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AN OFFICER WALKS INTO A BAR: ACKNOWLEDGING THE NEED FOR DETERRENCE IN OFFICER AND DIRECTOR BARS

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The U.S. Securities and Exchange Commission (SEC) is the civil regulatory agency responsible for helping to defend and protect the American investor. One significant threat to investor security occurs when an individual, acting as an officer or director, violates a fiduciary duty to his or her employer and its shareholders, risking investor money. These actions could involve insider trading, fraudulent statements in public filings, or other self-serving conduct.

Recognizing the importance of deterring such misconduct, Congress gave the SEC the authority to bar certain individuals from serving as officers and directors of public companies. An individual should be barred if he has demonstrated unfitness to serve in that capacity. Unfortunately, the current standard has resulted in inconsistent applications across different types of misconduct and has been unresponsive to both legislative enactments and widespread management misconduct leading up to the 2008 financial crisis, which has eroded its effectiveness as a key deterrence mechanism in the SEC's arsenal.

This Note begins by exploring the roles held by directors and officers and why effective corporate governance is critical to the functioning of the capital markets. Next, this Note discusses how the existing unfitness standard has failed to address Congress's intent to deter misconduct and has not appropriately responded to the Sarbanes-Oxley Act of 2002, which amended the statutory requirement for granting a bar. Ultimately, this Note proposes a new standard for officer and director unfitness that gives less opportunity for inconsistent results, focuses on the risk of future misconduct, and properly responds to recent legislative enactments and market events such as the 2008 financial crisis.

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INTRODUCTION

Charles C. Conaway, the chief executive officer of the publicly traded company Kmart, overpurchases inventory that his company cannot afford.[1] He lies about Kmart's true ability to pay for the inventory it has committed to buy, and he conspires to make materially false representations in Kmart's financial statements.[2] Unsuspecting investors then rely on this misinformation and purchase Kmart stock.[3] Ultimately, the fraud is uncovered, and Conaway is terminated as CEO, but too late for the Board of Directors to prevent the company's bankruptcy.[4] When news of the fraud becomes public, Kmart's stock plummets, wiping out millions of dollars in value from the investments of unsuspecting individuals.[5]

Brent C. Bankosky, a director at Takeda Pharmaceuticals International Inc., finds out his employer is about to announce a major acquisition.[6] Bankosky deliberately trades his employer's stock in advance of the lucrative deal's public announcement.[7] Based on his trading before the deal is announced, he makes $63,000.[8]

Each of these individuals committed misconduct that compromised his duty to his employer and violated the law. But, should each face an identical court order prohibiting him from serving as an officer or director of a public company?

Among the many legal remedies available against violators of federal securities laws,[9] the U.S. Securities and Exchange Commission (SEC) can seek a moratorium on a defendant's ability to serve as an officer or director of a public company.[10] 15 U.S.C. § 78u(d)(2) (2012) provides that an individual merits such a bar if he or she has demonstrated "unfitness" to serve in such a capacity.[11] In practice, the standard for determining whether a defendant is unfit is an examination of his or her behavior against a list of nonexhaustive factors.[12] The current standard, however, results in inconsistent remedies across similarly situated defendants, relies too heavily

1. *See infra* notes 148–50 and accompanying text.
2. *See infra* notes 149–58 and accompanying text.
3. *See infra* note 158 and accompanying text.
4. *See infra* notes 145–47 and accompanying text.
5. *See infra* note 158 and accompanying text.
6. *See infra* notes 159–60 and accompanying text.
7. *See infra* note 161 and accompanying text.
8. *See infra* note 162 and accompanying text.
9. *See infra* notes 32, 34–36 and accompanying text.
10. *See infra* Part I.C.
11. *See infra* Part I.C.
12. *See infra* Part I.C.

on concepts from criminal law, and fails to take into account statutory enactments and management misconduct during the recent financial crisis.[13]

Part I of this Note provides an overview of the SEC, the roles of officers and directors, and the common tests courts have used to determine unfitness. Part II examines the discretionary nature of the existing legal standards, explores inconsistencies, and highlights the consequences of using these existing standards. Finally, Part III proposes a revised standard to assess unfitness and better deter misconduct. The new standard reduces inconsistent results by eliminating certain "intangible considerations"—such as defendant contrition and reputational impact—from the test. It also focuses on deterrence instead of criminal punishment as the purpose of the remedy and responds to legislative enactments and recent management misconduct.

I. "UNFIT" OFFICERS AND DIRECTORS AND THE SEC'S ENFORCEMENT RESPONSIBILITIES

Part I of this Note provides a background on the legal standards for determining whether an individual is "unfit" to serve as an officer or director. Part I.A explores the roles of officers and directors of public corporations, their duties to employers and shareholders, and the rationale behind penalties for officers and directors who violate these duties. Part I.B discusses the history of the Commission and its responsibility to enforce federal securities laws. Next, Part I.C examines two cases, *SEC v. Patel*[14] and *SEC v. Levine*,[15] that courts have heavily relied upon to determine whether a defendant is unfit to serve as an officer or director and should therefore receive a bar.

A. *Officers and Directors: Their Duties and Roles*

An officer is a "person elected or appointed by the board of directors to manage the daily operations of a corporation."[16] Common examples are CEOs, presidents, and corporate treasurers.[17] Officers derive their authority from the corporation's bylaws or by resolution of the board of directors.[18] A director is a "person appointed or elected to sit on a board that manages the affairs of a corporation or other organization by electing and exercising control over its officers."[19]

13. *See infra* Part III.A.
14. 61 F.3d 137 (2d Cir. 1995).
15. 517 F. Supp. 2d 121 (D.D.C. 2007).
16. BLACK'S LAW DICTIONARY 1257 (10th ed. 2014).
17. *Id.*
18. DEL. CODE ANN. tit. 8, § 142 (2005). This Note will reference Delaware state corporate law as applicable. Nearly half of all registered corporations are incorporated in the state of Delaware. Leslie Wayne, *To Delaware, With Love: The Workings of a Tax Haven*, N.Y. TIMES, July 1, 2012, at BU4.
19. BLACK'S LAW DICTIONARY, *supra* note 16, at 557.

Officers and directors owe a variety of fiduciary duties to the corporations they serve.[20] Generally, a fiduciary is "[s]omeone who is required to act for the benefit of another person on all matters within the scope of their relationship."[21] The Model Business Corporation Act[22] prescribes the following duties of corporate officers:

> An officer, when performing in such capacity, has the duty to act: (1) in good faith; (2) with the care that a person in a like position would reasonably exercise under similar circumstances; and (3) in a manner the officer reasonably believes to be in the best interests of the corporation.[23]

These responsibilities impart two principal duties on officers: the duty of care and the duty of loyalty.[24] Under Delaware law, a board of directors owes fiduciary duties to the corporation and its shareholders.[25] Directors are subject to the same duties as corporate officers.[26]

Fiduciary duties are fundamental to the success of effective corporate governance and management: Justice Cardozo, writing for the New York Court of Appeals, referred to such responsibilities as "the punctilio of an honor the most sensitive."[27] While detailed standards of professional conduct exist for other professionals, such as lawyers or accountants,[28] the framework of corporate fiduciary duty and proper conduct has evolved largely through common law.[29] The underlying framework of fiduciary duty is to protect shareholders, since other nonshareholder participants in

20. *See* Kelli A. Alces, *Debunking the Corporate Fiduciary Myth*, 35 J. CORP. L. 239, 243–44 (2009). Fiduciary duties arise in relationships, which rise to a level above and beyond a nonfiduciary, contractual relationship governed by precise contract terms and "comparatively low standard[s] of good faith and fair dealing." *Id.* at 244.

21. BLACK'S LAW DICTIONARY, *supra* note 16, at 743.

22. *See generally* MODEL BUS. CORP. ACT (2010). The Model Business Corporation Act is a model set of statutes that legislatures may consider when passing state corporate law but carries no weight or authority unless states decide to codify it. Elliott Goldstein, *Revision of the Model Business Corporation Act*, 63 TEX. L. REV. 1471, 1471 (1985).

23. MODEL BUS. CORP. ACT § 8.42(a)(1)–(3) (2010).

24. *See, e.g.*, Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963) (discussing responsibilities of care); Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939) (discussing loyalty). The duty of care requires officers to exercise a degree of diligence, care, and skill that a reasonably prudent person in similar circumstances would use. *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 749 (Del. Ch. 2005). Officers also owe a duty of loyalty to avoid any conflict between their duty and self-interest. Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1345 (Del. 1987).

25. *See, e.g.*, Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) (incorporating fiduciary duty of loyalty into Delaware corporate law).

26. *See, e.g.*, Gantler v. Stephens, 965 A.2d 695, 709 (Del. 2009).

27. Meinhard v. Salmon, 164 N.E. 545, 546 (N.Y. 1928). While this case addresses the role of a fiduciary in the context of a partnership, it is nonetheless frequently recognized as establishing the foundational understanding of modern-day corporate fiduciary duties. Sarah Helene Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211, 224 (2006).

28. *See infra* Part I.D.1 (discussing the professional standards of conduct for accountants and attorneys).

29. *See* Frank Partnoy, *Financial Innovation in Corporate Law*, 31 J. CORP. L. 799, 801 (2006).

the capital structure are protected primarily through contract law.[30] Fiduciary duties require officers and directors to refrain from misconduct that might harm the company or its shareholders.[31]

B. The SEC and Its Role

Established by the Securities Exchange Act of 1934[32] (the "Exchange Act"), the Commission was created to protect investors from fraud and manipulative devices and to promote ethical behavior, honesty, and fair dealing in financial markets.[33] In addition to the Exchange Act, the Commission enforces other federal securities laws, including the Securities Act of 1933,[34] the Sarbanes-Oxley Act of 2002[35] (the "Sarbanes-Oxley Act"), and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[36] The SEC has the authority to conduct investigations and bring civil actions in U.S. federal district courts or administrative proceedings in front of an independent administrative law judge (ALJ).[37] The Commission can seek civil fines, penalties, disgorgement,[38] and injunctive relief against violators of federal securities laws.[39] Injunctive relief is the primary statutory remedy for violations of such laws.[40] The SEC will usually enjoin defendants from further violations of federal securities laws, though it may also seek an officer and director bar.[41]

The Commission only has civil authority in seeking relief for violations of federal securities statutes.[42] Criminal investigation and prosecution is exclusively within the purview of the Department of Justice (DOJ), though

30. *Id.* at 802. Therefore, shareholders, who do not have the shelter of contractual remedies, require protection via fiduciary duties which flow to them from the officers and directors of the corporation. *Id.* at 803.

31. *Cf.* Douglas G. Baird & M. Todd Henderson, *Other People's Money*, 60 STAN. L. REV. 1309, 1316–17 (2008) (detailing a number of ways that other parties, such as creditors, can usurp shareholder interests).

32. Pub. L. No. 73-291, 48 Stat. 881 (codified at 15 U.S.C. § 78a et seq.).

33. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976).

34. Pub. L. No. 73-22, 48 Stat. 74 (codified at 15 U.S.C. § 77a et seq. (2012)).

35. Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.).

36. Pub. L. No. 111-203, 124 Stat. 1376 (codified in scattered sections of 7, 12, and 15 U.S.C.).

37. 17 C.F.R. § 202.5(b) (2012).

38. Disgorgement is "[t]he act of giving up something (such as profits illegally obtained) on demand or by legal compulsion." BLACK'S LAW DICTIONARY, *supra* note 16, at 568. For example, an individual that gained $100,000 through illegal insider trading may be required to "disgorge," or give up, the illegal gain of $100,000, in addition to any other statutory fines, penalties, or injunctive relief.

39. 15 U.S.C. § 78u(d)(1) (2012). An injunction is a "court order commanding or preventing an action." BLACK'S LAW DICTIONARY, *supra* note 16, at 904.

40. SEC v. Randolph, 736 F.2d 525, 529 (9th Cir. 1984).

41. *Id.* Orders enjoining a defendant from future violations of the securities laws were the original enforcement mechanism granted to the Commission and are not intended to punish but rather to deter future behavior. David Franklin Levy, *The Impact of the Remedies Act on the SEC's Ability to Obtain Injunctive Relief*, 44 AM. U. L. REV. 645, 647–48 (1994). The basis for such injunctive relief is statutory rather than equitable. *Id.* at 649.

42. *See* THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 16.2[0][A] (6th ed. 2009).

the SEC may conduct a "parallel proceeding" in which a civil SEC action occurs alongside a DOJ criminal investigation or proceeding.[43]

C. Officer and Director Bars

An officer and director bar is a court declaration prohibiting an individual from serving as an officer or director of a public company.[44] Federal securities laws define a "public company" as having $10 million in assets and over 500 individual shareholders.[45] The authority to seek officer and director bars was first statutorily granted to the SEC in the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 (the "Remedies Act").[46]

When considering the Remedies Act, Congress noted that judicial authority to grant officer and director bars likely existed under a court's "inherent equitable powers to grant ancillary relief" to enforce the federal securities laws.[47] Yet explicit statutory authority was nevertheless included in the Remedies Act to ensure that there would be no doubt as to the availability of officer and director bars.[48] While corporate governance issues are typically matters determined by state law, Congress wanted to ensure an additional remedy would exist to protect the investing public from fraudulent misconduct.[49] Congress therefore wrote officer and director bar authority into the Remedies Act to "permit the Commission to achieve the appropriate level of *deterrence*" in order to "maintain investor confidence in the integrity, fairness, and efficiency of [the nation's]

43. Mark D. Hunter, *SEC/DOJ Parallel Proceedings: Contemplating the Propriety of Recent Judicial Trends*, 68 MO. L. REV. 149, 149 (2003). Hunter's article discusses the history of statutory and case law authority for such "parallel proceedings." *Id.* at 150–58. While the two agencies' investigations may overlap, their prosecutorial authority is distinct. *See, e.g.*, SEC v. Carter, 907 F.2d 484, 488 (5th Cir. 1990) (finding a due process violation where the SEC prosecuted a criminal contempt action against defendants who had infringed a civil injunctive order).

44. 15 U.S.C. § 78u(d)(2).

45. *Id.* § 78l(g)(1)(A).

46. Philip F.S. Berg, *Unfit to Serve: Permanently Barring People from Serving as Officers and Directors of Publicly Traded Companies After the Sarbanes-Oxley Act*, 56 VAND. L. REV. 1871, 1875 (2003). Though the Commission was granted the explicit statutory authority to seek officer and director bars in the Remedies Act, it frequently previously had argued that the bar existed within its inherent authority. *Id.* While arguably the SEC possessed the authority to seek officer and director bars prior to Congress's grant of explicit statutory authority, only one court had ever recognized the bar as falling within the Commission's ancillary relief, though that decision was made after the Remedies Act was passed. *See* SEC v. Posner, 16 F.3d 520, 522 (2d Cir. 1994) (recognizing the Commission's inherent authority to seek officer and director bars despite explicit statutory directive).

47. H.R. REP. NO. 101-616, at 27 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379, 1394, 1990 WL 256464.

48. *Id.*

49. *Id.*

securities markets."[50] Civil remedies in general are rooted in the concept of deterrence rather than punishment.[51]

The Senate Banking Committee observed that a "permanent bar might be appropriate if the violation were particularly egregious or the violator was a recidivist."[52] It further noted that officer and director bars were necessary because the "public shareholders may lack sufficient control to remove securities law violators from office or otherwise to protect their own interests."[53] The committee further noted that "broader public interests are involved when the actions of the violator undermine the integrity of the markets."[54]

As SEC Commissioner Luis Aguilar noted, officer and director bars are one of the most influential tools at the SEC's disposal.[55] The threat of a bar goes beyond the typical "cost of doing business" monetary penalty because it carries with it severe professional and economic consequences that could force a violator to change careers and seriously jeopardize the individual's financial well-being.[56]

Having explored the history, purpose, and utility of the bar, this section next will discuss the standard for granting one. The statutory language permits a court to issue a bar if an officer or director has "demonstrate[d] an unfitness" to serve further in that capacity.[57]

To determine whether an individual has demonstrated such "unfitness" to serve, a district court maintains "substantial discretion."[58] Yet courts and scholars alike have set out to attempt to prescribe and refine standards for determining unfitness.[59] The following sections will outline leading cases that have helped courts make this determination.

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50. *Id.* at 13–14 (emphasis added).

51. *See* United States v. Phelps Dodge Indus., Inc., 589 F. Supp. 1340, 1358 (S.D.N.Y. 1984) ("The civil penalty is not designed to punish or to assign moral culpability, but to deter.").

52. S. REP. NO. 101-337, at 21 (1990), 1990 WL 263550.

53. *Id.* at 22.

54. *Id.*

55. Luis Aguilar, Comm'r, SEC, Taking a No-Nonsense Approach to Enforcing the Federal Securities Laws (Oct. 18, 2012), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1365171491510#_edn26.

56. *Id.*

57. 15 U.S.C. § 78u(d)(2) (2012). Section 21(d)(2) currently provides:

> [T]he court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated section [10(b)] of this title or the rules or regulations thereunder from acting as an officer or director of any issuer that has a class of securities registered pursuant to section [12] of this title or that is required to file reports pursuant to section [15(d)] of this title if the person's conduct demonstrates *unfitness* to serve as an officer or director of any such issuer. *Id.* (emphasis added).

58. SEC v. Patel, 61 F.3d 137, 141 (2d Cir. 1995).

59. *See* Jayne W. Barnard, *When Is a Corporate Executive "Substantially Unfit to Serve"?*, 70 N.C. L. REV. 1489, 1492–93 (1992).

1. The Second Circuit's Six Factor Approach in *SEC v. Patel*

In *SEC v. Patel*, the Second Circuit relied heavily on a Jayne Barnard article to establish a group of factors to consider when determining whether to grant an officer and director bar.[60]

The facts of the case were as follows: Ratilal K. Patel, the defendant, was a director and senior vice president of Par Pharmaceutical, Inc. ("Par"), which manufactured generic drugs.[61] Par submitted to the Food and Drug Administration (FDA) an application for a new drug, which falsely claimed that the drug had been tested for and met specific FDA requirements.[62] Knowing that the application had been falsified, Patel sold 75,000 shares of Par common stock at an average sale price of approximately $21.[63] When knowledge of the false application became public, Par's stock price dropped dramatically, from a $10 closing price the day before the public announcement to between $7.125 and $8.375 in the days after.[64] The SEC won disgorgement of losses, civil penalties, and a permanent officer and director bar in the district court.[65] Patel then appealed to the Second Circuit.[66]

After outlining the defendant's behavior, the court put forth a new standard in determining whether misconduct merited a bar.[67] The Second Circuit held that a court may consider: "(1) the egregiousness of the underlying securities law violation; (2) the defendant's repeat offender status; (3) the defendant's role or position when he engaged in the fraud; (4) the defendant's degree of scienter; (5) the defendant's economic stake in the violation; and (6) the likelihood that misconduct will recur."[68] The Second Circuit also emphasized that while the six factors can assist in making an unfitness assessment, they are not necessarily "the only factors . . . [to] be taken into account," and it is not "necessary to apply all . . . in every case."[69] Applying the factors, the Second Circuit affirmed Patel's permanent bar.[70] A discussion of the *Patel* factors and its progeny follows below.

The first factor courts will consider is egregiousness.[71] Courts have generally eschewed a hard-line definition of egregiousness, instead citing specific behavior that constitutes egregiousness on a case-by-case basis.[72]

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60. *Patel*, 61 F.3d at 141 (citing Barnard, *supra* note 59, at 1492–93).
61. *Id.* at 138.
62. *Id.*
63. *Id.*
64. *Id.* at 139.
65. *Id.*
66. *Id.*
67. *Id.*
68. *Id.* at 141 (internal citations omitted).
69. *Id.*
70. *Id.* at 142.
71. *Id.* at 141.
72. *See, e.g.*, SEC v. Bankosky, No. 12 Civ. 1012 (HB), 2012 WL 1849000, at *2 (S.D.N.Y. May 21, 2012), *aff'd*, 716 F.3d 45 (2d Cir. 2013) (citing numerous fact-specific examples of egregious behavior).

One consideration is whether the conduct represented an isolated occurrence or if it occurred over an extended time period.[73] Courts have found that misconduct over a span of time is nonetheless "isolated" if it is performed in furtherance of the same scheme to defraud.[74] However, other courts have found "egregious" conduct in a single fraudulent scheme.[75] In a *Patel* analysis, it is "recognize[d] that the line between denying liability and arguing that violations [are] not egregious is a fine one."[76] Courts have declined to find egregiousness for reasonable reliance on counsel.[77] Such a determination, however, is not dispositive of liability altogether.[78]

Second, courts will consider the defendant's repeat-offender status.[79] "Repeat offender" denotes a defendant who has previously been found liable of securities fraud.[80] However, the fact that a defendant is not a repeat offender does not preclude barring officer or director service.[81]

Third, courts will consider the defendant's role or position at the time of the fraud.[82] The formal title or position of an individual is not dispositive—the inquiry is whether the bar is necessary to prevent similar acts that can be reasonably anticipated from the defendant's past conduct.[83] The standard does not require a defendant to hold a formal title of "officer" or "director"; rather, any employee "acting in a corporate or fiduciary capacity" or subject to a company's policies (such as those prohibiting insider trading) may be subject to a bar.[84]

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73. *See* SEC v. Maxxon, Inc., No. 02 Civ. 975 H(J), 2005 WL 6090229, at *5 (N.D. Okla. Mar. 11, 2005) (imposing a five-year bar against defendant who had "made misleading statements over a period of years").

74. SEC v. Conaway, 697 F. Supp. 2d 733, 772 (E.D. Mich. 2010) (holding defendant's "course of conduct causing the securities violations span[ning] several months" was actually a single wrongful course of conduct); SEC v. Johnson, 595 F. Supp. 2d 40, 44 (D.D.C. 2009) (finding several different actions of concealment with ultimate goal of the false "inclusion of one item of revenue" constituted an "isolated incident" (citing SEC v. Savoy Indus., 587 F.2d 1149, 1168 (D.C. Cir. 1978))).

75. SEC v. Aimsi Techs., Inc., 650 F. Supp. 2d 296, 299, 308 (S.D.N.Y. 2009) (finding defendant's conduct "egregious" in perpetrating a single "pump and dump" scheme over a span of several months).

76. SEC v. Selden, 632 F. Supp. 2d 91, 97 (D. Mass. 2009). This distinction is particularity important when performing a *Patel* analysis because arguing behavior was not "egregious" weighs against the imposition of an officer or director bar, yet denying wrongdoing if the court finds there was misconduct weighs strongly in favor of a bar. Therefore, defendants must decide between arguing their behavior was not "egregious" or conceding egregious misconduct and expressing remorse.

77. *Id.* at 98.

78. *Id.* In *Selden*, the court found that "egregious" and "liability" were not one in the same: the defendant was still liable for a two-year bar, even though his conduct was not "egregious." *Id.*

79. SEC v. Patel, 61 F.3d 137, 141 (2d Cir. 1995).

80. SEC v. Metcalf, No. 11 Civ. 493 (CM), 2012 WL 5519358, at *5 (S.D.N.Y. Nov. 13, 2012); SEC v. iShopNoMarkup.com, Inc., No. 04 Civ. 4057 (DRH)(ARL), 2012 WL 716928, at *5 (E.D.N.Y. Mar. 3, 2012).

81. *See* SEC v. Bankosky, No. 12 Civ. 1012 (HB), 2012 WL 1849000, at *2 (S.D.N.Y. May 21, 2012), *aff'd*, 716 F.3d 45 (2d Cir. 2013).

82. *Patel*, 61 F.3d at 141.

83. SEC v. Huff, 758 F. Supp. 2d 1288, 1356 (S.D. Fla. 2010).

84. *Bankosky*, 2012 WL 1849000, at *2.

Fourth, courts will consider a defendant's scienter.[85] Generally, scienter is "an intent to deceive, manipulate, or defraud."[86] In connection with securities fraud violations, scienter can also include recklessness, or at least, a "knowing misconduct."[87] Whether a court finds scienter is not necessarily dispositive of whether the court will issue an officer and director bar.[88] The existence of scienter can also be rebutted by showing a defendant's good faith reliance on an expert, such as legal counsel.[89]

Fifth, courts will consider a defendant's economic stake in the alleged misconduct.[90] This factor includes an examination of a defendant's personal economic gain when determining whether to grant an officer and director bar.[91] Some courts have opined that granting a permanent officer and director bar is "'far too draconian a remedy' where [a d]efendant did not actually gain any money from his violation of the Exchange Act."[92] Where there is clear and substantial economic gain, a court will weigh in favor of a permanent bar.[93] However, a defendant's mere hope of a significant economic gain (without actually having reaped it) has been sufficient for a court to grant a bar.[94]

Last, courts will consider the likelihood that a defendant's misconduct will recur.[95] The likelihood that the defendant will engage in future misconduct is of "particular importance" to a court when considering whether to order a bar, and how severe a bar to impose.[96] "[I]t is not

85. *Patel*, 61 F.3d at 141.

86. BLACK'S LAW DICTIONARY, *supra* note 16, at 1547. Scienter is used most frequently in the context of securities fraud. *Id.* The Supreme Court has held that scienter is required to establish a claim for damages under SEC Rule 10b-5. Ernst & Ernst v. Hochfelder, 425 U.S. 185, 185–86 (1976).

87. SEC v. Kelly, 765 F. Supp. 2d 301, 319 (S.D.N.Y. 2011).

88. *See* SEC v. Dibella, No. 3:04 Civ. 1342 (EBB), 2008 WL 6965807, at *11 (D. Conn. Mar. 13, 2008) (declining to impose a bar because defendant's actions were not "egregious" and he had no prior securities law violations).

89. Howard v. SEC, 376 F.3d 1136, 1147 (D.C. Cir. 2004) (holding that good faith reliance on counsel is "evidence of good faith, a relevant consideration in evaluating a defendant's scienter").

90. *Patel*, 61 F.3d at 141.

91. *See* SEC v. Robinson, No. 00 Civ. 7452, 2002 WL 1552049, at *5 (S.D.N.Y. July 16, 2002) (framing discussion of "economic stake" in terms of a defendant's stock holdings and receipt of suspect company loans).

92. SEC v. Jasper, 883 F. Supp. 2d 915, 930 (N.D. Cal. 2010) (quoting SEC v. Johnson, 595 F. Supp. 2d 40, 45 (N.D. Ga. 2009)) (considering economic stake). *But see* Dirks v. SEC, 463 U.S. 646, 663 (1983) (considering, in the context of a Rule 10b-5 violation for insider trading, that a defendant's gain could be "pecuniary" or a "reputational benefit," either of which could increase the potential for future earnings).

93. *See, e.g.*, SEC v. Lawbaugh, 359 F. Supp. 2d 418, 426 (D. Md. 2005) (finding a permanent bar appropriate where the "[d]efendant's role was central" to the scheme, which involved "millions of dollars").

94. SEC v. Miller, 744 F. Supp. 2d 1325, 1348 (N.D. Ga. 2010) (holding defendant's hope of "significant economic stake in the outcome," notwithstanding that his "actual gains were not substantial," nonetheless merited a five-year bar (citing *Patel*, 61 F.3d at 141)).

95. *Patel*, 61 F.3d at 141.

96. SEC v. Selden, 632 F. Supp. 2d 91, 99 (D. Mass 2009) (citing *Patel*, 61 F.3d at 141–42).

essential for a lifetime ban that there be past violations."[97] "However, 'in the absence of such violations, [it is essential] that a district court articulate the factual basis'" for its finding that there is a likelihood that misconduct will recur.[98] The court can consider a defendant's refusal to admit to or take responsibility for his actions as indicative of potential future misconduct.[99] The court may also determine that continued service in a position "of significant power" suggests a potential for future misconduct.[100]

After setting forth the six factors, the *Patel* court noted that the governing statute provides for a bar on service that is either conditional or unconditional (i.e., limited to a certain industry) and either permanent or time-limited ("for such period of time [as the court] shall determine").[101] The court interpreted those provisions to "suggest that, before imposing a permanent bar, the court should consider whether a conditional bar . . . and/or a bar limited in time . . . might be sufficient."[102]

The *Patel* court, therefore, left district courts to decide between permanent and unconditional bars or temporary and conditional ones, but it called for courts to specifically articulate their rationale when doing so.[103] Despite this, some courts have failed to articulate this final step.[104]

2. The Sarbanes-Oxley Act and Statutory Amendment from "Substantial Unfitness" to "Unfitness"

Seven years after *Patel*, in the drafting and passage of the Sarbanes-Oxley Act, Congress amended the statutory language from "substantial unfitness" to "unfitness."[105] *Patel* had been decided under "an earlier version of section 21(d)(2), which permitted a ban only 'if the person's conduct demonstrates *substantial unfitness* to serve as an officer or director.'"[106] Congress's intent in changing the standard was to "lower the threshold of misconduct for which courts may impose director and officer bans" from the prior statutory language.[107] Despite the change, courts

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97. *Patel*, 61 F.3d at 142.

98. SEC v. E. Delta Res. Corp., No. 10 Civ. 310 (SJF)(WDW), 2012 WL 3903478, at *9 (E.D.N.Y. Aug. 31, 2012) (citing *Patel*, 61 F.3d at 142).

99. SEC v. Drucker, 528 F. Supp. 2d 450, 453 (S.D.N.Y. 2007) (noting defendant's refusal to admit to the "brazenness of his misconduct").

100. SEC v. Universal Express, Inc., 475 F. Supp. 2d 412, 429 (S.D.N.Y. 2007).

101. *Patel*, 61 F.3d at 142. The idea that a court should specifically articulate why it was granting a permanent bar over a temporary one was first articulated in *Steadman v. SEC*, 603 F.2d 1126, 1139–40 (5th Cir. 1979).

102. *Patel*, 61 F.3d at 142.

103. *Id.*

104. *See, e.g.*, SEC v. Henke, 275 F. Supp. 2d 1075, 1086 (N.D. Cal. 2003) ("[T]he court in its discretion orders . . . [defendant] permanently and unconditionally prohibited from acting as an officer or director.").

105. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 305(a)(1), 116 Stat. 745, 778–79 (2002) (amending 15 U.S.C. § 78u(d)(2)).

106. SEC v. Bankosky, 716 F.3d 45, 48 (2d Cir. 2013) (citing *Patel*, 61 F.3d at 140–41 (quoting 15 U.S.C. § 78u(d)(2) (1990))) (emphasis added).

107. *Id.* (citing S. REP. NO. 107-205, at 27 (2002), 2002 WL 1443523).

continued to use pre-Sarbanes-Oxley standards and no court addressed the reduction in the SEC's burden of persuasion.[108]

3. Articulating "Unfitness" in *SEC v. Levine*

In *SEC v. Levine*, a court explicitly addressed the Sarbanes-Oxley statutory amendment.[109] The case involved two defendants who made false statements in connection with public filings and enriched themselves through the sale of their holdings in the artificially inflated stock.[110] The court noted that the post-Sarbanes-Oxley standard for granting an officer or director bar was a "question of first impression in the federal courts" because no other court had addressed the statutory amendment.[111] The court held that the proper rubric for determining "unfitness" should be a "holistic determination" involving the use of nine nonexhaustive factors:

> (1) the nature and complexity of the scheme; (2) the defendant's role in the scheme; (3) the use of corporate resources in executing the scheme; (4) the defendant's financial gain (or loss avoidance) from the scheme; (5) the loss to investors and others as a result of the scheme; (6) whether the scheme represents an isolated occurrence or a pattern of misconduct; (7) the defendant's use of stealth and concealment; (8) the defendant's history of business and related misconduct; and (9) the defendant's acknowledgment of wrongdoing and the credibility of his contrition.[112]

The *Levine* court used these nine factors to grant a ten-year bar against the defendants.[113] The court ultimately granted the bar despite the fact that, in its assessment, only six of the nine factors weighed in favor of a determination of "unfitness."[114] The court suggested that in light of the Sarbanes-Oxley Act, the "unfitness" language merited a new standard in place of the *Patel* factors.[115] Nevertheless, the court still considered the *Patel* factors after its own nine-factor test and concluded that the "[d]efendants' conduct clearly meets four out of the six."[116] The court then, "[d]rawing from pre-Sarbanes-Oxley precedent," considered whether a conditional, time- or industry-limited bar might be appropriate.[117] The court's decision not to grant a permanent bar hinged on a "finding that the Levines are unfit to serve as officers and/or directors of public companies,

108. *See, e.g.*, SEC v. Patterson, No. 03 Civ. 0302 (CVE) (PJC), 2006 WL 770626, at *3 (N.D. Okla. Mar. 23, 2006); SEC v. Save The World Air, Inc., No. 01 Civ. 11586 (GBD) (FM), 2005 WL 3077514, at *16 (S.D.N.Y. Nov. 15, 2005); SEC v. Global Telecom Servs., L.L.C., 325 F. Supp. 2d 94, 121 (D. Conn. 2004).

109. SEC v. Levine, 517 F. Supp. 2d 121, 144 (D.D.C. 2007).

110. *Id.* at 128.

111. *Id.* at 145.

112. *Id.* The *Levine* court borrowed heavily from another article by Jayne Barnard. *See infra* Part II.C.1.

113. *Levine*, 517 F. Supp. 2d at 146.

114. *Id.* at 145–46.

115. *Id.* at 146.

116. *Id.*

117. *Id.*

notwithstanding their status as first-time offenders," but the court concluded that "[a] shorter ban is an appropriate remedy."[118]

Even after *Levine* finally addressed the change in language, numerous courts continued to adopt or maintain the use of the *Patel* factors after the Sarbanes-Oxley Act.[119] It was not until May 2013 that a federal court explicitly addressed the appropriateness of the *Patel* factors in a post-Sarbanes-Oxley regime.[120] In *SEC v. Bankosky*,[121] the Second Circuit acknowledged the Sarbanes-Oxley statutory amendment, and ruled that the change in the statute's language "did not undermine the usefulness of the *Patel* factors."[122]

D. Other Civil Remedies Dealing with Similar Misconduct

Officer and director bars are an important civil remedy for the SEC, yet other important civil and criminal penalties exist for violators of federal securities laws. This section will provide an overview of other civil and criminal remedies against officers, directors, and other professionals who violate federal securities laws or professional standards of conduct. These examples are provided to show how other remedies differ in rationale and source from officer and director bars.

1. Other SEC Bars and Censures

In addition to its authority to bar individuals from serving as officers or directors, the Commission also has the power to censure certain licensed professionals and prevent them from practicing before it, pursuant to SEC Rule 102(e).[123] Rule 102(e) sanctions may be imposed for remedial purposes but not for punishment.[124]

The Commission uses its authority under Rule 102(e) most frequently to sanction attorneys and accountants if they lack requisite qualifications, character, integrity, have engaged in unethical or other improper

118. *Id.*

119. *See, e.g.*, SEC v. Resnick, 604 F. Supp. 2d 773, 783–84 (D. Md. 2009) (applying *Patel* to permanently bar a director who participated in a fraudulent scheme to overstate financial results).

120. SEC v. Bankosky, 716 F.3d 45, 48 (2d Cir. 2013).

121. 716 F.3d 45 (2d Cir. 2013).

122. *Id.*; *see also* SEC v. Gupta, No. 11 Civ. 7566 (JSR), 2013 WL 3784138, at *4 (S.D.N.Y. July 17, 2013) ("Despite [the lower Sarbanes-Oxley standard], courts in this Circuit have typically applied a pre-Sarbanes-Oxley list of six non-exhaustive factors to aid their determination of the propriety of an officer-director bar.").

123. Rule 102(e) provides:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . : (i) Not to possess the requisite qualifications to represent others; or (ii) To be lacking in character or integrity or to have engaged in unethical or improper professional conduct; or (iii) To have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

17 C.F.R. § 201.102(e)(1) (2012).

124. McCurdy v. SEC, 396 F.3d 1258, 1264 (D.C. Cir. 2005).

professional conduct, or have violated federal securities laws.[125] When barring attorneys, courts will rule in favor of the SEC if they find that the attorney violated professional rules of practice promulgated by either the Commission or a state bar association.[126] With respect to accountants, Rule 102(e) defines three classes of "improper professional conduct" that will result in a censure:

> (1) Intentional or knowing conduct, including reckless conduct, that results in a violation of applicable professional standards; (2) A single instance of highly unreasonable conduct that results in a violation of applicable professional standards; and (3) Repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.[127]

An accountant's "applicable professional standards" include both Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS).[128] Ultimately, a court's decision to censure attorneys and accountants from practicing before the SEC stems from violations of that professional's relevant standards of conduct.[129]

2. Censures Beyond the SEC

Outside the Commission, the Financial Industry Regulatory Authority[130] (FINRA) has the authority under Section 15(A) of the Exchange Act to permanently bar individuals from the securities industry for violating its codes of conduct, federal securities laws, or SEC rules.[131] FINRA hearing

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125. J. William Hicks, 17 CIVIL LIABILITIES: ENFORCEMENT & LITIGATION UNDER THE 1933 ACT § 2:115 (2011); *see also* Altman v. SEC, 687 F.3d 44, 45 (2d Cir. 2012) (sanctioning attorney); *McCurdy*, 396 F.3d at 1264 (affirming one-year sanction against accountant).

126. *See* Altman v. SEC, 768 F. Supp. 2d 554, 557–58 (S.D.N.Y. 2011), *aff'd*, 687 F.3d 44 (2d Cir. 2012).

127. Dearlove v. SEC, 573 F.3d 801, 803–04 (D.C. Cir. 2009) (quoting 17 C.F.R. § 201.102(e)(1)(iv)(A), (B)(1)–(2)).

128. *Id.* at 804. GAAP, published by the Federal Accounting Standards Board (FASB), are the country's accounting rules and prescribe how transactions are recorded in an entity's books and records. *Id.* GAAS are "'approved and adopted by the membership of the American Institute of Certified Public Accountants [(AICPA)],' and concern 'the quality of the performance . . . [and] the judgment exercised by' an auditor." *Id.* Such standards also prescribe specific auditor responsibilities, which include maintaining independence in fact and in appearance from the company under audit; properly planning, supervising, and performing an audit; and gathering sufficient evidence and preparing sufficient documentation of procedures performed and the auditor's conclusions. *Id.*

129. *McCurdy*, 396 F.3d at 1264 (upholding the Commission's finding of reckless behavior that merited a one-year bar based on defendant's lack of skepticism relating to a suspicious receivable in the accounting records of his audit client).

130. FINRA is a self-regulatory organization of national securities associations that are registered to the SEC. It is responsible for "conducting investigations and commencing disciplinary proceedings against [FINRA] member firms and their associated member representatives relating to compliance with the federal securities laws and regulations." Fiero v. FINRA, 660 F.3d 569, 571 (2d Cir. 2011) (quoting D.L. Cromwell Invs., Inc. v. NASD Regulation, Inc., 279 F.3d 155, 157 (2d Cir. 2002)).

131. *See Fiero*, 660 F.3d at 574.

panel decisions are appealed to the FINRA National Adjudicatory Council (NAC), which can affirm, modify, or reverse.[132] NAC decisions can then be appealed to the SEC and, subsequently, to the United States Courts of Appeal.[133]

E. White Collar Criminal Penalties and Offenses

The SEC maintains jurisdiction over securing civil injunctive penalties, including officer and director bars, while criminal authorities maintain separate investigation and prosecutorial jurisdiction over violations of federal securities law.[134] Though *Patel* and *Levine* address officer and director bars as a civil remedy, criminal penalties are also available when a criminal authority prosecutes a defendant for a securities law violation. Recognizing that civil and criminal sanctions have different policy justifications, the Supreme Court upheld Congress's ability to authorize both civil and criminal sanctions against the same defendant for the same misconduct.[135] Under the Sarbanes-Oxley Act, Congress strengthened both civil and criminal penalties against securities fraud violators.[136] In the statute, Congress called for the U.S. Sentencing Commission to promulgate guidelines that "reflect the serious nature of the [criminal] offenses and penalties set forth," in order to "deter, prevent, and *punish* such offenses."[137] Conversely, Congress never mentioned punishment in the context of officer and director bars or other civil remedies.[138]

Though civil and criminal penalties operate concurrently under different policy justifications, they call for examining similar defendant misconduct when determining liability. For example, federal criminal sentencing guidelines consider some of the same factors used in *Patel* and *Levine*, such as whether an individual is an organizer or has a central role in a scheme to defraud.[139]

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132. *Id.* at 572.

133. *Id.* (citing 15 U.S.C. §§ 78s(d), 78(y) (2012)).

134. *See supra* note 43 and accompanying text.

135. Rex Trailer Co. v. United States, 350 U.S. 148, 151–52 (1956) (holding criminal and civil penalties for the same act of omission was not a violation of double jeopardy as long as congressional intent was not to punish twice); *see also* Hudson v. United States, 522 U.S. 93, 103 (1997) (disagreeing with petitioner's argument that civil disbarment and monetary penalties precluded criminal prosecution and holding penalties were civil in nature, thus not amounting to a double-jeopardy violation).

136. *See supra* note 65 and accompanying text; *see also* MICHAEL J. KAUFMAN, 26 SECURITIES LITIGATION DAMAGES § 5A:25 (2006) (discussing increases in criminal penalties, such as maximum imprisonment for financial statement fraud).

137. KAUFMAN, *supra* note 136, § 5A:25 (quoting Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 §§ 905(b)(1), 1104(b)(1)) (emphasis added).

138. *See* H.R. REP. NO. 101-616, at 27 (1990), *reprinted in* 1990 U.S.C.C.A.N. 1379, 1394–96, 1990 WL 256464.

139. *Compare* U.S. SENTENCING GUIDELINES MANUAL § 3B1.3 (2006) (examining whether a defendant plays an "aggravating role" in determining whether additional levels should be added to the base sentencing guidelines), *with* SEC v. Abellan, 674 F. Supp. 2d 1213, 1220–21 (W.D. Wash. 2009) (granting a permanent officer and director bar against a defendant who "led a sophisticated scheme" to defraud).

II. A WORKABLE STANDARD? *PATEL* AND *LEVINE* STRUGGLE TO ADAPT

As *Patel* and *Levine* have made clear, courts enjoy wide discretion in making an unfitness determination. This judicial discretion opens the door for inconsistent results for different defendants. Part II.A begins by exploring two defendants who ultimately faced officer and director bars. The juxtaposition shows how the existing standards permit unpredictable results due to the discretion granted in *Patel* and *Levine*. Part II.B explores how courts prevent the Commission from achieving uniform penalties across similar levels of misconduct by weighing factors inconsistently. Part II.C highlights inconsistent responses to the Sarbanes-Oxley Act's statutory amendment. While many scholars have called for stronger remedies, courts have largely disregarded the statutory change. This disparity has resulted in the SEC frequently arguing for a permanent ban, while defendants frequently argue for no ban at all, across a wide variety of misconduct. Part II.D highlights how judicial discretion granted by *Patel* and *Levine* has made it difficult for the Commission to efficiently deter misconduct, evidenced by the recent financial crisis and a persistent lack of investor confidence in corporate governance.

A. A Tale of Two Officers

This section discusses two cases involving officer and director bars to highlight the inconsistencies that may arise if a court applies *Patel* or *Levine*.

Charles C. Conaway was hired as the Chairman and CEO of Kmart in 2000.[140] On January 22, 2002, Kmart filed for bankruptcy.[141] Amid Kmart's financial turmoil, Conaway departed as Chairman and, in March 2002, he finalized a separation agreement as CEO.[142] Despite Kmart's poor financial performance, Kmart's Board of Directors had no reason to specifically fault Conaway and thus did not dismiss him "for cause."[143] The board retained outside counsel to conduct an investigation into the cause of Kmart's poor financial performance.[144]

Later that year, the investigators reported their findings to the board,[145] which revealed that Conaway had been aware of, and had deliberately concealed, material adverse information from the board and the public.[146] The investigators also found that if the board "had been given all of the relevant information," it could have taken action to prevent the bankruptcy."[147]

140. *A Look Back at Some Major CEO Flameouts*, ASSOCIATED PRESS (Apr. 9, 2013), http://bigstory.ap.org/article/look-back-some-major-ceo-flameouts.
141. SEC v. Conaway, 697 F. Supp. 2d 733, 737 (E.D. Mich. 2010).
142. *Id.*
143. *Id.* at 738.
144. *Id.*
145. *Id.*
146. *Id.* at 739.
147. *Id.*

At trial, a jury found that Conaway had knowingly misrepresented to the board Kmart's ability to pay its suppliers throughout the fall of 2001.[148] Conaway had implemented a system at Kmart that deliberately slowed down payments to vendors, and he had failed to inform the board of the impending "cash crisis."[149] In October 2001, the program he implemented delayed a total of $982 million in vendor payments, while he personally represented to the board that Kmart had an improved $158 million "liquidity cushion."[150] In November, he told members of the board that the delayed payments were the result of an "IT system glitch."[151] Following a New York Times article that questioned "Kmart's ability to pay off the money it owes,"[152] Conaway responded, "Kmart is not short of cash."[153] Kmart CFO Jeffrey N. Boyer suggested, upon review of the company's accounting policies for its vendor payments, that Kmart might need to file for bankruptcy, and he was fired by Conaway shortly thereafter.[154] The court further found that Conaway had lied about discussing the possibility of bankruptcy in a meeting that occurred shortly before Conaway fired Boyer.[155]

Ultimately, the court found Conaway was "deceptive at trial" and "lied . . . repeatedly" regarding the source of the delays in vendor payments.[156] The court concluded Conaway had played a "central role" in securities fraud violations due to material misstatements and omissions in a November 27, 2001 Kmart public filing by manipulating Kmart's true financial picture.[157] Kmart's stock price dropped significantly following public disclosure of the bankruptcy.[158]

In January 2008, Brent C. Bankosky was hired as a director of Global Licensing and Business Development for Takeda Pharmaceuticals International Inc. (Takeda), a pharmaceutical manufacturer and was later promoted to a senior director role.[159] Bankosky learned material, nonpublic information regarding the company's mergers, strategic alliances, acquisitions, and other projects in his role at Takeda.[160] Based on this inside information, Bankosky illegally purchased securities that he knew would appreciate significantly in value once certain deals were publically

148. *Id.* at 754.
149. *Id.* at 752–53.
150. *Id.* at 753.
151. *Id.* at 754.
152. *Id.*
153. *Id.*
154. *Id.* at 754–55.
155. *Id.* at 756.
156. *Id.* at 763, 765.
157. *Id.* at 771, 773.
158. Joel Groover, *Kmart's Stock Price Rebounds as Its Restructuring Efforts Gain Favor with Wall Street*, NAT'L REAL ESTATE INVESTOR (Jan. 30, 2002), http://nreionline.com/news/kmart-s-stock-price-rebounds-its-restructuring-efforts-gain-favor-wall-street.
159. SEC v. Bankosky, 716 F.3d 45, 46 (2d Cir. 2013).
160. *Id.*

announced.[161] As a result of his trading, Bankosky netted an illegal gain of $63,000 on an initial investment of $37,500 for a total return of 169 percent.[162] After this trade, Bankosky again traded in two other pharmaceutical companies' shares, both of which were engaged in merger talks with Takeda.[163] In total, Bankosky made thirteen distinct illegal trades spanning two years.[164]

Each of these directors broke the law and violated duties to his respective employer and its shareholders. For his actions in netting a $63,000 personal gain, the court barred Bankosky from serving as an officer or director of a public company for ten years.[165] In contrast, although Conaway defrauded investors, and his actions contributed to the bankruptcy of a national retailer, the court did not bar him in any way from officer or director service.[166]

B. Opportunities for Inconsistent Application

Part II.B of this Note examines the current legal standard that gives judges the "substantial discretion" that contributed to the divergent results in *SEC v. Conaway*[167] and *SEC v. Bankosky*.[168] This discretion includes the authority to grant a bar that is permanent or limited in duration or scope.[169]

The court in *Patel* proposed a nonexhaustive factor-based standard for determining whether to grant an officer or director bar.[170] However, while it called on courts to articulate why they issued the type of bar they did, it failed to articulate how courts should do so.[171] Likewise, there exists no bright-line test for assessing whether misconduct, if it does rise to "unfitness," merits an unconditional bar or one limited in time or scope.[172]

As a result, courts purporting to apply *Patel* or *Levine* have reached vastly different results using a variety of analyses.[173]

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161. *See id.* Federal securities law prohibits insider trading on the basis of material, nonpublic information as a violation of Rule 10b-5. Dirks v. SEC, 463 U.S. 646, 653–54 (1983).

162. SEC v. Bankosky, No. 12 Civ. 1012 (HB), 2012 WL 1849000, at *1 (S.D.N.Y May 21, 2012), *aff'd*, 716 F.3d 45 (2d Cir. 2013).

163. *Id.*

164. *Id.* at *2.

165. SEC v. Bankosky, 716 F.3d 45, 46–47, 50 (2d Cir. 2013).

166. SEC v. Conaway, 697 F. Supp. 2d 733, 773 (E.D. Mich. 2010).

167. 697 F. Supp. 2d 733 (E.D. Mich. 2010).

168. SEC v. Patel, 61 F.3d 137, 141 (2d Cir. 1995). For example, compare *Conaway*, 697 F. Supp. 2d at 773 (granting no bar), with *Bankosky*, 716 F.3d at 50 (granting a ten-year bar).

169. *Patel*, 61 F.3d at 141.

170. *See id.* at 140–42.

171. *See supra* notes 100–01 and accompanying text.

172. *See, e.g.*, SEC v. Henke, 275 F. Supp. 2d 1075, 1086 (N.D. Cal. 2003) (barring a defendant "permanently and unconditionally" from officer or director service for simply "demonstrat[ing] unfitness" without an articulated, formal analysis).

173. *See* SEC v. Boey, No. 07 Civ. 39 (SM), 2013 WL 3805127, at *3 (D.N.H. July 22, 2013) (considering a first-time offender status to merit a five-year bar (citing SEC v. Chester Holdings, Ltd., 41 F. Supp. 2d 505, 530 (D.N.J. 1999))); SEC v. Gupta, No. 11 Civ. 7566 (JSR), 2013 WL 3784138, at *4 (S.D.N.Y. July 7, 2013) (applying *Patel* factors to grant a permanent associational bar); SEC v. Bankosky, No. 12 Civ. 1012 (HB), 2012 WL 1849000,

Courts also employ their discretion to consider factors that are less directly related to a defendant's misconduct. One such consideration is when a court evaluates a period of time subsequent to a defendant's misconduct when the defendant is unable to secure employment, which this Note refers to as effective service.[174] In *SEC v. Miller*,[175] the court determined that the defendant's conduct merited a fifteen-year bar, yet the court granted a five-year bar, noting the defendant "has not served in any responsible position in a publicly-traded corporation in the last 10+ years" and considered the ten years the defendant had not been employed to constitute "effective[] serv[ice]."[176] Similarly, the court held in *SEC v. Jasper*[177] that the defendant's conduct merited a five-year bar, but because he had already been "effectively barred from his profession for three and a half years," the court granted a bar for only two years.[178] In *Conaway*, in declining to grant a bar, the court considered the defendant's reputational damage in determining there was no "realistic likelihood" in the future that Conaway would "be hired to serve as an office[r] or director of a publically traded corporation."[179]

Conaway also considered whether, in light of other penalties, an officer and director bar might be a duplicate and unnecessary punishment.[180] The court referred to Conaway's "disgorgement and the penalty" as specifically mitigating the need for an officer and director bar.[181]

The SEC also has employed its own discretion in choosing the nature and extent of the bar it seeks.[182] Faced with a wide variety of results, the SEC has frequently sought a permanent bar against a defendant whenever it tries to secure an officer and director bar, irrespective of a defendant's level of conduct.

at *4 (S.D.N.Y. May 21, 2012) (granting ten-year bar); SEC v. Jasper, 883 F. Supp. 2d 915, 934 (N.D. Cal. 2010) (considering *Patel* and *Levine* and granting a two-year bar); SEC v. Selden, 632 F. Supp. 2d 91, 100 (D. Mass. 2009) (applying *Patel* factors to grant a two-year bar).

174. *See, e.g.*, SEC v. Miller, 744 F. Supp. 2d 1325, 1348 (N.D. Ga. 2010).

175. 744 F. Supp. 2d 1325 (N.D. Ga. 2010).

176. *Id. But see* SEC v. Capital Solutions Monthly Income Fund, LP, No. 10 Civ. 3995 (DWF) (JJK), 2014 WL 2922644, at *6 & n.3 (D. Minn. June 27, 2014) (granting a permanent bar despite the defendant's assertion he would never seek employment as an officer or director again).

177. 883 F. Supp. 2d 915 (N.D. Cal. 2010).

178. *Jasper*, 883 F. Supp. 2d at 931.

179. SEC v. Conaway, 697 F. Supp. 2d 733, 773 (E.D. Mich. 2010). The court declined to outline any specific metric used to determine "likelihood" of future employment or whether the defendant had made any actual efforts to secure employment. *Id.*

180. *Id.* The court referred to the disgorgement and penalty as teaching the defendant a "lesson . . . learned." *Id.*

181. *Id.*

182. *See, e.g.*, Second Amended Complaint at 3, SEC v. Berry, 580 F. Supp. 2d 911 (N.D. Cal. 2008) (No. 07 Civ. 04431 (RMW)) (seeking a permanent officer and director bar for accounting fraud).

In one case, the SEC sought a permanent officer and director bar against an insider trading tippee, and the court refused to grant a bar altogether.[183] In another, the Commission sought a permanent bar against an executive for backdating stock options, and the court granted a two-year bar.[184] In a third example, the SEC sought a permanent officer and director bar against a CEO and chairman who employed incorrect revenue recognition and other accounting principles and made materially false statements regarding his company's financial position in numerous press releases and SEC filings.[185] The court granted the permanent bar, even though the defendant had already been found guilty in a criminal proceeding and received a custodial sentence of thirty-six months, as well as criminal monetary penalties.[186] Despite wide variance in these defendants' misconduct, the SEC sought an identical, permanent bar in each case.

Conversely, in a case where a defendant sold his company's stock while he was aware of material, nonpublic information regarding the company's clinical trials and the result of its FDA applications, the Commission noted it was his "first and only violation of securities laws" and instead sought a five-year bar.[187] Despite suggesting the defendant's actions were "particularly serious," the court granted a two-year bar.[188]

Defendants, likewise, frequently argue there should be no bar, irrespective of the defendant's level of conduct.[189]

C. Responding to the Sarbanes-Oxley Act

As Part II.B demonstrated above, courts have employed wide latitude in their respective determinations of unfitness, leading to inconsistent results. Notwithstanding these divergent results, the Sarbanes-Oxley Act also impacts how courts should apply the bar, since it recast the standard of which behavior even merits a bar. Part II.C.1 explores how scholars recommended the court refine its analysis in light of the change from "substantial unfitness" to "unfitness." Part II.C.2 examines the Commission's response: use of *Patel* and *Levine* is rendered inapposite in light of Congress's intent to lower the threshold of misconduct and to use the remedy to deter bad acts, not punish bad actors.

183. *See* SEC v. Pardue, 367 F. Supp. 2d 773, 777 (E.D. Pa. 2005) (declining to grant a bar where evidence presented an "isolated incident" and where defendant had "capitalized more on his family connections . . . than on his status as a former executive vice president").

184. SEC v. Jasper, 883 F. Supp. 2d 915, 931 (N.D. Cal. 2010).

185. SEC v. Henke, 275 F. Supp. 2d 1075, 1086 (N.D. Cal. 2003).

186. *Id.* at 1080, 1086.

187. *See* SEC v. Selden, 632 F. Supp. 2d. 91, 98 (D. Mass. 2009).

188. *Id.* at 97.

189. *See, e.g.*, SEC v. Miller, 744 F. Supp. 2d 1325, 1348 (N.D. Ga. 2010) (granting a five-year bar, though the defendant denied wrongdoing, arguing against an officer and director bar); Reply Brief for Defendant-Appellant at 12–13, SEC v. Bankosky, 716 F.3d 45 (2d Cir. 2013) (No. 12 Civ. 2943) (upholding district court's ten-year officer and director bar).

1. Scholarly and Judicial Response

This section examines how scholars responded to the Sarbanes-Oxley Act and the degree of impact that the amended statute should have on the legal standard for granting a bar.

One proposed approach was to promulgate a standard in federal court that has a lower threshold than Barnard's six-factor test (adopted in *Patel*) and is more stringent than a "mere violation of one of the scienter-based fraud provisions of the securities laws."[190] This approach developed from a review of the Sarbanes-Oxley Act's legislative history, which concluded that the prior standard was "inordinately high."[191]

Barnard likewise revisited her discussion of officer and director unfitness.[192] Through an examination of misconduct rooted in bankruptcy law, employment law, banking law, and securities law, she articulated that common themes of unfit conduct include: "misuse of corporate resources; affirmative misrepresentations; stealth and concealment; arrogance or grandiosity; personal enrichment; and lack of contrition."[193] She proposed the new, nine-factor test that *Levine* ultimately adopted.[194]

Barnard further examined a defendant's contrition.[195] Relying on the expertise of remorse as a "concept familiar to federal district judges," she concluded that, as part of a moral judgment, judges ought to temper their finding of unfitness for genuinely contrite defendants.[196] Barnard supported her argument by analyzing previous civil and criminal cases where judges had "rewarded" defendants for their showing of remorse.[197]

Another response suggested that it becomes problematic for reviewing courts and the public when a court attempts to skirt the "unfitness" distinction altogether by failing to articulate its reasoning for granting a permanent or conditional bar.[198] When courts fail to explain any reason at all why a defendant merits a bar, they fail to meet Congress's intent, which requires an articulated finding of "unfitness."[199]

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190. Michael Dailey, *Officer and Director Bars: Who Is Substantially Unfit to Serve After Sarbanes-Oxley?*, 40 HOUS. L. REV. 837, 853 (2003).

191. *Id.* at 852 (citing S. REP. NO. 107-205, at 27 (2002)).

192. *See* Jayne W. Barnard, *Rule 10b-5 and the "Unfitness" Question*, 47 ARIZ. L. REV. 9 (2005).

193. *Id.* at 27.

194. *See supra* Part I.C.3.

195. Barnard, *supra* note 192, at 52–53.

196. *Id.*

197. *Id.* at 52 (finding that the appropriate civil penalty for a defendant demonstrating "substantial and meaningful contrition" should be "zero" (citing SEC v. Inorganic Recycling Corp., No. 99 Civ. 10159 (GEL), 2002 WL 1968341, at *14 (S.D.N.Y. Aug. 23, 2002))); *see also* United States v. Weeks, No. 00 Cr. 91-21 (RWS), 2003 WL 22671543, at *15 (S.D.N.Y. Nov. 12, 2003) (stating that defendant's "recognition of responsibility" for his misconduct reduces criminal sentence base offense level).

198. Jon Carlson, *Securities Fraud, Officer and Director Bars, and the "Unfitness" Inquiry After Sarbanes-Oxley*, 14 FORDHAM J. CORP. & FIN. L. 679, 698 (2009) (citing SEC v. Henke, 275 F. Supp. 2d 1075 (N.D. Cal. 2003)).

199. *Id.*

2. The SEC's Response

The Commission viewed the lowering of the standard from "substantial unfitness" to "unfitness" as an opportunity to develop a new legal framework that would lower its burden in obtaining a bar. The question before the Second Circuit in *SEC v. Bankosky* was whether the district court had abused its discretion in adopting the *Patel* factors, in light of the Sarbanes-Oxley statutory change.[200] The SEC argued that the *Patel* factors, despite granting some judicial discretion, were too rigid to permit courts to fully accommodate the Sarbanes-Oxley Act.[201] The SEC also argued that *Levine* was inconsistent with the legislative history of the Remedies Act and the Sarbanes-Oxley Act.[202]

The Commission further contended that under the *Levine* standard, it would be difficult or impossible for a first-time offender to ever be subject to a "permanent or substantial bar."[203] The SEC argued that the *Levine* test restricts the use of the bar by considering factors outside the speculation of Congress when it passed the Remedies Act and the Sarbanes-Oxley Act.[204] "[U]nless his 'fraud has been outside the heartland of conventional frauds, either because of its magnitude or its impact on investors, in which he has been the *driving and organizing force*,'" the SEC argued, no offender could ever be subject to an officer or director bar.[205]

Therefore, the Commission claimed that a scheme like insider trading would rarely result in a court issuing an officer or director bar since insider trading is not recognized to be outside the specter of traditional frauds.[206] Unlike a complex scheme to defraud, insider trading typically does not involve a number of coconspirators under the guidance of a "kingpin" organizing force.[207] Yet, Congress included in the Insider Trading and Securities Fraud Enforcement Act an explicit finding that "federal statutes and Commission rules directed at the suppression of insider trading 'are necessary and appropriate in the public interest'" to protect investors.[208] The Commission argued that any rubric that excluded from its scope the significant investor harms from insider trading was too narrow and failed to consider Congress's intent when granting the SEC authority to deter such bad acts in the first place.[209]

200. SEC v. Bankosky, 716 F.3d 45, 48 (2d Cir. 2013) (granting a ten-year bar relying on *Patel*).

201. Brief of Plaintiff-Appellee at 49–50, *Bankosky*, 716 F.3d 45 (No. 12 Civ. 2943).

202. *Id.* at 51.

203. *Id.* at 52.

204. *Id.*

205. *Id.* (quoting Barnard, *supra* note 192, at 54–55) (emphasis added).

206. *Id.* at 53.

207. *Id.*

208. *Id.* (quoting 15 U.S.C. § 78u–1(a) (2012)). It is commonly understood that investor loss occurs due to insider trading when the material nonpublic information that was traded upon would have caused a reasonable investor to act differently in making an investment decision. Guarantee Ins. Agency Co. v. Mid-Cont'l Realty Corp., 57 F.R.D. 555, 560 (N.D. Ill. 1972).

209. Brief of Plaintiff-Appellee at 53, *Bankosky*, 716 F.3d 45 (No. 12 Civ. 2943).

Further, the Commission argued that both *Levine* and *Patel* rely inappropriately on criminal law theories.[210] By applying concepts such as a "kingpin"-style organizing force and a "repeat offender," which trace their roots to criminal law sentence enhancements, sentences are "backward looking" because they punish certain criminals more harshly than others for their central role in criminal activity.[211] Conversely, in the Remedies Act, Congress intended general deterrence that was "remedial" and "forward looking," meant to protect investors against future misconduct.[212]

Instead, the Commission argued, the court should consider the following five nonexclusive factors when determining whether to issue a permanent officer and director bar:

> [(1)] the fact that defendant has been found liable for illegal conduct; [(2)] the degree of scienter involved; [(3)] whether the infraction is an isolated occurrence; [(4)] whether defendant continues to maintain that his past conduct was blameless; and [(5)] whether, because of his professional occupation, the defendant might be in a position where future violations could be anticipated.[213]

The key distinction between these factors and those adopted by the court in *Patel* is that *Patel* focuses on, almost "dispositively," whether a defendant had been found in past proceedings to have committed a violation.[214] The standard does not assess whether the particular facts of the defendant's conduct suggested a potential for *future* misconduct.[215] The ultimate thrust of the Commission's argument was that, in a quest to define unfitness, the *Patel* and *Levine* factors became consumed with a searching analysis of *past* repetitious behavior, when the Remedies Act's legislative history showed that the concern for investor protection was rooted in deterrence of *future* misconduct.[216]

D. Responding to the Financial Crisis of 2008 and Lingering Investor Misconduct

Inconsistent applications and divergent responses to the Sarbanes-Oxley Act highlight the Commission's concerns with the *Patel* and *Levine* standards for determining unfitness. Part II.D explores how this conflict impacted investor confidence in light of widespread management misconduct leading to the 2008 financial crisis.

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210. *Id.* at 54.
211. *Id.* at 54–55.
212. *Id.* at 55.
213. *Id.* at 57 (quoting SEC v. Commonwealth Chem. Sec., 574 F.2d 90, 100 (2d Cir. 1978)). The defendant in *Commonwealth* received an employment bar as a result of his misconduct. *Id.* This case was decided prior to the passage of the Remedies Act. *See* Berg, *supra* note 46, at 1875.
214. Brief of Plaintiff-Appellee at 56, *Bankosky*, 716 F.3d 45 (No. 12 Civ. 2943).
215. *Id.*
216. *Id.* (quoting SEC v. Gabelli, 653 F.3d 49, 61 (2d Cir. 2011), *rev'd on other grounds*, 133 S. Ct. 1216 (2013)) ("In determining whether injunctive relief is appropriate, '[t]he critical question . . . is whether there is a reasonable likelihood that the wrong will be repeated.'").

In 2008, the collapse of subprime lending led to a financial crisis that devastated the global economy.[217] In testimony before Congress, then-SEC Chairman Christopher Cox admitted and acknowledged that regulatory failures exacerbated the extent and impact of the crisis.[218] In the wake of its regulatory shortcomings, the Commission's Enforcement Division has taken an active role in deterrence by seeking, among other penalties, officer and director bars and by publicizing its success after winning them.[219]

The SEC has successfully argued for officer and director bars against numerous defendants whose misconduct related to the financial crisis. Through settlements, it obtained a five-year bar against executives who made material misstatements to conceal American Home Mortgage's deteriorating condition related to the subprime crisis;[220] a permanent bar against former Countrywide CEO Angelo Mozilo for deliberately misleading investors about subprime risks in order to increase Countrywide's market share;[221] six permanent officer and director bars of former Brooke Corporation executives for making misleading and fraudulent statements to conceal the firm's deteriorating loan portfolio;[222] and a permanent bar against two Tier One bank executives for deliberately understating losses and misleading investors and regulators,[223] among others. The SEC also won a five-year officer and director bar in an administrative proceeding against a former Evergreen lead fund portfolio manager for her role in improperly valuing assets impaired by the subprime crisis.[224]

Despite the Commission's successes, some practitioners have argued that the gradual shift in "recent years" has been away from granting officer and director bars.[225] In a DLA Piper Securities Enforcement Alert, Luis R. Mejia and Grayson D. Stratton argued that a marked decrease in courts'

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217. Edmund L. Andrews, *Greenspan Concedes Error on Regulation*, N.Y. TIMES, Oct. 24, 2008, at B1.

218. Stephen Labaton, *S.E.C. Concedes Oversight Flaws Fueled Collapse*, N.Y. TIMES, Sept. 27, 2008, at A1.

219. The Commission publishes Enforcement Action statistics, showing key metrics in its response to the financial crisis. *SEC Enforcement Actions: Addressing Misconduct That Led to the Financial Crisis*, SEC (July 24, 2014), http://www.sec.gov/spotlight/enf-actions-fc.shtml.

220. SEC v. Strauss et al., SEC Litig. Release No. 21014 (S.D.N.Y., April 28, 2009) *available at* http://www.sec.gov/litigation/litreleases/2009/lr21014.htm.

221. Former Countrywide CEO Angelo Mozilo to Pay SEC's Largest-Ever Penalty Against a Public Company's Senior Executive, SEC News Digest, 2010-196 (Oct. 18, 2010), 2010 WL 4072707.

222. SEC v. Orr et al., SEC Litig. Release No. 21957 (D. Kan., May 4, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr21957.htm; SEC v. Orr et al., SEC Litig. Release No. 22089 (D. Kan., Sept. 8, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr22089.htm.

223. *SEC Charges Bank Executives in Nebraska with Understating Losses During Financial Crisis*, SEC (Sept. 25, 2012), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171484998#.U_Of3WPB1IE.

224. Lisa B. Primo, Exchange Act Release No. 476, 2012 WL 6705813, at *29 (ALJ Dec. 26, 2012).

225. Luis R. Mejia & Grayson D. Stratton, *Courts Continue to Limit Officer and Director Bars Sought by SEC*, DLA PIPER (Mar. 24, 2010) (on file with Fordham Law Review).

willingness to grant officer and director bars (specifically, their refusal to do so in *SEC v. Conaway*), is evident of a recent trend against issuing permanent bars.[226] Mejia and Stratton identified the difficulty the SEC faces to establish at trial that a first-time offender both acted with a high degree of scienter and has a propensity toward future wrongdoing.[227]

Despite facing difficulty in the courts, the Commission has continued to pursue officer and director bars against individuals involved in the financial crisis. At the end of fiscal year 2011, the SEC had successfully won twenty-four out of thirty-six total cases brought against officers and directors arising out of misconduct relating to the 2008 financial crisis, a success rate of 67 percent.[228] The Commission reports that, as of July 24, 2014, forty individuals had received officer and director bars, industry bars, or Commission suspensions through enforcement actions relating to the 2008 mortgage crisis out of seventy total cases, a rate of 57 percent.[229] The Commission does not publicly disclose the number of bars it seeks, the percentage of attempted bars that are successful, or the number of settlements that result in a bar.

Though the SEC has imposed some monetary and injunctive penalties in an effort to deter corporate misconduct, investors remain generally distrustful of management. As of 2012, 48 percent of investors had no confidence in the corporate management of public companies and 51 percent had no confidence in the boards of directors of public companies.[230] Investors are likewise apprehensive about financial regulators: 50 percent of investors reported that they had no confidence in government regulators and oversight.[231]

A 2012 survey showed that 81 percent of investors do not believe the government has done enough to deter wrongdoing on the corporate level.[232] Further, 64 percent believe that "corporate misconduct" played a significant role in the creation of the economic crisis.[233]

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226. *Id.*

227. *Id.* This frustration was echoed in the SEC's *Bankosky* brief, giving, for example, reasons why the *Levine* standard made it difficult or impossible to argue for a bar for any "common" fraud scheme like insider trading, despite its clear danger to investors. *See supra* note 203 and accompanying text.

228. Brent R. Baker, D. Loren Washburn & Shannon K. Zollinger, *Conduct-Based Bars and Injunctions in SEC Enforcement Proceedings*, AM. BAR ASS'N (Sept. 18, 2012), http://apps.americanbar.org/litigation/committees/securities/email/summer2012/summer2012-0912-conduct-based-bars-injunctions-sec-enforcement-proceedings.html.

229. SEC, *supra* note 219.

230. *The Center for Audit Quality (CAQ)'s Annual Main Street Investor Survey*, 2013 CTR. FOR AUDIT QUALITY 11, *available at* http://www.thecaq.org/docs/press-release-attachments/2013mainstreetinvestorsurvey.pdf?sfvrsn=2.

231. *Id.*

232. LABATON SUCHAROW LLP, 2012 ETHICS & ACTION SURVEY: VOICES CARRY 1 (2012), *available at* http://www.labaton.com/en/about/press/upload/Ethics-Action-II-Report-Final.pdf.

233. *Id.*

III. A RETURN TO DETERRENCE

Part I of this Note introduces the *Patel* and *Levine* approaches for determining unfitness. Part II shows how judicial deference in the standard creates the potential for inconsistent application, how scholars and the Commission argue the standard should change to reflect the Sarbanes-Oxley Act, and how widespread investor mistrust of corporate governance remains in the aftermath of the 2008 financial crisis. Part III.A suggests three overarching shortcomings with the existing standard: (1) courts inconsistently weigh certain "intangible factors" which have little to do with deterrence of misconduct that threatens investor wealth, (2) the standard incorrectly relies too heavily on criminal law principles, and (3) the standard itself is too lenient in light of the Sarbanes-Oxley Act and the 2008 financial crisis. Part III.B then proposes a new standard that appropriately responds to the shortcomings identified in Part III.A by reducing judicial discretion, emphasizing forward-looking, general deterrence, and making the overall standard more stringent. Part III.C then applies the new standard to the examples of *Conaway* and *Bankosky* and demonstrates how it garners a result more consistent with Congress's original intent.

A. Overarching Issues with the Patel *and* Levine *Methodology*

Investors would rightly benefit from a revised standard that better serves Congress's intent to deter corporate misconduct.[234] However, to refine the standard, it is first necessary to identify and understand the principal shortcomings in the current framework.[235] The three critical mechanisms for improvement involve (1) reducing inconsistent results by preventing courts from considering certain individualized "intangible" factors, which have little to do with deterring future misconduct; (2) reframing the standard so it focuses less on concepts such as punishment, which originate in criminal law and are inappropriate in the context of civil remedies; and (3) making the standard more stringent to appropriately reflect the statutory change in the Sarbanes-Oxley Act and address widespread management misconduct during the 2008 financial crisis.[236]

The following sections specifically articulate how each of these shortcomings can be addressed in a new unfitness standard. First, by eliminating "intangible factors" from judicial consideration, courts can reduce inconsistent results among defendants. Second, by emphasizing forward-looking potential for recidivism instead of backward-looking behavior, courts can rightly emphasize deterrence instead of punishment. Third, by responding to the Sarbanes-Oxley Act and recognizing the lingering lack of investor confidence in light of the financial crisis, courts can ensure that the bar more successfully deters future misconduct.

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234. *See supra* notes 47–50 and accompanying text.
235. *See infra* Part III.A.1–3.
236. *See infra* Part III.A.1–3.

1. *Patel* and *Levine* Consider Intangible Factors That Contribute to Inconsistent Results

This section addresses the inconsistencies that arise when courts consider non-misconduct-based "intangible" factors. It argues how these inconsistencies undermine the use of officer and director bars to deter future misconduct.

The source of the courts' substantial discretion in determining unfitness is likely traceable to the lack of a formalized benchmark for officer and director conduct, which exists for most professional practitioners.[237] When an accountant commits misconduct, a reviewing court can evaluate her behavior against the benchmark of specific professional standards to determine whether to censure her pursuant to Rule 102(e).[238] Likewise, an attorney can be barred if his conduct violates professional rules of legal practice.[239] However, no consistent professional practice standards exist for officers and directors, beyond those conferred by their fiduciary duties.[240] The absence of a benchmark makes it difficult for courts to translate misconduct into the "unfitness" that ultimately merits a bar.[241] Courts have attempted to resolve the inherent complexities of assessing misconduct against a benchmark buried within the contours of corporate common law by developing a standard which gives them significant discretion.[242] This standard, however, has allowed courts to consider some factors that have little to do with deterrence of future misconduct and results in inconsistent application of the bar.[243]

An improved unfitness standard would remove from consideration certain "intrinsic" factors that have little to do with the harmful misconduct Congress aimed to deter.[244] These factors can include a defendant's reputational damage, effective service (whether a defendant has had trouble securing future employment), and whether a judge feels an individual "deserves" punishment or shows contrition to the court.[245] If courts continue to weigh these factors, which have little to do with a defendant's underlying scheme to defraud, they undermine the ability to create clear standards indicating which level of misconduct merits which remedy.[246] Clearer standards could provide both the Commission and future defendants a benchmark from which each can rely in litigation or settlement actions. More importantly, considering these factors undermines the ability for officer and director bars to effectively deter potential future violators, since

237. *See supra* note 29 and accompanying text; *see also supra* Part I.D.1.

238. *See supra* notes 123–25 and accompanying text.

239. *See supra* notes 123–25 and accompanying text.

240. *See supra* notes 28–31 and accompanying text.

241. This could explain why many courts have provided relatively brief analysis of the decision to issue one type of bar instead of another. *See supra* notes 102–04.

242. *See* Partnoy, *supra* note 29, at 801.

243. *See supra* Part II.B.

244. *See supra* note 212 and accompanying text.

245. *See supra* notes 174–79 and accompanying text.

246. *See supra* Part II.C.2.

they are applied inconsistently.[247] This section addresses how consideration of effective service, reputational impact, and defendant "contrition" undercuts Congress's goal of deterrence in the use of the bar.

a. Effective Service, Reputational Impact, and Other Penalties

Defendants often escape a bar because courts conclude that, despite their flagrant misconduct, defendants have already "suffered" some form of effective bar or reputational impact.[248] This consideration hinders the effectiveness of officer and director bars because it substitutes a necessary mechanism of deterrence with a court's finding that an individual defendant's personal situation merits "leniency."[249] Further, considering a defendant's personal issues in seeking employment due to reputational damage is ultimately rooted in the mindset of punishing a bad actor, not deterring a future bad act.[250]

Marketplace considerations can significantly impact the length of a court's imposed bar.[251] They also create perverse incentives—while some defendants might have legitimate trouble securing future employment, others could hypothetically circumvent a court's standard by simply not seeking employment and claiming "difficulty" to the court.[252] Potential defendants could also structure any future employment to bypass an officer role, so that they can later argue to the court that they had been "effectively barred" for a period of time, reducing the length of a judicial bar.[253] Creative options that could circumvent a judicial bar that are unrelated to a defendant's fraudulent scheme undermine the bar's ability to properly deter.[254]

Similarly, courts should disregard a defendant's additional civil or criminal penalties when making a bar determination.[255] The ability of the officer and director bar to effectively deter investor-eroding misconduct is weakened when courts either decline to impose one or decide on a lesser one because of "piling on" what they incorrectly view as a substitute penalty.[256]

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247. *See supra* Part II.B.

248. *See supra* notes 174–79 and accompanying text.

249. *See supra* notes 180–81 and accompanying text.

250. Evidence that the court's mindset is rooted in punishing the defendant rather than general deterrence of future misconduct appears in situations when bar determinations hinge on the "lesson" to be learned by the defendant. *See supra* notes 179–80 and accompanying text.

251. *See supra* notes 174–79 and accompanying text.

252. Indeed, the lack of any concrete metric for determining one's likelihood of future employment—or inability to secure employment—further exacerbates the potential for defendants to use this strategy. *See* SEC v. Conaway, 697 F. Supp. 2d 733, 773 (E.D. Mich. 2010); *see also supra* note 179 and accompanying text.

253. *See supra* notes 174–79 and accompanying text.

254. *See supra* notes 50–51, 174–79 and accompanying text.

255. *See supra* note 180 and accompanying text (considering a defendant's other civil liability as a mitigating factor for not issuing an officer/director bar).

256. *See supra* note 180 (considering a defendant's other civil liability as a mitigating factor for not issuing an officer/director bar).

Allowing a court to consider a defendant's criminal punishment in a bar imposition analysis is problematic for two reasons. First, the decision to criminally prosecute an individual defendant is made by criminal authorities and has little to do with the Commission and its decision whether to pursue a civil remedy.[257] Second, civil and criminal remedies have vastly different policy justifications that are not comparable substitutes for one another.[258] When Congress passed the Sarbanes-Oxley Act, it lowered the "substantial unfitness" standard for civil remedies *and* charged the Sentencing Commission with promulgating stricter criminal penalties for white collar offenses.[259] Courts undermine congressional intent for parallel remedies when they consider one as eliminating or reducing the need for the other.[260] Considering a defendant's other civil penalties is equally problematic. Pecuniary civil penalties, such as disgorgement, are meant to primarily restore losses, not deter future misconduct.[261] For example, failing to grant a bar because a particular defendant faced a significant pecuniary civil remedy might help to restore losses but controverts Congress's attempt to create a valid deterrence mechanism.

b. Defendant "Contrition"

The *Levine* factors include a defendant's contrition as the ninth consideration, and it was one of the main themes in Barnard's 2005 analysis.[262] She argued for considering contrition because officer and director bars involve a moral judgment and judges can parse out when a defendant has demonstrated legitimate remorse and justly reduce that defendant's sentence accordingly.[263] Applying contrition is problematic for two reasons. First, determining whether contrition is genuine or part of a skilled act is not an easy task.[264] Second, reducing an individual's "sentence" for remorse is fundamentally rooted in criminal law and is inconsistent with the legislative history supporting the Remedies Act, which emphasized deterrence, not punishment.[265]

While a genuinely contrite defendant is less likely to repeat his or her misconduct, contrition alone should not be a principal factor in weighing an officer and director bar. First, expressing contrition could be a legal strategy and may not reflect the true state of mind of the defendant.[266] Take, for example, a defendant who argues against a bar because his

257. *See supra* notes 42–43 and accompanying text (noting the Commission's authority to enforce the securities laws is limited to civil remedies because it has no criminal authority).

258. *See supra* note 51 and accompanying text.

259. *See supra* notes 107, 136–37 and accompanying text.

260. *See supra* notes 136–37 and accompanying text.

261. *See supra* note 38 and accompanying text.

262. *See supra* note 112 and accompanying text.

263. *See* Barnard, *supra* note 192, at 52–53.

264. This task becomes even more difficult when expression of remorse can either weigh in favor of or against imposing a bar. *See supra* note 76 and accompanying text.

265. *See supra* note 50 and accompanying text.

266. *See supra* note 76 and accompanying text.

conduct was not egregious under *Patel*.[267] He may genuinely feel remorse for his conduct, but he may be prevented from expressing it in court or to the Commission, since his legal defense is to argue that his conduct was not egregious misconduct in the first place. Consider another defendant, whose actions were so egregious that he has no choice of arguing there was no misconduct, and so his last-chance legal strategy is to appear as remorseful as possible, whether or not he actually feels genuinely contrite.[268]

This is not to say that state of mind is impossible to discern or irrelevant to the decision of whether to impose a bar. A more impartial way to assess a defendant's state of mind with regard to his or her misconduct would be to focus on how the defendant's conduct itself evidenced his or her state of mind at the time of the scheme. For example, a court could examine how elaborately a defendant uses stealth or concealment to perpetrate a fraud. Defendants who make extraordinary efforts in furtherance of their misconduct pose the greatest risk to shareholders if they are permitted to continue serving as an officer or director.[269]

Recall, for example, the blatant disregard Conaway demonstrated toward the Kmart Board of Directors.[270] His affirmative misrepresentations suggest that he is a much greater risk to investors than, for example, an individual whose insider trading does not involve lying in furtherance of the scheme itself.[271] Here, any remorse a defendant like Conaway might demonstrate at trial is much less relevant to an unfitness determination than an examination of his conduct while he was Kmart CEO.[272] What Congress sought to deter was the dangerous action that threatens investor wealth, not an unremorseful defendant at trial.[273]

Therefore, in delineating a standard for determining what level of officer and director misconduct merits an injunctive bar, the key is to look at just that—the misconduct itself—and disregard conduct or remorse which occurred after the scheme itself, such as contrition at trial.

Lastly, it is inapposite to consider a civil injunctive remedy as being rooted in moral decision making. Barnard specifically relied upon *United States v. Weeks*,[274] a criminal case, to make the argument that moral decision making is relevant to a judge's imposition of a civil remedy.[275] Civil penalties are inherently different from criminal penalties in that they are rooted in deterrence, not moral blame or punishment for a guilty

267. *See* SEC v. Conaway, 697 F. Supp. 2d 733, 773 (E.D. Mich. 2010) (defendant "did not acknowledge his wrongdoing" as part of his larger right to deny egregious misconduct occurred).

268. *See supra* note 76 (acknowledging the thin line between arguing violations were not egregious and admitting actions were egregious and showing remorse).

269. *See supra* notes 71–78 and accompanying text (discussing the extent and nature of misconduct as stronger indications of unfitness).

270. *See Conaway*, 697 F. Supp. 2d at 739.

271. *See supra* notes 71–78 and accompanying text.

272. *See Conaway*, 697 F. Supp. 2d at 752–73.

273. *See supra* note 49 and accompanying text.

274. No. 00 Cr. 91-21 (RWS), 2003 WL 22671543, at *15 (S.D.N.Y. Nov. 12, 2003).

275. *See supra* notes 195–97 and accompanying text.

defendant.[276] Congress was clear that its intent was to deter, not to punish, when it codified officer and director bars in the Remedies Act.[277] In basing a decision in part on the emotional response of an individual defendant, a court inappropriately assumes that the officer and director bar is a criminal punishment and erodes the underlying purpose of the remedy.

2. *Patel* and *Levine* Emphasize Backward-Looking History over Forward-Looking Potential for Recidivism

As the SEC highlighted in its brief before the Second Circuit in *SEC v. Bankosky*, a crucial inquiry in both the *Patel* and *Levine* analyses is a searching examination into a defendant's past violation of the securities laws.[278] While discussion of past violations is relevant insofar as it relates to potential recidivism, the key danger the Remedies Act and the Sarbanes-Oxley Act sought to protect against is future misconduct.[279] Requiring "past violations"[280] of securities laws to merit a permanent bar puts an unnecessary obstacle in the way of the court, which might otherwise conclude a defendant's conduct was so damaging he or she merits a permanent bar, even without a past violation.[281]

In light of the forward-looking mindset courts should have when determining whether or not to issue an officer or director bar, it is especially problematic when courts decline to grant a bar in significant part because it is the defendant's first federal securities law violation.[282] While an absence of past violations might bolster the argument that an individual defendant might be less likely to recidivate, it should not be dispositive.

Lastly, a standard that is primarily backward-looking also draws concepts from criminal law and its fundamental purpose of punishing a bad actor.[283] The officer and director bar, and its enforcement by the SEC, is a civil remedy and plays an entirely different role by seeking to deter future misconduct in general.[284] Courts risk blurring the fundamental line between civil and criminal remedies when they emphasize prior bad acts over the potential for future violations.[285]

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276. *See supra* note 51 and accompanying text.

277. *See supra* note 50 and accompanying text.

278. *See supra* note 215 and accompanying text.

279. *See supra* notes 49–50 and accompanying text.

280. SEC v. iShopNoMarkup.com, Inc., No. 04 Civ. 4057 (DRH) (ARL), 2012 WL 716928, at *5 (E.D.N.Y. Mar. 3, 2012) (citing SEC v. Patel, 61 F.3d 137, 142 (2d Cir. 1995)).

281. *See supra* notes 203–05 and accompanying text.

282. *See* SEC v. Selden, 632 F. Supp. 2d 91, 98 (D. Mass. 2009) ("That [defendant] had not previously violated securities laws in over a decade as an officer and director . . . certainly weighs in his favor. Whether it justifies imposing no bar, however, depends, at least in part, on the likelihood (or lack thereof) that he will commit such violations in the future.").

283. *See supra* notes 211–12 and accompanying text (discussing backward-looking nature of criminal remedies).

284. *See supra* notes 47–50 and accompanying text.

285. *See supra* note 51 (discussing how civil remedies are meant to deter while criminal remedies punish).

3. *Patel* and *Levine* Address Neither Legislative Enactments nor Investor Mistrust Following the 2008 Financial Crisis

The third significant shortcoming with *Patel* and *Levine* is that they do not have a stringent enough standard to determine unfitness. There are two reasons why the standard should be made more stringent and the Commission's burden lowered. First, a decade after clear congressional intent in the Sarbanes-Oxley Act compelled courts to lower the threshold from which they grant officer and director bars, they have failed to do so and continue to apply an inappropriately higher standard.[286] Second, widespread misconduct leading up to the 2008 financial crisis and lingering investor uncertainty suggest current standards are not serving the underlying purpose of the bar.[287] Both a response to the Sarbanes-Oxley Act and continued investor uncertainty support lowering the overall standard for the misconduct that merits a finding of unfitness.

a. Properly Addressing the Sarbanes-Oxley Act

Congress's unequivocal response to the accounting fraud crises that plagued the financial markets in 2000 and 2001 cannot be understated: facing widespread investor concern, Congress responded swiftly and decisively in passing the Sarbanes-Oxley Act.[288] Congressional intent makes clear that the threshold for misconduct warranting a bar should be lowered.[289]

It is a positive development that courts have recently started to acknowledge the lowering of the SEC's burden in the Sarbanes-Oxley Act.[290] Yet, it is problematic that even courts that do acknowledge the Sarbanes-Oxley Act conclude it should have no impact on their analysis.[291]

Despite the clear intent of Congress to lower the statutory threshold, the various multifactor rubrics that remain in use after the Sarbanes-Oxley Act permit judicial discretion to avoid granting a bar, even in cases of flagrant misconduct.[292] Industry experts have recognized a "lessening" potency of the bar in recent years,[293] suggesting that courts ought to reexamine their

286. *See supra* notes 107–08, 122, 191, 200 and accompanying text.

287. *See supra* Part II.D.

288. *See* Erin Massey Everitt, *Sarbanes-Oxley's Officer Certification Requirements—Has Increased Accountability Equaled Increased Liability?*, 6 DEPAUL BUS. & COM. L.J. 225, 228–29 & n.28 (2008) (discussing Congress's desire to administer "shock treatment" to individuals charged with corporate governance); *see also supra* note 105 and accompanying text.

289. *See supra* Part I.C.2.

290. *See supra* note 122 and accompanying text.

291. *See supra* Part II.C.1.

292. *See supra* Part II.C.1–2.

293. *See supra* notes 225–27 and accompanying text; *see also* Mary O'Connor & Patrick O'Brien, *Chinks in the Enforcement Armor: Recent Decisions Erode SEC's Favored Remedies*, BLOOMBERG LAW (Dec. 4, 2012), http://about.bloomberglaw.com/practitioner-contributions/chinks-in-the-enforcement-armor-recent-decisions-erode-secs-favored-remedies/.

approach to determining unfitness.[294] The statutory change and its legislative history support the SEC's efforts to lower the standard of imposing officer and director bars.[295]

b. Importance of Effectively Responding to the 2008 Financial Crisis

The authority to seek officer and director bars is a "potent weapon[] in the SEC's arsenal" from the point of view of potential defendants.[296] It is problematic that in an environment of misconduct, which contributed to the 2008 financial crisis, courts have become even more reluctant to grant officer and director bars.[297] Current officer and director bar standards have failed to help curtail a lack of investor confidence in corporate governance.[298] Half of American investors flatly conclude that the government's regulatory arm has not done enough to protect investors from management misconduct.[299] Courts should recognize the SEC's position and lower the threshold of misconduct in light of the flagrant delinquency at the heart of the financial crisis. While the Commission's overall success rate is publicly unknown, recent data suggests that the percentage of courts granting civil penalties against an officer or director has decreased.[300]

There are two likely reasons for the decrease in penalties. First, as experts have suggested, courts have been increasingly reluctant to issue officer and director bars.[301] Second, viewing an increasingly hostile legal landscape toward granting officer and director bars, the SEC may be seeking bars less frequently as an enforcement mechanism.[302] Whichever the case, it is troublesome that the potency of the officer and director bar has not tracked with its role as a crucial deterrence mechanism in light of the financial crisis.

B. A New Standard: Bringing Patel *and* Levine *into the Twenty-First Century*

Using the *Patel* and *Levine* frameworks as a starting point and refining them to remedy the three principal issues discussed above, this section proposes that courts consider the following factors when determining whether to grant an officer and director bar: (1) whether the conduct is isolated or represents a pattern or recurrence; (2) the defendant's degree of scienter; (3) the defendant's gain/loss avoided through the scheme; (4) the current and potential future loss to investors as a result of the scheme; (5) the defendant's role in the scheme; and (6) considering the defendant's

294. *See supra* Part II.C.2.
295. *See supra* note 209 and accompanying text.
296. O'Connor & O'Brien, *supra* note 293.
297. *See supra* notes 225–27 and accompanying text.
298. *See supra* notes 230–33.
299. *See supra* note 231 and accompanying text.
300. *See* SEC, *supra* note 219.
301. *See supra* note 225 and accompanying text.
302. Indeed, the SEC does not publicly disclose the number of attempted settlements. *See supra* Part II.D.

professional occupation, whether the defendant is in a position to commit future violations. Each of these factors should be seen as answering the ultimate inquiry: how will use of the bar appropriately deter future misconduct that threatens investor confidence?

1. Whether the Conduct Is Isolated or Recurring

The standard first dispenses with consideration of "egregiousness" as an intermediate step in determining unfitness.[303] Courts should not be required to make a formal finding of egregiousness, as required by *Patel*, because courts have struggled to define what the term means in the context of officer and director misconduct.[304] The term is also entirely absent from Section 21(d)(2).[305] Further, courts struggling to determine egregiousness have primarily relied on whether the scheme was isolated or recurring.[306] Instead of requiring this intermediate step, the new standard simply examines whether the scheme is isolated or recurring.[307]

That a factor such as "relying on the advice of counsel" could mitigate a finding of egregiousness but not preclude a finding of liability further complicates the standard.[308] The standard is clouded if a court can find a defendant's behavior to not be "egregious" but still find him liable.[309] There is no need to define misconduct with a vague word when it has, at best, a tenuous connection to actually granting a bar.

A Senate Banking Committee report suggests that use of the word "egregious" was an attempt to define a line between issuing a permanent versus temporary bar.[310] However, courts have failed to use egregiousness as a distinguishing factor when articulating whether to issue a permanent or time-limited bar.[311] The proposed standard therefore eliminates the responsibility to classify behavior by an abstract concept when courts can instead derive unfitness from the nature of the defendant's scheme itself.

Distinguishing a scheme between a one-time event and a pattern of explicit actions that repeatedly defrauded investors is also a critical examination that judges must make insofar as it is relevant to the potential for recidivism. In the case of a recurring pattern of misconduct, courts have appropriately recognized that conduct spanning over a period of time poses a greater threat to investor capital and must be deterred more potently than a unique act.[312] It is also important for courts to remember that misconduct spawning from a single isolated scheme to defraud should not prevent the court from granting a bar if the isolated conduct is severe enough to indicate

303. *See supra* note 71 and accompanying text.
304. *See supra* notes 71–78 and accompanying text.
305. *See* 15 U.S.C. § 78u(d)(2) (2012).
306. *See supra* notes 73–75 and accompanying text.
307. *See supra* notes 73–75 and accompanying text (citing examples of courts considering the isolated or recurring nature of a scheme to determine egregiousness).
308. *See supra* note 77 and accompanying text.
309. *See supra* note 78 and accompanying text.
310. *See supra* note 52 and accompanying text.
311. *See supra* Part I.C.1.
312. *See supra* notes 95–100 and accompanying text.

a potential for future misconduct. Maintaining a rule that proscribes a permanent bar for first-time offenders (absent particular justification) may cause certain bad actors to justify misconduct on the basis that they have no prior history of securities fraud liability.[313]

There is also some ambiguity as to whether a pattern of "various deceptions and critical omissions" should be considered isolated or recurring.[314] A single instance of insider trading can be reasonably classified as an isolated incident. However, repeated false statements and assurances, even if part of a common scheme, should not be classified as "isolated."[315] For example, compare a single instance of insider trading with Conaway, who lied over a period of four months, developed an IT system to falsely record vendor payments, lied repeatedly to the board of directors and the media, and fired a fellow executive who suggested that there was improper accounting.[316] There is a clear distinction between this course of conduct and that of the defendant in *SEC v. Dibella*,[317] who netted a personal gain of $121,000 through insider trading.[318] In applying *Patel*, each defendant received the same result of no bar. Continuous misconduct, even if in furtherance of a unified intent to deceive, should be recognized as recurring conduct and appropriately weigh more heavily in favor of a bar.

The proposed standard further drops the requirement that a scheme be "outside" the specter of traditional frauds.[319] A scheme such as insider trading, if as common as the Commission suggests, should be deterred even *more* strongly to prevent its recurrence, not *less* strongly as a *Levine* analysis would dictate.

2. Defendant's Degree of Scienter

Scienter is required under the standard because it is a fundamental element of federal securities law violations.[320] Further, Congress was explicit in legislating officer and director bars to protect the public from individuals who have demonstrated, through deliberate fraudulent misconduct, that they should not be entrusted with investor funds.[321] Therefore, it would be inconsistent with the purpose of the bar for a court to impose a bar against an individual who failed to display "an intent to deceive, manipulate, or defraud."[322]

The proposed standard recognizes that a first-time offender can be just as likely to demonstrate the requisite level of scienter as a repeat offender. If

313. *See supra* note 215 and accompanying text.
314. SEC v. Conaway, 697 F. Supp. 2d 733, 772 (E.D. Mich. 2010); *see also supra* notes 75–76 and accompanying text.
315. *See supra* note 75 and accompanying text.
316. *See supra* notes 148–55 and accompanying text.
317. No. 3:04 Civ. 1342 (EBB), 2008 WL 6965807 (D. Conn. Mar. 13, 2008).
318. *See supra* note 88 and accompanying text.
319. *See supra* notes 204–05 and accompanying text.
320. *See supra* note 86 and accompanying text.
321. *See* S. REP. NO. 101-337, at 21–22 (1990), 1990 WL 263550.
322. *See supra* note 86 and accompanying text.

conduct throughout a scheme is deliberate and recurring, a defendant's lack of prior violations should not be dispositive of the court's decision to issue a permanent officer or director bar.[323] It is this significant hurdle that practitioners have identified as one of the single greatest burdens to the SEC's success in securing officer and director bars.[324]

3. Defendant's Gain/Loss Avoided

Courts should examine the benefit the defendant gained or attempted to gain in furtherance of his scheme. *Patel* and *Levine* consider purely "economic" gain or stake, which omits other forms of noneconomic gains a defendant could extract from a scheme of misconduct.[325] Courts have rightly recognized that a defendant's personal monetary gain/loss avoided from his participation in a scheme to defraud should impact whether he receives an officer and director bar.[326] However, requiring "economic" gain is underinclusive because it fails to capture other types of gains that may motivate officer or director misconduct and fails to deter such acts, which may threaten investor wealth.

Defendants may commit misconduct that threatens investor wealth and should be deterred even if the misconduct does not bring them direct and immediate economic or financial gain.[327] Irrespective of that defendant's actual economic misappropriation from the scheme, the bar should be used to deter any such acts which threaten investor confidence.

The proposed standard captures defendants who craft a scheme to avoid an immediate or cognizable gain. Courts applying *Patel* have found it "far too draconian" to grant a permanent bar absent a concrete financial gain.[328] The proposed standard therefore implores courts to consider *both* monetary and nonmonetary gains or losses avoided when evaluating a defendant for unfitness. Recognizing pecuniary and nonpecuniary gains also aligns officer and director bars closer to the standards used to establish Rule 10b-5 liability for insider trading.[329]

4. Current and Potential Future Investor Losses

This factor is similar to the third consideration but is focused less on the scheme's impact on the defendant and more on the investor. In some cases, a defendant's gain may be quantifiable and investor loss may not be

323. *Contra* SEC v. Johnson, 595 F. Supp. 2d 40, 43–45 (D.D.C. 2009). The defendant "committed a number of separate actions" designed to mislead the auditors and the public and had a "substantial economic stake in the transaction," and the court granted only a five-year bar, noting that the Commission could not meet its burden for a permanent bar since the defendant was a first-time offender. *Id.*

324. *See supra* note 227 and accompanying text.

325. *See supra* Part I.C.1–3.

326. *See supra* Part I.C.1–3.

327. *See* SEC v. Johnson, 595 F. Supp. 2d 40, 45 (D.D.C. 2009) (noting that although the defendant did not actually gain any money from his misconduct, he had a significant economic stake in the outcome due to future salary, bonuses, and stock options).

328. *See supra* note 92 and accompanying text.

329. *See supra* note 92 and accompanying text.

quantifiable.[330] The reverse may also be true, and a standard which effectively deters misconduct should capture both scenarios.[331] Since the ultimate goal is to deter misconduct that threatens investor loss and erodes confidence in the market, it is necessary that the standard capture schemes in which either an investor's losses or a defendant's gain is readily quantifiable. Ultimately, either type of misconduct should merit an officer and director bar to deter future similar behavior.

5. Defendant's Role in the Scheme

The defendant's level of active participation in the scheme is an important factor insofar as it is indicative of future recidivism. The closer a defendant was to the center of the scheme, the more likely she is to repeat the misconduct and merits an officer and director bar.[332]

This factor also considers the defendant's role in the scheme as opposed to his formal position at the time of the misconduct.[333] While a defendant's role as an officer or director while perpetrating a scheme could weigh in favor of imposing a bar, it should not be required. Courts have been correct in eschewing a formalistic requirement that a defendant must occupy an officer or director position to merit a future bar.

Considering a defendant's role in the scheme helps courts in deterring future misconduct, even if the defendant was not an officer or director at the time. For example, in an insider trading scheme a tipper may make significant ill-gotten gains and be in a professional occupation posing risk of future violations.[334] However, if that individual was not at the center of the scheme and was a tippee, barring her from serving as an officer or director would do little to deter tippers—those who orchestrate the scheme in the first place and pose the greatest risk to investor wealth.[335]

6. Professional Occupation Posing Risk of Future Violations

A defendant's professional role might give him or her the opportunity to continue to misappropriate investor funds. A permanent or extended time-limited bar might be the only way to effectively deter such misconduct. This factor reflects the Commission's position that *Patel* and *Levine* overemphasize a defendant's historical conduct and position over the likelihood that a defendant will be in a position to commit misconduct in the *future*.[336] Aligning the standard with potential for recidivism instead of an emphasis on past securities laws violations also eliminates consideration of criminal law concepts, which are inapposite to the civil remedy of an officer and director bar.[337]

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330. *See, e.g.*, *supra* note 162 and accompanying text.
331. *See, e.g.*, *supra* note 158 and accompanying text.
332. *See supra* note 93 and accompanying text.
333. *See supra* note 83 and accompanying text.
334. *See, e.g.*, *supra* note 183 and accompanying text.
335. *See, e.g.*, *supra* note 183 and accompanying text.
336. *See supra* note 212 and accompanying text.
337. *See supra* note 283 and accompanying text.

C. *Applying the Standard: Revisiting* Conaway *and* Bankosky

To demonstrate the use of the proposed standard, this section applies it to Conaway's and Bankosky's conduct in an effort to show how the standard of "unfitness" garners a result that will better deter future misconduct.

1. *Conaway*

The first factor of the new standard is whether the defendant's conduct is isolated or recurring.[338] Conaway's conduct spanned throughout the fall of 2001.[339] Aware that Kmart was unable to meet its supplier obligations, he approved a confidential project which would delay vendor payments.[340] He lied to the board, blaming the delayed payments on a systems glitch, and committed securities fraud by knowingly filing false financial statements.[341] Under the proposed standard, this conduct, though a continuous single scheme to defraud with regards to Kmart's solvency, would represent recurring activity. This factor would therefore weigh in favor of imposing an officer bar.

The second factor is the defendant's degree of scienter.[342] Conaway made repeated false statements regarding Kmart's cash position to the board of directors which he knew to be untrue.[343] He also fired Kmart's CFO after the CFO suggested that Kmart reexamine its accounting policy.[344] The defendant's scienter also weighs in favor of imposing a bar.

The third factor is the defendant's gain or loss avoided.[345] Conaway did not directly profit from his involvement in the scheme.[346] While it could be argued that he benefited as an officer of the company by obscuring its dire financial situation, it is not clear that had he disclosed Kmart's true financial state to the board, he would have been terminated "for cause."[347] Because there is no direct financial or reputational gain from the scheme, or a loss avoided, this factor weighs against imposition of a bar because there was no evidence Conaway reaped any economic or pecuniary reward for his false statements.

The fourth factor considers the current and potential future investor losses as a result of the defendant's misconduct.[348] When Kmart's true financial position was announced, the value of its stock plummeted dramatically.[349] This factor weighs strongly in favor of imposition of a bar

338. *See supra* Part III.B.1.
339. *See supra* note 148 and accompanying text.
340. *See supra* note 149 and accompanying text.
341. *See supra* notes 149–51 and accompanying text.
342. *See supra* Part III.B.2.
343. *See supra* notes 149–51 and accompanying text.
344. *See supra* note 154 and accompanying text.
345. *See supra* Part III.B.3.
346. *See supra* Part II.A.
347. *See supra* notes 143–47 and accompanying text.
348. *See supra* Part III.B.4.
349. *See supra* note 158 and accompanying text.

because of the widespread investor losses in the wake of public disclosure of the fraudulent scheme and Kmart's true financial picture.

The fifth factor is the defendant's role in the scheme.[350] Conaway, as CEO of Kmart, was central to the scheme to mislead the board of directors and investors.[351] He approved the system that concealed Kmart's liquidity problems and discharged the executive who questioned the conduct.[352] This factor weighs in favor of a bar because Conaway was central to the scheme to defraud and fraudulently represent Kmart's financial state to investors.

The sixth factor analyzes whether the defendant's professional occupation poses a risk of potential future violations.[353] Conaway was terminated as CEO before the fraudulent scheme was discovered, so he was not in a professional position that could directly cause future violations.[354] He did, however, display little regard for the board of directors throughout his fraudulent conduct.[355] There is nothing to suggest that Conaway would not pursue a similar scheme if he were able to secure future employment as an officer of a public corporation. As considering future employment prospects is speculative, this factor weighs slightly against granting a bar.

Viewing the factors as a whole, Bankosky's conduct merits a long-term or permanent bar for the following reasons: his conduct represented blatant disregard for his fiduciary duties, evidenced by the duration of his conduct, the number of people he lied to, his central role in the scheme, and the substantial loss to Kmart's shareholders.

2. *Bankosky*

The first factor of the new standard is whether the defendant's conduct is isolated or recurring.[356] Bankosky's primary illegal trade was an isolated event.[357] Bankosky's principal gains came from multiple trades surrounding a single piece of material, nonpublic information. As there was no evidence of a systematic pattern of insider trading on multiple pieces of inside information, this factor therefore weighs against issuing a permanent bar.

The second factor is the defendant's degree of scienter.[358] Bankosky denied having knowledge of the negotiations before they were made public, yet evidence that the SEC presented at trial showed that he was aware of the confidential merger negotiations.[359] His denial of the material, nonpublic

350. *See supra* Part III.B.5.
351. *See supra* notes 146–50 and accompanying text.
352. *See supra* notes 149–50, 154 and accompanying text.
353. *See supra* Part III.B.6.
354. *See supra* Part II.A.
355. *See supra* Part II.A.
356. *See supra* Part III.B.1.
357. *See supra* note 161 and accompanying text.
358. *See supra* Part III.B.2.
359. *See supra* note 160 and accompanying text.

information on which he traded suggests that he knew his actions were illegal. This factor weighs in favor of issuing a bar.

The third factor analyzes the defendant's gain or loss avoided.[360] It is undisputed that Bankosky had a direct financial gain as a result of his violation of the securities laws.[361] This factor weighs in favor of a bar.

The fourth factor considers the current and potential future investor losses as a result of the defendant's misconduct.[362] Investor loss due to Bankosky's illegal trades is difficult to quantify, however, insider trading is commonly understood to result in investor harm.[363] This factor therefore weighs in favor of imposing a bar.

The fifth factor is the defendant's role in the scheme.[364] Bankosky was central to his own insider trading.[365] He also demonstrated that he knew the information was confidential and what he was doing was illegal based on his denial of wrongdoing.[366] This factor weighs in favor of a bar.

The sixth factor is whether the defendant's professional occupation poses a risk of potential future violations.[367] Though the defendant was not in the position of officer or director at the time he made the illegal trades, he was acting in a fiduciary capacity as an employee of Takeda, which exposed him to confidential information.[368] He violated his duty to his employer by trading on that confidential information.[369] This factor weighs in favor of imposition of a bar.

In analyzing Bankosky's conduct, the factors do weigh in favor of a finding of unfitness. However, his conduct likely merits a shorter, time-limited bar for the following reasons: his conduct, while deliberate, did not represent a systematic pattern of behavior. His personal gain does not rise to the amount that would significantly erode investor confidence, and investor loss does not rise to the same amount that Conaway's did. Lastly, it is less likely that he would be promoted to an officer or director position.

Under analysis of both Conaway and Bankosky, each defendant's conduct falls in favor of a bar imposition. Unlike the highly deferential standard adopted in *SEC v. Conaway*, the proposed approach gives little room for an individual whose misconduct rose to the level of Conaway's to escape the imposition of a bar. Applying the proposed standard achieves a more uniform result—crucial for the bar to effect its deterrence mechanism.

360. *See supra* Part III.B.3.
361. *See supra* note 162 and accompanying text.
362. *See supra* Part III.B.4.
363. *See supra* note 208.
364. *See supra* Part III.B.5.
365. *See supra* notes 161–64 and accompanying text.
366. *See supra* Part II.A.
367. *See supra* Part III.B.6.
368. *See supra* notes 159–60 and accompanying text.
369. *See supra* Part I.A.

CONCLUSION

Officer and director bars are a potent and necessary tool used by the SEC to deter misconduct which threatens to erode investor confidence in the financial markets. While existing standards in *Patel* and *Levine* help somewhat in protecting the American investor from failures in corporate governance, they fail to further Congress's intent in establishing the bar as a key mechanism of deterrence.

Ultimately, the proposed six-prong standard remedies the three principal shortcomings of the current *Patel* and *Levine* standards. First, the proposed methodology reduces the potential that courts will grant bars inconsistently among various defendants. By eliminating the use of "intangible" considerations, courts have less flexibility to make an unfitness determination using factors which have little to do with misconduct that harms investors. Second, the standard eliminates backward-looking concepts from criminal law, which aim to punish bad actors, and emphasizes forward-looking potential for recidivism, which deters bad acts. Third, the proposed standard recognizes that *Patel* was decided under a superseded statutory regime and updates the analysis to reflect congressional intent in the Sarbanes-Oxley Act. Lastly, the proposed standard addresses the Commission's need to properly respond to the 2008 financial crisis and augment its authority to restore investor confidence in the markets.

By adopting and using the proposed standard, courts can ensure that officer and director bars will more efficiently and effectively deter the fraudulent misconduct that threatens the ability of the American investor to entrust the financial markets with her hard-earned capital.