscript{22} See, e.g., Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), https://www.sec.gov/News/Speech/Detail/Speech/137039872100#_fireid6 ("[I]nvestors in our markets want to know that there is a strong cop on the beat—not just someone sitting in the station house waiting for a call, but patrolling the streets and checking on things. . . . I believe the SEC should strive to be that kind of cop—to be the agency that covers the entire neighborhood and pursues every level of violation.").
Control is essential to the role of corporate executives as gatekeepers. Within a business enterprise, gatekeepers may be defined as executives or at times advisers whose functions encompass the effectuation of compliance with the law by the subject enterprise. Gatekeepers include CEOs, CFOs, directors, compliance managers, lawyers, and auditors; depending on the underlying circumstances, these individuals are in the position to influence, if not control, the enterprise's conduct with respect to its compliance with the law. While the SEC recognizes that individual liability for gatekeepers is an

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23 As discussed in the text, supra notes 14–21, Section 15 of the Securities Act of 1933 imposes joint and several liability on any person who controls another person who is liable under Sections 11 (codified at 15 U.S.C. § 77k) or 12 (15 U.S.C. § 77l). That person is liable “unless the controlling person had no knowledge of or reasonable grounds to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.” Section 15 is irrelevant for purposes of this Article as Sections 11 and 12 are private claims which are not available for SEC enforcement actions.

24 Lawson v. FMR LLC, 134 S. Ct. 1158, 1170–71 (2014) (discussing the role of gatekeepers to detect and deter fraud); Kirschner v. KPMG, 938 N.E.2d 941, 962 (N.Y. 2010) (“Investors rely heavily on information prepared by or approved by auditors, accountants, and other gatekeeping professionals”) (citing United States v. Arthur Young & Co., 465 U.S. 805 (1984)); Reiner H. Kraakman, Corporate Liability Strategies and the Costs of Legal Controls, 93 YALE L.J. 857, 886–98 (1984) (addressing the role of gatekeepers); Andrew F. Tuch, Multiple Gatekeepers, 96 VA. L. REV. 1583, 1584 (2010) (“The liability of professionals for the wrongs of their clients is premised on the ability of professionals to monitor and control their clients’ conduct.”). In a more narrow sense, gatekeepers traditionally have been confined to attorneys, accountants, and other professionals who are “positioned to observe client conduct and prevent wrongdoing from taking place.” Assaf Hamdani, Gatekeeper Liability, 77 S. CAL. L. REV. 53, 83 (2003). This Article uses the term in a more expansive manner to include insiders whose position and obligations within the subject enterprise encompass the effectuation of law compliance.

effective way of promoting compliance with the law, the Commission steadfastly refuses to bring enforcement actions premised on control person liability against individuals at large publicly-traded companies and investment firms.

A. SEC's Authority to Pursue Control Persons

Section 20(a) of the Securities Exchange Act imposes liability upon any person who controls another liable person to the same extent as such controlled person, unless she can establish that she acted in good faith and did not induce the violation. In the brokerage firm setting, there is an additional enforcement tool that may be used against “associated persons” of a broker-dealer: Section 15(b)(4)(E) of the Exchange Act, which gives the Commission power to institute administrative proceedings against an associated person of a broker-dealer for his failure to reasonably supervise another person who commits certain enumerated securities law violations.

See also Stein, supra note 25:
The Commission recently imposed a $200 million penalty against a large bank for misstating financial results and lacking effective internal controls. This breakdown in controls, a core part of compliance, contributed to billions—yes billions—in trading losses. The penalty was unprecedented for this type of case and is one of the largest penalties in the history of the Commission. Yet it amounted to a tiny fraction of the firm’s net income for just one quarter.

If our actions become nothing more than a footnote in the litigation reserve section of a firm’s financial statements, or a brief media storm that can be easily weathered before it is back to business as usual, have we been effective? Or is it more effective to hold individuals to account? The people who could have, and should have, prevented the harm?


Section 20(a) of the Securities Exchange Act, 15 U.S.C. § 78t(a) (providing that “[e]very person who . . . controls any person liable under any provision of this title . . . shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable . . . unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action”).

Sections 15(b)(4)(E) and 15(b)(6)(A) of the Securities Exchange Act, 15 U.S.C. §§ 78o(b)(4)(E), (b)(6)(A). These provisions create personal liability in tandem, with Section 15(b)(4)(E) providing for liability against a broker-dealer who “has failed reasonably to
Like the control person provision, the SEC generally has declined to invoke this enforcement tool against supervisors of large brokerage firms in response to misconduct that transpired, such as that which led to the financial crisis.\footnote{Prior to the enactment of the Dodd-Frank Act in 2010, the case law was divided as to whether the SEC had the authority to bring a claim based on control person liability, with the majority view holding that the SEC had such authority. This confusion arose over disagreement as to whether the SEC is a “person” under the Exchange Act. See sources cited supra note 30. In 1974, the Sixth Circuit held that Section 20(a) did not apply to SEC enforcement actions, because the SEC is not a person under the Act. See Cofey, 493 F.2d at 1318 (“As a matter of legislative interpretation, we hold that the SEC is not a person under section 20(a), since section 20(a) was meant to specify the liability of controlling persons to private persons suing to vindicate their interests.”). Without addressing the statutory wording, the Second Circuit reached the opposite conclusion in First Jersey Sec., Inc. v. SEC, 101 F.3d 1450, 1472 (2d Cir. 1996) (“Since § 20(a) is available as an enforcement mechanism to ‘any person to whom such controlled person is liable,’ and the 1934 Act includes government agencies in the definition of ‘person,’ we have upheld the SEC’s authority to pursue an enforcement action under § 20(a).”); see also SEC v. Stringer, No. CV-01-1341-ST, 2003 U.S. Dist. LEXIS 25523, at *39 (D. Or. Apr. 24, 2003) (refusing to allow the SEC to bring a claim under § 20(a) in an enforcement action). See also sources cited supra note 30.}

Prior to the enactment of the Dodd-Frank Act in 2010, the case law was divided as to whether the SEC had the authority to bring a claim based on control person liability, with the majority view holding that the SEC had such authority. This confusion arose over disagreement as to whether the SEC is a “person” under the Exchange Act.\footnote{Prior to the financial crisis, the major exception to this policy was the Commission’s enforcement proceeding in the Salomon Brothers proceeding. See Gutfreund, Exchange Act Release No. 34-31554, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,067 (Dec. 3, 1992); Salomon Bros., Inc., Exchange Act Release No. 30721, [1991–1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,948 (May 20, 1992). The alleged discrepancy in treatment between large and small firms has been addressed by numerous commentators. See, e.g., Stavros Gadinis, The SEC and the Financial Industry: Evidence from Enforcement Against Broker-Dealers, 67 Bus. L. 679, 728 (2012) (stating that “when big firms and their staff were engaged in misconduct, the SEC often brought actions based exclusively on corporate liability, without naming any specific individuals as defendants”).}
20(a) provided that a control person “shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable.”

Although case law had largely settled this dispute, the Dodd-Frank Act provided language cementing the SEC’s power to pursue control persons by directly amending that section. Thus, as the law stands today, the SEC clearly has the authority to invoke control person liability against individuals within a subject enterprise.

B. The Meaning of Control

The term “control” is left undefined in the Exchange Act; however, the SEC has construed the term to encompass “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies

1975, finding the SEC to be within the statutory meaning of a person. See SEC v. Mgmt. Dynamics, Inc., 515 F.2d 801, 813 (2d Cir. 1975). This view was adopted by the Third Circuit in Barcay, 442 F.3d at 842.


Id.: Every person who, directly or indirectly, controls any person liable under any provision of this title or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable (including to the Commission in any action brought under paragraph (1) or (3) of section 78u(d) of this title), unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action.

(emphasis added); see also Section 21(d) of the Securities Exchange Act, 15 U.S.C. § 78u(d): Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this title [15 U.S.C. §§ 78(a) et seq.], the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title [15 U.S.C. §§ 78(a) et seq.] or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title [15 U.S.C. §§ 78(a) et seq.].
of a person. With regularity, courts have allowed control person claims in private litigation to proceed against executive officers, including CEOs, CFOs, and COOs. Indeed, in a number of cases, courts have found that outside directors may be control persons and thus subject to liability under Section 15 of the Securities Act and Section 20(a) of the Securities Exchange Act. Status as an outside director alone, however, may not be sufficient to impose control person liability. Rather, some participation in the prohibited conduct may be required. For instance, in In re Proxima Corp., outside directors were adequately pleaded to be control persons where

34 17 C.F.R. § 230.405 (2014). The courts are generally in accord with this definition. See Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992) (“We have looked to whether the alleged control-person actually participated in, that is, exercised control over, the operations of the person in general and, then, to whether the alleged control-person possessed the power or ability to control the specific transaction or activity upon which the primary violation was predicated, whether or not that power was exercised.”); G.A. Thompson & Co., Inc. v. Partridge, 636 F.2d 945, 958 (5th Cir. 1981) (finding that control was established when the defendant “had the requisite power to directly or indirectly control or influence corporate policy”).

35 See, e.g., In re Trotton, Inc. Sec. Litig., 769 F. Supp. 2d 202, 217–22 (S.D.N.Y. 2011) (In denying the officer-defendants’ motion to dismiss claims under Section 20(a), the court found that “[a] company acts through its officers, and plaintiffs have alleged sufficient facts to support the inference that . . . [t]he senior officers . . . effectuated the control injected into the relationship between KMG and Trotton . . . .”); Maverick Fund v. Comverse Tech., 801 F. Supp. 41, 51–52 (E.D.N.Y. 2011) (denying a motion to dismiss Section 20(a) claims brought against the Chief Financial Officer, General Counsel, and several board members of the defendant corporations); Puskala v. Koss Corp., 799 F. Supp. 2d 941, 956–58 (E.D. Wis. 2011) (The court denied the motion of the defendant corporation’s board member, Michael Koss, to dismiss the control person claim. Although Koss argued that the court should dismiss the plaintiff’s claim as proving that he acted in good faith because the claim stated that he did not know of the behavior constituting the primary violation, the court stated that Koss as “a controlling person can be liable if he is reckless in failing to prevent the primary violation.”); Metzger v. Am. Food Mgmt., Inc., 389 F. Supp. 469 (W.D. Pa. 1975) (individuals who were secretary-treasurer and vice-president of company, and directors of that company, were found to be controlling persons within the meaning of federal securities laws and were liable for fraudulent sales of securities).


[C]ertain outside directors had influential board and committee positions, including membership on the Audit, Finance and Compensation Committees, . . . had considerable stock ownership; [and] . . . actively participated in producing the false and misleading statements by, among other things, assisting in the drafting and preparation of, or endorsing or approving the Prospectus and Registration Statement and various other public statements . . . .

In another case, plaintiffs sufficiently pleaded the control element by alleging that the outside director defendants were members of the board and served on the company’s finance and audit committees. There, the court also focused on the fact that the corporation’s SEC filings stated that its board of directors was “actively engaged in formulating and overseeing management’s implementation of risk management policies.”

Control person liability may also be extended to lower level managers and department heads if they exercised the requisite amount of control over the primary violator(s). For example, in one case, the court allowed a control person claim to proceed against the company’s Vice President of Marketing and Communications. The underlying primary violation in that litigation arose out of the company’s hiring of an outside promotion firm, which, as alleged, fraudulently inflated the company’s stock price through disguised postings on online articles and blogs, using aliases such as “Stock Whisper”

38 Id. at *23-24 (citations omitted).
40 Id. (“Plaintiffs successfully state a claim for control person liability against all Outside Director Defendants by alleging that, in a 2008 SEC filing, WaMu stated that ‘our entire board are and have been actively engaged in formulating and overseeing management’s implementation of risk management policies.’ Bare allegations of Outside Director status are not sufficient to establish control person liability, but Plaintiffs’ allegation goes beyond this to affirmatively link board membership to WaMu’s primary violations.”).
42 Id. at 1168–69, 1201 (finding that a marketing director may be liable as a control person, even when she did not possess the requisite scienter); see also Dutton v. D&K Healthcare Res., No. 4:04CV1478NL, 2006 U.S. Dist. LEXIS 42553, at *58 (E.D. Mo. June 23, 2006) (In considering a Section 20(a) claim against a middle manager, the court stated that “[t]he control-person statute is ‘seminal and is to be construed liberally. It has been interpreted as requiring only some indirect means of discipline or influence short of actual direction to hold a ‘controlling person’ liable.’” However, the court ultimately dismissed the claim against the manager as it found that he did not actually have control over the accounting protocols, financial statements, public disclosures, or employees in charge of such items.).
and “Wonderful Wizard.” The court, in denying the vice president’s motion to dismiss the Section 20(a) claim, found that she exercised significant control over the primary violators. The court, however, did grant her motion to dismiss the underlying securities fraud claim, reasoning that the allegations were insufficient to support an inference of the level of scienter required in order to be liable for that claim. This case illustrates that a relatively low level executive may be liable as a control person even when she has not committed the underlying violation.

C. Establishment of the “Good Faith” Defense

Importantly, a defendant may avoid control person liability under Section 20(a) by showing that she acted in good faith and did not induce the violation. With the good faith and non-inducement requirement as an affirmative defense, the burden of proof thus falls on the control person to establish this defense. Nonetheless, the Supreme Court has made it clear

44 Id. at 1201 (“Bernarda was Galena’s vice president of marketing and communications and is responsible for Galena’s investor and public relations; was involved in hiring DreamTeam and other promotional firms; monitored DreamTeam’s work; and reviewed, edited, and approved the allegedly false and misleading articles. Accordingly, Plaintiffs sufficiently allege that Bernarda had authority both over the management and policies of Galena with respect to its investor and public relations and over the primary violations of both the allegedly false and misleading articles and the alleged scheme.”).
45 Id. at 1168–69 (dismissing the underlying § 10(b) claim as scienter was not adequately shown).
46 Note that lower level employees who were not prosecuted for their participation in the financial crisis often exhibited substantially more participation in the underlying fraud. See discussion of Citigroup, infra notes 93–102 and accompanying text.
48 See Frank v. Dana Corp., 646 F.3d 954, 963 (6th Cir. 2011) (The lower court’s dismissal of a claim based on the fact that plaintiffs did not plead that the defendants failed to act in good faith was overturned by the appellate court. There is no requirement that the plaintiffs plead lack of good faith as an element of a Section 20(a) claim); In re Stone & Webster, Inc. Sec. Ling., 424 F.3d 24, 26 (1st Cir. 2005) (“Based on the language of § 20(a), which treats the defendant’s good faith as a part of the defendant’s affirmative defense, and makes no other reference to the defendant’s state of mind, we noted that § 20(a) does not on its face require the plaintiff to prove any state of mind of the defendant.”) (citation omitted); Harrison v. Dean Witter Reynolds, Inc., 974 F.2d 873, 881 (7th Cir. 1992) (The court noted that the statute provides for a defense of good faith, where the burden rests on the defendant. When a defendant cannot conclusively show that he acted in good faith, nor that he directly or indirectly induced the primary violation, a determination of good faith is left to the factfinder to decide); In re WorldCom, Inc. Sec. Ling., No. 02 Civ. 3288 (DLC), 2005 U.S. Dist. LEXIS 4193, at *49 (S.D.N.Y. Mar.
that “something more than negligence” is required in order to find a control
person liable.\textsuperscript{49} The prevailing view is that a plaintiff need not show that a
control person participated in the fraud in order to establish liability, although
a minority of jurisdictions require a greater degree of misconduct.\textsuperscript{50}

\textsuperscript{49} Ernst & Ernst v. Hochfelder, 425 U.S. 185, 209 n.28 (1976) (“Each of the provisions of the
1934 Act that expressly create civil liability... contains a state-of-mind condition
requiring something more than negligence. ... § 20, which imposes liability upon
‘controlling person[s]’ for violations of the Act by those they control, exculpates a
defendant who ‘acted in good faith and did not ... induce the act ... constituting the

\textsuperscript{50} See, e.g., Lustgraaf v. Behrens, 619 F.3d 867, 877 (8th Cir. 2010) (“federal control-person
liability is dependent on control, not fraud”); SEC v. Jackson, 908 F. Supp. 2d 834, 866
(S.D. Tex. 2013) (“[The Fifth Circuit has made clear that, like the Eighth Circuit, it does
not require the plaintiff to show that the control person actually participated in the
primary violation.”); Metge v. Baehler, 577 F. Supp. 810, 816 (S.D. Iowa 1984), aff’d in
pertinent part, 762 F.2d 621 (8th Cir. 1985), cert. denied, 474 U.S. 1057 (1986) (“A plaintiff’s
prima facie case under the Securities Exchange Act 20(a) (1934), 15 U.S.C.S. § 78t(a), does
not include proof of the controlling person’s culpability. Culpability and good faith are
two sides of the same issue, and the burden of proving good faith is on the defendant. To
require the plaintiff also to prove culpability would amount to giving both parties the
burden of proof on the same issue. ... [T]he weight of authority is to the effect that the
plaintiff need not prove participation in the activity which gave rise to liability.”); see also
Brian A. Melhus, Note, Control Person Liability: A Repudiation of Culpable Participation, 37
IOWA J. CORP. L. 929, 940 (2012). Some courts have required a plaintiff to show that a
controlling person’s conduct, such as lack of supervision, “‘was deliberate and done
intentionally to further the fraud.’” Sharp v. Coopers & Lybrand, 649 F.2d 175, 185 (3d
Cir. 1981) (quoting Rochez Bros. Inc. v. Rhodea, 527 F.2d 880, 890 (3d Cir. 1975)); see also
Belmont v. MB Inv. Partners, Inc., 708 F.3d 470, 485 (3d. Cir. 2013) (While “culpable
participation may be premised on inaction [ ... if it is apparent that the inaction
intentionally furthered the fraud or prevented its discovery.’ ... ‘inaction alone cannot be a
basis for liability,’ and a § 20(a) claim based on inaction fails if the controlling person ‘had
no knowledge of [the controlled person’s] fraudulent acts and did not consciously intend to aid
the controlled person’) (second emphasis added) (citation omitted) (quoting Rochez Bros.,
527 F.2d at 890). Some courts have found that in alleging a Section 20(a) claim, a plaintiff
must “plead facts showing either conscious misbehavior or recklessness.” See In re
require that a plaintiff plead “culpable conduct,” meaning that the plaintiff must “show
that the controlling person was in some meaningful sense a participant” in the securities
violations executed by the controlled person. See SEC v. First Jersey Sec., Inc., 101 F.3d
1450, 1472–73 (2d Cir. 1996) (In order to establish a prima facie case of controlling-
person liability, a plaintiff must show a primary violation by the controlled person and
D. Lack of Pleading Obstacles for the SEC

The SEC’s reluctance to invoke the control person provision cannot be explained by overly burdensome pleading requirements, as generally a low pleading threshold applies to such claims. For instance, the question of whether an officer, director, or other insider is a control person is “a question of fact which cannot ordinarily be resolved at the pleading stage.”

While a respondent may assert a good faith defense against a control person claim, a plaintiff is not required to plead bad faith in order to continue the litigation. For example, one court reasoned that an assertion of good faith is a defense under Section 20(a), thereby not requiring a plaintiff to “anticipate and negate” an opponent’s affirmative defense. This fact alone should make the control person liability provision an attractive enforcement tool, as these claims are likely to survive a defendant’s motion to dismiss. Given this, a good faith defense may not be adjudicated on its merits until the summary judgment stage, except in those “relatively rare” circumstances in which a plaintiff is entitled to gather additional facts during discovery, and in doing so may uncover information undercutting the good-faith defense.

control of the primary violator by the targeted defendant, and show that the controlling person was “in some meaningful sense [a] culpable participant[ ] in the fraud perpetrated by [the] controlled person[.]” . . . Control over a primary violator may be established by showing that the defendant possessed “the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise.”

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51 See In re Worlds of Wonder Sec. Litig., 694 F. Supp. 1427, 1435 (N.D. Cal. 1988) (“Whether or not liability as a controlling person should be imposed cannot be otherwise resolved at the pleading stage.”).


53 See Puskala v. Koss Corp., 799 F. Supp. 2d 941, 956 (E.D. Wis. 2011) (“[i]f the defendant acted in good faith and did not directly or indirectly induce the primary securities violation, he is not liable even if he is shown to have controlled the primary violator. However . . . good faith is an affirmative defense rather than an element of plaintiff’s case. Thus, to state a claim, a plaintiff need not plead facts that negate the good-faith defense. Instead, once the plaintiff pleads the primary violation and that the defendant controlled the primary violator, his job is done.” (citation omitted)); Healey v. Chelsea Res. Ltd., 736 F. Supp. 488, 495 (S.D.N.Y. 1990) (stating that the Second Circuit “requires that the plaintiff allege and prove control, leaving it to the defendant to plead and prove good faith and lack of participation”); Terra Res. I v. Burgin, 664 F. Supp. 82, 88 (S.D.N.Y. 1988) (“Plaintiffs need plead only that a defendant controlled a primary violator of the securities laws. Any defense, such as the good faith defense here, must be raised in the responsive pleadings.”).

54 Terra Resources I, 664 F. Supp. at 88.

55 See Puskala, 799 F. Supp. 2d at 957 (“[P]laintiff is not required to plead facts negating the good-faith defense. Instead, . . . plaintiff is entitled to gather additional facts during discovery, and in doing so he may uncover information undercutting the good-faith defense.”).
which “all facts necessary to the affirmative defense ‘clearly appear[ ] on the face of the complaint.’” 56

Furthermore, due to the fact that proof of good faith is an affirmative defense under Section 20(a), these claims do not require the SEC to adhere to the heightened Rule 9(b) pleading standard under the Federal Rules of Civil Procedure. 57 Rule 9(b) requires that “[i]n alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person’s mind may be alleged generally.” 58 Such specificity pertains only to the circumstances constituting fraud, and does not apply to every element of a securities claim. 59 Of course, when the underlying primary violation requires proof of manipulative or deceptive conduct (such as Section 10(b) of the Securities Exchange Act), 60 the control person claim cannot survive when fraud is inadequately plead against the primary violator(s). 61

57 Teamsters Local 617 Pension & Welfare Funds v. Apollo Grp., Inc., 690 F. Supp. 2d 959, 967–68 (D. Ariz. 2010) (a § 20(a) claim need not be pled in accordance with Rule 9(b) or the PSLRA because scienter and fraud are not elements of such a claim); Siemens v. Wells Fargo & Co., No. C 05-04518 WHA, 2006 U.S. Dist. LEXIS 60858, at *40–41 (N.D. Cal. Aug. 14, 2006) (“The control exerted by [the defendant] is not a circumstance that constitutes fraud. Plaintiff is only required to assert fraud with particularity as to primary violations. At the control-person level, liability exists irrespective of the control person's scienter”); In re Initial Pub. Offering Sec. Litig., 241 F. Supp. 2d 281, 296 (S.D.N.Y. 2003) (“Pleading a Section 15 claim is also governed by Rule 8, and thus only requires an allegation that the defendant controlled a person or entity that violated Section 11.”).
58 See Tellabs, 551 U.S. at 319; see also Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 319 (2007) (“Rule 9(b) applies to ‘all averments of fraud or mistake’” (quoting Greenshine v. Cambex Corp., 975 F.2d 22, 25 (1st Cir. 1992))).
59 See Tellabs, 551 U.S. at 319; see also Marc I. Steinberg & Diego E. Gomez-Cornejo, Blurring the Lines Between Pleading Doctrines: The Enhanced Rule 8(a)(2) Plausibility Pleading Standard Converges with the Heightened Fraud Pleading Standards Under Rule 9(b) and the PSLRA, 30 REV. LITIG. 1, 16–22 (2010).
III. "CALLED THIRD STRIKES"—MAJOR SETTLEMENTS FOLLOWING THE FINANCIAL CRISIS FAIL TO INCLUDE CONTROL PERSON AND FAILURE TO SUPERVISE LIABILITY

Due to the alleged misconduct culminating in the financial crisis, banks and broker-dealers have paid billions of dollars in negotiated settlements with the government.\(^{62}\) While these institutions have been saddled with large sums in penalties and disgorgement, there have been few individual actions, and indeed only one such action approaches the scale of the corporate penalties that have been levied.\(^{63}\) The discussion below, by way of example, highlights several of the major settlements and examines the underlying alleged misconduct which led to the actions against these corporations. Notably, the SEC complaints have focused on the lack of oversight and diligence by persons who supposedly were controlling the subject corporation’s conduct.

A. Bank of America and Merrill Lynch

The largest of these settlements, $16 billion, was entered into by Bank of America.\(^{64}\) According to the settlement’s statement of facts, Bank of America and its affiliate, Banc of America Mortgage Securities Inc. ("BOAMS"),\(^{65}\) made numerous materially false representations in promoting the bank’s residential mortgage backed securities ("RMBS").\(^{66}\) Offering these securities

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\(^{63}\) See discussion of Settlement with Angelo Mozilo, infra notes 140–43 and accompanying text.


\(^{65}\) As Michael Lewis points out in his book The Big Short, "By early 2005 all the big Wall Street investment banks were deep into the subprime game. Bear Sterns, Merrill Lynch, Goldman Sachs, and Morgan Stanley all had what they termed 'shelves' for their subprime wares, with strange names like HEAT and SAIL and GSAMP, that made it a bit more difficult for the general audience to see that these subprime bonds were being underwritten by Wall Street's biggest names." MICHAEL LEWIS, THE BIG SHORT: INSIDE THE DOOMSDAY MACHINE 24 (W.W. Norton & Company, Ltd ed., 1st ed. 2010).

in a securitization trust known as BOAMS 2008-A, the bank represented that these RMBS were backed by bank-oriented prime mortgages. In fact, however, the mortgages contained in the RMBS were known as “wholesale mortgages,” which are loans that originated from third-party mortgage brokers; internal reports showed that these mortgages were decreasing in performance and “were experiencing an increase in underwriting exceptions.” This information regarding the quality of the underlying loans was offered to a select few investors but was not disclosed to the investing public or to the SEC.

Moreover, Bank of America did not have third-party due diligence conducted on the individual mortgages comprising the BOAMS 2008-A offering. This was a substantial deviation from what the bank had done in previous BOAMS offerings. Importantly, the due diligence that was conducted for the allegedly fraudulent offering showed that several mortgages contained in the BOAMS “did not conform to Bank of America underwriting standards.” Allegedly, this lack of third-party due diligence represented an

settlement agreement included conduct committed by Countrywide and Merrill Lynch, as both entities were later affiliates of Bank of America.

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69 Id.

70 Id. at 2.

71 Id. The Financial Crisis Inquiry Commission found that the lack of government oversight contributed to a “crime-facilitative environment” that encouraged banks to commit violations with little fear of repercussion. For instance, a sampling of fifty Bank of America mortgages showed that sixteen (or nearly one-third) of the samples would have required “suspicious activity reports” to be issued to the Financial Crimes Enforcement Network; however, no such report was issued by the Bank for any of the sampled mortgages. See FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 161–62 (Jan. 2011), http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf [hereinafter FCIC REPORT].

72 D.O.J. Statement of Facts, supra note 66, at 2 (“Bank of America did not have third-party, loan-level due diligence conducted on the specific mortgage loans collateralizing the BOAMS 2008-A securitization. This was contrary to its past practice. Third-party, loan level due diligence had been conducted on previous BOAMS securitizations that closed in March, April, and August 2007; these diligence reviews revealed that some of the mortgages reviewed did not conform to Bank of America underwriting standards. Third-party due diligence also had revealed data errors in the preliminary loan tapes that Bank of America had provided to investors. Bank of America did not disclose in the BOAMS
intentional change of course in order to cover up the lack of compliance with the bank's own underwriting standards.73

Based on these facts, the SEC brought a complaint against Bank of America claiming violations of Sections 5(b)(1), 17(a)(2), and 17(a)(3)74 of the Securities Act.75 These sections are premised on non-fraudulent misconduct. Section 5(b)(1) of the Securities Act is a strict liability provision focused on registration mandates, which accordingly includes no mens rea requirement.76 Similarly, for violations of Sections 17(a)(2) and 17(a)(3), based on materially misleading misrepresentations or other faulty disclosures, the SEC need only show negligence.77 Conspicuously absent in the complaint is any allegation based on fraudulent primary misconduct, control person liability under Section 20(a) of the Exchange Act, or failure to supervise under Sections 15(b)(4)(E) and 15(b)(6)(A) of the Exchange Act. The SEC

2008-A offering documents that third-party, loan-level due diligence was not conducted on the loans collateralizing BOAMS 2008-A.

73 See Josef Ackermann, The Subprime Crisis and Its Consequences, 4 J. Fin. Stability 329, 336 (2008) ("It is also undeniable that there is evidence that originators of US mortgage-related securitisations [sic] displayed a lack of due diligence in assessing the risk of the packaged mortgages . . . .").


77 See id. at 46 ("From at least November 2007, through at least January 2008, BAS and BOAMS, directly or indirectly made use of means and instruments of transportation or communication in interstate commerce or of the mails to carry or transmit a prospectus relating to a security with respect to which a registration statement had been filed without ensuring that the prospectus met the requirements of Section 10 of the Securities Act."). For a discussion of Section 5(b)(1) of the Securities Act and the requirements of a statutory prospectus, see MARC I. STEINBERG, UNDERSTANDING SECURITIES LAW § 4.02 (LexisNexis ed., 6th ed. 2014).

78 See Aaron v. SEC, 446 U.S. 680, 697 (1980) (stating that "the language of § 17(a) requires scienter under § 17(a)(1), but not under § 17(a)(2) or § 17(a)(3)"). Registration violations such as a violation of Section 5(b)(1) of the Securities Act and violations of Section 17(a)(2) and 17(a)(3) may be brought in order to shield the defendant from the negative stigma of fraud. See James J. Park, Rules, Principles, and the Competition to Enforce the Securities Laws, 100 Calif. L. Rev. 115, 140 (2012) ("An enforcer may also be wary of the moral element of bringing a fraud case against a defendant. The open-ended nature of the fraud prohibition is justified as a way of giving regulators the ability to target a wide array of morally reprehensible conduct. But some enforcers may not want to enter the realm of moral debate in pursuing principle-enforcement. It might be safer to bring lesser charges of rule violations that can be characterized in technocratic terms."); MARC I. STEINBERG, SEC AND OTHER PERMANENT INJUNCTIONS—STANDARDS FOR THEIR IMPOSITION, MODIFICATION, AND DISSOLUTION, 66 CORNELL L. REV. 27, 34–36 (1981) (discussing standards for imposition of injunctive relief under Sections 17(a)(2) and 17(a)(3)).
eventually settled its case against Bank of America. However, pursuant to the settlement, the only provision of law Bank of America allegedly violated was the SEC reporting mandates set forth in Section 13(a) of the Exchange Act, a provision not requiring proof of scienter.

The settlement’s statement of facts also outlined the allegedly unlawful conduct of Merrill Lynch in the time frame leading up to the crisis. The government alleged that through 2006 and 2007, Merrill Lynch marketed seventy-two RMBS made up of “thousands of subprime mortgage loans.” While these offerings were being conducted, Merrill Lynch continued to publicly represent that all of the mortgages contained in the securities offerings “originated generally in accordance with the [originator’s] Underwriting Guidelines,” and that the underlying loans conformed to federal, state, and local law.

Unlike Bank of America, Merrill Lynch had a third-party due diligence provider rate the loans comprising the RMBS; these vendors rated the underlying loans EV1–EV3, with EV1 being the highest. Loans could be given the lowest rating, EV3, when extended to borrowers who had recently declared bankruptcy. Likewise, an EV3 rating was given where: the loan was a “high cost” loan that appeared to violate state lending laws; debt-to-

80 See id. at *1; see also SEC v. Floroserve Corp., SEC Litigation Release No. 19154, 85 SEC Docket 146 (D.D.C. 2005); cf. Aaron, 446 U.S. at 697 (interpreting language of the applicable statute to determine level of culpability required to be shown).
83 Id. (alteration in original).
84 Id. at 3.
85 Id. at 2.
income ratios did not comply with applicable product guidelines; there was inadequate or missing documentation of income, assets, and credit history; and stated incomes were determined to be unreasonable.\textsuperscript{86} Amazingly, some samples of Merrill Lynch RMBS were made up of over 50% \textsuperscript{EV3} rated loans.\textsuperscript{87}

While Merrill Lynch received and reviewed these reports, it made no changes in its approval or marketing of RMBS. An internal email between two employees is illustrative: \textquote{\textbf{\textit{[h]ow much time do you want me to spend looking at these [loans] if [the co-head of Merrill Lynch’s RMBS business] is going to keep them regardless of issues . . . \textbf{.}. . Makes you wonder why we have due diligence performed other than making sure the loan closed.}}}\textsuperscript{88} Furthermore, Merrill Lynch began to learn in 2005–2006 that some of the lenders that supplied the mortgages that would be part of its securitizations were relaxing their lending and underwriting guidelines;\textsuperscript{89} however, Merrill Lynch did not disclose this information to investors or to the SEC.\textsuperscript{90} Merrill Lynch settled claims based on alleged violations of Sections 5(b)(1), 17(a)(2) and 17(a)(3) without admitting or denying fault of any kind.\textsuperscript{91} Once again, there is no mention in either the complaint or settlement documents of control person liability under Section 20(a) of the Exchange Act, or failure to supervise pursuant to Sections 15(b)(4) and 15(b)(6)(A).\textsuperscript{92}

\textsuperscript{86} Id (alteration in original). Such high cost loans included those that would violate state predatory lending laws. It has been argued, however, that these laws were ineffective in preventing foreclosure and otherwise predatory loans. \textit{See generally} Katherine M. Lehe, \textit{Comment, Cracks in the Foundation of Federal Law: Ameliorating the Ongoing Mortgage Foreclosure Crisis Through Broader Predatory Lending Relief and Deterrence}, 98 \textit{CALIF. L. REV.} 2049 (2010).

\textsuperscript{87} D.O.J. \textit{Statement of Facts, supra note 66, at 3.}

\textsuperscript{88} Id (emphasis added).

\textsuperscript{89} Id at 5. The \textbf{\textit{loosening}} of the underwriters’ guidelines resulted in an increase in the amount of loans with unreasonable stated incomes being included in Merrill Lynch’s investment products. This was discovered by Merrill Lynch’s due diligence manager, who wrote two separate memorandums in 2005 and 2006 respectively, disclosing the problem to the head of whole loan trading, yet the firm did not substantially alter its disclosures.

\textsuperscript{90} Id.

\textsuperscript{91} \textit{See Final Judgment as to Merrill Lynch, Pierce, Fenner, & Smith Inc. f/k/a Banc of Am. Sec. LLC, SEC v. Bank of Am. et al., No. 3:13-cv-447, 2014 U.S. Dist. LEXIS 169996, at *1–2 (W.D.N.C. Nov. 25, 2014). None of these statutes require proof of knowing or intentional misconduct.}

\textsuperscript{92} \textit{See Complaint for Injunctive and Other Relief, SEC v. Bank of Am.; et al., No. 3:13-CV-00447, 2013 WL 4007382 (W.D.N.C. Nov. 20, 2014); cf Final Judgment as to Merrill Lynch, Pierce, Fenner, & Smith Inc. f/k/a Banc of Am. Sec. LLC, SEC v. Bank of America et al., No. 3:13-cv-447, 2014 U.S. Dist. LEXIS 167627 (W.D.N.C. Nov. 25, 2014). It seems that the Commission may have another crack at Merrill Lynch, based on its brokers’ shady actions. The SEC recently probed the firm in regards to an investment...}
B. Citigroup

In August 2015, the SEC reached a settlement with Citigroup to pay $180 million for alleged violations of the securities laws arising out of pre-2008 conduct. The alleged violations occurred in connection with Citigroup’s conduct related to two hedge funds, ASTA/MAT and Falcon Strategies (“Falcon”). According to the Commission, from 2002 to 2008, financial advisors at these funds misrepresented the investment risks to clients; the advisors touted the funds as “safe” or “low-risk” investments, even going so far as to label them “bond substitutes.” Financial advisors and the fund manager continued to market the funds as low-risk investments, even when it became apparent that the two funds were experiencing increased margin calls and liquidity problems. Of course, these funds were not as safe as they appeared; both funds collapsed in 2008, leaving investors with billions of dollars in total losses.

In the settlement order, the SEC gives particularly scathing treatment to the fund’s manager, outlining his significant lapse in oversight. Interestingly,
in spite of this damning language, no fund manager or other executive is named in the order. The Commission's lack of control person allegations makes little sense, as it has successfully brought such claims against managers of smaller funds for similar behavior.

In the Citigroup enforcement proceeding, the Commission invoked Section 15(b)(4)(A) to impose censure and cease and desist proceedings against the company based on its alleged violation of Sections 17(a)(2) and 17(a)(3). Although the Commission had the power to bring a claim for failure to supervise under Sections 15(b)(4)(E) and 15(b)(6)(A), it declined to was checked adequately or to ensure that the fund manager's communications with investors and financial advisers concerning the ASTA/MAT and Falcon funds were accurate and not misleading. (emphasis added).

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99 See Citigroup Order, supra note 93.

100 See, e.g., SEC v. Quan, No. 11-723 ADM/JSF, 2014 U.S. Dist. LEXIS 131618, at *3-4 (D. Minn. Sept. 19, 2014); SEC v. Lauer, No. 03-80612-CIV-MARRA/JOHNSON, 2008 U.S. Dist. LEXIS 73026, at *29-42, *88-90 (S.D. Fla. Sept. 23, 2008). For instance, in Quan, Marlon Quan, while acting as manager and owner of two separate hedge funds, "met with investors and distributed Preferred Placement Memoranda (PPMs) and marketing materials touting the risk management techniques that would be used to protect [his] funds' investments. [Such] promised safeguards included the use of a lock box account, 'full due diligence' on loan transactions, audits of 'intermediaries,' and the retention of cash collateral in a blocked account." 2014 U.S. Dist. LEXIS 131618, at *3-4. More than half of the hedge funds' capital was invested in loans to a company called PAC Funding. Id. at *4. Unbeknownst to Quan, PAC was part of a multi-billion dollar Ponzi scheme that had been operating for over a decade. Id. Quan was ultimately held personally liable under both a Section 10(b) claim and a Section 20(a) control person claim. Id. at *27, *39.

101 Citigroup Order, supra note 93, at *7:
Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b)(4) of the Exchange Act and Sections 203(e) and 203(k) of the Advisers Act, it is hereby ORDERED that:
A. Respondents CAI and CGMI shall cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act. Additionally, CGMI shall cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act, and CAI shall cease and desist from committing or causing any violations and any future violations of Section 206(4) of the Advisers Act and Rules 206(4)-7 and 206(4)-8 promulgated thereunder.
B. Respondents CAI and CGMI are censured.
C. Respondents shall, within ten days of the entry of this Order, pay disgorgement of $139,950,239 and prejudgment interest of $39,612,089 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.
Instead, it punt this powerful tool by refusing to invoke it against the supervisors of the persons who committed the alleged violations.

C. Deutsche Bank

In May 2015, Deutsche Bank agreed to pay the SEC $55 million in connection with allegations that the bank misrepresented the value of derivatives leading to a material misstatement of its accounts. The SEC alleged that the bank overvalued certain leveraged super senior trades ("LSS"), which led to a misstatement of the bank’s financial statements in its 2008 Form 10-K and 2009 first quarter Form 10-Q. The resulting misstatements were due to the fact that Deutsche Bank failed to adequately measure the "gap risk" associated with such trades. According to the SEC, "Deutsche Bank’s deficient internal accounting controls contributed to Deutsche Bank’s failure to adequately assess the Gap Risk, resulting in the

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102 Compare Section 15(b)(4)(A) of the Exchange Act, 15 U.S.C. § 78o(b)(4)(A) (2012) (allowing for liability for a broker-dealer who “has willfully made or caused to be made in any application for registration or report required to be filed with the Commission or with any other appropriate regulatory agency . . . any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state any material fact required to be stated therein”), with Section 15(b)(4)(E) of the Exchange Act, 15 U.S.C. § 78o(b)(4)(E) (allowing for liability for a broker-dealer who “has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision”).


104 See Deutsche Bank AG, Exchange Act Release No. 75040, 2015 SEC LEXIS 2145, at *2–3 (May 26, 2015) [hereinafter Deutsche Bank Order] (“The [Leveraged Super Senior] trades at issue had a notional value of C$120 billion, or approximately $98 billion, reflecting credit protection Deutsche Bank purchased from Canadian counterparties. Initially, the trades were leveraged approximately eleven times which meant that the Canadian counterparties posted collateral of approximately 9% of the notional value of the trades or approximately $8.5 billion. Following a restructuring, finalized in early 2009, the trades were partially deleveraged by the addition of collateral (bringing the collateral total to $16.6 billion, plus additional margin funding from Deutsche Bank of approximately $20 billion). The fact that the trades were leveraged created the risk that Deutsche Bank’s value of the full notional trade would exceed the value of the collateral and thus expose Deutsche Bank to ‘Gap Risk.’”).

105 See id. at *3–4. Gap risk is the risk that the price of an investment product will significantly drop from one trade to the next.
misstatement of its financial statements.”106 The alleged violations were limited to reporting violations premised on Section 13(a) of the Exchange Act, and Exchange Act Rules 13a-1,107 13a-16,108 and 12b-20.109 The Deutsche Bank settlement drew the ire of Senator Elizabeth Warren who took offense to the fact that the bank did not admit wrongdoing and that no individuals were named.110 Indeed, in 2015, Deutsche Bank entered into two major settlements with the federal government.111 To some, including Senator Warren, the settlement was a mere slap on the wrist. In fact, one analyst said that the settlement “isn’t relevant for Deutsche Bank.”112

D. JP Morgan-Chase

Another recent settlement—which also angered Senator Warren—involved a $307 million settlement between the SEC and banking giant JP Morgan-Chase.113 The SEC alleged that JP Morgan wealth management companies, JPMorgan-Chase Bank, N.A. (“JPMCB”) and J.P. Morgan Securities LLC (“JPMS”), failed to disclose conflicts of interests to its investment clients.114 Specifically, JP Morgan financial advisors directed clients, without adequate disclosures, to invest in funds that were owned by JP Morgan, or funds where JP Morgan had a financial interest.115 This conduct occurred consistently from 2008 to 2015.116

106 Id.
107 Id. at *27; 17 C.F.R. § 240.13a-1 (2016) (requiring that subject issuer file an annual report).
109 Deutsche Bank Order, supra note 104, at *27; 17 C.F.R. § 240.12b-20 (2016) (requiring that filings made with the SEC contain such additional material information as needed to not make the report misleading).
110 WARREN REPORT, supra note 11, at 5–6.
112 Choudhury & Strowmatt, supra note 103 (quoting Kilian Maier, an analyst at Mainfrist Schweiz AG in Zurich).
113 See WARREN REPORT, supra note 11, at 6.
115 Id.
116 Id.
While JP Morgan-Chase did admit fault in the settlement, the SEC characterized the non-disclosures as a “negligent failure” and did not bring any individual actions. However, the New York Times reported that several JP Morgan-Chase advisors revealed that “they were encouraged by their superiors to put their clients into proprietary funds, even when lower cost or better performing funds were available.” Even though this conduct evidently was facilitated by superiors, no executives were named and JP Morgan was given a relatively light penalty.

E. Goldman Sachs

One of the U.S. government's most recent settlements amounted to $5 billion, entered into by Goldman Sachs for its alleged misconduct in the
mortgage-backed securities market.\footnote{Press Release, U.S. Dep't of Justice, Goldman Sachs Agrees to Pay More than $5 Billion in Connection with Its Sale of Residential Mortgage Backed Securities (Apr. 11, 2016), https://www.justice.gov/opa/pr/goldman-sachs-agrees-pay-more-5-billion-connection-its-sale-residential-mortgage-backed.} The Department of Justice’s statement of facts asserts that Goldman misled investors in its RMBS market about the ways in which loans were securitized and the methods the bank would take to protect investors.\footnote{Id. For a discussion of Goldman’s role in the financial crisis, see Matt Taibi, The People v. Goldman Sachs, ROLLING STONE (May 26, 2011), http://www.rollingstone.com/politics/news/the-people-vs-goldman-sachs-20110511 (“The bank seemed to count on the unwillingness or inability of federal regulators to stop them — and when called to Washington last year to explain their behavior, Goldman executives brazenly misled Congress, apparently confident that their perjury would carry no serious consequences. Thus, while much of the Levin report describes past history, the Goldman section describes an ongoing crime — a powerful, well-connected firm, with the ear of the president and the Treasury, that appears to have conquered the entire regulatory structure and stands now on the precipice of officially getting away with one of the biggest financial crimes in history.”).} The bank touted its portfolio of mortgage loans as “originated generally in accordance with the loan originator’s underwriting guidelines,” ensuring investors that they were safe when in fact these loans were tied to high-risk mortgages.\footnote{Settlement Agreement Between the U.S. Dep’t of Justice and Goldman Sachs at 2 (Apr. 11, 2016), https://www.justice.gov/opa/file/839901/download (on file with U.S. Dep’t of Justice) [hereinafter Goldman Settlement]. The Department of Justice concentrated on this statement which was included in offering documents produced by Goldman Sachs after January 2006: Prior to acquiring any mortgage loans, [Goldman] will conduct a review of the related mortgage loan seller. [Goldman’s] review process consists of reviewing select financial information for credit and risk assessment and underwriting guideline review, senior level management discussion and background checks. The scope of the loan due diligence review will depend on the credit quality of the mortgage loans. The underwriting guideline review considers mortgage loan origination processes and systems. In addition, such review considers corporate policy and procedures relating to HOEPA [Home Ownership and Equity Protection Act] and state and federal predatory lending, origination practices by jurisdiction, historical loan level loss experience, quality control practices, significant litigation and material investors. Id.} Furthermore, the bank acknowledged that it sold billions of dollars in high-risk mortgage bonds, while neglecting (or refusing) to screen out questionable loans even though it represented to investors that it undertook such a screening process.\footnote{See Aruna Viswanatha, New Details Disclosed in Goldman Mortgage Pact, WALL ST. J., Apr. 12, 2016, at C1.} The settlement included $2.3 billion in federal penalties, another $875 million paid to state and other federal agencies, and $1.8 billion paid as
Notably, and predictably, the settlement and corresponding documents did not name any bank officials responsible for the violations. Senator Elizabeth Warren called this settlement a “farce,” criticizing the federal government for its refusal to hold executives accountable for “Wall Street recklessness.”

In 2015, Goldman settled a class action suit based on the allegedly materially false statements contained in the offering documents. Unlike the government’s suit, the private litigants asserted control person liability claims against Goldman Sachs Mortgage’s CEO, Vice President, and one director.

Goldman Settlement, supra note 122, at 3–4. While this seems like a hefty price to pay, some commentators say that this is not enough, and remark that the bulk of the penalty will not be felt by Goldman. See Susanna Kim, Goldman Sachs $5B Settlement May Not Be as It Seems, ABC NEWS (Apr. 12, 2016, 4:10 PM), http://abcnews.go.com/Business/goldman-sachs-5b-settlement/story?id=38332248 (Noting that half of the penalty will be tax deductible. “‘If that amount is tax deductible, and you apply the corporate tax rate of 30 percent, they get to deduct almost a billion dollars,’ Dennis Kelleher, president and CEO of nonprofit Better Markets, told ABC News. ‘If you read the fine print, the agreement will allow Goldman Sachs to pay significantly less.’”).

See Viswanatha, supra note 123, at C1 (“[t]he pact . . . mirrors past agreements other banks have reached tied to the crisis and doesn’t specifically name any allegedly culpable employees or executives”).

See U.S. Senator Elizabeth Warren, FACEBOOK (Jan. 15, 2016), https://www.facebook.com/senatoretizwarren/posts/546470835515414 (“In the 2008 financial crisis, we lost trillions in wealth and millions of people lost their homes and their jobs because of Wall Street recklessness. Today, Goldman Sachs announced it will pay $5.1 billion for its role in precipitating the economic collapse by misleading investors about the quality of the junk mortgage securities they peddled. Seven years later. No admission of guilt. No individuals are going to jail. A payment that’s barely a fraction of the billions investors lost—and the trillions our economy lost—because of this fraud. And over half of it could be tax deductible! That’s not justice—it’s a white flag of surrender. It’s time to end this farce. These companies think they’re above the law—and too many government officials go along with them. A first step would be to pass the bipartisan Truth in Settlements Act to shine more light on these backroom deals. A second step would be to get government officials who have the backbone to fight back.”) (emphasis added) (responding to a report of the settlement prior to its official approval).


Amended Complaint for Plaintiff at 87, NECA-IBEW Health & Welfare Fund v. Goldman Sachs & Co., 693 F.3d 145 (S.D.N.Y. 2009) (No. 11-2762-cv) (Control person liability was asserted in this case under Section 15 of the Securities Act, as the primary violations were alleged under the private causes of action found in Section 11 of that Act. The complaint did not assert a claim based on Section 20(a) of the Exchange Act, as the only other violation alleged was premised on Section 11 of the Securities Act).
F. FCIC Investigation

Misconduct, such as that exhibited by the foregoing examples, was all too common during the buildup to the financial crisis. An investigation conducted by the Financial Crisis Inquiry Commission (“FCIC”)\(^\text{129}\) asserted that “[t]he captains of finance and the public stewards of our financial system ignored warnings and failed to question, understand, and manage evolving risks within a system essential to the well-being of the American public.”\(^\text{30}\)

For instance, the FCIC found that Countrywide executives recognized that many of the loans they were originating could lead to massive default and significant damage to the firm and its investors; however, they refused to stop approving these mortgages.\(^\text{131}\) Likewise, the FCIC found that AIG management was ignorant regarding the terms and risks of the company’s $79 billion derivatives exposure with respect to mortgage-related securities.\(^\text{132}\)

Clearly, the crisis was brought about, in significant part, by a lack of oversight by the executives and board members tasked with monitoring these corporations’ operations. Control person and failure to supervise claims could have been instituted against specified directors, high level officers, and other executives; however, all these individuals avoided sanctions pursuant to the above settlements.\(^\text{133}\)

\(^{129}\) The FCIC was established through the Fraud Enforcement and Recovery Act of 2009. It is a ten-person panel made up of private citizens with experience in housing, economics, finance, market regulation, banking and consumer protection. The FCIC was given statutory instruction to investigate twenty-two different topics, or “factors,” which Congress believed contributed to the financial collapse. These factors included fraud and abuse in the financial sector, the quality of due diligence by financial institutions, and corporate governance. History of the Commission, Fin. Crisis Inquiry Comm’n, https://fcic.law.stanford.edu/about/history (last visited Oct. 24, 2016).

\(^{130}\) FCIC REPORT, supra note 71, at 6.

\(^{131}\) Id. at xxi.

\(^{132}\) Id. at xix.

\(^{133}\) For a discussion of control person liability against lower level employers, see supra notes 41–46 and accompanying text.
IV. SEC’s Limited Use of Control Person Liability

“The SEC doesn’t always use all of the penalties at its disposal, and it should.”134
Senator Chuck Grassley, July 9, 2015

Although the SEC clearly has the power to bring actions premised on control person and failure to supervise liability, these actions, when instituted at all, have frequently been brought against top level personnel of relatively small enterprises, not the “big fish” associated with the financial crisis and misconduct perpetrated thereafter.135 This inaction has precipitated a call for an increase in prosecution of individuals responsible for corporate misconduct.136 Indeed, the SEC has made lofty statements in the past regarding the pursuit of corporate individuals. Consider the following speech given by SEC Chair Mary Jo White in 2013:

Another core principle of any strong enforcement program is to pursue responsible individuals wherever possible. That is something our enforcement division has always done and will continue to do. Companies, after all, act through their people. And when we can identify those people, settling only with the company may not be sufficient. Redress for wrongdoing must never be seen as “a cost of doing business” made good by cutting a corporate check.137


136 See WARREN REPORT, supra note 11; see also Memorandum from Sally Quillian Yates, Deputy Att’y Gen., U.S. Dep’t of Justice, to All U.S. Att’ys et al., (Sept. 9, 2015), http://www.justice.gov/adc/file/709036/download [hereinafter Yates Memo] (calling for an increase in DOJ prosecution of individuals).

137 Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, Speech at the Council of Institutional Investors Fall Conference in Chicago, IL: Deploying the Full Enforcement Arsenal (Sept. 26, 2013), https://www.sec.gov/News/Speech/Detail/Speech/1370539841202 (“Individuals tempted to commit wrongdoing must understand that they risk it all if they do not play by the rules. When people fear for their own reputations, careers or
This statement, however, at least with respect to the “big players,” appears to be an empty mandate—mere “jawboning.”

A. Actions Against Executives

Actions against executives and other insiders are more common than those against outside directors; however, the SEC regularly declines to invoke control person liability. In one of the largest individual settlements in the wake of the financial crisis, the SEC reached an agreement with former Countrywide CEO, Angelo Mozilo. Among the sanctions levied, Mozilo paid $22.5 million in penalties and an additional $45 million in disgorgement.

Pocketbooks, they tend to stay in line. Of course, there will be cases in which it is not possible to charge an individual. But I have made it clear that the staff should look hard to see whether a case against individuals can be brought.


Final Judgment as to Defendant Angelo Mozilo, SEC v. Mozilo, No. CV 09-3994-JFW (MANx), 2010 WL 3656068 (C.D. Cal. Sept. 16, 2010) (holding that, in addition to fines and disgorgement, Mozilo was permanently barred from serving as an officer or director of a publicly-traded company; see also Press Release, U.S. Sec. & Exch. Comm’n, Former Countrywide CEO Angelo Mozilo to Pay SEC’s Largest-Ever Financial Penalty Against a Public Company’s Senior Executive (Oct. 15, 2010).
The SEC alleged that Mozilo assured the public that Countrywide was a prime mortgage lender, while in fact, the firm continued to write risky loans and packaged these loans in its mortgage-backed securities. In its complaint, the SEC alleged violations of Section 17(a) of the Securities Act, Section 13(a) of the Exchange Act, and fraud under Section 10(b). The complaint did not, however, include a control person allegation.

Similarly, the U.S. Court of Appeals for the Sixth Circuit affirmed the finding of liability against a former Chief Accounting Officer for engaging in accounting improprieties and acting recklessly in regard to certain transactions. The defendant argued that he "relied on experienced subordinates to advise him on the transactions, vetted the transactions with the firm's outside auditors, and made an independent assessment of the facts before him in approving the accounting treatment for these transactions." The court, however, upheld his liability for securities fraud under Section 10(b) and Rule 10b-5, finding that his "willful blindness" constituted recklessness, and thus he possessed the requisite scienter for securities

https://www.sec.gov/news/press/2010/2010-197.htm (Robert Khuzami, then Director of SEC Enforcement, stated that "Mozilo's record penalty is the fitting outcome for a corporate executive who deliberately disregarded his duties to investors by concealing what he saw from inside the executive suite — a looming disaster in which Countrywide was buckling under the weight of increasing risky mortgage underwriting, mounting defaults and delinquencies, and a deteriorating business model.").

See sources cited supra note 140.

Complaint at 47, SEC v. Mozilo, No. CV 09-3994-JFW (MANx), 2010 WL 3656068 (C.D. Cal. Sept. 16, 2010). Section 17(a)(1) makes it unlawful, in connection with the sale of securities, to employ any device, artifice, or scheme to defraud; Section 17(a)(2) makes it illegal to obtain money or property by use of untrue statement of material fact or any omission of a material fact; and Section 17(a)(3) is violated when one engages in any transaction that would operate as a fraud or deceit upon the purchaser. 15 U.S.C. § 77q(a) (2012). Scienter is required to be proven for a violation of Section 17(a)(1), while negligence suffices for Sections 17(a)(2) and 17(a)(3). Aaron v. SEC, 446 U.S. 680, 695–700 (1980).

Complaint, supra note 142, at 49. For a discussion of Section 13(a) of the Exchange Act, see supra note 80 and accompanying text.

Complaint, supra note 142, at 48. Section 10(b) and the rules promulgated thereunder make it unlawful to employ any deceptive or manipulative device "in connection with the purchase or sale of any security." 15 U.S.C. § 78j(b) (2012). While the private right of action may be applied only to primary violators, the SEC is entitled to bring an enforcement action premised on this section against aiding and abetting. See, e.g., Section 20(e) of the Securities Exchange Act, 15 U.S.C. § 78t(e); SEC v. Apuzzo, 689 F.3d 204 (2d Cir. 2012); SEC v. DiBella, 587 F.3d 553 (2d Cir. 2009).


Id. at *8–9.
fraud. Although here recklessness was enough to get the SEC past the scienter bar, it could have pursued the chief accounting officer under the control person provision, yet declined to do so.

As illustrated by these examples, it is clear that in the “big player” setting, the SEC has declined to invoke control person liability even when it brings an enforcement action against an individual. This refusal to do so, as discussed above, cannot be due to unfavorable law. Rather, the SEC must have some other reason for its unwillingness to hold control persons liable—namely, it may be posited that the SEC is taking a purposely weak approach in prosecuting “big fish” individual violators in “blue chip” publicly-held or regulated enterprises, such as Goldman Sachs, JP Morgan, and Citigroup. The Commission can wax poetically about the importance of corporate gatekeepers; nonetheless, the SEC allows these “players” to exit the backdoor when the government comes knocking.

B. Actions Against Directors

One area where the SEC has been particularly timid is in the pursuit of directors. Indeed, as observed by a former SEC Commissioner, “these matters are so infrequent that the agency does not currently maintain statistics

147 Id. ("Free argues that in finding that there was sufficient evidence to sustain the jury’s finding that he acted with scienter, the district court cited documents that he did not see or did not know about and improperly concluded that attacks on his credibility could substitute for a culpable state of mind. On de novo review, however, we find that the record contains sufficient evidence to sustain the jury’s verdicts. First, we find that there was sufficient evidence that Free acted recklessly or turned a blind eye to the fact that the Bank One Transaction lacked economic substance as a sale. Second, we find that there were a number of red flags indicating that the EDS Transaction was not a true rebate that Free ignored.").

148 This idea is not new; the SEC is frequently criticized for attacking smaller issuers, while allowing the “big players” to escape with little repercussion. See generally Jeffrey H. Rasansky & Helen L. Miller, A Slap on the Wrist or a Punch in the Face: The SEC’s Disproportionate Treatment of NYSE Member and Non-NYSE Member Firms, 19 SEC. REG. L.J. 243 (1991).

149 Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, Statement to The Twentieth Annual Stanford Director’s College: A Few Things Directors Should Know About the SEC (June 23, 2014), https://www.sec.gov/News/Speech/Detail/Speech/1370542148863 ("Those of you who are directors play a critically important role in overseeing what your company is doing, and by preventing, detecting, and stopping violations of the federal securities laws at your companies, and responding to any problems that do occur. In other words, you are the essential gatekeepers upon whom your investors and, frankly, the SEC rely.") (emphasis added).
Generally, actions against directors are brought only when their conduct is particularly egregious. This is true even though failure by board members and other gatekeepers is a "common denominator in many of the major frauds." The SEC's most recent action against a public company director involved Stephen Pence, Chairman of the Board of Directors for General Employment Enterprises, a publicly-traded company. Pence was the majority shareholder of the company; however, in reality, he was acting as agent for Wilber Huff, a convicted felon who sought to take over a controlling interest in the company for the purpose of acquiring and rolling into one public entity several private companies which Huff himself owned. The SEC brought claims under Section 10(b), Rule 10b-5, and Rule 13b2-2. While this case may represent the extreme, it showcases the SEC's unwillingness to touch directors unless their conduct rises to an egregious level.

While actions against directors are uncommon, a number of these cases involved failures in oversight by audit committee members. For instance,
the Commission filed a complaint against outside directors of the publicly-traded company DHB Industries. The complaint alleged that three of the company's independent directors engaged in misconduct through their "willful[ ] blind[ness] to red flags signaling accounting fraud." Their actions allowed the corporation's management to file materially false and misleading documents with the SEC and use business proceeds for personal expenses. In its complaint, the SEC charged seven counts, including violations of Sections 10(b), 13, and 14 of the Exchange Act. Conspicuously absent, however, was a control person claim under Section 20(a). This is particularly notable considering the SEC brought an aiding and abetting claim under Section 10(b), a claim which requires proof of substantial assistance and knowing or reckless misconduct.

The fact scenario made a Section 20(a) claim available against the outside directors. Crantz, Chasin, and Nadelman were members of the audit committee; nonetheless, they allowed the company's CEO to run the external investigation involving allegations that focused on his own personal spending. Moreover, Nadelman signed a fraudulent document, which was backdated in order to explain the CEO's lavish spending. Given these...
allegations, the named board members apparently exercised sufficient control over the primary violator to bring them within Section 20(a); however, the SEC did not bring a claim under this provision.168

For decades, the SEC has been willing to bring actions premised on failure to supervise against officers and directors of smaller broker-dealers.166 On only rare occasions, however, has the SEC brought such actions against the “big players.” For example, over two decades ago, the Commission invoked its authority under Sections 15(b)(4)(E) and 15(b)(6)(A) to issue civil penalties and officer and director bars against Salomon Brothers’ CEO, President, and Vice President.167 These charges were based on their failure to supervise a Salomon Brothers’ employee who had submitted a false bid of $3.15 billion in an auction of U.S. Treasury securities.168 Although the defendants told the Chief Legal Officer that they would report the improper act, they neither timely did so nor did they investigate the matter.169 The SEC stated: “[t]he respondents are not being charged with any participation in the underlying violations. . . . [T]he Commission believes that the Respondents’ supervision was deficient and this failure was compounded by the delay in reporting the matter to the government.”170

As discussed, actions against directors certainly are not the norm for the SEC, and when they do happen, they usually involve smaller publicly-traded companies as opposed to executives and directors at the big banks and brokerage firms allegedly responsible for the financial collapse.171 Meanwhile,

165 See discussion of liability of outside directors, supra notes 150–61 and accompanying text.
166 See Gadinis, supra note 29; Rasansky & Miller, supra note 148.
167 Gutfreund, Exchange Act Release No. 31554, 1992 WL 362753, at *11 (Dec. 3, 1992). Gutfreund, the Chairman of the Board and CEO, was ordered to pay a $100,000 fine and received a permanent officer and director bar. Thomas Strauss, the firm’s President, was prohibited from associating with any broker-dealer for a period of six months and was ordered to pay $75,000 in civil penalties. Vice President John Meriweather was suspended from associating with any broker-dealer for three months and was required to pay a $50,000 penalty. Id. at *16–17.
168 Id. at *2.
169 Id.
170 Id. In a controversial proceeding, the SEC brought failure to supervise charges against the general counsel of the broker-dealer firm Ferris Baker Watts. The charges against the general counsel subsequently were dismissed. See also Urban, Exchange Act Release No. 66259, 2012 WL 1024025, at *1 (Jan. 26, 2012). One of the authors of this Article, Marc I. Steinberg, served as an expert witness in this matter and testified on behalf of Mr. Urban.
171 See Zachary A. Goldfarb, SEC to Examine Boards’ Role in Financial Crisis, WASH. POST (Feb. 20, 2009), http://www.washingtonpost.com/wp-dyn/content/article/2009/02/19/AR2009021903172.html; Glenn Greenwald, The Real Story of How ‘Untouchable’ Wall Street
the Commission purports to be holding “gatekeepers” accountable, even suggesting that such stringent responsibility may make director roles unattractive. In reality, however, the Commission has the perfect tool, Section 20(a), to aggressively pursue these directors, as well as Section 15(b)(6)(A) in the brokerage firm setting. Yet, it declines to use these provisions, generally only bringing primary or aiding and abetting claims when there is blatant misconduct engaged in by these fiduciaries.

V. POSSIBLE RATIONALE FOR LACK OF CONTROL PERSON ACTIONS

The Securities and Exchange Commission (SEC) is particularly feble, often failing to use the full range of its enforcement toolbox. Senator Elizabeth Warren, January 2016

In many proceedings, the SEC declines to bring control person claims because they are unnecessary in order to procure the desired relief. Consider the action against Stephen Pence. Pence was essentially acting as a sham controller so that Wilber Huff could operate a self-serving scam behind the scenes. Taking the allegations as true, the SEC successfully instituted claims under Section 10(b) for fraud and for reporting violations under Section 13 of the Exchange Act.

Does the SEC’s non-use of the control person provision signify that this provision is unnecessary or that the misconduct at issue is otherwise being

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113 Mary Jo White, Chair, U.S. Sec. & Exch. Comm’n, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), https://www.sec.gov/News/Speech/Detail/Speech/1370539872100?#frrref6 (“It has been suggested that our focus on gatekeepers may drive away those who would otherwise serve in these roles, for fear of being second-guessed or blamed for every issue that arises. I hear and I am sensitive to that concern. But this is my response: first, being a director or in any similar role where you owe a fiduciary duty is not for the uninitiated or the faint of heart. And, second, we will not be looking to charge a gatekeeper that did her job by asking the hard questions, demanding answers, looking for red flags and raising her hand.”).

114 See, e.g., Complaint, supra note 158, at 24.

115 WARREN REPORT, supra note 11, at 1.

116 See supra notes 153–55 and accompanying text.

117 See Complaint, supra note 155, at 31–32.
addressed? Absolutely not. Instead, settlements such as this one show that the SEC may pursue those insiders who are viewed as primary violators or aiders and abettors. Surprisingly, the Commission declines to invoke Section 20(a) as an effective resource to fill in the gap between primary violators and culpable directors, officers, supervisors, managers, and other executives who allow securities violations to happen, but who cannot themselves be held liable as aiders and abettors (either due to the lack of the requisite heightened mens rea or inability to prove the substantial assistance element). Section 20(a)—as well as Section 15(b)(6)(A) in the brokerage firm setting—can be used in instances where a responsible control person or supervisor has not engaged in a primary violation or acted as an aider or abettor, but nonetheless should still be held responsible for his or her failure of oversight. This is consistent with the thrust of the Sarbanes-Oxley and Dodd-Frank Acts, which aimed to enhance corporate governance by seeking to incentivize directors, executive officers, and other gatekeepers to be more accountable to shareholders and the securities markets.\(^{177}\)

A. General Unwillingness to Enforce Stronger Liability Against Control Persons

The SEC’s laxity in bringing control person claims is made clearer when compared to the amount of private litigation alleging liability under Section 20(a). Indeed, within the last three years, cases have been filed in every single U.S. circuit alleging Section 20(a) control person liability.\(^{178}\) These claims are

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\(^{177}\) Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Hous., & Urban Affairs, 111th Cong. 1 (2009) (statement of Sen. Jack Reed, Chairman, Subcomm. on Sec., Ins., & Inv. of the S. Comm. on Banking, Hous., & Urban Affairs) (“Wall Street executives who pursued reckless products and activities they did not understand brought our financial system to this crisis. Many of the boards that were supposed to look out for shareholders’ interests failed at this most basic of jobs.”).

commonly asserted side by side with primary violations in private securities class actions, yet the SEC has not caught on.

The SEC’s refusal to assert liability under the control person provision may signify that the Commission simply wants to avoid attacking big time Wall Street executives. While it may be extreme to suggest that the SEC is in bed with the executives, it seems that the regulatory agency is, at the very least, afraid to pull back the covers. If the SEC wants to accomplish its goal of protecting investors and promoting efficient markets, it should address corporate misconduct at the source—the individuals who manage or monitor publicly-held corporations.

Perhaps in part to placate criticisms by Senator Elizabeth Warren, the media, and others, the Department of Justice recently announced in a memo that it would begin to pursue corporate individual wrongdoers more vigorously. This memo, issued by Deputy Attorney General Sally Quillian Yates, posits that holding individuals accountable provides deterrence, incentivizes proper corporate conduct, ensures that responsible parties are held liable, and promotes public confidence in the government’s oversight of corporations. In recent comments, Ms. Yates recognized that addressing

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179 See cases cited supra note 178; see also Ari M. Berman, How PE Firms Can Mitigate Secondary Liability Risks, LAW360 (Mar. 5, 2015, 2:27 PM), http://www.law360.com/articles/514586/how-pe-firms-can-mitigate-secondary-liability-risks (noting that control person claims are a “staple” of private class action litigation).

180 See WARREN REPORT, supra note 11, at 1 (“The Securities and Exchange Commission (SEC) is particularly feeble, often failing to use the full range of its enforcement toolbox. Not only does the agency fail to demand accountability, the SEC frequently uses its prosecutorial discretion to grant waivers to big companies so that those companies can continue to enjoy special privileges despite often-repeated misconduct that legally disqualifies them from receiving such benefits.”) (emphasis added). One commentator has even suggested that the SEC has gone so far as to cover up the “crimes” of Wall Street Executives. Matt Taibi, Is the SEC Covering Up Wall Street Crimes?, ROLLING STONE (Aug. 11, 2011), http://www.rollingstone.com/politics/news/is-the-sec-covering-up-wall-street-crimes-20110817.

181 Yates Memo, supra note 136. Early reports indicate that the Department of Justice is pleased with the effect of the Yates memo on corporate compliance. See Che Odom, Justice Department Sees Cooperation from Companies in Response to Yates Memo, 48 SEC. REG. & L. REP. (BNA) 988 (May 16, 2016). However, in the context of this Article, we focus on the DOJ’s rationale in issuing this memo.

182 Yates Memo, supra note 136, at 1 (“One of the most effective ways to combat corporate misconduct is by seeking accountability from the individuals who perpetrated the wrongdoing. Such accountability is important for several reasons: it deters future illegal activity, it incentivizes changes in corporate behavior, it ensures that the proper parties are held responsible for their actions, and it promotes the public’s confidence in our justice system.”).
corporate misconduct is not simply about obtaining the most money possible; indeed, more good is done by punishing those responsible.183

While the Department of Justice has vowed to prosecute individuals both criminally and civilly through the Yates Memo mandate, the SEC has sat idly by, even though it has civil enforcement authority, including under the control person provision. In her remarks, Deputy Attorney General Yates recognized that it is frequently difficult to reach those most responsible for corporate wrongdoing, observing that the lines of illegality are often blurred and that it can be difficult to determine when a CEO or other insiders were part of a fraudulent scheme.184 By contrast, under the control person provision of Section 20(a), the SEC is not required to plead whether the participant had the requisite intent; nor must the Commission determine whether the control person actually engaged in the violative conduct—control person liability can be asserted simply because the control person had the requisite power to control the activities of the person who engaged in the misconduct.185 Therefore, the SEC, from a civil enforcement posture, has more deterrent power than does even the Department of Justice in promoting compliance, but it refuses to invoke this power.

Furthermore, by refusing to assert control person liability, the SEC is ignoring what could be one of its strongest enforcement tools—namely, the corporate individual’s selfish desire for self-preservation.186 The SEC should

183 See Sally Q. Yates, Deputy Att’y Gen., Dep’t of Justice, Deputy Attorney General Sally Q. Yates Delivers Remarks at the New York City Bar Association White Collar Crime Conference (May 10, 2016), https://www.justice.gov/opa/speech/deputy-attorney-general-sally-q-yates-delivers-remarks-new-york-city-bar-association (“But now, the focus of our civil enforcement efforts has broadened. We recognize that our obligation is about more than recovering the most money from the greatest number of companies. It’s also about deterrence, about stopping fraud from happening in the first place and about redressing misconduct of those responsible. There is a real deterrent value in the prospect of being named in a civil suit or having a civil judgment. And this kind of deterrence can change corporate conduct.”)

184 Id. (“[T]hese cases do have a special set of challenges, challenges that can impede our ability to identify the responsible parties and to bring them to justice. It is not easy to disentangle who did what within a huge corporate structure—‘to discern whether anyone had the requisite knowledge and intent. Blurred lines of authority make it hard to identify who is responsible for individual business decisions and it can be difficult to determine whether high-ranking executives, who appear to be removed from day-to-day operations, were part of a particular scheme.’”) (emphasis added).

185 See discussion supra notes 23–45 and accompanying text.

186 See David M. Uhlmann, The Pendulum Swings: Reconsidering Corporate Criminal Prosecution, 49 U.C. DAVIS L. REV. 1235, 1273–74 (2016) (speaking in the criminal law context: “Given the pernicious harm and lawless conduct inherent in corporate crime, both corporations
use the control person provision as a deterrent mechanism to promote compliance with securities law and to facilitate enhanced corporate governance practices. Also, using Section 20(a) in the same way that private plaintiffs do—to seek a more beneficial monetary settlement—will likely result in more meaningful relief. While this rationale may not satisfy those who want to see culpable executives incarcerated, it would at the very least allow the Commission to achieve meaningful equitable and monetary relief against these individuals, including the procurement of injunctions, bar orders, and monetary penalties. These actions would also put the word out to Wall Street that the SEC is receptive to naming control persons in its complaints. Unfortunately, however, that simply is not the case in practice. In the hundreds of cases that proceed in federal courthouses, gatekeepers are rarely, if ever, named as control persons in SEC enforcement actions.

B. SEC’s Concern over Losing at Trial

The SEC may also worry that an increase in control person claims will lead to an increase in cases going to trial or more losses at the summary judgment stage of litigation. A former SEC enforcement director commented that “as the agency gets tougher [and] demands more, more and more people are willing to go to trial, and the risk, I think, for the agency’s trial record is increasing.” Could the SEC be protecting its litigation

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187 See Janet Cooper Alexander, Do the Merts Matter? A Study of Settlements in Securities Class Actions, 43 STAN. L. REV. 497, 530–31 (1991) (Noting that it is always advantageous for the plaintiff in a securities case to name directors and officers as individual defendants because they are inherently more risk averse than entity defendants. Thus, the individual defendants will be more likely to settle cases even when the cost of such settlements is higher than the potential outcome at trial; it simply is not worth the risk for these individuals.).


189 See discussion supra notes 174–78 and accompanying text.


191 Id (statement of William R. McLucas, partner and leader of the securities department at Wilmer Cutler Pickering Hale & Dorr LLP). This practice is consistent with the SEC’s long-standing approach to adjudicate roughly 90% of its enforcement actions pursuant to
record? Under the current model, defendant corporations are willing to consent to large monetary settlements when insiders are not named and the corporation does not admit fault.\textsuperscript{192} Indeed, in the Citigroup matter, the Commission drew the ire of U.S. District Court Judge Jed Rakoff who refused to approve the SEC’s $285 million settlement.\textsuperscript{193}

the settlement negotiation process, where the defendant neither admits nor denies wrongdoing. See, e.g., SEC v. Vitesse Semiconductor Corp., 771 F. Supp. 2d 304, 308–09 (S.D.N.Y. 2011). Discussing the history of the practice, the court stated: Long before 1972, the S.E.C. had already begun entering into consent decrees in which the defendants neither admitted nor denied the allegations. This was strongly desired by the defendants because it meant that their agreement to the S.E.C.’s settlements would not have collateral estoppel consequences for parallel private civil actions, in which the defendants frequently faced potential monetary judgments far greater than anything the S.E.C. was likely to impose. But there were benefits for the S.E.C. as well. First, the practice made it much easier for the S.E.C. to obtain settlements. And second, at a time (prior to 1972) when the S.E.C.’s enforcement powers were largely limited to obtaining injunctive relief, the S.E.C.’s focus was somewhat more centered on helping to curb future misconduct by obtaining access to the Court’s contempt powers than on obtaining admissions to prior misconduct. But, by 1972, it had become obvious that as soon as courts had signed off on such settlements, the defendants would start public campaigns denying that they had ever done what the S.E.C. had accused them of doing and claiming, instead, that they had simply entered into the settlements to avoid protracted litigation with a powerful administrative agency. Thus, the real change effected by the S.E.C. in 1972 was the requirement that a defendant who agreed to a consent judgment “without admitting or denying the allegations of the Complaint” nevertheless agree that the defendant would not thereafter publicly deny the allegations. To this end, each of the proposed Consent Judgments now presented to this Court is accompanied by a formal written “Consent” of the defendant agreeing, pursuant to 17 C.F.R § 205.5, “not to take any action or to make or permit to be made any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis.”

The result is a stew of confusion and hypocrisy unworthy of such a proud agency as the S.E.C. The defendant is free to proclaim that he has never remotely admitted the terrible wrongs alleged by the S.E.C.; but, by gosh, he had better be careful not to deny them either (though, as one would expect, his supporters feel no such compunction). Only one thing is left certain: the public will never know whether the S.E.C.’s charges are true, at least not in a way that they can take as established by these proceedings. Id. For other cases criticizing the SEC’s use of settlement agreements where the defendants are not required to admit fault, see, e.g., SEC v. Van Gilder, [2014 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶¶ 97,938 (D. Colo. 2014); SEC v. Dennis, 46 Sec. Reg. & L. Rep. (BNA) 807 (S.D.N.Y. 2014); SEC v. Bridge Premium Fin. LLC, 45 Sec. Reg. & L. Rep. (BNA) 402 (D. Colo. 2013); SEC v. CR Intrinsic Investors, LLC, 939 F. Supp. 2d 431 (S.D.N.Y 2013); SEC v. Cioffi, 868 F. Supp. 2d 65 (E.D.N.Y. 2012). See discussion of settlements, supra notes 62–128 and accompanying text. SEC v. Citigroup Global Mkts., Inc., 827 F. Supp. 2d 328, 329–30, 335 (S.D.N.Y. 2011), rev’d, 752 F.3d 285 (2d Cir. 2014) ("[T]he S.E.C. alleged that Citigroup knew in advance that it would be difficult to sell the Fund if Citigroup disclosed its intention to use it as a
Judge Rakoff observed that the SEC has a “long-standing policy—hallowed by history, but not by reason—of allowing corporate defendants to enter into Consent Judgments without admitting or denying the underlying allegations.” Nonetheless, Judge Rakoff’s decision was overturned by the Second Circuit, and the settlement was eventually approved some three years later. While this litigation presented a challenge to the SEC’s settlement record, the Second Circuit’s rejection of Judge Rakoff’s well-placed concerns shows just how common these types of settlements are.

Given the SEC’s success in these settlements, the Commission may be hesitant to pursue individuals who have a lot more to lose, and thus have a vehicle to unload its hand-picked set of negatively projected assets. Although this would appear to be tantamount to an allegation of knowing and fraudulent intent (“scienter,” in the lingo of securities law), the SEC, for reasons of its own, chose to charge Citigroup only with negligence, in violation of Sections 17(a)(2) and (3) of the Securities Act.”; id. at 333 (“The SEC. . . took the position that, because Citigroup did not expressly deny the allegations, the Court, and the public, somehow knew the truth of the allegations. This is wrong as a matter of law and unpersuasive as a matter of fact. As a matter of law, an allegation that is neither admitted nor denied is simply that, an allegation. It has no evidentiary value and no collateral estoppel effect. . . . It follows that the allegations of the complaint that gives rise to the consent judgment are not evidence of anything either.”) (emphasis added) (citation omitted).

On the other hand, the fact that Judge Rakoff felt that Citigroup was able to evade justice by negotiating a relatively light settlement with the SEC may suggest that the Commission would have success in bringing individual actions under control person liability, at least in Judge Rakoff’s court. For further discussion of Judge Rakoff’s view toward the accountability of individuals responsible for the financial collapse, see Jed S. Rakoff, The Financial Crisis: Why Have No High-Level Executives Been Prosecuted?, N.Y. REV. BOOKS (Jan. 9, 2014), http://www.nybooks.com/articles/2014/01/09/financial-crisis-why-no-executive-prosecutions/.
greater incentive to contest the SEC’s claims. While it may be true that more individual civil prosecutions could result in more cases being contested, the SEC should invoke its enforcement resources to fulfill its enforcement mandate as directed in the Securities Acts.

C. Use of Control Person Liability Is Not Inconsistent with Current Policy

In allaying concerns by directors, executive officers, and their lawyers, the SEC has made repeated assertions that it is not seeking to punish directors for unintended mistakes. For instance, in a recent statement, Lara Shalov Mehrabah, Associate Director for a SEC regional office, said that “[e]nforcement isn’t second guessing good-faith decisions by the board, but rather bringing cases where directors have either taken affirmative steps to participate in fraud or enabled fraudulent conduct by unreasonably turning a blind eye to obvious red flags.”

Given this statement, control person liability should be a preferred tool for implementing the SEC’s policy as it provides for good faith as an affirmative defense.

Additionally, SEC actions under the control person provision of Section 20(a) should be a preferred enforcement tool. Under its current approach to holding individuals accountable, the Commission invokes primary and aider and abettor liability rationales. The control person provision, a more attractive enforcement tool as discussed above, lends itself to the initiation of meaningful enforcement actions directed against gatekeepers, thus promoting compliance with the law and enhanced corporate governance practices.

Recently, the Commission has sought to strengthen financial transparency by instituting actions relating to alleged deficiencies in internal

198 See, e.g., SEC v. Schvacho, 991 F. Supp. 2d 1284 (N.D. Ga. 2014) (holding that the SEC provided insufficient evidence to prove insider trading allegations under Section 10(b) of the Securities Exchange Act, Rule 10b-5, Section 14(e) of the Securities Exchange Act, and under Rule 14e-3); SEC v. Jensen, No. CV 11-5316-R, 2013 U.S. Dist. LEXIS 173532 (C.D. Cal. Dec. 10, 2013) (holding that the SEC did not carry its burden of proof in charging defendants with violations of Sections 17(a), 10(b), and 13(a)). Note, however, that all of these decisions where the SEC lost were premised on a primary liability theory, as opposed to the control person provision.


200 For discussion of good faith defense, see supra notes 48–50 and accompanying text.
control over financial reporting ("ICFR"). Violations for ICFR stem from Section 13(b) of the Exchange Act, which requires publicly-held companies to keep and maintain a reliable system of internal accounting controls sufficient to provide reasonable assurance that the company’s transactions are recorded in order to permit preparation of financial statements that conform with generally accepted accounting principles. Likewise, Rule 13a-15(a) requires that subject issuers maintain internal control over financial reporting.

In certain cases, the Commission has sought to impose liability against companies when only ICFR violations are alleged. In one case, the Commission instituted proceedings against a rapidly growing oil and gas company. The SEC alleged that the company had deficient ICFR, including inadequate staffing, significant delays in financial reporting, and limited or incomplete documentation of the company’s accounting deficiencies. Based purely on ICFR violations, the SEC levied penalties against the company as well as its Chief Financial Officer.

201 See Jason M. Halper, SEC Enforcement and Internal Control Failures, HARV. L. SCH. ON CORP. GOVERNANCE & FIN. REG. (May 4, 2016), https://corpgov.law.harvard.edu/2016/05/04/sec-enforcement-and-internal-control-failures/; David Woodcock, Individuals in the Crosshairs? What this Means for Directors, HARV. L. SCH. ON CORP. GOVERNANCE & FIN. REG. (Mar. 17, 2016), https://corpgov.law.harvard.edu/2016/03/17/individuals-in-the-cross-hairs-what-this-means-for-directors/ ("The board’s oversight role, usually through the audit committee, is critical because the SEC is keenly interested in the state of a company’s internal controls. All financial reporting and disclosure investigations will involve a detailed look at a company’s internal controls, and most of these investigations will involve an analysis and investigation into the board’s oversight over financial reporting and internal controls.").

202 This provision applies to issuers whose securities are registered under Section 12 of the Exchange Act, and who thereby are required to issue annual reports. 17 C.F.R. § 240.13a-15(a) (2014) ("Every issuer that has a class of securities registered pursuant to section 12 of the Act (15 U.S.C. 781), other than an Asset-Backed Issuer, a small business investment company registered on Form N-5, or a unit investment trust as defined in section 4(2) of the Investment Company Act of 1940 (15 U.S.C. 80a-4(2)), must maintain disclosure controls and procedures and, if the issuer either had been required to file an annual report pursuant to section 13(a) or 15(d) of the Act for the prior fiscal year or had filed an annual report with the Commission for the prior fiscal year, internal control over financial reporting.") (citations omitted).


204 Id. at *4.

205 Id. at *5–10.

206 Id. at *10 (instituting a $250,000 civil penalty against the company, as well as requiring it to cease and desist from future violations of Section 13); Ronald D. Ormand, Exchange...
Officials within the SEC have stressed the importance of pursuing these “minor” violations, in order to promote a “culture” of compliance. SEC Chair Mary Jo White has touted this practice of pursuing minor violations as the “broken windows” approach to enforcement. Although the Chair’s talk is tough, these actions generally have focused on smaller issuers. Furthermore, commentators question whether the SEC’s broken windows approach has had any deterrent effect; it seems that issuers and executives may view these types of sanctions simply as a risk of doing business.

If the Commission was actually interested in promoting a culture of compliance, it would have the perfect tools in Sections 20(a) and 15(b)(6)(A) of the Exchange Act. Using these enforcement mechanisms, the SEC would not be confined to alleging primary or aiding and abetting liability. Rather, invoking these provisions, the Commission could institute proceedings...
against higher-ups and other gatekeepers based on a violation of the federal securities laws committed by those persons under their control. Thus, effective use of Sections 20(a) and 15(b)(6)(A) will enable the Commission to pursue gatekeepers with vigor.\textsuperscript{212}

\textbf{VI. CONCLUSION}

The financial crisis and subsequent episodes of major corporate financial misconduct have shed light on the importance of adequate and consistent corporate governance.\textsuperscript{213} The SEC has frequently stressed the importance of holding “gatekeepers” accountable in order to achieve stronger corporate governance practices.\textsuperscript{214} However, for the most part, the Commission has been unwilling to put its money where its mouth is. As addressed above, the SEC has two major tools with which to hold executives and directors accountable for their failure to adequately oversee those under their control.

Through the use of Section 20(a), the SEC has within its tool chest the power to hold “control persons” liable for the actions of those that they oversee, even when the control person did not commit the underlying violation(s) at issue.\textsuperscript{215} Further, invocation of this provision would provide a powerful incentive for executives and directors to more deeply acknowledge that their respective companies must comply with the law—or face the sobering reality of being named in an SEC enforcement action. Likewise, Section 15(b)(6)(A) of the Exchange Act allows for directors, officers, and other overseers in the brokerage firm setting to be held responsible for their failure to reasonably supervise those individuals under their control who commit specified securities law violations.\textsuperscript{216} Without explanation, the Commission has declined to meaningfully utilize these provisions, and instead has tended to pursue gatekeepers only if they commit or aid in a primary violation. Indeed, with respect to the “big players” on Wall Street, the SEC has declined to pursue any individual liability at all, except on rare occasions.

Examples from the financial crisis as well as more recent debacles evince an unwillingness on the part of the SEC to pursue control persons whose allegedly culpable failures to adequately monitor the actions of individuals under their control have resulted in billions of dollars in losses to investors.

\begin{itemize}
\item \textsuperscript{212} See discussion supra notes 29–61 and accompanying text.
\item \textsuperscript{213} For discussion of major settlements, see supra notes 62–133 and accompanying text.
\item \textsuperscript{214} See Stein, supra note 25.
\item \textsuperscript{215} See supra notes 23–61 and accompanying text.
\item \textsuperscript{216} See supra notes 23–61 and accompanying text.
\end{itemize}
Citizens and public servants alike have urged the Commission to take a
tougher stance against those who should be held responsible for widespread
economic damage.\textsuperscript{217} To make this a reality, the SEC should fulfill its
statutory directive by utilizing the powerful enforcement tools that it has been
provided. By doing so in a reasoned and good faith manner, improved
compliance with the securities laws and enhanced corporate governance
practices will eventuate.

\textsuperscript{217} See, e.g., \textit{Warren Report}, supra note 11.