MENS REA AND THE MARTIN ACT: A WEAPON OF CHOICE FOR SECURITIES FRAUD PROSECUTIONS?

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Given the lack of significant federal criminal prosecutions stemming from the 2008 financial crisis, state enforcement—in particular, by the New York State Attorney General through Section 352-c of the General Business Law, known as the "Martin Act"—could play a larger role. This is because it is widely believed that the statute's culpability standards are weaker than those required for prosecution under federal law. Were the Martin Act to become a more significant means of criminal prosecution however, its heightened use would inevitably magnify two major problems with the statute. First, the consensus view is that the Martin Act establishes strict liability for misdemeanor securities fraud crimes. Yet there has been almost no analysis of whether it is "appropriate" to prosecute securities fraud as a strict liability crime, at least under this provision. Second, in part because there have been so few Martin Act decisions, New York courts have had little opportunity to develop a cohesive doctrine of mens rea under the felony provisions of the statute. As a result, they have never thoroughly explained exactly what showing of culpability is required for felony liability, or how their interpretations comport with the Martin Act's text and legislative history.

This Note demonstrates that the mental state requirements for Martin Act misdemeanor and felony liability

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need to be clarified and more thoroughly supported, especially because the statutory text and legislative history are somewhat ambiguous, and the subsequent jurisprudence has failed to provide a coherent explanation for the current state of the doctrine. Nonetheless, the Martin Act's text, history and underlying policy rationale can be interpreted to support strict liability prosecution for misdemeanor securities fraud, and to impose felony liability for reckless violations of the statute.

I. INTRODUCTION

> Fraud is among the most serious, costly, stigmatizing, and punitive forms of liability imposed on actors in modern corporations and financial markets. . . . If the legal system cannot be clear on what fraud is, then policymakers and the general public are not likely to get very far in understanding what of legal significance has happened when something goes wrong in the markets, much less in knowing what to do about it.[1]

Four years after the 2008 recession began, the American public's demand for legal accountability from those whose actions brought about the financial crisis has hardly subsided.[2] Even the President of the United States has

[1] Samuel W. Buell, *What is Securities Fraud?*, 61 DUKE L.J. 511, 521–22 (2011).

[2] *See, e.g.*, Michael S. Schmidt & Edward Wyatt, *Corporate Fraud Cases Often Spare Individuals*, N.Y. TIMES, Aug. 8, 2012, at B1; Phil Angelides, Op-Ed., *Will Wall Street Ever Face Justice?*, N.Y. TIMES, Mar. 2, 2012, at A25; Peter J. Henning, *A Renewed Focus on a Financial Crisis Crackdown*, N.Y. TIMES DEALBOOK (Jan. 30, 2012, 3:40 PM), http://

publicly commented on the need for the government to bring prosecutions related to the economic collapse.[3] Still, although there are many possible explanations,[4] by the fall of 2012 the federal government had not brought criminal charges against any high-ranking individual or institution in connection with the subprime market meltdown that precipitated the crash.[5]

dealbook.nytimes.com/2012/01/30/a-renewed-focus-on-a-financial-crisis-crackdown.

3 Edward Wyatt, *Obama Urges Tougher Laws on Financial Fraud*, N.Y. TIMES, Jan. 25, 2012, at B1. *But see* Evan Perez & Jean Eaglesham, *Uphill Fight Awaits New Mortgage-Fraud Unit*, WALL ST. J. ONLINE (Jan. 26, 2012), http://online.wsj.com/article/B10001424052970204624204577183392997838200.html (noting that "most of the investigations into alleged wrongdoing behind the 2008 financial crisis have gone nowhere—in part, Mr. Obama has said, because conduct may have been reckless but not illegal" under federal law).

4 *See infra* Part II.A.

5 *See, e.g.*, Robin Sidel, *Gap in U.S. Bank Prosecutions Seen*, WALL ST. J. ONLINE (Nov. 11, 2012, 7:51 PM), http://online.wsj.com/article/SB10001424127887324073504578109451053220428.html (collecting cases); Gretchen Morgenson & Louise Story, *In Financial Crisis, No Prosecutions of Top Figures*, N.Y. TIMES, Apr. 14, 2011, at A1. Furthermore, the likelihood of any such prosecutions seems to be diminishing. Peter J. Henning, *Dim Prospects for Financial Crisis Prosecutions*, N.Y. TIMES DEALBOOK (May. 29, 2012, 3:13 PM), http://dealbook.nytimes.com/2012/05/29/dim-prospects-for-financial-crisis-prosecutions. *But see* Susan Pulliam et al., *U.S. Plans Charges on Bond Fraud*, WALL ST. J., Feb. 1, 2012, at A1 (describing the second-ever federal criminal prosecution of employees in major institutions related to the financial crisis, but noting that politicians and investors have "criticized federal prosecutors for not holding individuals on Wall Street criminally accountable for questionable activity during the crisis"); Evan Perez, *Ex-Bankers Are Charged with Fraud*, WALL ST. J., July 13, 2012, at C3 (discussing a "rare" criminal indictment filed by the U.S. Department of Justice against four executives at a regional bank in Virginia). Similarly, the federal government has not pursued *civil* actions against high-ranking individuals in connection with the financial crisis. *See, e.g.*, Jesse Eisinger, *Taking on the Little Guy, but Missing the Bigger Ones*, N.Y. TIMES DEALBOOK (May 2, 2012, 12:00 PM), http://dealbook.nytimes.com/2012/05/02/taking-on-the-little-guy-but-missing-the-bigger-ones.

Federal enforcement is not the only means by which the public's demand might be met, however. The executive branch has long acknowledged the role that state governments play in combating securities fraud, particularly in cases where the federal government has decided not to prosecute securities fraud criminally, or in recognition of circumstances in which state enforcement might be more effective.[6] For example, at the beginning of the twenty-first century, Attorney General Eliot Spitzer used a powerful New York anti-fraud statute known as the Martin Act to hold financial executives and their companies accountable for criminal securities fraud when the SEC or the U.S. Attorney's Office did not pursue the cases themselves.[7] But given the magnitude and scope of the damage that ensued from the most recent financial crisis, and the current media and political environment in which the financial industry has been subject to repeated attacks for its leading role, the substitution of state prosecution for federal enforcement would take on even greater significance this time. Indeed, Martin Act suits recently filed by New York State Attorney General Eric Schneiderman against Credit Suisse and a

[6] In some cases, federal law does not enable criminal enforcement, whereas state law might. *See infra* Part II.A. In other cases, political considerations may determine the jurisdiction in which enforcement takes place. *Id.* Regardless, a dual-enforcement scheme has existed for many years. *See, e.g.*, James J. Park, *The Competing Paradigms of Securities Regulation*, 57 DUKE L.J. 625, 651–62 (2007) (describing examples of the SEC following the lead of New York State); Eric Schneiderman & Beau Biden, *State AGs Target Mortgage Mess*, POLITICO (Nov. 6, 2011, 9:04 PM), http://www.politico.com/news/stories/ 1111/67702.html. *But see* Amanda M. Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173 (2010) (considering the costs and benefits of the longstanding but unquestioned tradition of simultaneous federal and state enforcement).

[7] *See* Robert A. McTamaney, *New York's Martin Act: Expanding Enforcement in an Era of Federal Securities Regulation*, 18 LEGAL BACKGROUNDER 1 (2003), *available at* www.wlf.org/upload/022803LB Mctamaney.pdf.

former Bear Stearns unit, now a part of JPMorgan Chase, have served as leading examples of this dynamic.[8]

Were New York State's Martin Act to return as a central means of *criminal* prosecution, however, its heightened use would inevitably prompt serious questions. Fundamentally, it is widely believed that the statute's culpability standards are weaker than those required for prosecution under federal law.[9] But the statute itself contains substantial ambiguities, which—with greater prominence—would be magnified, and thus raise two major concerns. First, most commentators believe that the Martin Act clearly establishes strict liability for misdemeanor securities fraud crimes.[10] Yet few have questioned whether it is "appropriate" to prosecute securities fraud as a strict liability crime under this statute? Second, because there have been so few reported cases, to which critics have paid even less attention,[11] New York courts have done little to coherently interpret mens rea under the felony provisions of the statute. As a result, they have never thoroughly explained exactly what showing of culpability is required for felony liability, or how their conclusions comport

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[8] However, the suits filed on November 20 and October 1, 2012, respectively, allege only *civil* violations of the Martin Act. *See* Christian Berthelsen & Nathalie Tadena, *N.Y. Attorney General Sues Credit Suisse Over Alleged Crisis-Era Fraud*, WALL ST. J. ONLINE (Nov. 20, 2012, 4:25 PM) http://online.wsj.com/article/SB10001424127887323713104578131384 221066990.html; Jean Eaglesham & Dan Fitzpatrick, *JPMorgan Sued on Mortgage Bonds*, WALL ST. J., Oct. 2, 2012, at A1. *But see* Peter J. Henning, *In JPMorgan Suit, a Lack of New News*, N.Y. TIMES DEALBOOK (Oct. 2, 2012, 6:16 PM), http://dealbook.nytimes.com/ 2012/10/02/in-the-j-p-morgan-suit-a-lack-of-new-news (pointing to evidence suggesting that further criminal charges were unlikely: only civil charges were filed, no individuals were named, and after all, the federal government could be said to have "pushed" Bear Stearns "into the arms of JPMorgan" during the financial crisis).

[9] *See, e.g.*, 19 DAVID J. KAUFMANN ET AL., MCKINNEY'S CONSOLIDATED LAWS OF NEW YORK ANNOTATED 6 (1996).

[10] *See infra* Part II.A.

[11] *See* Robert J. Anello, *Financial Crimes—The Martin Act: New York State Securities Fraud Statute*, *in* 4C COMMERCIAL LITIGATION IN NEW YORK STATE COURTS § 90:17, at 21, 25 (Robert L. Haig ed., 3d ed. 2010).

with the Martin Act's text and legislative history. The questions thus become: What mens rea requirement does the statute actually impose for these crimes, and can it be justified? As Professor Buell's quote underscores, there is an obvious problem with using a poorly understood and seemingly watered-down statute as a tool for holding senior corporate executives accountable for massive financial collapses. When governments use securities fraud to condemn individuals who are less than truly deserving, the power of criminal laws to define and sanction asocial behavior is dramatically weakened.[12]

This Note demonstrates that the mental state requirements for Martin Act Section 352-c misdemeanor and felony liability need to be clarified and more thoroughly supported, because the statutory text and legislative history are somewhat ambiguous, and the subsequent jurisprudence has failed to provide a coherent explanation for the current state of the doctrine. Nonetheless, the Martin Act's text, history and underlying policy rationale *can* be interpreted to support strict liability prosecutions for misdemeanor securities fraud, and to impose felony liability only for reckless violations of the statute.

Part II explains why the Martin Act may play an increasingly significant role in securities fraud prosecutions related to the financial crisis, but highlights the gap in understanding with regard to its mens rea requirements and the need to remedy this problem.

Part III explores the legislative text, history, and judicial construction of the Martin Act's criminal culpability standards. With regard to the misdemeanor provision, Part III demonstrates that a conflict currently exists between the statute's text and history, and its interpretation by New York courts. In fact, its background suggests that although the Martin Act is touted as a groundbreaking remedial weapon for combating securities fraud, the business community originally supported the statute only because it

12 *See* Buell, *supra* note 1, at 521–22.

was seen as a corporate-friendly initiative to sweep out low-level fraud that was suffocating the development of commerce. At the time it was enacted, it was not widely viewed as a tool for punishing senior executives. Instead, the statute's initial champions supported the Martin Act because its promulgation was seen as bringing New York law in line with federal law and the securities fraud statutes in force in other states. In recent decades however, New York courts have simply interpreted the Act as creating strict liability for misdemeanor violations, largely without acknowledging the tension between this reading and the statute's context.

Drawing conclusions about felony mens rea is similarly fraught with difficulty. While the plain language of the Martin Act's felony provisions seems to require criminal intent, the jurisprudence appears to have diluted this standard, and courts have poorly articulated specifically what showing of culpability now suffices for liability.

Part IV nevertheless seeks to determine which mental state requirements best satisfy the constraints of the forgoing authority in light of public policy. It shows how the interpretation that best reconciles the text and legislative purpose with the subsequent judicial construction is one that reads the Martin Act as creating strict liability for misdemeanor violations, but requires a showing of recklessness for felony prosecutions.

Part V concludes by assessing the impact that mens rea standards in the Martin Act have on the broader criminal securities fraud enforcement context.

II. THE MARTIN ACT IN 2012

Seeking to explain the culpability requirements for Martin Act misdemeanor and felony liability is an important endeavor for two primary reasons. First, in the context of a perceived shortfall in federal criminal enforcement, the New York State Attorney General's Office has asserted its intention to take on a leading role nationally in investigating securities fraud related to the mortgage meltdown.[13] Second, the Martin Act's mens rea standards—the major sources of protection for defendants against unfair prosecutions—are poorly understood.

A. A New Role in Prosecuting Financial Crimes

In the wake of the recent financial crisis and the severe damage it caused, there has been mounting public pressure for criminal enforcement action against the controlling officers of large financial institutions, whose actions, especially in the subprime mortgage market, were a significant cause of the global economic recession.[14] At first glance, the repeated calls for prosecutions against senior executives seem to have merit in light of much evidence of widespread fraud and serious wrongdoing, as revealed by federal investigations and other civil suits.[15] And yet,

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[13] Nelson D. Schwartz & Shaila Dewan, *Political Push Moves Mortgage Deal Inches Closer*, N.Y. TIMES, Jan. 24, 2012, at B1. It does not appear as though the recent multi-state mortgage fraud settlement will change this. Solomon L. Wisenberg, *Criminal Prosecutions Apparently Not Prohibited by Historic Mortgage Settlement Agreement*, WHITE COLLAR CRIME PROF BLOG (Feb. 9, 2012), http://lawprofessors.typepad.com/whitecollarcrime_blog/2012/02/criminal-prosecutions-apparently-not-prohibited-by-historic-mortgage-settlement-agreement.html (citing a U.S. Department of Justice press release explaining that the agreement does not prevent state authorities from pursuing criminal prosecutions related to mortgage fraud).

[14] *See supra* note 5; *see also Highlights Day 2: Chanos Bemoans Failure to Prosecute Bankers*, REUTERS, Dec. 6, 2011, *available at* http://reuters.com/article/2011/12/06/us-investment-summit-highlights-idUSTRE7B42CM20111206; Daniel Fisher, *Why Rogue Traders Get Jail But Bad Execs Get a Pension*, FORBES (Sept. 15, 2011, 12:43 PM), www.forbes.com/sites/danielfisher/ 2011/09/15/why-rogue-traders-get-jail-higher-ups-a-pension.

[15] *See* Gretchen Morgenson & Louise Story, *Naming Culprits in the Financial Crisis*, N.Y. TIMES, Apr. 13, 2011, at B1 (citing STAFF OF S. PERMANENT SUBCOMM. ON INVESTIGATIONS, COMM. ON HOMELAND SEC. AND GOV'T AFFAIRS 112TH CONG., WALL STREET AND THE FINANCIAL CRISIS: ANATOMY OF A FINANCIAL COLLAPSE (Comm. Print 2011), *available at* hsgac.senate.gov/imo/media/doc/Financial_Crisis/FinancialCrisisReport.pd

despite the worldwide crisis, federal prosecutions for financial institution fraud "have tumbled over the last decade."[16] Although the total number of federal prosecutions has been rising,[17] according to an analysis of Justice Department data, criminal enforcement action against banks have fallen by twenty-nine percent in the last five years, and by almost sixty percent since 2001.[18] And no senior financial executives have been criminally prosecuted in connection with the actual crisis itself.[19]

Explanations for this state of affairs abound. The complete absence of criminal enforcement actions may be due to an insufficient allocation of resources to the investigative agencies responsible for presenting evidence of

f); Jesse Eisinger, *On Wall Street, Some Insiders Express Quiet Outrage*, N.Y. TIMES DEALBOOK (Nov. 30, 2011, 12:15 PM), http://dealbook.nytimes.com/2011/11/30/on-wall-street-some-insiders-express-quiet-outrage (observing that even insiders report "malfeasance at literally all the investment banks"); *Prosecuting Wall Street* (CBS television broadcast Dec. 4th, 2011), www.cbsnews.com/video/watch/ ?id=7390540n (noting with concern the lack of Wall Street prosecutions "even though fraud and financial misrepresentations played a significant role in the meltdown").

16 Catherine Rampell, *Prosecutions for Bank Fraud Fall Sharply*, N.Y. TIMES ECONOMIX BLOG (Nov. 15, 2011, 4:33 PM), http://economix.blogs.nytimes.com/2011/11/15/prosecutions-for-bank-fraud-fall-sharply.

17 *Id.* (noting that federal criminal prosecutions have nearly doubled in the last decade).

18 *Criminal Prosecutions for Financial Institution Fraud Continue to Fall*, TRANSACTIONAL RECORDS ACCESS CLEARINGHOUSE (Nov. 15, 2011), http://trac.syr.edu/tracreports/crim/267.

19 *Prosecuting Wall Street*, *supra* note 15. *See also* Andrew Ross Sorkin, *Nowadays, Wall Street Saviors May Wish They Weren't*, N.Y. TIMES, Oct. 16, 2012, at B1 (noting that "few of the lawsuits that the government has brought against the banks have anything to do with the culpability of those individuals who were actually responsible for the problems" that caused the crisis); Peter J. Henning, *Is That It for Financial Crisis Cases?*, N.Y. TIMES DEALBOOK (Aug. 13, 2012, 11:22 AM), http://dealbook.nytimes.com/2012/08/13/is-that-it-for-financial-crisis-cases/ ?hp (noting that—as is the case for senior executives too—it "does not look as if any other criminal cases against other banks are likely to emerge from the financial crisis now that four years have gone by").

financial fraud to prosecutors.[20] But some have suggested that officials in the federal government hesitated to pursue criminal enforcement action aggressively because of the impact it might have on the financial markets, which were already severely weakened.[21] More cynically, others suspect that any financial fraud investigations stemming from the crisis would eventually inculpate federal regulators themselves.[22] Finally, because financial executives often solicited advice from outside parties such as accountants and lawyers, their reliance on experts may have "shelter[ed] them from some potential charges."[23]

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[20] *See* Morgenson & Story, *supra* note 5 (observing further that "the same dynamic that helped enable the crisis—weak regulation—also made it harder to pursue fraud in its aftermath").

[21] *Id.* This supposition however, seems somewhat contradicted by the many *civil* enforcement actions that have been brought against large financial institutions and individuals. In fact, it is in civil proceedings that the institutions themselves—as opposed to individual executives—stand to lose the most in economic terms.

[22] *The Case Against Lehman Brothers* (CBS television broadcast Apr. 22, 2012), *available at* www.cbsnews.com/video/watch/?id=7406224n (suggesting that despite the availability of sufficient evidence to prosecute senior executives at Lehman Brothers for securities fraud, the federal government was discouraged form pursuing enforcement action out of concern that regulators were at least partially responsible); Louise Story & Gretchen Morgenson, *Financial Finger-Pointing Turns to Regulators*, N.Y. TIMES, Nov. 22, 2011, at A1. At the very least, many question the close relationship between the regulators and the regulated. *See* Nathan Pippenger, *Is the Government's Watchdog All Bark and No Bite?*, NEW REPUBLIC (Jan. 17, 2009, 12:00 AM), http://www.tnr.com/aritcle/politics/99677/fannie-mae-freddie-mac-securities-fraud (noting that enforcement actions against "friends in high places" may prove "politically disastrous"); Solomon L. Wisenberg, *Libor: The Regulatory Mind and the Prosecutorial Mind*, WHITE COLLAR CRIME PROF BLOG (July 11, 2012), http://lawprofessors.typepad.com/ whitecollarcrime_blog/2012/07/libor-the-regulatory-mind-and-the-prosecutorial-mind.html (suggesting that regulators approach investigating financial fraud with a fundamentally different attitude, overlooking signals that prosecutors would otherwise interpret as potential red flags).

[23] Morgenson & Story, *supra* note 5; *see also* Reed Albergotti, *Holder to Wall Street: It Ain't Over Yet*, WALL ST. J. L. BLOG (Feb. 24, 2012, 12:11 PM), http://blogs.wsj.com/law/2012/02/24/holder-to-wall-street-it-aint-over-

Ultimately, however the prosecution of any criminal case turns on the ability of the government to satisfy its burden of proof. Thus the primary reason why no high-ranking Wall Street executive has faced criminal charges for any wrongdoing that might have contributed to the financial crisis may be the difficulty faced by the government in its obligation to prove mens rea.[24] In order to successfully prosecute a defendant for financial fraud under federal law, the government is required to prove intentional deceit, and prosecutors may not believe that a jury could be persuaded that any potential defendant is guilty beyond a reasonable doubt.[25] Some analysts have therefore concluded that the "paucity of criminal prosecutions from the financial crisis shows that the real difficulty lies in *gathering evidence to prove* a crime took place."[26]

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yet/?mod=WSJBlog (citing Attorney General Eric Holder's observation that senior executives "understood where the lines were and they went right up to those lines").

[24] Jean Eaglesham, *Financial Crimes Bedevil Prosecutors*, WALL ST. J., Dec. 6, 2011, at C1; Henning, *supra* note 19.

[25] *See* Joe Palazzolo, *An Ex-FBI Official Explains Lack of Convictions Tied to Financial Crisis*, WALL ST. J. L. BLOG (Dec. 6, 2011, 9:37 AM), http://blogs.wsj.com/law/2011/12/06/an-ex-fbi-agent-explains-lack-of-convictions-tied-to-financial-crisis (explaining that federal officials were "wary of bringing to trial criminal prosecutions where a jury might decide the losses were due to bad judgment or market conditions, not deceit"); Peter J. Henning, *The Limits of Bigger Penalties in Fighting Financial Crime*, N.Y. TIMES DEALBOOK (Dec. 12, 2011, 4:03 PM), http://dealbook.nytimes.com/2011/12/12/the-limits-of-bigger-penalties-in-fighting-financial-crime (underscoring the difficulties involved in meeting the higher standard of proof).

[26] Henning, *supra* note 19 (emphasis added). The "classic defense" for senior corporate officers is that "they were not directly involved and therefore did not have the intent to mislead." *Id.* It is, of course, possible that no financial executive is actually guilty of any intentional fraud, however. *See* Eaglesham, *supra* note 24 ("Many legal experts have said much of the most controversial behavior likely was a product of poor judgment, not criminal wrongdoing."); Peter Lattman, *Holder Defends Efforts to Fight Financial Fraud*, N.Y. TIMES DEALBOOK (Feb. 23, 2012, 9:30 PM), http://dealbook.nytimes.com/2012/02/23/holder-defends-efforts-to-combat-financial-fraud (explaining that conduct leading to the financial

Still, whatever the real cause is, the lack of federal prosecutions has underscored again the importance of state Attorneys General taking the lead in bringing criminal enforcement actions for massive financial fraud.[27] In New York, the location of corporate headquarters for many senior financial executives, the major prosecutorial tool used by the Attorney General to combat financial fraud is Section 352-c of the New York General Business Law, otherwise known as the Martin Act. The Act was first made famous during former Attorney General Eliot Spitzer's crusade against Wall Street in the early 2000s.[28] Moreover, from 2008–2010 this statute served as the basis for over forty securities fraud actions against financial institutions,[29] and is a "powerful" means of enforcement at present.[30]

The Martin Act is of special concern among all other financial fraud statutes though, because it confers "the broadest and most easily triggered investigative and prosecutorial powers of any securities regulator, state or federal."[31] Not only is the New York State Attorney General uniquely situated geographically to prosecute securities fraud, but what makes the Martin Act truly worthy of extraordinary attention is "the scope of its investigatory

crisis, "while morally reprehensible—may not necessarily have been criminal").

[27] *See, e.g.*, William K. Black, *2011 Will Bring More De Facto Decriminalization of Elite Financial Fraud*, HUFFINGTON POST (Dec. 28, 2010, 5:29 PM), www.huffingtonpost.com/william-k-black/the-role-of-the-criminal_b_802115.html (suggesting that state investigations have been more extensive than those conducted at the federal level).

[28] Anello, *supra* note 11, at 21–22.

[29] David A. Markowitz, *New York Attorney General's Office Martin Act Enforcement Actions 2008–2010*, 1836 PLI/CORP 85 (2010).

[30] *See* Eaglesham & Fitzpatrick, *supra* note 8; Eric Dash and Peter Lattman, *U.S. and New York Sue Bank of New York Mellon Over Foreign Exchange Fees*, N.Y. TIMES, Oct. 4, 2011, at B3 (noting that "[b]y taking advantage of the powerful New York state securities law known as the Martin Act," the Attorney General has brought New York State to the front of the stage in financial crimes prosecutions).

[31] KAUFMANN ET AL., *supra* note 9, at 9.

power, the breadth of its jurisdiction, and the combination of civil and criminal authority at the [A]ttorney [G]eneral's disposal."[32] Most significantly, the literature claims that the Attorney General apparently "need not allege or prove scienter or intentional fraud in order to establish liability in an enforcement proceeding under the Martin Act."[33] The statute's potent nature therefore serves to demonstrate—at an extreme end—the extent to which state securities fraud enforcement actions could supplement, if not substitute for,

[32] Aaron M. Tidman, Note, *Securities Law Enforcement in the Twenty-First Century: Why States Are Better Equipped than the Securities and Exchange Commission to Enforce Securities Law*, 57 SYRACUSE L. REV. 379, 389 (2007). For example, unlike any other jurisdiction, under the Martin Act the Attorney General has both civil and criminal authority. KAUFMANN ET AL., *supra* note 9, at 11. This means that an investigation that began initially as only a civil proceeding may terminate in criminal penalties. Anello, *supra* note 11, at 24. Upon conducting an investigation, the AG may secretly compel written testimony or witnesses themselves either in his office or before a judge, without a grand jury. Frank C. Razzano, *The Martin Act: An Overview*, 1 J. BUS. & TECH. L. 125, 130 (2006). In contrast to FED. R. CIV. P. 6(e), it is a misdemeanor for witnesses to disclose the name of any witness or information provided. Razzano, *supra*, at 130. The AG may also bring a public investigation by filling out an order to a State supreme court, in which the judge has almost no discretion. Razzano, *supra*, at 130. "The shock value and potential business damage of having a criminal investigation conducted in public gives the Attorney General awesome power." Anello, *supra* note 11, at 22. In addition, because Martin Act requests may be purely investigatory, rather than adjudicatory, it has been held that witnesses have no constitutional right to counsel. *Id.* at 23–24. And under the Martin Act's substantive law, there need not have been any sale or transaction, nor must the Attorney General demonstrate reliance, for a defendant to be criminally liable. 72 N.Y. JUR. 2D INVESTMENT SECURITIES §§ 228, 232 (2012). Finally, the Attorney General may seek to recover not just ill-gotten gains, but may also include restitution in an enforcement action. N.Y. GEN. BUS. LAW § 353(3) (McKinney 2012).

[33] INVESTMENT SECURITIES, *supra* note 32, § 232 (2012). *See also* KAUFMANN ET AL., *supra* note 9, at 31; *infra* Part III.C (discussing the distinction between the mens rea showing required for civil versus criminal liability, and between criminal misdemeanor and felony liability under the Martin Act).

the lack of federal prosecutions stemming from the financial crisis.[34]

Yet if the Martin Act is to take on a significant role in holding senior financial executives criminally accountable for the global financial crisis, the expansive reach of the statute deserves much closer scrutiny. Under a criminal liability regime in which the major goals are general deterrence and signaling to the public what constitutes wrongful conduct, the lack of an intent requirement carries added danger.[35] The more the mens rea element in a statute is watered down, the less successfully the public will be able "to identify instances of seriously culpable wrongdoing from among the great mass of all market failings."[36] Thus, when a prosecutor is given a powerful, expansive tool like the Martin Act, particularly

> [i]n the context of securities fraud—in which the enforcement system is selecting and identifying bad actors from enormously important markets that are vital to the American economic engine—insisting that the standard for criminal fault be both high and clear and that it be closely tethered to a conception of genuine core fraud seems uncontroversial.[37]

In reality, however, the standard of culpability required for a defendant to be criminally liable under the Martin Act is not clear and may not be very high. Despite the certainty

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[34] *See* Michael J. de la Merced, *In JPMorgan Case, the Martin Act Rides Again*, N.Y. TIMES DEALBOOK (Oct. 2, 2012, 12:06 PM), http://dealbook.nytimes.com/2012/10/02/in-jpmorgan-case-the-martin-act-rides-again (describing a recent civil Martin Act suit against JPMorgan as showcasing "one of the legal weapons most feared on Wall Street"); Tidman, *supra* note 32, at 381–82 (arguing that the Attorney General's use of the Martin Act "has proven that state securities law enforcement has been more effective than federal securities law enforcement in the twenty-first century").

[35] *See* Buell, *supra* note 1, at 575–76. The U.S. Supreme Court has not yet established the intent requirement for criminal liability under the securities fraud statutes. *See id.* at 556.

[36] *Id.* at 575.

[37] *Id.* at 573.

underlying many commentators' treatment of the Martin Act, there is in fact substantial ambiguity as to what mental state is actually required by the statute for either a felony *or* misdemeanor violation.[38] For a statute that has been amended several times, it is not surprising that the statutory language leaves "some question" as to the answer.[39] Even where the text does seem clear, it may nevertheless conflict with the Martin Act's legislative history.[40] Unfortunately, very few reported decisions construe the misdemeanor provision of the Martin Act.[41] Further, the New York Court of Appeals has never clearly or directly established what level of culpability must be proven to establish a felony violation.

While the Court of Appeals once observed that the Martin Act reaches deceptive or misleading conduct "even absent proof of scienter or intent"[42] in criminal misdemeanor cases, this determination constituted nothing more than dictum. The lower courts have also interpreted the statute inconsistently, producing "judicial fogginess about fault standards and the distinction between fraud and misrepresentation."[43] With regard to misdemeanors, those courts have alternatively concluded that the statute creates strict liability,[44] or "a less burdensome standard," than intent, which would only require a defendant's "intentional or knowledgeable conduct."[45] With regard to felonies, decisions accepting proof of knowledge as giving rise to the

38 *See* Anello, *supra* note 11, at 24–25.

39 *Id.*

40 *See infra* Part III.B.

41 Anello, *supra* note 11, at 24–25.

42 People v. Landes, 645 N.E.2d 716, 717–18 (N.Y. 1994).

43 Buell, *supra* note 1, at 559 n.172.

44 *See* People v. Barysh, 408 N.Y.S.2d 190, 193–94 (Sup. Ct. 1978) (holding that "no intent to defraud is required for a violation of the statute").

45 *See, e.g.*, People v. Florentino, 456 N.Y.S.2d 638, 645 (Crim. Ct. 1982).

inference of intent[46] have raised the question of whether lower New York courts have actually watered down the felony intent requirement, or merely recognize a lower evidentiary burden. These cases thus evince two distinct areas of uncertainty in the Martin Act's culpability requirements for criminal liability: (1) whether a criminal misdemeanor conviction can truly be supported on a strict liability basis; and (2) whether anything less than "intentional fraud" suffices to establish a felony violation.

The Martin Act's lack of clarity and weakened culpability requirements may be deeply troubling for both commentators and, more importantly, the senior financial executives potentially subject to the statute's powerful reach.[47] Most significantly, the requirement that a prosecutor establish a particular defendant's mens rea serves "an important role in protecting those who do not intend to commit wrongful or criminal acts from prosecution and conviction."[48] There has also been a longstanding concern—particularly in the case of financial fraud—that "[p]rosecutors are given too much latitude in pursuing perceived wrongdoers whose conduct [is not] explicitly proscribed by statutory language."[49] Moreover, the importance of "preserving the expressive force of the concept of fraud" implies that "one should want to reserve fraud doctrine for serious wrongs . . . which might include limiting liability for securities fraud to cases of purposeful deception or its near equivalent."[50] Since, at the very least, the statute

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46 *See, e.g.*, People v. Sala, 695 N.Y.S.2d 169, 177–178 (App. Div. 1999), *aff'd*, 739 N.E.2d 727 (N.Y. 2000).

47 *See generally* Buell, *supra* note 1.

48 Gary Fields & John R. Emshwiller, *Federal Offenses: As Federal Crime List Grows, Threshold of Guilt Declines*, WALL ST. J., Sept. 27, 2011, at A1. *See generally* Michael L. Seigel, *Bringing Coherence to Mens Rea Analysis for Securities-Related Offenses*, 2006 WIS. L. REV. 1563 (2006).

49 Harvey Silvergate, *Protecting Investors or Prosecuting Innocents? The Dangers of Vagueness in Financial Fraud Laws*, THE VOLOKH CONSPIRACY (Dec. 16, 2009, 9:22 AM), http://volokh.com/2009/12/16/vagueness-in-financial-fraud-laws.

50 Buell, *supra* note 1, at 576.

dilutes traditional notions of criminal culpability, and the subsequent jurisprudence is unclear, there is a pressing need to examine the Martin Act in more searching detail. If the Martin Act is to become an important means of seeking redress for the wrongdoing that led to the financial crisis,[51] its limits must be better understood.

B. A Lack of Critical Attention

Despite its role as the primary enforcement mechanism used by the New York State Attorney General to prosecute financial crimes, the Martin Act has not received nearly the same degree of attention in the literature as the analogous federal provisions have. This is particularly surprising because the Martin Act served as the model statutory language for Congress when it drafted Section 17 of the Securities Act of 1933,[52] which the Department of Justice employs in its own criminal securities fraud prosecutions. The SEC, in turn, drew heavily from Section 17 in drafting Rule 10b-5.[53] Moreover, the Martin Act served as the statutory basis for former New York State Attorney General Eliot Spitzer's widely publicized crusade against financial fraud on Wall Street following the stock market collapse in 2000, which did in fact thrust a greater amount of attention on the statute.[54]

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51 There is strong evidence to suggest that New York's investigation of securities fraud related to the 2008 financial crisis will continue. *See* David McLaughlin, *N.Y. Mortgage Probe Said to Get Extension to Sue 12 Firms*, BLOOMBERG, Oct. 4, 2012, *available at* www.bloomberg.com/news/2012-10-04/n-y-mortgage-probe-said-to-get-extension-to-sue-12-firms.html (describing tolling agreements between the Attorney General and financial institutions that preserve civil claims despite the expiration of the six-year statute of limitations); Shahien Nasiripour, *States Win Right to Block $8.5bn BofA Settlement*, FT.COM, Nov. 22, 2011, http://www.ft.com/intl/cms/s/0/d0c70a66-1496-11e1-85c7-00144feabdc0.html (noting that New York State has "vowed to investigate wrongdoing on Wall Street").

52 *See* Buell, *supra* note 1, at 541 n.88.

53 *Id.* at 541.

54 *See* Kulbir Walha & Edward E. Filusch, Note, *Eliot Spitzer: A Crusader Against Corporate Malfeasance or a Politically Ambitious*

At the same time, the Martin Act has been used far fewer times in *criminal* prosecutions than in civil actions.[55] Even where the Attorney General pursues criminal charges, there is tremendous pressure on defendants to settle, largely as a result of the tremendous prosecutorial leverage provided by the statute.[56] But this does not make critical analysis of the Martin Act any less important; on the contrary, it has been described alternatively as "the legal equivalent of a weapon of mass destruction," and as a statute with "an unlimited capacity for good."[57] At the very least, these descriptions illustrate the Martin Act's significant impact on securities fraud enforcement.

Still, despite the absence of clear guidance from the New York Court of Appeals,[58] no published work has ever focused on fully defining and explaining Section 352-c's culpability requirements in a way that reconciles the text, legislative history, and existing jurisprudence. Where mens rea under the Martin Act *has* received critical attention, it has most often been in the context of its relationship the federal securities fraud enforcement regime.[59] Other commentators

Spotlight Hound? A Case Study of Spitzer and Marsh & McLennan, 18 GEO. J. LEGAL ETHICS 1111, 1114 (2005).

55 *See generally*, Markowitz, *supra* note 29 (detailing the Attorney General's Martin Act enforcement actions from 2008–2010).

56 *See supra* Part II.A.

57 Nicholas Thompson, *The Sword of Spitzer*, LEGAL AFF., June 2004, at 50.

58 *See supra* Part II.A.

59 *See, e.g.*, Tidman, *supra* note 32, at 389–92. *See also* Park, *supra* note 6, at 630 (highlighting Spitzer's deployment of the Martin Act as an example of a "principles-based enforcement action," in contrast to the SEC's more predictable administrative regulatory scheme); Walha & Filusch, *supra* note 54, at 1117–18 (comparing Martin Act powers to the SEC's); Wendy Gerwick Couture, *White Collar Crime's Gray Area: The Anomaly of Criminalizing Conduct Not Civilly Actionable*, 72 ALB. L. REV. 1, 17–18 (2009) (concluding that the breadth of conduct incurring criminal liability under the Martin Act is broader than that which might be under federal securities laws); Johnathan Mathiesen, Note, *Dr. Spitzlove or: How I Stopped Worrying and Learned to Love "Balkanization"*, 2006 COLUM. BUS. L. REV. 311, 323 (2006) (observing the competitive advantage over

have gone further, and directly address the history of the Martin Act to explain its culpability requirements.[60] But even those analyses that recognize the legislative materials only do so in brief, and accept the various New York courts' pronouncements regarding men's rea at face value, without necessarily attempting to distinguish between civil and criminal cases, or misdemeanor and felony violations.[61] Although Professor Buell goes the furthest in detailing the extent of the uncertainty,[62] a comprehensive examination of mens rea under the Martin Act was outside the scope of his study.

This Note therefore has two important roles to play in shaping a better understanding of criminal intent under Section 352-c. The first role is to determine, in light of what previous commentators have suggested, specifically which mental state requirements best comport with both the legislative history and the relatively few judicial opinions construing the Martin Act for both misdemeanor and felony criminal liability. Based on that finding, the second role is to assess the normative arguments about the standards of criminal culpability for securities fraud under the Martin Act. Although these questions are not new, the 2008 financial crisis and the nature of the wrongdoing at its core

federal regulators provided to New York State Attorneys General by the Martin Act).

60 *See, e.g.*, KAUFMANN ET AL., *supra* note 9, at 13–14; Lydie Nadia Cabrera Pierre-Louis, *Hedge Fund Fraud and the Public Good*, 15 FORDHAM J. CORP. & FIN. L. 21, 34–35 (2009) (citing the historical evolution of the statute as an explanation for its broad reach).

61 *Compare* Razzano, *supra* note 32, at 129 ("A showing of neither intent nor scienter is required to prove a violation of the Act and sustain civil or criminal culpability, unless a felony is charged."), *and* Couture, *supra* note 59, at 17 (asserting that the Martin Act "essentially eliminates the scienter requirement"), *with* Anello, *supra* note 11, at 25 (concluding that there is "some question as to the exact nature of the intent requirement" under the Martin Act's misdemeanor provision), *and* Buell, *supra* note 1, at 559 n.172 (noting the "judicial fogginess" surrounding Martin Act culpability requirements).

62 *See* Buell, *supra* note 1, at 559 n.172.

suggest that, at a minimum, the previous understanding be reevaluated.

III. CRIMINAL INTENT IN THE MARTIN ACT'S TEXT, HISTORY, AND CONSTRUCTION

To better understand the mens rea requirements under the Martin Act, the initial inquiry is descriptive. First, does the statute's text clearly specify which levels of culpability will be required for misdemeanor and felony charges? If not, does the legislative history behind the Martin Act support any particular interpretation? Next, how have New York courts interpreted the statute? Have they defined the mental state requirements for misdemeanor and felony liability with any greater precision than the text or history alone provide? Lastly, how do these sources of interpretation comport with prior analyses?

A. Criminal Liability Under the Martin Act: Section 352-c

Section 352-c of the New York General Business Law ("Prohibited acts constituting misdemeanor; felony") establishes the core of criminal liability under the Martin Act.[63] Subsection 4 establishes misdemeanor liability for "using or employing any act or practice declared to be illegal

[63] Section 359-g ("Violations and Penalties") also creates misdemeanor liability for a violation of any other provision in Article 23-A of the General Business Law, and for violating an injunction obtained under the Martin Act. N.Y. GEN. BUS. LAW § 359-g(1)(a) (McKinney 2012). *See also* Razzano, *supra* note 32, at 128 (noting that misdemeanor liability may be created during the investigatory stage as well). In addition, under Section 359-g(1)(a) a defendant can be found guilty of a Class E felony if, within five years of having violated any provision of the Martin Act or having committed a felony-level financial fraud in another jurisdiction, the defendant is found guilty of violating any provision in the Martin Act. BUS. § 359-g(1)(a).

and prohibited by [Sections 352-c(1)–(3)] . . . ."[64] Under Subsection 1, the Martin Act prohibits

> (a) Any fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale;
> (b) Any promise or representation as to the future which is beyond reasonable expectation or unwarranted by existing circumstances;
> (c) Any representation or statement which is false, where the person who made such representation or statement:
>
> > (i) knew the truth; or
> > (ii) with reasonable effort could have known the truth; or
> > (iii) made no reasonable effort to ascertain the truth; or
> > (iv) did not have knowledge concerning the representation or statement made;
>
> where engaged in to induce or promote the issuance, distribution, exchange, sale, negotiation or purchase within or from this state of any securities or commodities, as defined in [the Martin Act], regardless of whether issuance, distribution, exchange, sale, negotiation or purchase resulted.[65]

According to Subsection 2, it is illegal "to engage in any artifice, agreement, device or scheme to obtain money, profit or property by any of the means prohibited by [Section 352-c]."[66] And Subsection 3 prohibits an entity engaged in the sale of securities or commodities—as defined in Section 352—from representing itself as an "exchange" unless that entity "is in fact registered as an exchange with either the [SEC] or the [CFTC]."[67]

64 BUS. § 352-c(4).

65 § 352-c(1).

66 § 352-c(2).

67 KAUFMANN ET AL., *supra* note 9, at 31.

A violation of either Subsection 5 or 6, however, creates Class E felony liability.[68] Subsection 5 punishes a defendant

> who intentionally engages in any scheme constituting a systematic ongoing course of conduct with intent to defraud ten or more persons or to obtain property from ten or more persons by false or fraudulent pretenses, representations or promises, and so obtains property from one or more of such persons while engaged in inducing or promoting the issuance, distribution, exchange, sale, negotiation or purchase of any securities or commodities, as defined in [Article 23-A of the New York General Business Law] . . . .[69]

Subsection 6 also establishes felony liability for a defendant

> who intentionally engages in fraud, deception, concealment, suppression, false pretense or fictitious or pretended purchase or sale, or who makes any material false representation or statement with intent to deceive or defraud, while engaged in inducing or promoting the issuance, distribution, exchange, sale, negotiation, or purchase within or from this state of any securities or commodities, as defined in [Article 23-A of the General Business Law], and thereby wrongfully obtains property of a value in excess of two hundred fifty dollars . . . .[70]

Thus, read in isolation, the Martin Act is silent on mens rea for misdemeanor liability under Subsections 1(a)–(b), 2, and 3. Subsection 1(c)(iv), however, seems to establish criminal liability independent of mental state by prohibiting

68 For Class E felonies in New York, the minimum punishment is one year's imprisonment, and the maximum is three to four years' imprisonment. N.Y. PENAL LAW §§ 70.00-2(e), 70.00-4 (McKinney 2012).

69 N.Y. GEN. BUS. LAW § 352-c(5) (McKinney 2012). The Martin Act (Section 352) is itself a subsection of Chapter 20, Article 23-A (Fraudulent Practices in Respect to Stocks, Bonds and Other Securities) of the New York General Business Law.

70 BUS. § 352-c(6).

false representations even when the speaker does not know of their falsity. Nonetheless, construing Subsections 1(a), 2, and 3 as establishing strict liability for misdemeanor violations appears to conflict with a natural reading of the statutory language.

One interpretation of Subsection 1(a)'s language of "fraud," "deception," "concealment," "suppression," and "pretended" is that the statute prohibits only conduct undertaken with the goal of keeping the truth from the victim.[71] Similarly, the connotation of "artifice," "device," and "scheme" in Subsection 2 suggests a requirement that the actor have a conscious plan designed for the purpose of deception. This interpretation is bolstered by the presence of Subsection 1(c), which distinguishes misrepresentations from other types of fraud, and carefully highlights the mental states, including knowledge, by which a defendant can be criminally liable for false statements.[72] Subsections 1(b) and 3 provide even less guidance on which mental states are sufficient for criminal liability.[73] Finally, absent other indicia of legislative intent, the presumption in New York is against strict liability crimes.[74] As a result, the question of whether misdemeanor violations under the Martin Act may be prosecuted on a strict liability basis is largely unanswered by the text itself.

The Martin Act's felony liability provisions are more explicit about the requisite mental state for establishing a violation: both Subsections 5 and 6 condition criminal liability on intentional conduct.[75] But this heightened

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[71] *See* Buell, *supra* note 1, at 526–33 (distinguishing between instances of "core fraud," where the actor has the explicit purpose of deceiving the victim to obtain property, and "misrepresentations," where the relevant inquiry is into the effect of the actor's conduct on the victim, regardless of the actor's purpose).

[72] *See* BUS. § 352-c(1)(c).

[73] *See* § 352-c(1)(b), (3).

[74] N.Y. PENAL LAW § 15.15(2) (McKinney 2012) ("A statute defining a crime, unless clearly indicating a legislative intent to impose strict liability, should be construed as defining a crime of mental culpability.").

[75] N.Y. GEN. BUS. LAW § 352-c(5), (6) (McKinney 2012).

requirement may be weakened in practice. As an evidentiary matter, the mens rea standard may be diluted because prosecutors are permitted to argue in securities fraud cases that "facts showing a defendant's indifference to the truth of her representations tend to support the inference that she intended to deceive the listener."[76] Consequently, defendants are routinely found guilty of intentional fraud without direct proof of criminal intent.[77] More dramatically, however, the few courts that have addressed the question have interpreted the felony provision as not actually requiring proof of intent *as an element* of the crime. Instead, those courts read the statute to require something less.[78] As a result, whatever meaning the Martin Act has taken on, it is surely not one based exclusively on the text alone. Further analysis is therefore necessary to clarify specifically which levels of culpability are required to hold defendants liable for either felony or misdemeanor violations.

B. The Martin Act's Legislative History

In the absence of clearer language in the text, the legislative history behind the enactment of the statute has a significant role to play in determining which mental state the Martin Act requires for criminal liability in the misdemeanor and felony contexts. Moreover, in New York, legislative intent is the *primary* tool used in statutory

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76 Buell, *supra* note 1, at 560.

77 *See* Couture, *supra* note 59, at 26 ("Although the criminal mental states are more stringent than civil scienter, this difference is diminished by the practicality of how a defendant's mental state is proven at trial.").

78 *See, e.g.*, People v. Sala, 695 N.Y.S.2d 169, 177 (App. Div. 1999), *aff'd*, 739 N.E.2d 727 (N.Y. 2000) (holding that in a felony case "neither scienter nor an intent to defraud need be proven in order to establish liability under the Martin Act. . . . Rather, the People need only prove that the defendant committed an intentional act constituting fraud" (citations omitted)). The issue raised by a case like this is whether a defendant may be shown to have committed an *intentional* criminal act in the absence of proof of criminal intent. *See infra* Part IV.B.

interpretation, even where the text seems clear.[79] New York courts also follow the plain meaning of the statute's language, but "[l]egislative intent drives judicial interpretations in matters of statutory construction . . . ."[80] Furthermore, at least for the misdemeanor provision, the presumption against strict liability crimes similarly requires consulting legislative materials in the case of ambiguous text.[81] Under Penal Law Section 15.15, New York courts have consistently refused to construe statutes as enacting crimes of strict liability without clear legislative intent.[82] Thus, where the language of Section 352-c itself fails to provide a conclusive answer, the Martin Act's legislative history plays an essential role.[83] And the scarcity[84] of felony cases actually decided by judicial opinion results in a similarly heightened need to consult historical resources.

The Martin Act was first enacted in 1921, in response to the increasing use of the corporate form and public knowledge of widespread dishonesty among securities dealers, who "had become accustomed to pursuing fraudulent practices whereby the rights of their customers were violated and, on occasion, the public widely victimized."[85] Modeled

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79 *See* N.Y. STAT. LAW § 92(a) (McKinney 2012) ("The primary consideration of the courts in the construction of statutes is to ascertain and give effect to the intention of the Legislature.").

80 People v. Santi, 818 N.E.2d 1146, 1151–53 (N.Y. 2004) (drawing on the legislative history underlying the statute to arrive at the "only reasonable interpretation").

81 *See* N.Y. PENAL LAW § 15.15(2) (McKinney 2012).

82 *See* People v. Campbell, 532 N.E.2d 86, 90 (N.Y. 1988) (holding that "[in] the absence of a clear legislative intent to impose strict criminal liability, such construction should not be adopted").

83 *Id.* ("We have held offenses to be of the strict liability variety where the statute specifies only an *actus reus*, where the purpose of the law suggests that it is a strict liability offense and where the legislative history indicates an intent that the offense was one of strict liability.").

84 *See infra* Part III.C.2.

85 KAUFMANN ET AL., *supra* note 9, at 11.

after the so-called "blue sky laws"[86] previously enacted by other states,[87] the Martin Act, named after the Assemblyman who introduced the statute, Louis M. Martin, essentially "enshrined the principle 'thou shall not commit fraud' into state law."[88] As a result, the first New York Attorney General to aggressively use the Martin Act to pursue securities fraud,[89] Albert Ottinger, was able to convince New York courts that, because the statute was remedial in nature, it should be broadly construed. It was therefore "given a wide meaning so as to include all acts, although not originating in any actual evil design or contrivance to perpetrate fraud or injury upon others, which *do by their tendency to deceive or mislead* the purchasing public come within the purpose of the law."[90]

Nonetheless, there were meaningful limitations on the Attorney General's power under the statute in its original form. For example, the Martin Act provided for automatic immunity "to anyone who testified under [the statute] or even answered questions."[91] More importantly however, the statute provided only for civil penalties to combat securities fraud—in the form of injunctive relief—"which was felt to be sorely inadequate to protect the public from conduct that was

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[86] *See* Thompson, *supra* note 57, at 51 (noting the name was derived from "hustlers who, the story went, would sell shares of the blue sky" if they could find buyers).

[87] *See* Buell, *supra* note 1, at 541 n.88.

[88] Pierre-Louis, *supra* note 60, at 34. *See also* KAUFMANN ET AL., *supra* note 9, at 13 (noting that the Commission behind the statute's enactment expressed a desire for the Attorney General to "obtain more information in respect to the issuance and negotiation of securities than any one could be required to give under any statute which has been enacted or contemplated").

[89] Thompson, *supra* note 57, at 51. Prior to 1925, however, the Martin Act was barely used, and New York spent "almost nothing" on enforcement. *Id.*

[90] People v. Federated Radio Corp., 154 N.E. 655, 657 (N.Y. 1926) (emphasis added).

[91] Thompson, *supra* note 57, at 51.

misleading or deceptive."[92] Nicholas Thompson even argues that the Martin Act was "deliberately enfeebled" by the large financial companies that dominated New York politics, for whom "[a] simple fraud statute seemed like a good way to swat down small-time sharks and keep the field open for themselves," by excluding any registration requirement.[93]

This interpretation of the Martin Act's genesis is consistent with historical analyses of the efforts of large financial corporations to self-regulate in the 1920s and 1930s.[94] At that time, "leading capitalists became sufficiently anxious about the issue of deceptive commercial speech to create a series of nonprofit business organizations . . . all primarily dedicated to rooting out fraud in the American marketplace."[95] Although these organizations, like the Investment Bankers Association, the New York Stock Exchange, and the Better Business Bureaus "strenuously advocated the adoption of state securities laws

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92 KAUFMANN ET AL., *supra* note 9, at 13.

93 Thompson, *supra* note 57, at 51. Kaufmann et al. also note that then-Governor Alfred Smith received letters in support of the legislation from the Private Bankers Association, the U.S. Real Estate Owners Association, and the Investment Bankers Association. *See* KAUFMANN ET AL., *supra* note 9, at 13.

94 Then, swindling—and in particular, securities fraud—flourished because "the economic growth unleashed by industrialization had put savings and disposable income in the hands of relatively unsophisticated consumers and investors." Edward Balleisen, *Private Cops on the Fraud Beat: The Limits of American Business Self-Regulation, 1895–1932*, 83 BUS. HIST. REV. 113, 124 (2009).

> [S]uccessful prosecutions proved to be the exception, rather than the rule. Fraud cases around the turn of the twentieth century usually turned on comparatively complex factual situations, especially regarding the precise character of the misrepresentation at issue, and the question of fraudulent intent. . . . The result . . . was that the state's efforts to enforce laws against fraud did little more than slightly increase most swindlers' requirements of working capital, essentially constituting a "license fee."

Id. at 126.

95 Balleisen, *supra* note 94, at 121.

that would facilitate criminal prosecutions of fraudulent stock promoters," they simultaneously, and "even more strenuously," *opposed* proposals to create state or federal administrative securities agencies with the power to impose licensing requirements or approve public offerings.[96] Even when more strenuous laws were passed, however, these organizations used their quasi-governmental status to ensure that the titans of the financial industry were regulated only on their own terms. "By keeping the initial monitoring and investigation of fraudulent activity within the confines of a nongovernment agency friendly to well-established businesses . . . the antifraud organizations maintained considerable flexibility in law enforcement," and had "significant say over key prosecutorial positions in their bailiwicks, such as . . . the New York State assistant attorney general responsible for enforcement of securities fraud."[97]

Contemporary critics of these organizations maintained that they "systematically kept relatively new and small firms from gaining footholds," and "consistently ignored the unethical, or even illegal, commercial practices of the large corporations on which the Bureaus depended for much of their funding."[98] Because the Bureaus did not address the practices of big companies whose executives sat on their boards, "at no point during the 1920s stock boom did any of the Better Business Bureaus identify some of the era's most egregious conflicts of interest or misrepresentations within

[96] Balleisen, *supra* note 94, at 127. The "very founding of the New York City Better Business Bureau formed a central element of Wall Street's efforts to deflect legislative proposals to have New York adopt 'blue sky' legislation that would create such administrative authority." *Id.* at 144.

[97] *Id.* at 137, 142.

[98] *Id.* at 153. Balleisen argues that these "regulatory institutions turned out to be the pawns of entrenched businesses, which simply created indefensible barriers to entry for would-be competitors." *Id.* at 153–54.

the hallowed confines of the reputable finance industry . . . ."[99]

1. The 1955 Amendment: Section 352-c's Criminal Sanctions

Thus, despite the statute's broad construction in the lower courts,[100] it remained underutilized for preventing the types of securities fraud it was enacted to remedy.[101] To provide an additional deterrent against deceptive conduct in the financial industry, in 1955 then-Attorney General Jacob K. Javits appointed David Clurman to rewrite the Martin Act "in a manner [that would be] more protective of the public."[102] Clurman's revisions were intended "to make the law as fierce as he could," by giving the Attorney General the power to prosecute securities fraud criminally, eliminating the requirement that any buyer be actually defrauded or that a sale even took place, and writing "in the broadest

99 Balleisen, *supra* note 94, at 157. In examples that resemble the conduct that lead to another financial crisis almost a century later, "[b]ureau managers issued no warnings about the deceitful tactics used by most leading investment banks to push exceedingly risky Latin American bond issues on their customers," nor "cautions about the stock manipulations undertaken by several leading New York City Banks . . . ." *Id.*

100 *See* People v. F. H. Smith Co., 243 N.Y.S. 446, 449 (App. Div. 1930) ("The statute is remedial in its nature, and was passed to protect the inexperienced, confiding, and credulous investor, and save him from his own foolish cupidity. It should therefore be liberally and sympathetically construed in order that its beneficent purpose may, so far as possible, be attained."); Thompson, *supra* note 57, at 52 (noting that courts have "liberally interpreted every important term in the act—including 'security,' 'material,' 'public offering,' and 'fraud'—and have declared that they [lack] authority to review the attorney general's discretion under the act [as] the state's chief law enforcement officer.").

101 *See* KAUFMANN ET AL., *supra* note 9, at 13.

102 Pierre-Louis, *supra* note 60, at 35. *See also* Thompson, *supra* note 57, at 52 (suggesting political opportunism as an additional motive for Javits, given that he was "hyperambitious" but had not campaigned against securities fraud).

definitions of fraud he could think of."[103] Accordingly, by enacting Section 352-c, the 1955 amendment to the statute made it a misdemeanor to violate any provision of the Martin Act.[104]

The legislative materials from this enactment also show that the statute was framed to the Legislature and Governor as providing for criminal culpability based on "mere conduct, absent any proof of scienter or criminal intent."[105] The most direct evidence for this conclusion is the memorandum written by Attorney General Javits to accompany the bill and justify his revision of the statute. Javits first observed that "fraud in the sale of securities in New York State [was] increasing at an alarming rate," and the Attorney General's role was to ensure "the interest in risk-taking and the desire for financial gains [was] not played upon and exploited by sharpsters who, by means of fraudulent practices, [tricked] people out of their money without a reasonable opportunity for success in the investments they [bought]."[106] Although "[f]ear of injunctive relief [had] been found to be a deterrent against the commission of fraud to the well-established security broker-dealer," he observed that the more "unscrupulous securit[ies] operator[s]" had merely altered

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[103] Thompson, *supra* note 57, at 52. According to Thompson, Clurman—only three years after graduating from Columbia Law School—did "his best to avoid ambiguity about the law's intent." *Id.* (noting that Clurman declared, "I'm not interested in writing well. I'm interested in winning cases.").

[104] In addition to the Martin Act's existing prohibitions, the 1955 amendment further prohibited the making of false promises that tend to deceive, or promises which are unwarranted or unreasonable, and brought agents and employees of securities operators within the purview of the statute. KAUFMANN ET AL., *supra* note 9, at 13.

[105] *Id.* at 14. But it is worth pointing out that "scienter" is "a confusing word because its most natural meaning—and one often associated with it—is knowledge. But the term is used, at least in the area of securities fraud, to mean simply level of fault." Buell, *supra* note 1, at 534.

[106] Memorandum from the Attorney General, *in* NEW YORK STATE LEGISLATIVE ANNUAL 1955, at 133, 134 (N.Y. Legis. Serv., Inc. ed. 1955).

their tactics to evade punishment.[107] Javits specifically noted with concern the "mushroom[ing]" of "Boiler Room" operations, which "employ salesmen of dubious reputation who resort to gross misrepresentations, false promises and other fraudulent and deceptive practices in order to sell their gullible prospects" over the telephone, and specifically concentrated their efforts on securities low enough in value to be exempt from federal registration requirements.[108]

Javits then explained how his revisions to the Martin Act would close this enforcement gap: "While the crimes of larceny, embezzlement, forgery and other felonies would be involved in many security frauds, *they require that the prosecutor prove criminal intent*, thereby making conviction extremely difficult."[109] Because he was submitting the amendments to the Martin Act "[t]o avoid these difficulties,"[110] an obvious possibility is that the Legislature understood his proposal to establish a crime of strict liability.[111] Furthermore, Javits emphasized that the proposed amendments were:

> [N]ot intended to narrow or repeal the coverage of prior language but rather they [were] intended to expressly broaden those acts and practices coming within the condemnation of the statute, so as to bring within its scope *all acts and omissions* which *tend* to deceive or mislead, based on present day experiences of fraudulent practices indulged in by certain individuals dealing in securities.[112]

Nevertheless, Javits also clarified that he intended for the amendments to "more nearly conform [New York] statutes with similar provisions contained in the laws of the more

107 Memorandum from the Attorney Genera, *supra* note 106, at 134.

108 *Id.* at 135.

109 *Id.* (emphasis added).

110 *Id.*

111 *See* KAUFMANN ET AL., *supra* note 9, at 14.

112 Memorandum from the Attorney General, *supra* note 106, at 135 (emphasis added).

progressive States and the Federal Government."[113] This statement is difficult to square with the widely held view that the Martin Act represents a much broader approach to criminal securities anti-fraud enforcement than that taken by the thirty-seven states that follow the Uniform Securities Act.[114] One way these statements could be reconciled is by concluding that Javits meant merely for the statute to require something less than criminal intent, without necessarily implying he meant to propose a strict liability crime.[115] This was how the New York City Bar Association Committee on State Legislation interpreted the amendment, having observed that Section 352-c

> may give rise to unease because it does not contain the usual statutory requirement that criminal acts be "wilfully" [sic] or "knowingly" committed. This may be serious with respect to the proposed subdivision (b), above, for the language "beyond reasonable expectation" or "unwarranted by existing circumstances" is not a precise test to guide those selling securities as to what they may say about future market probability. The result could be that one forecasts at his peril.[116]

The Committee further noted that unlike federal securities fraud legislation, the amendment would not limit criminal liability under 352-c(1)(c) to material statements. As a result, a securities salesman

> might find himself saddled with criminal liability for a careless but innocent misstatement of an immaterial fact. Because courts will generally construe criminal statutes strictly, however, and

[113] Memorandum from the Attorney General, *supra* note 106, at 135.

[114] *See, e.g.*, Razzano, *supra* note 32, at 125 (representing the view that the Martin Act's provisions go beyond those of other states adopting the Uniform Securities Act).

[115] *See* Anello, *supra* note 11, at 24–25 (emphasizing the ambiguity in the Martin Act's misdemeanor provision).

[116] COMM. ON STATE LEGIS., MEMO NO. 124, *in* 7 N.Y. CITY B.A. BULL. 421, 423 (1955).

> because the intent of the bill appears to sanction criminal liability only for obviously intentional or irresponsible acts, these objections are not sufficient to cause this Committee to disapprove the bill.[117]

Consequently, it appears that the Committee's approval rested on a seriously faulty premise; that New York courts would always construe criminal statutes strictly. This understanding was not accurate of the Martin Act before 1955,[118] nor was it a correct prediction of the following years.[119] The Committee's conclusion also demonstrates a serious inconsistency with how some commentators claim the Martin Act was understood at the time of the 1955 amendment. Although modern analysts view Section 352-c as having endowed the Martin Act with more power than any other state's securities fraud statute,[120] the New York City bar approved the bill only because

> [a] majority of states have *much more* restrictive and far reaching "Blue Sky" or securities laws than New York. The New York philosophy has been to provide adequate protection to the investing public without unduly restricting the free flow of securities. The bill provides an additional measure of public protection by creating higher standards of conduct for those dealing in securities and commodities, but without imposing the sweeping regulation which in some states reduces the flexibility of the securities distribution system.[121]

117 COMM. ON STATE LEGIS., *supra* note 116, at 423–24.

118 *See supra* Part III.B.

119 *See infra* Part III.C.

120 *See, e.g.*, KAUFMANN ET AL., *supra* note 9, at 15 (asserting that a securities law practitioner could find "no other statute so laden with an arsenal of investigative and prosecutorial powers" as the Martin Act "which, nevertheless, has been deemed 'paternalistic in its design'") (quoting People v. Concord Fabrics, Inc., 371 N.Y.S.2d 550 (Sup. Ct. 1975), *aff'd*, 377 N.Y.S.2d 84 (App. Div. 1975)).

121 COMM. ON STATE LEGIS., *supra* note 116, at 424 (emphasis added).

As a result, there is a much stronger tension than commentators have previously acknowledged between how the Martin Act is traditionally depicted—as an unparalleled weapon of choice for combating securities fraud—and how the statute was understood when it was first enacted.

Materials in the legislative bill jacket accompanying the amendment also complicate Section 352-c's history. For example, the Commissioner of the New York Department of Commerce refused to approve the bill, as it was his opinion that the vote had been too rushed, which meant that "[n]o opportunity [had] been given those in the security field to make a complete study of the bill, the necessity therefor [sic], and the consequences thereof."[122] In contrast, the local Chairman of the National Association of Securities Dealers believed his organization had adequate input on the 1955 amendment, although he understood the bill to have been "drafted in such a way as to not hamper or disturb legitimate practices or enterprises in the securities industry."[123] Moreover, even Attorney General Javits's memorandum to the Governor left out any specific discussion of culpability under the statute, other than what would otherwise be implied in the words "fraud" or "deception."[124] These

122 Letter from Edward T. Dickinson, Comm'r, N.Y.S. Dep't of Commerce, to W. Averell Harriman, Governor, N.Y. State (Apr. 4, 1955), *microformed on* N.Y. Bill Jackets Collection, L. 1955, ch. 553, at 5 (N.Y. State Archives) [hereinafter 1955 Amendment Bill Jacket] (noting further how "[t]he Attorney General himself had been in office only two months and could not have had the opportunity to give this matter adequate time for research and study").

123 Letter from Harold H. Cook, Chairman, District No. 13 Comm., Nat'l Ass'n of Securities Dealers, Inc., to W. Averell Harriman, Governor, N.Y. State (Apr. 5, 1955), *microformed on* 1955 Amendment Bill Jacket, *supra* note 122, at 8.

124 Memorandum from Jacob K. Javits, N.Y. State Attorney General, to the Governor (Apr. 7, 1955), *microformed on* 1955 Amendment Bill Jacket, *supra* note 122, at 11 (explaining, in relevant part, that Section 352-c provides "a penal sanction for any person or company utilizing fraud, deception, the making of any false promise, etc., while engaged in the issuance, purchase, sale or related activities of securities or commodities, whether or not such fraud or deception is actually consummated").

documents provide some evidence to suggest that, even at the time the Martin Act was enacted, it may not have been clear exactly which culpability level sufficed to prove liability under the statute.

Thus, at the time of the 1955 amendment there were at least two potentially competing perspectives in the legal community concerning the threshold of guilt for a defendant under the Martin Act's criminal misdemeanor provision. Still, the Attorney General seemed to be focused to a greater degree on protecting investors than on the nuanced determination of a defendant's culpability.[125] This conclusion is supported by a 1955 speech Javits gave to the New York State Bar Association, in which he emphasized:

> There is nothing wrong with speculation, and there is no reason why only millionaires should speculate. . . . The only thing we want to be sure of is that they get an honest share and they are not cheated in the share that they get, and that people do not water down what they get or deceive them about what it is or manipulate it so that its price is way out of line. In short, no one is trying to be a guardian for the intelligence of our own people, but certainly we want to be sure that they are not victimized and abused and their confidence is not violated.[126]

In sum, while it is very possible that the New York State Legislature understood Section 352-c to create a strict liability crime,[127] the available evidence could alternatively

[125] *See* Buell, *supra* note 1, at 534 ("A regime centered on the belief that fraud is a problem of costs and harm might—in its focus on results caused, not plans hatched—require a low level of fault or perhaps no scienter at all.").

[126] Jacob K. Javits, N.Y. State Attorney General, Address at the New York State Bar Association Annual Meeting (Jan. 28, 1955), *in* N.Y. STATE BAR ASS'N, PROCEEDINGS OF THE N.Y. STATE BAR ASSOCIATION ANNUAL MEETING 32–33 (1955).

[127] Unfortunately, there are no records available from any legislative hearings or sessions during which the amendment might have been discussed. Thus, legislative intent can be inferred only to the extent that one assumes the documents that have been preserved were made available

support a theory that rejected the need to prove criminal intent, but would have still required a standard of negligence, recklessness, or something closer to knowledge. Ultimately, the historical materials lend even greater uncertainty to the question of mens rea than the text does—an attribute of the statute's past that has largely been ignored.[128] While this part of the Martin Act has been championed as an example of broad authority for the aggressive criminal enforcement of securities laws, at least when it was first written, the misdemeanor provision was more likely understood to be a conservative enactment than a groundbreaking one.

2. The 1982 Amendment: The Felony Provisions

After the 1955 amendment, the New York State Attorney General could prosecute securities fraud cases criminally, but only for misdemeanor violations. That changed in 1982, when the "intentional felony" provisions were added to the statute[129] "to distinguish between Section 352-c *per se* crimes and intentionally committed fraudulent conduct in securities for which the higher felony penalty [would attach]."[130] The same legislation also amended the Martin Act to establish felony liability for repeated violations of securities fraud acts, even when the separate crimes were themselves only misdemeanors.[131] Not only did the prevailing contemporary

to legislators at the time of the bill's enactment. That the Attorney General addressed memoranda specifically to members of the Legislature nonetheless supports such an assumption. *See also* Memorandum from Jacob K. Javits to the Governor, *supra* note 124, at 10 (emphasizing that certain legislators had in fact received his memoranda). The Bill Jackets make clear what was available to the Governor.

128 *See supra* Part II.B.

129 N.Y. GEN. BUS. LAW § 352-c(5), (6) (McKinney 2012).

130 KAUFMANN ET AL., *supra* note 9, at 49 (emphasis in original). In referring to "per se" criminal liability, the author appears to mean strict liability.

131 Memorandum from Robert Abrams, N.Y. State Attorney General, *microformed on* N.Y. Bill Jackets Collection, L. 1982, ch. 146, at 7 (N.Y. State Library) [hereinafter 1982 Amendment Bill Jacket]. This provision

interpretation of the 1982 amendment more obviously conform to the statutory language than it did for the 1955 amendment, but it also seemed to explicitly clarify the New York State Legislature's understanding of mens rea in the misdemeanor provision.

In support of the amendment to Section 352-c, the bill's sponsors, Assemblyman Roger J. Robach and Senator Ronald Stafford, cited *People v. Barysh*[132] in observing that the Martin Act had "no requirement . . . [that the] fraudulent activity originate with an intent to deceive or defraud."[133] This created an enforcement gap because "[a]n increasing number of unscrupulous promoters [were] willfully engaging in fraudulent securities practices in violation of Section 352-c . . . [and] reaping large sums of money under circumstances which [did] not permit a felony indictment under the penal law."[134] By creating felony liability for intentional fraud, state regulators, like the Department of Banking, hoped that the amendment "might" tend to discourage some misconduct

was intended to increase the Martin Act's deterrent effect by correcting the following inconsistency to provide felony liability in both cases: defendants charged with a Martin Act violation were guilty of a misdemeanor if they were previously convicted of a Martin Act violation (or any other securities fraud crime), but were guilty of a felony if they were previously convicted of violating an injunction procured under the Martin Act. *Id.*

132 People v. Barysh, 408 N.Y.S.2d 190 (N.Y. Sup. Ct. 1978). *See also infra* Part III.C.1.

133 Memorandum from Roger J. Robach, N.Y. State Assemb., *in* NEW YORK STATE LEGISLATIVE ANNUAL 1982, at 75 (N.Y. Legis. Serv., Inc. ed. 1982).

134 *Id.* Specifically, Attorney General Abrams noted these practices included but were "not limited to boiler rooms, Ponzi schemes, insider trading, pyramid schemes, fictitious transactions[,] and other artifices to defraud the investing public." Memorandum from Robert Abrams, N.Y. State Attorney General, to Hugh Carey, Governor, N.Y. State (May 25, 1982), *microformed on* 1982 Amendment Bill Jacket, *supra* note 131, at 9.

in the securities field."[135] The bill was passed without objection.

The 1982 amendment therefore seemed to both clarify and strengthen the Martin Act. By codifying a trial court's ruling that violations of Section 352-c were "per se" criminal misdemeanors, the Legislature appeared to confirm the interpretation that the 1955 amendment created a strict liability crime.[136] In empowering Attorney General Robert Abrams to prosecute frauds committed intentionally as felonies, the Legislature unambiguously intensified criminal punishments at the same time that it explicitly appreciated —and perhaps ratified—the broad construction courts were giving to the statute.[137] Still, the Legislature left unexplained precisely what showing was required to establish proof of criminal intent. Moreover, there was almost no opportunity for the courts to consider the question in serious felony cases. Instead, when it came to enforcement, Abrams "largely left the dignitaries of Wall Street alone," pursuing only "quirky hustlers."[138]

3. The 1986 Penal Law Amendments for White-Collar Crime

Despite the inclusion of a felony provision, and the liberal interpretation courts subsequently gave to the amended Martin Act,[139] a lax pattern of enforcement characterized the statute's implementation. As a result, the existing punishments for white-collar crimes—grand larceny,

[135] Memorandum from Alan R. Cohen, Acting Superintendent of Banks, to Hugh Carey, Governor, N.Y. State (May 26, 1982), *microformed on* 1982 Amendment Bill Jacket, *supra* note 131, at 11.

[136] KAUFMANN ET AL., *supra* note 9, at 49.

[137] The New York Court of Appeals however, had not yet decided a criminal case. *See infra* Part III.C.

[138] Thompson, *supra* note 57, at 52. *See also* Elkan Abramowitz & Barry A. Bohrer, *The Ever-Expanding Martin Act: Has It Reached Its Limit?*, 243 N.Y. L.J. 84 (2010) (noting that "in the pre-Spitzer era, the [A]ct had been used only to go after 'small-time fraud'").

[139] *See* discussion *infra* Part III.C.

insurance fraud, and other schemes to defraud—were not viewed as adequately deterring the type of conduct addressed by the statute.[140] The State, however, was not without other options. Under Section 352-d, the Attorney General had the authority to prosecute other New York State Penal Law violations "arising out of or connected with Martin Act crimes," in addition to the Martin Act violations themselves.[141] Still, while these prosecutions usually involved vast amounts of stolen money, Martin Act violations were punishable only as Class D felonies, which carried maximum prison sentences of seven years.[142] Frustrated with the significant disparity in punishments faced by white-collar and street-level criminals,[143] the New York State Legislature amended the Penal Law in 1986 to create a new degree of larceny, which raised the maximum prison sentence for white-collar criminals to twenty-five years, and "greatly strengthened" the Attorney General's power to prosecute securities fraud.[144]

The legislative materials accompanying the amendment similarly reflected a sense of dissatisfaction with the pervasiveness of economic crime. The bill's sponsor, Dean G. Skelos, argued that, unlike street criminals, white-collar criminals may be deterred, and that by "increasing substantially the potential punishment, the attraction of wrongfully taking property will be diminished."[145] Skelos also justified the amendment on equitable grounds, explaining that since "the large-scale white-collar thief is [as] culpable, and as deserving of state prison, as the street youth who takes property by unsophisticated threats of force," disparity in punishments "for the street criminal and the

140 *See* Memorandum from Dean G. Skelos, N.Y. S., *in* NEW YORK STATE LEGISLATIVE ANNUAL 1986, at 235 (N.Y. Legis. Serv., Inc. ed. 1986).

141 KAUFMANN ET AL., *supra* note 9, at 47 (citing N.Y. GEN. BUS. LAW § 352-d (McKinney 2012)).

142 *Id.*

143 *See* Memorandum from Dean G. Skelos, *supra* note 140, at 235.

144 KAUFMANN ET AL., *supra* note 9, at 47.

145 Memorandum from Dean G. Skelos, *supra* note 140, at 235.

white-collar crook corrodes confidence in the fairness of the criminal justice system."[146] Borrowing substantially from Skelos's language, Governor Mario Cuomo also struck a heavily retributive tone in his Approval Memorandum. Noting a 1976 study by the Joint House-Senate Subcommittee on Investigations that estimated the cost of white-collar crime to be $44 billion dollars per year,[147] Cuomo pointed out that the incidence of white-collar crime "has not abated in the last decade; instead, it has spiraled ever-upward as economic crime has become increasingly profitable and sophisticated. The effects of major economic crime can be devastating: the whole society suffers as crimes against business become crimes against consumers."[148] The amendment was adopted unanimously.

Nonetheless, the implications of this amendment for interpreting the Martin Act are not as clear as the legislative history might indicate. After all, the historical record demonstrates that, from the late 1950s to the mid-1990s, the Martin Act was only used "as a tool to go after small-time fraud."[149] It is therefore more difficult to argue, as some commentators may suggest,[150] that the New York State Legislature and Governor specifically intended the 1986 amendment to strengthen Martin Act prosecutions, especially of senior financial executives, if these officials even had the statute on their minds. While it is technically

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[146] Memorandum from Dean G. Skelos, *supra* note 140, at 235.

[147] *Id.* at 234.

[148] Memorandum from the Governor, *in* NEW YORK STATE LEGISLATIVE ANNUAL 1986, at 236 (N.Y. Legis. Serv., Inc. ed. 1986).

[149] Thompson, *supra* note 57, at 52. *See also* Walter Olson, *Devil's Bargain: Wall Street & the Martin Act*, N.Y. POST (Aug. 29, 2011, 10:15 PM), http://www.nypost.com/p/news/opinion/opedcolumnists/devil_bargain_wall_st_the_martin_JmUXYCie3XWjzQyZHzK72N (arguing that, unlike Louis K. Lefkowitz and others, Attorneys General Spitzer, Cuomo and Schneiderman broke an "unspoken gentlemen's agreement" by using the Martin Act aggressively against the large, established financial institutions that originally accepted the far-reaching legislation).

[150] *See, e.g.*, KAUFMANN ET AL., *supra* note 9, at 47; Razzano, *supra* note 32, at 126–27.

true that the felony provision of the Martin Act was rendered more powerful under this legislation, little evidence exists to suggest that this amendment codified a particular trend in Section 352-c jurisprudence.

C. Martin Act Jurisprudence: A Liberal Construction

Beyond the legislative history, the other primary sources of interpretive strategies in determining the Martin Act's culpability requirements are judicial opinions construing the statute. Drawing conclusions from the existing Martin Act decisions is difficult, however, in part because there are so few reported misdemeanor or felony cases,[151] and the New York Court of Appeals has never directly established specifically which mens rea is required to prove culpability for either provision.[152] Part III.C further illustrates how even the lower court decisions that *have* addressed the question fail to engage the ambiguity in the legislative history. Nevertheless, they have interpreted the statute broadly. While lower courts have held that the Martin Act creates strict liability for misdemeanor crimes, which standard has emerged from the felony jurisprudence is less clear, although it is almost certainly not what the text alone implies.

1. Section 352-c Misdemeanor Jurisprudence

The first reported case interpreting the criminal misdemeanor provision of Martin Act was *People v. Kaufman & Broad Homes of Long Island, Inc.*, a 1977 false representations case decided on appeal from the defendant's guilty plea.[153] In a per curiam opinion, the court declared, "The purpose of the Martin Act . . . is to prevent frauds of all

[151] *See* Anello, *supra* note 11, at 24–25.

[152] *See* Buell, *supra* note 1, at 559 n.172.

[153] People v. Kaufman & Broad Homes of Long Island, Inc., 393 N.Y.S.2d 144 (App. Term 1977) (per curiam) (holding that Section 352-c covers false statements made in connection with the sale of interests in a condominium development).

types in connection with the sale of securities and commodities, and it should be liberally construed to achieve such end."[154] To support this reading of the statute, the court cited only one authority, *People v. Lexington Sixty-First Associates*, a 1976 Court of Appeals case upholding a civil injunction brought by the Attorney General to prevent the defendants from operating a scheme to defraud tenants in an apartment building by converting it to cooperative ownership.[155] Importantly, however, the issue in *Kaufman* was actually whether the defendant's misrepresentations fell within the meaning of "false statements" under Section 352-c, not which level of culpability would support liability.[156] The defendant conceded having made knowing misrepresentations in connection with the sale of cooperative interests in real estate, so the question of criminal intent was irrelevant.

Mens rea was at issue, however, in the next Section 352-c opinion reported from a New York State court, *People v. Barysh*.[157] *Barysh* was a 1978 criminal misdemeanor case decided by a trial court on a motion to dismiss an indictment that alleged the defendant violated the Martin Act by fraudulently recording securities transactions.[158] In holding that "no intent to defraud is required for a violation of the statute,"[159] the court supported its conclusion through an analysis of the Martin Act's language and legislative history. Justice Irving Lang first examined the text and observed that facially, the statute was directed "at acts or practices, and not at any particular mental state on the part of the actor."[160] Next, Justice Lang turned to the Attorney General's memorandum in support of the 1955

154 *Kaufman*, 393 N.Y.S.2d at 145 (citation omitted).

155 People v. Lexington Sixty-First Assocs., 345 N.E.2d 307 (N.Y. 1976).

156 *Kaufman*, 393 N.Y.S.2d at 145.

157 People v. Barysh, 408 N.Y.S.2d 190 (Sup. Ct. 1978).

158 *Id.*

159 *Id.* at 193.

160 *Id.*

amendment,[161] which he concluded "clearly evinces an intent to make certain designated practices per se fraudulent and criminal."[162] Finally, the court observed that the Martin Act "was not enacted in a vacuum" and pointed out how the Court of Appeals had in *Federated Radio Corporation* already interpreted the civil provision of the statute to cover "*all* acts . . . although not originating in any actual evil design or contrivance to perpetuate fraud . . . ."[163] Thus, *Barysh* held that in the criminal context as well, the statute "clearly does not require several of the common-law elements of fraud, namely, reliance and scienter."[164]

Nonetheless, a New York City criminal court took a different approach in the first Martin Act case that the Attorney General brought for insider trading, *People v. Florentino*.[165] In posing the question of whether a mens rea requirement should be read into Section 352-c, Justice Stephen G. Crane noted the report written by the Committee on State Legislation of the New York City Bar Association, which "expressed misgivings over the omission of a requirement that a defendant 'knowingly' or 'willfully' engage in the prohibited conduct."[166] Therefore, although the *Barysh* court purported to read intent to defraud out of the statute, Justice Crane concluded that it "was not excluding a requirement that the underlying conduct be intentional or knowing."[167] Instead, he found that the intent necessary to support a conviction was "merely that of intending to do the acts prohibited, rather than intent to violate the statute."[168]

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161 *See supra* notes 106–110 and accompanying text.

162 *Barysh*, 408 N.Y.S.2d at 194.

163 *Id.* at 194 (quoting People v. Federated Radio Corp., 154 N.E. 655, 657 (N.Y. 1926) (emphasis added)).

164 *Barysh*, 408 N.Y.S.2d at 193.

165 People v. Florentino, 456 N.Y.S.2d 638, 640 (Crim. Ct. 1982).

166 *Id.* at 645 (citing COMM. ON STATE LEGIS., *supra* note 116, at 424).

167 *Id.*

168 *Id.* (quoting United States v. Charnay, 537 F.2d 341, 357 (9th Cir. 1976) (Sneed, J., concurring) (arguing that Section 32 of the Securities

Like the courts in *Kaufman* and *Barysh*, Justice Crane considered himself constrained by the authority of judicial opinions on civil liability under the Martin Act,[169] which required that he adopt "a less burdensome standard."[170] Accordingly, despite the statute's omission of an explicit mental state requirement, he "would require proof only of [a] defendant's intentional or knowledgeable conduct."[171] Yet the entire mens rea discussion in *Florentino* was dictum, since the court was deciding a motion to dismiss misdemeanor information that actually charged the defendant with intentional fraud.[172] As a consequence, Justice Crane admitted that, in reality, the case at bar presented "no opportunity to rule on the question of whether a *scienter* requirement is to be read into § 352-c to conform with Federal requirements."[173]

As a result, the only three reported New York cases interpreting the misdemeanor provision of the Martin Act—only one of which actually required the court to consider mens rea—were uniform in deciding that the Attorney General could bring charges for violations on a strict liability

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Exchange Act of 1934 did not require proof of an evil motive to support a criminal conviction)).

169 *See* People v. Concord Fabrics, 371 N.Y.S.2d 550 (Sup. Ct. 1975); People v. Cadplaz Sponsors, 330 N.Y.S.2d 430 (Sup. Ct. 1972).

170 *Florentino*, 456 N.Y.S.2d at 645. By "less burdensome standard," the court apparently meant less burdensome than a standard that would require the defendant to have some degree of mens rea with respect to the victim being defrauded. Thus, *Florentino* purports to adopt the same reading as *Kaufman* and *Barysh*.

171 *Florentino*, 456 N.Y.S.2d at 645. Justice Crane further noted with uncertainty that "[i]n this respect, perhaps, the jurisprudence under § 352-c has parted company with Federal case law in spite of the intent of Attorney General Javits that the Martin Act anti-fraud provisions 'more nearly conform' with their Federal counterparts." *Id.* (quoting Memorandum from the Attorney General, *supra* note 106, at 135). *See also infra* Part IV.B.3 (seeking to explain what the *Florentino* court could have meant by "intentional conduct").

172 *Florentino*, 456 N.Y.S.2d at 644–45.

173 *Id.* at 645 (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)).

basis. What the courts were less consistent about, however, was the use of authority to support their findings.

2. Section 352-c Felony Jurisprudence

The state of Martin Act felony jurisprudence is even more ambiguous. Handed down in 1994, the first reported felony decision was *People v. Landes*, the only criminal Martin Act case decided by the New York Court of Appeals.[174] Although the indictment charged six counts of fraud in violation of Section 352-c(6), the question on appeal in *Landes* was limited to whether the defendant's misrepresentations about a return he had promised to investors in a new venture related to "a public or private offering of securities" within the meaning of the Martin Act.[175] In passing, however, Judge Simons commented that Section 352-c of the Martin Act covered conduct "which, *in some instances*, *may* be criminal because deceptive or misleading even absent proof of scienter or intent."[176] Although he cited Kaufman's commentaries to support this observation, it was nonetheless dictum since the defendant's criminal intent was not actually at issue on appeal.

The only other published opinion interpreting mens rea under the felony provisions of Section 352-c is *People v. Sala*.[177] In *Sala*, the Supreme Court Appellate Division, Third Department upheld the defendants' convictions for marketing fraudulent financial planning services in violation of Section 352-c(6). Although the defendants challenged the sufficiency of the evidence as to proof of criminal intent, the court affirmed their convictions, citing *Lexington Sixty-First Associates* and another civil case, *State of New York v.*

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[174] People v. Landes, 645 N.E.2d 716 (N.Y. 1994).

[175] *Id.* at 717.

[176] *Id.* at 717–18 (noting the purpose of the statute was "remedial: to protect the public from fraudulent exploitation in the offering and sale of securities") (emphasis added).

[177] People v. Sala, 695 N.Y.S.2d 169 (App. Div. 1999).

Rachmani Corporation,[178] for the proposition that "neither scienter nor an intent to defraud need be proven to establish [felony] liability under the Martin Act."[179] Instead, Judge Mercure wrote for the court that the Attorney General "need only prove that the defendant committed an intentional act constituting fraud, which under the Martin Act 'includes all deceitful practices contrary to the plain rules of common honesty and all acts tending to deceive or mislead the public.'"[180]

While the text of the felony provisions in Section 352-c appears to clearly require criminal intent, through these two cases the New York courts seem to have watered down the mens rea requirement. Whereas a prior construction might have read "intent" to require purpose, now the Attorney General need only show some form of "intentional conduct." Unfortunately, the reported cases do not provide any greater detail on specifically what the courts meant by "intentional conduct." As a result, the only insight that *can* be taken away from the jurisprudence is that the State need not prove intent *as an element* of a Martin Act felony. This appears to be a difference in kind, not degree, from the lower burden a prosecutor may face as an evidentiary matter when mental state is at issue in any trial.[181]

D. Commentary on Section 352-c Culpability Standards

In the relatively few opinions construing culpability under Section 352-c of the Martin Act, the jurisprudence

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[178] State of N.Y. v. Rachmani Corp., 525 N.E.2d 704, 707 n.6 (N.Y. 1988).

[179] *Sala*, 695 N.Y.S.2d at 177.

[180] *Id.* (quoting KAUFMANN ET AL., *supra* note 9, at 32–33). Kaufmann also notes "the absence of scienter or intent to defraud does not relieve a defendant from civil liability under Section 352, or *misdemeanor* criminal culpability under Section 352–c." KAUFMANN ET AL., *supra* note 9, at 33 (emphasis added) (citing People v. Barysh, 408 N.Y.S.2d at 190, 193 (Sup. Ct. 1978)).

[181] *See supra* note 76 and accompanying text.

appears to have weakened the mental state requirements. For misdemeanor violations, where the statutory language was arguably ambiguous, courts have clearly settled on a strict liability construction. For felony violations, where the text appeared to clearly require intent, the New York courts have signaled that less is necessary—but how much so is unclear. Unfortunately, the academic commentary on Martin Act culpability mirrors this confusion, and does little to strengthen the courts' holdings for misdemeanor offenses or clarify the courts' construction of the felony provisions.

For example, some analysts—intentionally or unintentionally—conflate standards for civil and criminal liability, or fail to distinguish between misdemeanor and felony provisions.[182] Even those who do recognize the distinctions are not always clear on precisely which mental state actually applies. One commentator observed that under the Martin Act, a perpetrator's misleading statement in and of itself is illegal because intent to deceive is thereby implied.[183] The article made no apparent effort, however, to distinguish the standards in civil and misdemeanor cases from felony violations. Yet, if criminal intent could always be proven by the conduct itself, the difference in culpability standards between the misdemeanor and felony provisions would evaporate. Others accept the judicial construction of felony liability, noting that "'[i]ntentionally engaging' in fraud . . . has been interpreted as the intent to act, not the intent to defraud,"[184] without at least acknowledging the text

182 *See, e.g.*, Mathiesen, *supra* note 59, at 316 (claiming that "the Martin Act requires no showing of an intent to defraud, nor proof of a willful and knowing violation of the law").

183 Margery A. Colloff, *The Role of the Trustee in Mitigating Fraud in Structured Financings*, J. STRUCTURED FIN. 73, 74 (Winter 2005).

184 DECHERT, LLP, NEW YORK STATE'S MARTIN ACT: A PRIMER 3 (2004), *available at* www.dechert.com/files/Publication/a4def5dd-77bf-48ae-bead-491bfcb9142c/Presentation/PublicationAttachment/dbeb2852-2e00-49d6-971f-4c2db9674658/FS_2004-04.pdf (citing People v. Sala, 695 N.Y.S.2d 169 (App. Div. 1999)). *See also* McTamaney, *supra* note 7, at 3 (claiming the Martin Act "specifies virtually per se criminal and civil liability if the

or legislative history, which seem to argue for a higher level of culpability for felonies.[185] Moreover, the conclusions reached by analysts interpreting the case law often conflict with each other and reflect the very ambiguities remaining in the jurisprudence.[186]

As a result, the sources of authority for interpreting mens rea under the Martin Act perpetuate a significant degree of uncertainty. The legislative history does not uniformly clarify the text, judicial constructions may exacerbate ambiguities in the language, and the commentary reflects the underlying confusion. One explanation for this situation may be the statute's historical pattern of use.[187] Perhaps the Martin Act "is a fierce sword in the hand of a zealous prosecutor because it was written in a day when defendants' rights were mere curiosities, then it was not refined by judges to modern standards because it lay so dormant . . . ."[188] This tension is illustrated, for example, in comparing claims that the Martin Act is "one of the broadest anti-fraud statutes ever devised, at least in a democratic society,"[189] with Attorney General Javits's supporting memorandum, which advocated enactment of the 1955 amendment to bring New York anti-fraud law more closely

designated acts occur"). It is worth noting that in the literature, the terms per se liability and strict liability are used interchangeably.

185 *See supra* Part III.B.2.

186 *Compare* Razzano, *supra* note 32, at 128 n.21 (The Martin Act "seems to create strict liability for uttering a false statement"), and KAUFMANN ET AL., *supra* note 9, at 31 (Martin Act creates strict liability for civil and misdemeanor violations), *with* Anello, *supra* note 11, at 24–25 (there is "some question" as to the exact mental state requirement for misdemeanor crimes), *and* Buell, *supra* note 1, at 559 n.172 (noting the "judicial fogginess" surrounding Martin Act culpability requirements).

187 *See* Thompson, *supra* note 57, at 53 (The Martin Act's "long siesta helps explain its current strength. A conservative court or one aligned with Wall Street could well have blunted much of the law's edge. But few high-profile cases have come before New York's courts at times when they might have been inclined to dull the Martin Act's sharpest elements.")

188 McTamaney, *supra* note 7, at 2.

189 Eric Dinallo, *Prosecuting Securities Fraud from a New York Perspective*, 5 N.Y.U. J. LEGIS. & PUB. POL'Y 41, 43 (2001).

into alignment with that of the federal government and other states.[190] After all, when it was written and interpreted by the courts, the statute had not been targeted at the types of institutions and individuals against whom it is used today. But regardless of how the confusion came about, the academic commentary demonstrates that the statute's language, legislative history and judicial construction have not yet been adequately explained and reconciled.

IV. NORMATIVE ANALYSIS OF CRIMINAL CULPABILITY UNDER THE MARTIN ACT

The relationship among the text, legislative history, jurisprudence, and academic commentary on the mental state requirements for criminal liability under the Martin Act thus remain unresolved. With little in the way of justification, New York courts have firmly established that a misdemeanor violation may be charged on a strict liability theory, even though this interpretation was not inevitable under the text or legislative history. In contrast, the language and purpose behind the felony provision seemed obvious, until the jurisprudence reduced the stringency of the culpability inquiry—although to what degree is unclear. An even larger problem is that there are so few published opinions from which to glean doctrinal insights. If the Martin Act is to assume a central role in holding senior financial executives criminally accountable for both post and future wrongdoing, a more coherent explication of the statute's diminished culpability standards should be required. Yet no judicial opinion or published academic work engages in any serious questioning of the appropriateness of strict liability for misdemeanor securities fraud, nor demands a sufficient level of clarity about the mental state requirement for felony violations. Part IV seeks to address both of these gaps.

190 *See supra* note 112 and accompanying text.

A. Strict Liability for Martin Act Misdemeanors

Although the maximum sentence for a misdemeanor violation of the Martin Act is only one year,[191] it is difficult to overstate the seriousness with which strict liability crimes should be considered. If any individual who deals in securities or commodities may be deprived of liberty despite having taken reasonable measures to guard against making false or even unrealistic statements,[192] criminal enforcement action must be thoroughly justified. While there is precedent for enacting strict liability statutes for public welfare offenses,[193] in no other jurisdiction—state or federal—do securities fraud statutes ostensibly authorize the breadth of potential liability as does the Martin Act.[194] As a result, it is particularly important to ask the question of whether strict liability for misdemeanor financial fraud under the Martin Act is truly justifiable given the statute's text, history, and purpose. The answer is of even greater significance because it is a task the New York courts have neglected to seriously undertake.

1. Superficial Analysis in Judicial Construction

The New York jurisprudence regarding culpability for misdemeanor violations under the Martin Act is unsettling for several reasons. Not only have the opinions largely ignored the ambiguities latent in the statutory text and legislative history, but courts have also applied inconsistent

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191 N.Y. GEN. BUS. LAW § 359-g(2) (McKinney 2012) (establishing a one-year imprisonment and/or a fine of $500 as the maximum punishment for misdemeanor violations of § 352).

192 *See* BUS. § 352-c(1)(a)–(b).

193 *See infra* Part IV.A.1.

194 *See, e.g.*, Couture, *supra* note 59, at 17–19 (noting that the Martin Act's strict liability misdemeanor provision is broader than federal securities law); Thompson, *supra* note 57, at 50 (observing that the Uniform State Securities Law statutes have a higher standard for liability).

approaches, and often failed to distinguish between civil and criminal liability.

In *Kaufman*,[195] for example, the only authority cited by the court in support of its broad reading of the Martin Act in the criminal context was *People v. Lexington Sixty-First Associates*, a civil case regarding the discretion of the Attorney General to seek a permanent injunction against defendants in a scheme admittedly in violation of the statute.[196] While the civil and criminal provisions are obviously related, there are several important reasons to expect that criminal liability might be necessarily more constrained than civil liability.[197] Most significantly, the fact

195 People v. Kaufman & Broad Homes of Long Island, Inc., 393 N.Y.S.2d 144 (App. Term 1977).

196 People v. Lexington Sixty-First Assocs., 345 N.E.2d 307, 309 (N.Y. 1976).

197 *See* Margaret V. Sachs, *Harmonizing Civil and Criminal Enforcement of Federal Regulatory Statutes: The Case of the Securities Exchange Act of 1934*, 2001 U. ILL. L. REV. 1025, 1038–39 (2001) (acknowledging that although statutes—such as federal securities laws—enforced both civilly and criminally should be interpreted similarly across enforcement contexts, this rule changes when the text and legislative history supports a finding of differentiated intent requirements); Couture, *supra* note 59, at 37–39 (noting with concern the enforcement theory behind broad grants of discretion given by the legislature to prosecutors in the form of vaguely worded statutes). Some argue, however, that because prosecutors (federal, state, or local) serve as gatekeepers for criminal liability, there is actually less need to construe criminal statutes more strictly than civil statutes, which lack "gatekeeping" by government officials. *See, e.g.*, Terrance G. Reed, Symposium, *The Defense Case for RICO Reform*, 43 VAND. L. REV. 691, 712–13 (1990) (arguing that with RICO, Congress trusted the Department of Justice with an open-ended statute in a way it did not trust private plaintiffs). This suggestion is much less relevant in the context of the Martin Act though, because the New York Court of Appeals has eliminated a private right of action under the statute. *See* CPC Int'l, Inc. v. McKesson Corp., 514 N.E.2d 116, 118 (N.Y. 1987) (holding that the Martin Act does not give rise to an implied private cause of action). Because the Attorney General is the only party authorized to bring a case under the Martin Act, the typical argument against applying civil standards to the criminal context is weaker. *Cf.* Daniel M. Kahan, *Is* Chevron *Relevant to Federal Criminal Law*, 110 HARV. L. REV. 469 (1996) (arguing, at least in the federal law context, that

that criminal liability—even at the misdemeanor level—deprives defendants of liberty means, at a minimum, that a more thoughtful discussion than that in which *Lexington* engaged should be undertaken before transferring the entire scope of civil liability into the criminal sphere.[198] Furthermore, *Kaufman*'s construction of Section 352-c was only dictum, thus depriving an already weak rationale of any remaining weight.

Similarly, the court in *Barysh* relied on decisions from civil injunction proceedings to justify its finding that criminal liability under the Martin Act did not require intent to defraud.[199] But unlike *Kaufman*, the defendant's criminal intent was actually at issue. Moreover, Justice Lang even sought to explain his refusal to distinguish between civil penalties and criminal punishment by arguing that "nothing in the statute or its legislative history suggests . . . a dichotomy" between the two theories of liability.[200] Because Section 352-c "was clearly enacted to add another weapon . . . to the Attorney General's existing arsenal of powers," according to the court, the traditional distinction between civil and criminal enforcement did not apply.[201] This line of reasoning, however, ignores the possibility that the simple fact of *having* the criminal sanctions provided by the 1955

Congress properly grants discretionary lawmaking authority to prosecutors in the form of broad statutes, based on prosecutors' institutional advantage in determining whether public policy supports applying a statute to a particular case).

198 *See* Couture, *supra* note 59, at 41–45, 55 (observing that traditional theory on the criminal-civil divide assumes that criminal liability is necessarily more limited than civil liability primarily because of the scope of sanctions, but demonstrating that excessively broad criminal statutes may need to be reined in by Congress, which if it preempted broad state law criminal liability, could restore an appropriate balance between deterrence, retribution, and compensating victims).

199 People v. Barysh, 408 N.Y.S.2d 190, 194 (Sup. Ct. 1972) (citing People v. Federated Radio Corp., 154 N.E. 655 (N.Y. 1926); People v. Cadplaz Sponsors, 330 N.Y.S.2d 430 (Sup. Ct. 1972)).

200 *Barysh*, 408 N.Y.S.2d 190.

201 *Id.*

amendment alone may have strengthened the Attorney General's power under the Martin Act, even if prosecuting defendants under the provision required a showing of some level of intent.

Florentino is also an unsatisfying decision in many ways. Although the court went further than *Kaufman* and *Barysh* into the legislative history,[202] it is not immediately clear how well its holding fits with precedent. Justice Crane claimed to have been "constrained" by the interpretations of the Martin Act in *Kaufman* and *Barysh* as eliminating any mental state requirement, but he nevertheless used the legislative materials to read an intentional *conduct* requirement back into the statute. The weight of the court's finding is also limited in other respects, as *Florentino* was only a trial court opinion, and—as Justice Crane himself acknowledged—the entire discussion of Section 352-c's mental state requirement was dictum, given that the indictment had actually charged the defendant with intentional fraud.[203]

2. Securities Fraud as a Public Welfare Crime

The conclusion to be drawn from analyzing the Section 352-c misdemeanor decisions is that in interpreting the same text, the three New York courts relied on different sources of authority, and reached poorly supported, and possibly inconsistent conclusions[204] about which mens rea showing was required to support criminal liability. Still, despite the inadequate support offered in judicial opinions, the conclusion that Section 352-c establishes strict liability for misdemeanor violations may nonetheless be justified. The idea of creating strict liability for certain types of criminal offenses is not new, nor was it when the New York State

202 *See supra* note 166 and accompanying text.

203 People v. Florentino, 456 N.Y.S.2d 638, 644 (Crim. Ct. 1982).

204 *Compare Barysh*, 408 N.Y.S.2d at 193 (Sup. Ct. 1972) (Section 352-c creates strict liability), *with Florentino*, 456 N.Y.S.2d at 645 (intentional conduct is required to charge a misdemeanor violation).

Legislature first attached criminal penalties to the Martin Act.

As the United States Supreme Court explained in *Morissette v. United States*,

> The industrial revolution multiplied the number of workmen exposed to injury from increasingly powerful and complex mechanisms, driven by freshly discovered sources of energy, requiring higher precautions by employers. . . . Wide distribution of goods became an instrument of wide distribution of harm when those who dispersed food, drink, drugs, *and even securities*, did not comply with reasonable standards of quality, *integrity, disclosure and care*. . . . While such offenses do not threaten the security of the state in the manner of treason, they may be regarded as offenses against its authority, for their occurrence impairs the efficiency of controls deemed essential to the social order.[205]

As a result, legislation that addressed this type of offense, as a matter of public policy, did not need to specify intent as an element of the crime.[206] The justification was that liability under these laws was premised not on individual culpability, but was instead a matter of assigning the costs of harm to those best able to bear them, thus achieving greater economic efficiency.[207] For example, during the New Deal, Congress passed legislation that criminalized certain conduct—regardless of the defendant's awareness of wrongdoing—to protect public health and welfare, "which, in the circumstances of modern industrialism, [were] largely beyond self protection . . . ."[208] Therefore, in the interest "of the larger good" these statutes put the burden of acting "at

[205] Morissette v. United States, 342 U.S. 246, 253–56 (1952) (emphasis added).

[206] *Id.* at 256.

[207] *See, e.g.*, Buell, *supra* note 1, at 515–16 (distinguishing between theories of fraud based on the actor's intent and the impact on the victim).

[208] United States v. Dotterweich, 320 U.S. 277, 280 (1943).

hazard upon a person otherwise innocent but standing *in responsible relation to* a public danger."[209]

The public welfare offense theory subsequently led to the development in federal law of the responsible corporate officer doctrine, by which managers could be held criminally liable in certain regulatory contexts for the unlawful acts of employees over whom such managers had power or control, even if that power was not exercised.[210] Under this doctrine, federal courts have extended criminal liability to directors and officers under a broad array of statutes, including the Federal Food and Drug Act of 1906, Hazardous Substances Act, Sherman Act, Economic Stabilization Act of 1970, Occupational Safety & Health Act, and Water Pollution Control Act.[211] Given the difficulty of proving intent, and the public harm caused by the subprime mortgage crisis, some commentators have even suggested extending the doctrine to prosecute high-ranking financial executives where criminal action may not be otherwise supported by federal securities law.[212]

To a lesser—but still meaningful—extent, New York State has also recognized the constitutionality of public welfare legislation establishing strict liability for certain criminal offenses. In the leading case, the Court of Appeals

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209 *Dotterweich*, 320 U.S.at 281 (emphasis added).

210 *See, e.g.*, United States v. Park, 421 U.S. 658, 672–74 (1975) (holding that the Food and Drug Act does not require consciousness of wrongdoing to impose criminal liability on a corporate executive found to be in responsible relation to the manufacture of contaminated food).

211 Dan K. Webb, Steven F. Molo, & James F. Hurst, *Understanding and Avoiding Corporate and Executive Criminal Liability*, 49 BUS. LAW. 617, 628–29 (1994).

212 Christina M. Schuck, Note, *A New Use for the Responsible Corporate Officer Doctrine: Prosecuting Industry Insiders for Mortgage Fraud*, 14 LEWIS & CLARK L. REV. 371, 388–89 (2010). *But see* Amiad Kushner, Comment, *Applying the Responsible Corporate Officer Doctrine Outside the Public Welfare Context*, 93 J. CRIM. L. & CRIMINOLOGY 681, 710 n.182 (2003) (citing Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976)) (noting that because the doctrine still requires proof of the mens rea of the underlying statute, it would not apply to federal securities prosecutions that lacked a showing of scienter).

held in *People v. Munoz* that "[c]rimes may be created without intent as a factor other than the intent to commit the prohibited act, but there must be some *reasonable relationship* between the public safety, health, morals or welfare and the act prohibited."[213] It is not difficult to argue, in light of the social harm caused by wrongdoing in the subprime mortgage market, that such a relationship exists between securities fraud and public welfare.[214] But courts that authorized strict liability criminal prosecutions under the Martin Act's misdemeanor provision failed to explicitly acknowledge the implications of treating securities fraud as a public welfare offense.[215]

Nevertheless, there are several arguments in support of strict liability for criminal securities fraud under this part of the statute. Most importantly, much of the legislative history suggests that the Martin Act was a quintessential public welfare statute.[216] Even the Court of Appeals observed, "The purpose of the statute is remedial: to protect the public from fraudulent exploitation in the offering and sale of securities."[217] Official commentaries on the Martin Act have also noted that the statute "is not aimed primarily at the punishment of offenders, but rather at protection of the public."[218] Moreover, the Martin Act jurisprudence seemed to have "hinged on the philosophy that the purpose of the Martin Act is to protect the public to a greater degree

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213 People v. Munoz, 172 N.E.2d 535, 539 (1961) (emphasis added) (citations omitted).

214 *See, e.g.*, Eric A. Posner & E. Glen Weyl, *An FDA for Financial Innovation: Applying the Insurable Interest Doctrine to 21st Century Financial Markets*, 107 NW. U. L. REV. (forthcoming 2012) (advocating for a federal agency that would approve new financial products on the basis of social welfare).

215 *See supra* Part IV.A.1.

216 *See supra* Part III.B.1.

217 People v. Landes, 645 N.E.2d 716, 717 (N.Y. 1994).

218 72 N.Y. JUR. 2D INVESTMENT SECURITIES § 205 (2011) (quoting People v. Scanlon, 223 N.Y.S.2d 127, 128 (App. Div. 1961)).

than can be achieved in an ordinary action for fraud."[219] According to structural interpretations of Section 352-c, the fact that criminal liability is not premised on proof of actual damage, causation, or reliance was "specifically designed to allow the Attorney General to invoke the protective criminal penalties . . . before any actual *public injury* occurred."[220]

In addition to the legislative intent behind the Martin Act, there are pragmatic reasons that promote reading Section 352-c as establishing a public welfare offense. Most significantly, the public loss inflicted by the subprime mortgage meltdown—including rampant foreclosures, massive unemployment, and evaporated personal savings—surely constitutes a widespread hazard beyond individual control.[221] The financial crisis demonstrated that a toxic financial product, like contaminated food or a mislabeled pill, is capable of causing enormous social costs,[222] costs that high-ranking corporate executives can prevent, or at least mitigate, more effectively than can the general public. Moreover, the notion that certain financial institutions were "too big to fail"[223] during the financial crisis arguably implies

219 KAUFMANN ET AL., *supra* note 9, at 33. This aspect of the Martin Act, however, does not distinguish it from the federal mail fraud statute, which similarly does not require the government to prove actual injury, only intent. *See, e.g.*, United States v. Welch, 327 F.3d 1081, 1108 (10th Cir. 2003) (finding that a defendant "still may commit mail or wire fraud if he knowingly provides or withholds materially false information which imposes a substantial risk of loss on another . . . even if the risk does not materialize").

220 *Id.* at 34 (emphasis added).

221 *See* Schuck, *supra* note 212, at 389–91 (comparing mortgage fraud to the public hazard from Food and Drug Act violations).

222 *See generally* Elizabeth Warren, *Unsafe at Any Rate*, DEMOCRACY, Summer 2007, at 8 (arguing for a Financial Products Safety Commission on the grounds that subprime mortgages are just as dangerous as other consumer products that are more strictly regulated).

223 *See, e.g.*, ANDREW ROSS SORKIN, TOO BIG TO FAIL 538 (2009) (noting that lack of regulation and the conception of financial institutions as "too big to fail" may lead to continuous cycles of busts followed by government bailouts). On the origin of the phrase "too big to fail", *see* Robert P. Bartlett, III, *Making Banks Transparent*, 65 VAND. L. REV. 293, 324 (2012)

that securities fraud could be considered an offense against public welfare. If the potential social welfare destruction is large enough that the government must inevitably assume the financial obligations of large financial institutions at risk of failure, it seems uncontroversial to allow criminal misdemeanor prosecutions for securities fraud on a strict liability basis. The traditional counterarguments are that a lower mens rea standard would discourage innovation, chill disclosure, and steer the best talent away from corporate executive suites.[224] Nevertheless, those consequences have not been realized in other industries regulated by strict liability legislation, whereas harmful conduct *has* been deterred.[225] And many commentators contend that strengthening securities fraud statutes has a significant impact on deterring would-be wrongdoers.[226]

3. Limitations of Strict Liability Prosecutions

Still, there are important reasons why courts should have hesitated before interpreting the ambiguous text of the Martin Act as creating strict liability for misdemeanor violations. At least traditionally, strict liability laws

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(citing WALTER ADAMS & JAMES W. BROCK, THE BIGNESS COMPLEX: INDUSTRY, LABOR, AND GOVERNMENT IN THE AMERICAN ECONOMY 293 (1986)).

224 *See, e.g.*, SEC v. Tex. Gulf Sulfur Co., 401 F.2d 833, 867 (2d Cir. 1968) (Friendly, J., concurring) (questioning a negligence standard in the federal, civil fraud context, which would run "the risk that a slip of the pen or failure properly to amass or weigh the facts—all judged in the bright gleam of hindsight—will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers").

225 For example, there are still individuals willing to take on executive positions in the pharmaceutical industry, and effective, new products have been introduced following the decision in *Park*. United States v. Park, 421 U.S. 658 (1975).

226 *See, e.g.*, Thompson, *supra* note 57, at 54 (arguing that "[o]ther hucksters no doubt have been and will be deterred by the flames that engulfed Merrill Lynch" during the New York Attorney General's investigation).

"appear[] to conflict with the most fundamental principles of just punishment."[227] Particularly in the white-collar context, where criminal law serves a public signaling function only insofar as it provides a conception of fraud that is useful in organizing legal and public discourse about wrongdoing in financial affairs, "[t]o condemn everyone is, ultimately, to condemn no one."[228] If good faith statements made in the course of a transaction that ultimately misled a buyer were enough to constitute criminal securities fraud, the argument goes, convicting a defendant of this type of crime would no longer mean very much.[229] Notably, former Attorney General Eliot Spitzer also harbored doubts about the value of allowing a state like New York to deviate so widely from the constraints of federal securities statutes with regard to mens rea.[230]

Furthermore, the case against strict liability may be especially strong in the securities fraud context, where "there is clear evidence that initial media reports of fraud affect the market's assessment of a firm's value long before legal proceedings resolve the question of liability."[231] The ease with which prosecutors may obtain an indictment or information against defendants is well known. Since the vast majority of the damage from criminal sanctions in these types of cases may come through the public announcement itself,[232] the only real constraints on the negative consequences of potential prosecutorial misconduct are the

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[227] Laurie L. Levenson, *Good Faith Defenses: Reshaping Strict Liability Crimes*, 78 CORNELL L. REV. 401, 427 (1993).

[228] Buell, *supra* note 1, at 575.

[229] *Id.*

[230] *See* Thompson, *supra* note 57, at 54 (noting that Spitzer "admitted the potential pitfalls of allowing 50 states to regulate the international financial markets"). To be guilty of criminal securities fraud under federal law, the government must prove that the defendant committed the violation willfully. *See* 15 U.S.C. § 78ff(a) (2002).

[231] Buell, *supra* note 1, at 574 n.207.

[232] *See* Anello, *supra* note 11, at 22 (referring to the "shock value" of the public announcement).

prosecutors themselves.[233] But reliance on prosecutors' "good sense" is "precisely what our constitutional system sought to avoid."[234] And while courts have traditionally pointed out that public welfare criminal penalties "commonly are relatively small, and conviction does no[] grave damage to an offender's reputation,"[235] these contentions are of questionable veracity in the modern securities fraud context.[236]

4. Justifying Strict Liability for Misdemeanor Violations

Despite strong arguments both for and against strict liability, conducting the policy analysis in light of the statute's text and history—which New York courts have so far neglected to do—points to a particular outcome. Ultimately, reading Sections 352-c(1)–(3) as strict liability provisions best serves the goal of faithfulness to the text and the Legislature's purpose, while simultaneously maximizing doctrinal consistency.

Clearly, New York courts have already interpreted Section 352-c of the Martin Act as establishing strict liability for misdemeanor violations. While this might otherwise be the end of the inquiry, the opinions underlying these decisions have serious flaws, and require greater support than that which they offer for their conclusions.[237] The first shortcoming in the New York courts' reasoning is the apparent failure to draw a distinction between civil and

233 While this may be true of a prosecutor's decision to charge other crimes with higher mens rea requirements, one would expect that standards of professional conduct and office policies regarding charging decisions largely mitigate the potential for abuse (by requiring, for example, that prosecutors show at least a certain level of evidence that the government will be able to prove each element of the crime).

234 United States v. Dotterweich, 320 U.S. 277, 292 (1943) (Murphy, J., dissenting).

235 Morissette v. United States, 342 U.S. 246, 256 (1952).

236 *See, e.g.*, Buell *supra* note 1, at 575.

237 *See supra* Part IV.A.1.

criminal liability. Despite the significant differences between the two spheres, those courts have decided that since *civil* enforcement actions may proceed on a strict liability basis, the same must be true of *criminal* actions.[238] They also rely on the finding that the 1955 amendment authorizing criminal prosecutions was intended to *strengthen* the Attorney General's power to protect the public. As a result, the courts reason, this necessarily means that Section 352-c created strict liability for misdemeanor crimes.[239]

This conclusion was not inevitable, however. Not only is the statute itself completely silent as to the mens rea element, but the legislative history provides evidence to support either construction: that Section 352-c creates a strict liability offense, or that prosecutors must prove at least *some* level of culpability less than intent.[240] Although courts adopted the first interpretation, concluding that the misdemeanor provision requires proof of at least negligence would have enhanced the Attorney General's power under the Martin Act as well.

Still, in the post-crisis era, there are strong arguments to be made that financial regulation under federal statutes like Dodd-Frank[241] may not go far enough in protecting consumers from the same malfeasance that brought about the financial crisis.[242] New York courts may therefore serve valid public policy goals by weakening mens rea under the Martin Act. Ultimately, it may be hard to prove that strict liability misdemeanor prosecutions will restore public accountability to the financial industry; the lack of a

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238 *See supra* Part IV.A.1

239 *Id.*

240 *See supra* Part II.B.1.

241 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

242 *See* Posner & Weyl, *supra* note 214; Ivo Welch, *Preventing the Next Financial Crisis*, HARV. L. SCH. F. ON CORP. GOV. & FIN. REG. (June 8, 2011, 9:26 AM), http://blogs.law.harvard.edu/corpgov/2011/06/08/preventing-the-next-financial-crisis (expressing serious skepticism over whether regulations promulgated under Dodd-Frank actually reduce the risk of another financial crisis).

criminal intent requirement provides little public satisfaction that the "right" people are being brought to justice. Nevertheless, the fact that the Attorney General could bring criminal penalties against financial executives who lack culpability may serve at least some deterrent effect. This interpretation of the statute is also consistent with the Legislature's intention to promulgate a *remedial* statute.[243]

In conclusion, the most important point is that the text and general understanding of the statute's authors can adequately support reading Section 352-c as creating strict liability offenses. Because a more thorough examination of allowing strict liability convictions for securities fraud also counsels in favor of this interpretation, New York courts—despite their failings—seem to have reached the right answer in the misdemeanor context.

B. A Willfulness Standard in the Martin Act Felony Context

Determining the mental state requirements under the Martin Act's felony provisions, Subsections 352-c(5) and (6), presents a very different problem. Whereas courts interpreting the misdemeanor provision were confronted by ambiguous text, the courts deciding felony cases were required to construe an otherwise clear legislative enactment. On its face, the Martin Act appears to require "intent" to create felony liability.[244] Cases interpreting the felony provisions, however, demonstrate that this standard of culpability—ostensibly equivalent to "purpose"—has been watered down to something less.[245] Furthermore, the few cases in which New York courts have construed mens rea under the felony provisions fail to provide any detail in their

243 *See, e.g.*, People v. Landes, 645 N.E.2d 716, 717 (N.Y. 1994) ("The purpose of the statute is remedial . . . .").

244 *See supra* Part III.B.2.

245 *See, e.g.*, KAUFMANN ET AL., *supra* note 9, at 49 (explaining that intent to commit fraud is required to commit a felony offense under the Martin Act).

reasoning. Nevertheless, by placing the Martin Act's history and jurisprudence in context with *federal* criminal securities fraud culpability requirements, it is possible to justify setting the culpability standard for Subsections 352-c(5) and (6) at a specific version of willfulness equivalent to recklessness.

1. Jurisprudential Confusion in Defining "Intent"

There is a strong case for challenging the jurisprudence on mens rea under the felony provisions of the Martin Act. Although New York courts have determined that proof of intentional fraud is not required to support felony liability, they have not clearly articulated which alternative standard of culpability is required instead. Such relaxation of mental state requirements stands in stark contrast to a legislative history that demonstrates a desire to punish only frauds committed intentionally, and a statute that carries punishments as high as twenty-five years' imprisonment.[246] This provides sufficient cause to seriously question the courts' dilution of the felony mens rea requirement, and demand a clearer standard for liability.

The New York Court of Appeals has only considered the question of mens rea culpability in the Martin Act's felony context once, in *People v. Landes*. In that case, however, the court's determination that a defendant could be liable in the absence of a showing of criminal intent was dictum.[247] Additionally, the only authority the court offered in support of its sweeping statement was Kaufmann's *Practice Commentaries*, which itself relied on civil cases to draw conclusions about mens rea in criminal prosecutions.[248] One

246 *See supra* text accompanying note 144.

247 *Landes*, 645 N.E.2d at 717–18.

248 *See* KAUFMANN ET AL., *supra* note 9, at 31 (What elevates the Martin Act to the position of being perhaps the strongest blue sky law nationwide is the fact that neither intent to defraud nor scienter need be alleged or proven to sustain civil liability for committing any violation of the Act or criminal culpability for engaging in those acts or practices prohibited and made illegal by Section 352-c thereof).

possible explanation for this apparent gap in reasoning is that the court only had misdemeanor liability in mind, and thus its pronouncement—while made in passing and largely unsupported—was not an inaccurate statement of the law. On the other hand, given the facts of *Landes*, the court made its reference in the context of a case where the defendant had been charged with, but not convicted of, six felony counts of fraud in violation of Section 352-c(6).[249] Thus, the court paved the way for an expansive reading of felony liability without providing a sufficient justification for its interpretation.

The most important case on mens rea under the felony provision of the Martin Act is thus *People v. Sala*, in which both the culpability standard and sufficiency of the evidence under Section 352-c(6) were challenged. Comparing the text of the provision to the crime of a "scheme to defraud," the court held that a defendant has the requisite mens rea "where he 'intentionally engages in fraud . . . while engaged in inducing or promoting the . . . sale'" of securities within the meaning of the Martin Act.[250] Unfortunately, *Sala* is no clearer than *Landes* in explaining its reasoning. To support its conclusion about the culpability requirement for criminal felony prosecutions, the *Sala* court cited only two civil cases[251] and Kaufmann's *Practice Commentaries*. In doing so, it neglected to adequately consider not just the statutory language and legislative intent to assign felony punishment only to *intentional* frauds, but also any distinctions that reasonably could and should have been made between civil

[249] *Landes*, 645 N.E.2d at 717.

[250] People v. Sala, 695 N.Y.S.2d 169, 177 (App. Div. 1999) (citing N.Y. GEN. BUS. LAW § 352-c(6) (McKinney 2012); People v. Lurie, 673 N.Y.S.2d 60, 62 (App. Div. 1998) (noting "there must be an intent to defraud" for liability under Section 352-c(6))), *aff'd*, 739 N.E.2d 727 (N.Y. 2000).

[251] *Sala*, 695 N.Y.S.2d at 177 (citing State v. Rachmani Corp., 525 N.E.2d 704 (N.Y. 1988); People v. Lexington Sixty-First Assocs., 345 N.E.2d 307 (N.Y. 1976)).

and criminal liability.[252] Instead, the court found that "the People need only prove that the defendant committed an *intentional act* constituting fraud, which under the Martin Act includes . . . all acts tending to deceive or mislead the public."[253]

The impact of *Landes* and *Sala* on felony culpability is therefore uncertain. Whereas the statute would seem to require purpose, that reading is now in jeopardy. By requiring only an "intentional act constituting fraud,"[254] the jurisprudence appears to have shifted the culpability requirement away from a purpose standard. Instead, the focus is almost exclusively on the defendant's mental state regarding the tendency of his or her representations to mislead, but not the defendant's goal vis-à-vis the victim in making such representations.[255] Therefore, it may no longer matter whether the defendant's object was to deprive the victim of money through the use of a false representation. Instead, the fault inquiry might apply only to the factual matter of "whether the representation or conduct was false or misleading."[256]

In this fashion, the New York courts may have reduced the mens rea standard for felony prosecutions under the Martin Act to something that more closely resembles a willfulness standard.[257] But as many commentators in the

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252 *See* Buell, *supra* note 1, at 538 (arguing that mental state is of primary importance in differentiating criminal and civil penalties for securities fraud).

253 *Sala*, 695 N.Y.S.2d at 177 (emphasis added) (internal quotation marks omitted).

254 *Id.*

255 For an explanation of the difference between the two, see Buell, *supra* note 1, at 526–27 (distinguishing between two theories of fraud: "core" fraud, which requires that the defendant's goal was to deceive the victim, and mere "misrepresentation," which requires awareness only with regard to the simple falsity of the representation).

256 Buell, *supra* note 1, at 531.

257 *See* People v. Florentino, 456 N.Y.S.2d 638, 645 n.9 (Crim. Ct. 1982) (implicitly accepting a definition of mens rea under Section 352-c as a "willfulness requirement," satisfied by gross indifference, which could be

securities fraud context have pointed out before, attempting to define what constitutes a willful violation of a statute is wrought with difficulty,[258] and the answer varies across statutes and jurisdictions.[259] Thus New York courts have simultaneously weakened the statute's culpability standard with regard to felonies, and increased the degree of ambiguity about precisely what behavior constitutes a violation of that standard.

2. Willfulness in Federal Securities Fraud Prosecutions

The Martin Act's Section 352-c jurisprudence illustrates that something less than purposeful intent is required to establish a felony violation. But if a general willfulness standard is in fact a correct interpretation of the statute, there is a threshold problem to resolve before exploring the details of precisely what that standard means. The issue arises in the purported relationship between the Martin Act and the federal criminal securities fraud regime. While commentators almost universally agree that the Martin Act is the strongest securities fraud statute in the country,[260] the culpability standard for criminal prosecutions under federal laws—at least as written in the statutes—is also some variation on willfulness.[261]

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equated with knowledge (citing Kim B. Stogner, Note, *Securities Regulation: Criminal Liability Under the Oklahoma Securities Act—The Willfulness Requirement*, 31 OKLA. L. REV. 486, 499 (1978) (observing that, in the omission context, gross carelessness or indifference suffices to establish "intent to defraud" under most states' securities laws))).

[258] *See infra* Part IV.B.2.

[259] *See* 5 ALAN R. BROMBERG & LEWIS D. LOWENFELS, SECURITIES FRAUD 9–10 (2d ed. 2011).

[260] *See, e.g.*, KAUFMANN ET AL., *supra* note 9, at 47 (the conduct "declared to be fraudulent and illegal under the Martin Act is extremely broad, far exceeding those expressly prohibited activities set forth in either" the Securities Exchange Act or Rule 10b-5).

[261] *See* 2 LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, FUNDAMENTALS OF SECURITIES REGULATION 1418 (6th ed. 2011) (highlighting several possible interpretations of "willful and knowing").

For example, under Section 32 of the Securities Exchange Act of 1934, a defendant may be charged with felonious criminal securities fraud for "willfully" violating any SEC regulations, rules or orders.[262] In general, courts and commentators have construed this culpability standard as requiring only that the prosecution show the defendant "knew what she or he was doing, not that she or he knew it was illegal."[263] Commentators agree this means a prosecutor is not required to prove a defendant's specific intent to violate a particular provision of the law,[264] but only that the defendant acted with "a bad purpose."[265] Yet federal courts have engendered the same degree of confusion in interpreting this requirement as New York courts have in construing mens rea for Martin Act felonies.[266] In fact, federal courts have interpreted "willfully" under Section 32(a) to include even defendants who acted only with knowledge or mere recklessness.[267] Moreover, the language of the statute establishing criminal penalties for making false or misleading statements to the SEC, which covers "willful *and knowing*" violations, further exacerbates the uncertainty in federal securities fraud culpability requirements.[268] Finally, many opinions "elide the

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262 15 U.S.C. § 78(ff) (2012). *See also* LOSS, SELIGMAN & PAREDES, *supra* note 261, at 1418.

263 BROMBERG & LOWENFELS, *supra* note 259, at 9–10.

264 *See, e.g.*, *id.* at 10–11; Seigel, *supra* note 48, at 1609–10 (arguing this allows for a "good faith" defense).

265 *See, e.g.*, Sachs, *supra* note 197, at 1054 (arguing that this interpretation therefore means "willfulness" requires something more than recklessness or even knowledge).

266 *See, e.g.*, United States v. Ladish Malting Co., 135 F.3d 484, 487 (7th Cir. 1998) (Easterbrook, *J.*) ("'Willfully' is a notoriously slippery term") (citing Ratzlaf v. United States, 510 U.S. 135, 141 (1994) (Ginsburg, *J.*) ("'Willful,' this Court has recognized, is a 'word of many meanings,' and 'its construction [is] often . . . influenced by its context.'")).

267 *See* LOSS, SELIGMAN & PAREDES, *supra* note 261, at 1865.

268 *See id.* at 1421 (emphasis added) (explaining the various interpretive strategies courts have used to construe this phrase). *But see* Buell, *supra* note 1, at 556 (arguing that even though statutes should not

distinction between the evidentiary and constitutive questions"[269] by failing to specify to what extent evidence of a lower mental state (like recklessness) can suffice as proof of the higher mental state required under the language of the statute (such as willfulness or purpose).[270]

This raises the question of what the confusion[271] with regard to the precise definition of willfulness in the federal system means for the felony provisions of the Martin Act.[272] Although much of the legislative history and academic commentary emphasize that the Martin Act is more powerful than any other securities fraud statute, state or federal,[273] this does not necessarily mean the mens rea requirement for felony Martin Act violations must be lower than in the federal statutes. To the contrary, there are many aspects other than mens rea in which liability under Section 352-c of the Martin Act is more expansive than under federal law.[274] As a result, it is simply not true that the mens rea standard in Martin Act felony prosecutions is *necessarily* lower than the federal willfulness standard. A more precise definition of which mental state New York courts had in mind when reading an "intentional conduct" requirement into the statute should be driven primarily by the felony provisions' text and legislative purpose instead, and refer to

be read to create redundancies, at the very least, "knowingly" cannot require knowledge of the relevant criminal statute, since this would allow a mistake of law defense).

269 Buell, *supra* note 1, at 558.

270 *See id.* at 556.

271 *See supra*, note 266.

272 Seigel concludes that resolving the "interpretive stalemate" in attempting to distill specific mens rea requirements is a matter of deciding which policy arguments are most persuasive. Seigel, *supra* note 48, at 1613–14 (arguing that the public desire to hold accountable difficult-to-reach senior executives may justify lower standards).

273 *See supra* Part II.A.

274 *See supra* note 32. In addition, the text of Section 352-c(6), but not 352-c(5), of the Martin Act requires materiality. Materiality is, however, an element in all federal securities fraud prosecutions. LOSS, SELIGMAN & PAREDES, *supra* note 261, at 1421.

interpretations of similar federal language only where it aids in the interpretive process.

3. Justifying and Committing to a Willfulness Construction for Martin Act Felonies

Precisely where willfulness might fit into the Martin Act culpability scheme in particular is not clear ex ante. Still, there are several guiding principles to be considered in determining what future courts should hold violates the felony provisions of the Martin Act under the *Sala* court's standard.[275] Considering the Martin Act's specific legislative history in light of the traditional understanding of willfulness is instructive. Although its precise meaning always depends on the context, a willful violation requires some general sense of wrongdoing, but not the specific intent to violate a particular statutory prohibition.[276] Thus, for example, to successfully prosecute a felony case, the Attorney General would not be required to prove a defendant knew his or her false misrepresentations violated Section 352-c of the Martin Act. In addition, the term willful cannot be meaningless.[277] The legislative history makes clear that the language of intentionality in Sections 352-c(5) and (6) was included in the statute precisely to target the more culpable defendants.[278] Thus, it is obvious that this cannot be a strict liability crime. Yet it is also clear under *Sala* that

275 Of course the effort to develop more precise culpability requirements should always be balanced by the need to instill flexibility in the law to capture innovative forms of socially harmful conduct. *See* Buell, *supra* note 1, at 521.

276 *See supra* note 263 and accompanying text.

277 *See, e.g.*, People v. Luciano, 2012 WL 1473438, at *8 (N.Y. Sup. Ct. Apr. 27, 2012) ("In construing a statute, a court should generally assume that every word in the statute has a meaning and was inserted for a purpose.").

278 *See supra* Part III.B.2.

even if it requires an "intentional act," willfulness does not require purpose.[279]

Another potential source of guidance is evidence of how New York courts have interpreted "intent to defraud" in non-securities contexts. Most significantly, "[a]lthough a significant number of penal statutes require an 'intent to defraud,' there is no Penal Law definition of that . . . mental state."[280] In *People v. Taylor*, however, the Court of Appeals held that "intent to defraud," in the context of filing a false instrument as part of an insurance fraud scheme in violation of Penal Law Section 175.35, referred to "a defendant's state of mind in acting with a conscious aim and objective to defraud."[281] *People v. Bailey* similarly reflects the court's emphasis on proof of a specific goal.[282] In *Bailey*, the court held that the state failed to prove the defendant acted with "intent to defraud" in violation of Penal Law Section 170.30 (possession of a forged instrument) despite evidence that he knowingly possessed counterfeit bills in a shopping district.[283] To support this conclusion, the court relied on the fact that "when the Legislature intends for there to be a presumption or inference of intent" by evidence of a less culpable mental state, "it so specifies in the statute."[284] Furthermore, the Appellate Division, Second Department's

279 People v. Sala, 695 N.Y.S.2d 169, 177 (App. Div. 1999), *aff'd*, 739 N.E.2d 727 (N.Y. 2000). *See* Seigel, *supra* note 48, at 1608 (noting that securities fraud cannot require purpose, which would make criminal statutes practically ineffective, other than in egregious cases). *See also* Buell, *supra* note 1, at 559 (observing that "courts have made virtually no effort to distinguish between the goal-oriented mental state involved in a defendant's purpose to deceive and the knowledge-based mental state involved in a defendant's awareness of the falsity of her representation (or tendency of her conduct or omission to mislead)").

280 N.Y. PENAL LAW § 15.00 note para. 3 (McKinney 2012) (Culpable Mental States).

281 People v. Taylor, 926 N.E.2d 591, 592 (N.Y. 2010) (deciding further that reliance was not an element of the statute).

282 People v. Bailey, 915 N.E.2d 611, 614 (N.Y. 2009).

283 *Id.*

284 Bailey, 915 N.E.2d at 614.

opinion in *People v. Saporita* illustrates that this focus on the defendant's object—in addition to awareness of the relevant falsity itself—is not a relatively new phenomenon.[285] Writing in 1987, the *Saporita* court held that in the context of tampering with public records and falsifying business records, in violation of Penal Law Sections 170.25 and 170.10, intent to defraud meant intent "to cheat or deprive another person of property or a thing of value or a right."[286] Thus it seems clear that in contexts other than the Martin Act, the element of "intent to defraud" requires that the prosecution prove the defendant had a conscious purpose to *deprive* the victim.

In the Martin Act felony context, however, the relevant decisions have emphasized the term "intentional conduct" rather than "intent to defraud," underscoring that "intentional conduct" requires something *less* than proof of purpose.[287] But exactly how much less is the central question that has yet to be resolved by the courts or commentary. Unfortunately for defendants, the persistence of this ambiguity largely benefits the State. The ambiguity enables the Attorney General to wield greater leverage in negotiating guilty pleas from defendants, leaving it to the courts to later determine precisely which conduct falls within the statute, while allowing the Legislature to avoid accountability.[288] Yet it is also true that New York courts typically refuse to construe criminal statutes liberally, especially when the statute proscribes conduct that is malum prohibitum and lies outside the Penal Law.[289] Consequently,

285 People v. Saporita, 518 N.Y.S.2d 625 (App. Div. 1987).

286 *Id.* at 627.

287 *See supra* Part III.C.2.

288 *See generally* Kahan, *supra* note 197 (suggesting broadly worded federal criminal statutes be characterized as delegations of legislative power to the Executive). It is also significant that courts only have the opportunity to interpret the law in cases in which the defendant does not plead guilty.

289 N.Y. PENAL LAW § 5.00 (McKinney 2012) (general rule that statutes are to be construed strictly applies to statutes outside the Penal Law); People v. Scott, 258 N.E.2d 206, 210 (N.Y. 1970) ("The proscribed

seeking to resolve this ambiguity offers potential value to defendants, courts, and the Legislature alike: to defendants, fair notice; to courts, something more than a blank slate from which to interpret the statute; and to the Legislature, feedback from which to decide whether or not the Martin Act's use accurately vindicates its intent.

The critical issue thus becomes understanding what New York courts mean by "intentional conduct" in the Martin Act context. According to Penal Law Section 15.00, "conduct" means "an act or omission and its accompanying mental state."[290] Furthermore, a defendant acts "intentionally" when "his conscious objective is to cause such result or to engage in such conduct."[291] Professor Buell's dichotomy is helpful in deciding which conclusion should be drawn from the foregoing analysis.[292] Suppose that mens rea in securities fraud requires two inquiries—one into the defendant's awareness of the falsity of his representation, and the other into the defendant's goal with respect to the representation. *Sala* implies that purpose may not apply to either aspect of mens rea, while the Penal Law counsels that a high degree of consciousness must attach to the act or omission. Therefore, a definition of "intentional conduct" in the Martin Act context that best reconciles the sources of interpretive guidance appears to require that the defendant have knowledge[293] that his or her representation was false,

conduct . . . should be clearly enunciated so that all those who may be affected may gauge their actions accordingly.").

290 N.Y. PENAL § 15.00(4) (McKinney 2012).

291 N.Y. PENAL § 15.05(1) (McKinney 2012).

292 *See supra* notes 255 and 279.

293 *See* N.Y. PENAL § 15.05(2) (McKinney 2012) ("A person acts knowingly with respect to conduct or to a circumstance described by a statute defining an offense when he is *aware* that his conduct is of such nature or that such circumstance exists.") (emphasis added). This conclusion also has the virtue of conforming to the previous discussion of mens rea in the federal securities fraud felony context. *See supra* Part IV.B.2. While the argument that Martin Act felony liability is necessarily broader than felony liability—which is predicated on willful and knowing

but—unlike "intent to defraud" in other contexts—does not require purpose with regard to the defendant's goal or awareness of the victim's response to the representation. This conclusion is also consistent with *In re Reich*, where the New York appellate court held that a defendant could be convicted of insider trading under Section 352-c(6), despite having decided not to collect profits from the exchange of information.[294]

Because only the second element of intent to defraud—the defendant's awareness with respect to depriving the victim—remains undefined within the meaning of "intent to defraud" under the felony provisions of the Martin Act, the potential mental states that might fall within the conduct proscribed by the statute thus include:

1) Defendants who were aware of a representation's falsity, and aware that this representation would cause a victim to give up something of value (knowledge);
2) Defendants who were aware of a representation's falsity, and were "aware of and consciously disregarded a substantial and unjustifiable risk" that this representation would induce a person to give up something of value (recklessness);[295]
3) Defendants who were aware of a representation's falsity, but failed to perceive a substantial and unjustifiable risk that this representation would induce a person to give up something of value so as to constitute a gross deviation from the standard of care that a reasonable person would observe in the situation (criminal negligence);[296]
4) Defendants who were aware of a representation's falsity, and this representation induced a person to give up something of value, regardless of whether

conduct—is not particularly strong, the argument that mens rea should be *equivalent* between the two systems has much more adequate grounds.

294 *In re* Reich, 515 N.Y.S.2d 775 (App. Div. 1987).

295 As defined in N.Y. PENAL LAW § 15.05(3) (McKinney 2012).

296 As defined in N.Y. PENAL LAW § 15.05(4) (McKinney 2012).

the defendant exercised due care (strict liability).[297]

The idea of willfulness traditionally excludes conduct not considered wrongful, and thus typically, negligence. In the securities context however, where senior executives are aware that public disclosure is highly regulated, there is a strong argument that simply failing to exercise due care in the face of known duties is nonetheless worthy of felony punishment.[298] Yet because the New York Legislature's purpose was to target more culpable defendants whose crimes were not adequately punished by misdemeanor penalties,[299] the question seems to be whether the bar for felony liability under the Martin Act should be set any higher than hypothetical mental state (2). This is especially important, given the need for securities fraud prosecutions arising out of the financial crisis to provide a sense of public accountability. Pursuing felony convictions against defendants who were negligent with regard to the deceptive impact of a false representation seems intuitively unsatisfying.[300] Nevertheless, there is very little evidence to suggest that the standard should be any higher than "recklessness" as defined by the New York Legislature, particularly where this definition includes an element of

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297 Selecting this option would imply that, according to Professor Buell's construct, Martin Act felonies are more akin to misrepresentation crimes, not "core" fraud.

298 *Cf.* Staples v. United States, 511 U.S. 600, 610–11 (1994) (explaining that gun ownership, unlike possession of a hand grenade, is not the type of activity that puts owners "on notice that they stand 'in reasonable relation to a public danger'") (citing United States v. Dotterweich, 320 U.S. 277, 281 (1943)).

299 *See supra* Part III.B.2–3.

300 A prosecutor may nonetheless make the argument before a jury that evidence of a defendant's carelessness with regard to a representation supports a finding of advertence but indifference to risk. The role of evidentiary arguments in potentially manipulating constitutive elements of a crime is a real concern, *see* Buell, *supra* note 1, at 560, but is outside the scope of this Note. Accordingly, the foregoing analysis is only concerned with the legal definition of the crime, and not with the degree to which certain evidence may be sufficient to establish liability.

consciousness, and thus essentially mirrors the federal felony standard.

As a result, the construction of mens rea under the Martin Act felony provisions that best comports with the text, history, and jurisprudence of Section 352-c establishes liability for those who—at a minimum—were aware of the tendency of their representations to mislead but were reckless as to whether it would induce a person to give up something of value. For example, if a chief financial officer certifies a 10-K, promising full disclosure of a company's liabilities, but knowingly omits information about an off-book accounting technique that serves the purpose of hiding further liabilities, he or she may be held liable under the Martin Act's felony provisions for intent to defraud if he or she were reckless as to whether this would deprive investors.[301]

V. CONCLUSION

A. Committing to Reconcile Text, History and Jurisprudence

Because the New York Court of Appeals has never directly decided which mens rea showing is required for criminal violations of the Martin Act under either the misdemeanor or felony provisions, assertions of public officials and academic commentators notwithstanding, the question has not been fully resolved. Furthermore, where lower courts *have* issued opinions in Martin Act cases, their reasoning has been particularly susceptible to attack. Regarding misdemeanor culpability, the jurisprudence fails to provide a thorough justification for the strict liability standard. For felony offenses, judges have twisted the

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[301] This conclusion is consistent with New York courts' decisions upholding "intent to defraud" convictions in other contexts when the defendants disclaim any intent to defraud the specific victim deceived by their conduct. *See, e.g.*, People v. Dallas, 848 N.Y.S.2d 132, 134 (App. Div. 2007).

statute's text and substantial legislative history to render a clear statute more vague.

But the lack of federal prosecutions against senior financial executives for securities fraud in connection with the financial crisis has created a situation in which New York State's Martin Act may take on a more substantial, nationally visible role in criminal enforcement action against Wall Street. There is tremendous danger, however, in utilizing a criminal statute with weakened and inadequately supported culpability requirements as a solution to public demands for individual accountability. If it becomes too difficult to explain why certain conduct should be criminally sanctioned, the force of securities law in deterring future conduct and signaling appropriate behavior will be depleted.

If New York commits to more clearly define the mens rea showing required for holding individuals liable under the Martin Act, and endeavors to justify these standards in terms of the statute's text, history, and policy goals, the State could restore both legitimacy and effectiveness to its fight against securities fraud. Strict liability does in fact serve these goals under the misdemeanor provision of Section 352-c. And a willfulness standard, not necessarily greater or less than the level of culpability required under federal criminal law, can be justified as the best interpretation of the "intent to defraud" requirement under the felony provisions. Setting these as minimum thresholds for criminal liability would restore a degree of certainty and fairness to securities fraud prosecutions under the Martin Act, and provide the best chance at moving the statute away from its perception as a "weapon of mass destruction," and toward one as a tool with "unlimited capacity for good."[302]

B. Addressing Practical Considerations

Ultimately, however, it may be the case that a clearer, more nuanced, and more thoroughly justified understanding of mens rea under the Martin Act would not make a

302 Thompson, *supra* note 57, at 50.

pragmatic difference in the value of criminal enforcement actions after the financial crisis. Practically speaking, scienter distinctions ultimately become irrelevant in most cases.[303] While mental state requirements have a formal, "bookkeeping" role to play, the reality is that the criminal justice system affords wide discretion to juries in determining whether the facts of a specific case are sufficient to prove the defendant's culpability, according to whichever language the judge decides to incorporate into the instructions. White-collar defendants whose alleged crimes related to the financial crisis may be particularly harmed by this situation.[304]

Culpability standards under the Martin Act in particular may be of lesser consequence for other reasons. For example, there is some evidence to suggest that while the Merrill Lynch case, which brought national attention to former Attorney General Eliot Spitzer and the Martin Act in 2002, could have been prosecuted on a strict liability basis, the allegations suggested that a more demanding scienter requirement would have been met.[305] According to Spitzer himself, even if the Martin Act did not exist, his targets could have been prosecuted under existing New York case law on other statutes, because there was ample evidence of intentional deception.[306] Moreover, commentators have

[303] Buell, *supra* note 1, at 560.

[304] Jake Mooney, *Just One Not-Angry Man*, N.Y. MAGAZINE, Jan. 29, 2012, *available at* http://nymag.com/news/intelligencer/benjamin-brafman-barry-bohrer-2012-2 ("You have op-eds crying out, 'Why haven't people been prosecuted?' There's a presumption of guilt there that's not necessarily based upon an analysis of the facts in the case or the application of law . . . . It becomes the potential juror's view that there should be some scapegoats or some example set.")

[305] Park, *supra* note 6, at 655 n.125 (2007).

[306] John Caher, *Spitzer: A Scholar Intent on Bringing Ethics, Integrity to the Marketplace*, 231 N.Y. L. J. 28 (Dec. 8, 2004).

found, in general, that political considerations usually prevent prosecutions for strict liability crimes.[307]

Finally, although securities fraud prosecutions may function well in signaling behavioral norms to the public, there are reasons to doubt their practical impact in preventing future financial crises. While "[s]eeking greater punishments for white-collar offenders gives the impression the government is taking steps to prevent crime, . . . there is a substantial question whether these proposals will have any appreciable impact on deterring future violations."[308] According to one commentator's explanation,

> The expression of public values through criminal law does not necessarily lead to law-abiding behavior when powerful subgroups create opposing values. Criminal law is not particularly effective against such subgroups and may not create the internalized social norms that are necessary for compliance. Nor does the threat of stigmatization or punishment always trigger the rational calculation that might deter wrongdoers. Conduct that is perilously unlawful may not be recognized or the risk of punishment may not be accurately assessed. And even when the danger is recognized, it may be too late to change behavior.[309]

But the Martin Act is not targeted at senior executives alone. In fact, the role of institutions in shaping individual behavior raises interesting questions about the relationship between corporate and executive liability in the securities

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307 Eric W. Zitzewitz, *Prosecutorial Discretion in Mutual Fund Settlement Negotiations, 2003–7*, 9 B.E. J. ECON. ANALYSIS & POL'Y. 1, 4 (2009).

308 *Supra* note 25.

309 Geraldine Szott Moohr, *An Enron Lesson: The Modest Role of Criminal Law in Preventing Corporate Crime*, 55 FLA. L. REV. 937, 968 (2003).

fraud context, and may have implications for prosecutorial strategy.[310]

Still, it is not obvious to which conclusion these considerations point. If financial executives can be held criminally accountable without the use of weaker culpability requirements, that is a strong rationale for requiring heightened culpability standards. But if legal norms do not materially change behavior among those whose conduct falls under the statute, it is more difficult to argue that a potentially sweeping criminal statute with lower mental state requirements would have a significantly detrimental impact on the marketplace. In either case, the growing public spotlight on criminal prosecutions related to the financial crisis has a clear implication for the need to

[310] The scope of this Note is limited in two important respects that are worthy of mention in this regard. First, while the issue of mens rea under the Martin Act is an interesting and important one, it is only half of a prosecutor's case. In order to prosecute a defendant for securities fraud, the Attorney General also has to prove the requisite actus reus of the crime. The likelihood of prosecutors obtaining evidence regarding the involvement of senior executives in potential wrongdoing related to the crisis exceeds the limits of this research effort. Second, there are doctrinal and practical reasons why individual criminal liability may be less important than the potential liability exposure of corporations under the statute. *See, e.g.*, Jennifer H. Arlen, *The Potentially Perverse Effects of Corporate Criminal Liability*, 23 J. LEGAL STUD. 833, 835 (1994) (observing that corporations are generally better able to identify wrongdoing than prosecutors). Doctrinally, the idea of collective knowledge may make prosecutions at the corporate level more feasible given the availability of evidence. *But see* Kate Stith, William J. Stuntz & Daniel C. Richman, Federal Criminal Law 827 (forthcoming 2013) (unpublished manuscript) (on file with author) (expressing skepticism about the role of collective knowledge in criminal prosecutions). Prosecutors may therefore need to exert pressure on a corporation in order to obtain information on individuals within it. *See* Arlen, *supra*, at 835–36. There may be something unsatisfying, however, about prosecuting individuals who acted in what they perceived to be the best interests of the corporation. *But see* Jennifer H. Arlen & William J. Carney, *Vicarious Liability for Fraud on Securities Markets: Theory and Evidence*, 1992 U. ILL. L. REV. 691, 703 (1992) (suggesting that the main driver of criminal securities fraud is personal, rather than corporate, benefit).

understand and justify mens rea under the Martin Act. By doing so, the Attorney General would only be better positioned to restore justice and legitimacy to the financial markets; there would finally be a convincing public rationale for why punishment should be imposed in certain cases.