Washington University Law Review

Volume 81 | Issue 3

January 2003

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Recommended Citation

Luke A. E. Pazicky, *A New Arrow in the Quiver of Federal Securities Fraud Prosecutors: Section 807 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. § 1348)*, 81 WASH. U. L. Q. 801 (2003).
Available at: https://openscholarship.wustl.edu/law_lawreview/vol81/iss3/4

A NEW ARROW IN THE QUIVER OF FEDERAL SECURITIES FRAUD PROSECUTORS: SECTION 807 OF THE SARBANES-OXLEY ACT OF 2002 (18 U.S.C. § 1348)

I. INTRODUCTION

Last year, U.S. citizens lost approximately $40 billion to securities fraud schemes.[1] The recent escalation of securities-related scandals typified by Enron and WorldCom has seriously weakened the U.S. economy.[2] To respond, Congress enacted the Sarbanes-Oxley Act of 2002[3] (the "SOA") and, in particular, a new federal securities fraud statute (the "Securities Fraud Statute").[4]

Congress enacted the Securities Fraud Statute for three primary reasons.[5] First, gaps in federal securities and criminal fraud laws at least partially induced an increased number of securities fraud schemes during the past decade.[6] Congress enacted the statute to close this gap and make it easier for prosecutors to convict defrauders.[7] Second, Congress sought to give federal prosecutors an elastic rule that would enable them to

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1. Federal Bureau of Investigation, *About the Economic Crimes Unit: Securities/Commodities Fraud*, *available at* http://www.fbi.gov/hq/cid/fc/ec/about/about_scf.htm (last visited Sept. 09, 2002) [hereinafter Economic Crimes Unit] ("Securities regulators and other prominent groups have estimated that securities and commodities fraud totals approximately $40 billion per year.").

2. S. REP. NO. 107-146, at 2 (2002) ("In the wake of the continuing Enron Corporation debacle, the trust of the United States' investors and pensioners in the nation's stock market has been seriously eroded. This is bad for our markets, bad for our economy, and bad for the future growth of investment in American companies.") (internal abbreviation omitted).

3. The Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

4. 18 U.S.C.A. § 1348 (West 2003). The Securities Fraud Statute reads as follows:

> Whoever knowingly executes, or attempts to execute, a scheme or artifice—
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> (1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(d)); or
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> (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(d));
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> shall be fined under this title, or imprisoned not more than 25 years, or both.

5. *See, e.g.*, S. REP. NO. 107-146, at 2-6, 10-11, 14, 20, 30.

6. *Id*. at 5-6, 10-11, 20, 30.

7. *Id*.

prosecute yet unforeseen classes of schemes.[8] Third, Congress wove a stiff twenty-five year sentence into the statute to deter securities fraud more effectively.[9]

Although there have not yet been any prosecutions under the Securities Fraud Statute, to convict securities defrauders under section 1 of the statute prosecutors should be required to prove that the defendant (1) knowingly, with the intent to defraud, (2) executed or attempted to execute a scheme or artifice to defraud another person (3) in connection with a security of a publicly traded company.[10] Alternatively, to convict a defendant under section 2 of the statute, courts should require prosecutors to prove that the defendant (1) knowingly, with the intent to defraud, (2) executed or attempted to execute a scheme or artifice to obtain money or property by false or fraudulent representations, pretenses, or promises (3) in connection with the purchase or sale of a security of a publicly traded company.[11]

On the one hand, it appears that the Securities Fraud Statute will significantly impact federal securities fraud prosecutions.[12] First, the statute will make it easier, in a limited number of cases, for federal prosecutors to convict securities defrauders.[13] Second, the elements of the Securities Fraud Statute are flexible enough to enable federal prosecutors to keep up with the most complex new fraud schemes that inventive criminals may devise in the future.[14] Third, the Securities Fraud Statute has a tough twenty-five-year sentence that will effectively deter many potential violators and thus enable federal agents and prosecutors to target particularly egregious schemes.[15]

On the other hand, it seems like the Securities Fraud Statute will only nominally impact federal securities fraud prosecutions.[16] First, the mail and wire fraud statutes are written[17] and interpreted[18] flexibly, and it seems like these “catch-all” provisions cover nearly all securities fraud schemes.[19] Second, even though the Securities Fraud Statute eliminates the

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8. *Id.* at 11, 14, 20.
9. *Id*. at 2, 6, 11.
10. *See infra* notes 84-136 and accompanying text.
11. *See infra* notes 137-59 and accompanying text.
12. *See infra* notes 160-69 and accompanying text.
13. *Id.*
14. *See infra* notes 164-67 and accompanying text.
15. *See infra* notes 168-69 and accompanying text.
16. *See infra* notes 170-90 and accompanying text.
17. *See infra* notes 110-18 and accompanying text.
18. *See infra* notes 119-25 and accompanying text.
19. *See infra* notes 170-72 and accompanying text.

need for prosecutors to prove the technical elements such as reliance[20] and the use of interstate commerce or mail[21] that inhere in section 10(b) of the 1934 Securities Exchange Act ("section 10(b)")[22] and Securities and Exchange Commission Rule 10b-5 ("Rule 10b-5"),[23] the elements of the Securities Fraud Statute and these two other securities laws largely overlap.[24] Third, the Securities Fraud Statute will not enable prosecutors to target some of the most pervasive and pernicious schemes that have evolved during the past decade,[25] including Micro-Cap schemes,[26] prime bank schemes,[27] and many Internet transaction schemes.[28]

This Note will (1) explain the origin and purpose of the Securities Fraud Statute, (2) identify the elements federal prosecutors should be required to prove beyond a reasonable doubt to convict individuals under the statute, (3) assess whether the statute will have any practical impact on federal securities fraud prosecutions, and (4) propose that Congress should broaden the scope of the new statute.[29]

II. ORIGIN AND PURPOSE OF THE SECURITIES FRAUD STATUTE

The Enron debacle and subsequent plethora of corporate scandals prompted members of the Senate Judiciary Committee[30] (the "Judiciary Committee") to introduce the Corporate and Criminal Fraud Accountability Act of 2002 (the "CCFAA"),[31] and, in particular, the Securities Fraud Statute. At the behest of Senators Leahy and McCain,[32]

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20. *See* Twiss v. Kury, 25 F.3d 1551, 1558 (11th Cir. 1994) (stating elements of a Rule 10b-5 offense); Rubenstein v. Collins, 20 F.3d 160, 166 (5th Cir. 1994) (stating that reliance is a requirement under Rule 10b-5); United States v. Schaefer, 299 F.2d 625, 629 (7th Cir. 1962) (holding that defendant committed no crime because the government failed to prove the identity of the defrauded investors and failed to demonstrate a connection between the victims and the alleged scheme).

21. *See* United States v. O'Hagan, 521 U.S. 642, 651 (1997) (stating that the use of interstate commerce is a necessary element of Rule 10b-5 violations).

22. 15 U.S.C.A. § 78*j*(b) (West 2003).

23. 17 C.F.R. § 240.10b-5 (2003).

24. *See infra* notes 174-81 and accompanying text.

25. *See infra* notes 182-90 and accompanying text.

26. *See infra* note 65.

27. *See infra* note 66.

28. *See infra* note 67.

29. *See infra* notes 191-207 and accompanying text. Congress should extend the reach of the Securities Fraud Statute to any fraud scheme that connects to a "contrived security." This language would expand the scope of illicit activities that the government can prosecute under the statute beyond the scope of activities already illegalized under federal securities and fraud laws.

30. *See* S. REP. NO. 107-146, at 2-6 (2002).

31. The Corporate and Criminal Fraud Accountability Act of 2002, S. 2010, 107th Cong. (2002).

32. *See* 148 CONG. REC. S1785-89 (2002) (statement of Senator Leahy); 148 CONG. REC. S6528-29 (2002) (statement of Senator McCain).

the Senate incorporated the CCFAA into the Public Company Accounting Reform and Investor Protection Act of 2002 (the "PCARIPA"),[33] which the Senate passed on July 15, 2002.[34] Simultaneously, the House of Representatives drafted the Corporate Fraud Accountability Act of 2002 (the "CFAA").[35] The CFAA contained a securities fraud provision with language identical to that in the Securities Fraud Statute drafted by the Senate,[36] subject to just one exception: the Senate version imposed a maximum sentence of ten years in prison,[37] while the House version imposed a maximum sentence of twenty-five years in prison.[38] The House and Senate held a joint conference to reconcile the conflicting bills[39] and filed a conference report on July 24, 2002.[40] This conference report contained the text of the Sarbanes-Oxley Act of 2002 and incorporated the Securities Fraud Statute, the CCFAA, and the PCARIPA.[41] The twenty-five-year maximum sentence proposed by the House ultimately prevailed.[42]

According to the Judiciary Committee, Congress enacted the Securities Fraud Statute for three primary reasons.[43] First, the Enron debacle and subsequent escalation of corporate scandals revealed significant gaps in federal securities and criminal fraud laws.[44] For example, although

33. *See* 148 CONG. REC. S6436-39 (2002) (text of measure incorporated into Amendment No. 4174 to PCARIPA, S. 2673, 107th Cong. (2002)).

34. SARBANES-OXLEY ACT OF 2002: LAW AND EXPLANATION 159 (James Hamilton & Ted Trautmann eds., 2002) [hereinafter Hamilton].

35. H.R. 5118, 107th Cong. (2002).

36. H.R. 5118 § (2)(c).

37. S. REP. No. 107-146, at 34 (2002) ("[S]hall be fined under this title or imprisoned not more than *10 years*, or both.") (emphasis added).

38. H.R. 5118 § (2)(c) ("[S]hall be fined under this title, or imprisoned not more than *25 years*, or both.") (emphasis added).

39. Hamilton, *supra* note 34, at 159.

40. *See* H.R. CONF. REP. NO. 107-610 (2002).

41. *Id*.

42. *See supra* note 4.

43. *See* S. REP. NO. 107-146, at 2-7, 10-11, 20, 30 (2002). Because the House minimally modified the draft of the Securities Fraud Statute that the Senate Judiciary Committee originally authored, the Judiciary Committee's report has the greatest probative value regarding Congress' reasons for enacting the statute, as well as the elements Congress intended courts to read into it.

44. *See id.* at 2-7, 10-11, 14, 20, 30. *See also* Stephen M. Cutler, Director of the Securities and Exchange Commission Division of Enforcement, Address at the University of Michigan Law School (Nov. 1, 2002), *available at* http://www.sec.gov/news/speech/spch604.htm (last visited Feb. 22, 2002). Director Cutler describes the retrenchment in federal securities laws that occurred during the 1990's:

> Why didn't the potential costs to auditors [of companies like Enron and WorldCom] of passing on inaccurate financials, for example, impel them to fulfill their gatekeeper role? Why did they apparently believe they stood a good chance of getting away with it, so to speak? One answer lies in the changes in the legal landscape during the last decade, which substantially limited the exposure of secondary actors to private securities fraud liability.

Congress enacted bank fraud,[45] health care fraud,[46] and even bankruptcy fraud statutes,[47] Congress failed to enact a criminal securities fraud provision.[48] To convict securities defrauders, federal prosecutors often had to rely on the mail fraud and wire fraud statutes,[49] both of which carried maximum sentences of only five years imprisonment.[50] Moreover, these provisions required federal prosecutors to "carry the sometimes awkward burden"[51] of proving that defendants used the interstate mail or wire networks to further their schemes.[52] Alternatively, federal prosecutors had

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> The first step down this path came with the Supreme Court's 1994 decision in *Central Bank of Denver* [Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994)], which eliminated aiding and abetting liability in private lawsuits under Section 10(b) of the Exchange Act. Since professionals like attorneys and auditors frequently are viewed as having only an indirect or secondary role in the fraud, *Central Bank* significantly limited their legal exposure in most settings.
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> In 1995, with the passage of the Private Securities Litigation Reform Act of 1995 (PSLRA), Congress provided further comfort to gatekeepers by confirming that an aiding and abetting theory could be pursued only by the SEC (not by private plaintiffs). It also placed additional restrictions on securities class actions.
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> Specifically, the PSLRA imposed a heightened standard for pleading scienter, including requiring a complaint to specify each statement alleged to be misleading, the reasons why it is misleading, and to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." In addition, it seems to have influenced at least one circuit to heighten not only the standard for *pleading* scienter, but also the substantive standard for *proving* scienter. The Ninth Circuit, in *In re Silicon Graphics* [183 F.3d 970 (9th Cir. 1999)], arguably nudged the scienter requirement from simple recklessness to something called "deliberate" recklessness.
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> . . . .
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> The burdens of the PSLRA prompted an immediate reaction from securities class action plaintiffs' attorneys — they sought out friendlier fora in state courts. Not to be outflanked, however, Congress responded by adopting the Securities Litigation Uniform Standards Act of 1998 (SLUSA), which had the effect of preempting most securities fraud class actions filed in state court.

Id. (internal citations omitted).

45. 18 U.S.C.A. § 1344 (West 2003).

46. 18 U.S.C.A. § 1347 (West 2003).

47. 18 U.S.C.A. § 157 (West 2003).

48. S. REP. NO. 107-146, at 6. *See also id*. at 20. ("[U]nlike bank fraud or health care fraud, there is no generally accessible statute that deals with the specific problem of securities fraud."); 148 CONG. REC. at S6439 (2002) (remarks of Senator Leahy) ("As one who was a prosecutor, I was surprised to learn that unlike bank fraud, health care fraud, and even bankruptcy fraud, there is no specific Federal crime of securities fraud to protect victims of fraud related to publicly traded companies.").

49. *See* 18 U.S.C.A. § 1341 (West 2003) (mail fraud); 18 U.S.C.A. § 1343 (West 2003) (wire fraud).

50. S. REP. NO. 107-146, at 6, 20. Sections 903(a) and (b) of the Sarbanes-Oxley Act increased the maximum sentence for mail and wire fraud from five years to twenty years. *See infra* note 186.

51. S. REP. NO. 107-146, at 6.

52. *Id*. Because the mail fraud statute applies to any person who "deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing," the "mailing in furtherance" requirement generally does not impede successful prosecutions. *But see* ELLEN S. PODGOR & JEROLD

to prove willful violations of complex, technical securities laws such as section 10(b) and Rule 10b-5.[53] The technical requirements of these securities laws, such as the "purchase or sale" requirement,[54] may be difficult to satisfy.[55] According to the Judiciary Committee, Congress enacted the Securities Fraud Statute to close these legal gaps and make it easier for federal prosecutors to convict securities defrauders.[56]

Second, Congress sought to give federal prosecutors an elastic statute that would enable them to prosecute yet unforeseen securities fraud schemes.[57] The Judiciary Committee thus modeled the Securities Fraud Statute on the extremely flexible bank fraud and health care fraud statutes,[58] which, in turn are modeled on the mail fraud[59] and wire fraud[60] statutes. The Judiciary Committee reasoned that writing the Securities Fraud Statute expansively would provide "needed enforcement

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H. ISRAEL, WHITE COLLAR CRIME IN A NUTSHELL 66-71 (2d ed. 1997). Professors Podgor and Israel highlight four limitations courts have traditionally imposed on the "mailing in furtherance" requirement: "Mailings which conflicted with the scheme, were an imperative command of duty imposed by the state, occurred prior to commencement of the scheme, or occurred after fruition of the scheme, were found not to be in furtherance of the scheme to defraud." *Id*. at 66-67.

53. S. REP. NO. 107-146, at 6 ("[P]rosecutors may charge a willful violation of certain specific securities laws or regulations, but such regulations often contain technical legal requirements, and proving willful violations of these complex regulations allows defendants to argue that they did not possess the requisite criminal intent.").

54. *See* SEC v. Zandford, 238 F.3d 559, 564 (4th Cir. 2001) (holding that by stealing investors' money, the defendant did not violate Rule 10b-5 because the act of stealing investors money is related too tenuously to the purchase or sale of a security), *cited with disapproval in* S. REP. No. 107-146, at 6, *rev'd*, SEC v. Zandford, 535 U.S. 813 (2002).

55. *See supra* notes 53-54 and accompanying text.

56. S. REP. NO. 107-146, at 6, 11, 20. The Judiciary Committee emphasized that "[i]n our view, this provision will make it easier, in a limited class of cases, for prosecutors to prove securities fraud by eliminating, for example, the element that the mails or wires were used to further the scheme to defraud." *Id*. at 30. *See also* 148 CONG. REC. S6528 (statement of Senator McCain) ("The [securities fraud] provision makes it easier, in a limited class of cases, to prove securities fraud.").

57. S. REP. NO. 107-146, at 11, 14. The Judiciary Committee emphasized that "[t]he [securities fraud] provision should not be read to require proof of technical elements from the securities laws, and is intended to provided needed enforcement flexibility in the context of publicly traded companies to protect shareholders and prospective shareholders against all the types [of] schemes and frauds which inventive criminals may devise in the future." *Id*. at 20. *See also* 148 CONG. REC. S6437 (2002) (statement of Senator Daschle) ("[The Securities Fraud Statute] provides prosecutors with a new tool that is flexible enough to keep up with the most complex new fraud schemes . . . .").

58. 18 U.S.C.A. § 1344 (West 2003) (bank fraud); 18 U.S.C.A. § 1347 (West 2003) (health care fraud). S. REP. NO. 107-146, at 14, 20, 30. For example, the Senate emphasized that "[l]ike the bank and health care fraud statutes on which this provision is modeled, prosecutors must prove that a defendant knowingly engaged in a scheme or artifice to defraud, or knowingly made false statements or representations to obtain money in a securities transaction." *Id*. at 30. The Senate also indicated that "[t]he provision would supplement the patchwork of existing technical securities law violations with a more general and less technical provision, with elements and intent requirements comparable to current bank fraud and health care fraud statutes." *Id*. at 14.

59. *See infra* note 94.

60. *See infra* note 95.

flexibility"[61] to federal prosecutors and help to protect the nation's shareholders "against all the types [of] schemes and frauds which inventive criminals may devise in the future."[62] In the Senate Report, the Judiciary Committee failed to explain specifically the need for such flexibility.[63]

This need is apparent, however. During the past two decades, the evolution of new, complicated investment vehicles, coupled with technological advances, enabled clever criminals to devise and execute a host of previously unimaginable securities fraud schemes.[64] These include Micro-Cap schemes,[65] prime bank schemes,[66] Internet transaction schemes,[67] Ponzi schemes,[68] and market manipulation schemes.[69]

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61. S. REP. NO. 107-146, at 20.

62. *Id*.

63. *See id.*

64. Economic Crimes Unit, *supra* note 1.

65. *Id*. Micro-Cap schemes account for approximately $10 billion in annual frauds. *Id*. The FBI explains these schemes: "Micro-Cap fraud typically involves high pressure telephone sales of risky and low-priced stock, generally in start-up companies with little or no track record. Often, their stocks are sold by unregistered brokers who call investors from boiler rooms, using elaborate scripts." *Id*.

66. Peter Schenck, *Overview of Securities Fraud Schemes* at 5, contained in *Securities Fraud Prosecution Manual*, Department of Justice Office of Legal Education (2000) [hereinafter Schenck]. According to Peter Schenck, the Chief of the Fraud Division of the Eastern District of Pennsylvania's United States Attorney's Office, prime bank schemes can be described as follows:

> Prime bank schemes involve the investment in fanciful notes, debentures, letters of credit, and guarantees which are purported to be issued by "prime" banks or "prime" European banks. These are often allusions to secret financial networks which are usually closed to the average investor. High, often absurdly high, interest rates are guaranteed. Often there is a guarantee of no risk, with the victim's money to remain in a reputable bank's escrow account as collateral for the deal.

Id. *See also* Joel E. Leising & Michael McGarry, *Prime Bank/High Yield Investment Schemes*, United States Attorneys' Bulletin 10, 11 (Mar. 2002); Economic Crimes Unit, *supra* note 1. The FBI explains prime bank investments:

> [Prime bank investments] are fraudulently sold as if from financial instruments of well-known domestic or foreign financial institutions, the World Bank, or a country's central bank. The financial instruments may be sold as notes, letters of credit, debentures, or guarantees. The schemes include false claims of high rates of return, of being "risk free," of the financial instrument being traded on a worldwide secret exchange, and of being issued in formats approved and/or sanctioned by the Federal Reserve, the International Chamber of Commerce (ICC) or other well-known international organizations.

Id.

67. Schenck, *supra* note 66, at 6. Peter Schneck explains the role of the Internet in securities fraud:

> The internet is used as a vehicle for the traditional frauds . . . with the added danger of instant saturation of a huge potential market. Bulk e-mailing (spamming) reaches large numbers at a small cost. Software is cheaply available to harvest thousands of e-mail addresses from internet files and create mailing lists, so at a fraction of the cost of a boiler room mass solicitations can be sent out. Fraudsters can also create e-mail message [sic] which appear to be internal memos from well known investment firms, inducing the recipient of the

Investment brokers also invented and executed predatory schemes such as churning,[70] self-dealing,[71] skimming,[72] and front running.[73] Finally, corporate executives invented and implemented new, aggressive book-

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> "misdirected" email to invest. Internet users tend to view the net as a trusted community . . . . They will be more susceptible to internet solicitations than to a high pressure telephone call.

Id. See also Securities and Exchange Commission, *Internet Fraud: How to Avoid Internet Investment Scams*, *available at* http://www.sec.gov/investor/pubs/cyberfraud.htm (last visited Feb. 18, 2003). The SEC discusses numerous ways in which creative criminals have used the Internet to execute previously non-existent fraud schemes. *Id*. For example, perpetrators send out fraudulent online newsletters, post fraudulent online bulletin boards, and mail *en masse* fraudulent "spam" messages. *Id*. Furthermore, the Internet has enabled perpetrators to carry out traditional fraud schemes online:

> The types of investment fraud seen online mirror the frauds perpetrated over the phone or through the mail. Remember that fraudsters can use a variety of Internet tools to spread false information, including bulletin boards, online newsletters, spam, or chat. . . . All of these tools cost very little money and can be found at the fingertips of fraudsters.

Id. For example, perpetrators use the Internet to implement "pump and dump" scams, pyramid schemes, off-shore schemes, and "risk-free" investment schemes. *Id*.

68. Schenck, *supra* note 66, at 5. Peter Schenck describes Ponzi schemes: "Ponzi schemes can involve investments in virtually anything, not simply stocks or bonds. Investors are generally promised very high returns and they are paid with funds obtained from later investors. Often early investors are so pleased with the return they leave their principle [sic] in the scheme." *Id.*

69. *Id.* at 1-2. Market manipulation schemes fall into three classes:

(1) Bribed Touts and Brokers:

> Traditional newsletters, internet analysts, and media stock experts are all potential candidates for improper influence by stock promoters, particularly of microcap stocks, to affect stock prices . . . . Touts also often provide false information about the stocks they push. A stock may also be pushed by brokers who are paid bribes to sell the stock.

Id.

(2) Pump and Dump Schemes:

> [These schemes] involve pushing the market up with false information and selling before reality sets in and the stock price drops. Boosting of stock can be done through internet chat rooms and sites such as Raging Bull, barrages of internet hype ostensibly from different sources, and posting false press releases from or about the company.

Id.

(3) Parking Schemes:

> These schemes make a stock's market more volatile by removing much of the stock from trading. The stock is "parked" in nominee accounts to keep it off the market and make the price easier to manipulate. As the price rises, the parked stock is put back on the market.

Id.

70. *Id*. at 3. Peter Schenck explains, "[c]hurning is the broker's fraudulent repeated trading in a client's stock portfolio to generate exorbitant fees based on multiple transactions. Successful prosecution relies on proof of substantial bleeding of the account with high frequency trades and with little client acquiescence." *Id.*

71. *Id*. Self dealing may be described as follows: "Brokers or corporate employees controlling their company's trades may fraudulently assign winning trades to their personal account and the losses to their customer's or employer's account." *Id.*

72. *Id.* at 4. ("Brokers can skim money from trades by trading at a more advantageous price than the client had requested, and keeping the difference.").

73. *Id*. ("Brokers may trade on their own prior to placing a customer's order, hoping the large customer order will raise the price of the stock.").

cooking schemes.[74] Most notably, Enron's executives "used thousands of off-the-book entities" to weave an "intricate spider's web of deceit."[75] Enron's accounting jujitsu tricks enabled it to overstate corporate profits, understate corporate debts, inflate the corporate stock price, and ultimately ruin the financial stability of countless investors.[76] The Judiciary Committee therefore drafted the Securities Fraud Statute flexibly to help federal prosecutors "keep pace with the most sophisticated and clever con artists" who will invent new fraud schemes in future years.[77]

Third, Congress sought to deter securities fraud more effectively.[78] Before the enactment of the Securities Fraud Statute, federal prosecutors traditionally used the mail fraud and wire fraud statutes to convict securities defrauders, but these statutes carried maximum sentences of only five years.[79] In the climate of American investors losing billions of dollars because of securities-related scandals, Congress believed that such minimal exposure to incarceration was unacceptable.[80] Senator John McCain underscored this disgust:

> Until somebody responsible goes to jail for a significant amount of time, I am not sure that these people are going to get the message. Defrauding the shareholder has to carry a meaningful penalty . . . . The threat of real time in jail is a deterrent that will make people pay attention.[81]

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74. *Id.* at 3. Peter Schenck explains how corporate executives "cook the books": "Corporate officials can manipulate their financial picture to present the façade of success by booking phony receivables and other accounting fraud. This lays the groundwork for boosting the value of stock, use of stock as collateral for loans or other activity, or purchasing other companies through stock exchange."

75. S. REP. NO. 107-146, at 2 (2002).

76. *Id*.

77. *Id.* at 11.

78. *Id*. ("[The CCFPA] also means providing for criminal penalties tough enough to make [potential perpetrators] think twice before defrauding the public."). *See also* 148 CONG. REC. S6437 (2002) (statement of Senator Daschle) ("The Leahy amendment . . . provides prosecutors with a new tool that is . . . tough enough to deter violations on the front end."); 148 CONG. REC. S6439 (2002) (statement of Senator Leahy) ("The idea of 10 years in the slammer is going to focus the attention of those who are more interested in taking their money and hiding it in offshore bank accounts."); 148 CONG. REC. H4684 (2002) (statement of Representative Sensenbrenner) ("In addition, a distinct securities fraud crime is established with a maximum penalty of 25 years in jail. Again, the other body only calls for a 10-year penalty.").

79. *See* 18 U.S.C.A. § 1341 (before July 2002); 18 U.S.C.A. § 1343 (before July 2002).

80. S. REP. NO. 107-146, at 11.

81. 148 CONG. REC. S6528 (statement of Senator McCain).

Hence, the Securities Fraud Statute has a tough twenty-five-year sentence[82] that many in Congress believe will effectively deter potential violators.[83]

III. ELEMENTS OF THE SECURITIES FRAUD STATUTE

To decipher the elements of the Securities Fraud Statute, one must first examine the statute's text. The Securities Fraud Statute reads as follows:

> Whoever knowingly executes, or attempts to execute, a scheme or artifice—
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> (1) to defraud any person in connection with any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(d)); or
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> (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any money or property in connection with the purchase or sale of any security of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*) or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(d));
>
> shall be fined under this title, or imprisoned not more than 25 years, or both.[84]

The Judiciary Committee modeled the Securities Fraud Statute on the bank fraud[85] and health-care fraud[86] statutes,[87] which are in turn modeled on the mail fraud[88] and wire fraud[89] statutes. Congress indicated that courts and prosecutors should interpret elements in the new statute by examining courts' treatment of similarly worded elements in prosecutions under these other fraud provisions.[90] Although there have not yet been any

82. *See supra* note 4.
83. *See supra* note 78.
84. 18 U.S.C.A. § 1348 (West 2003).
85. 18 U.S.C.A. § 1344 (West 2003).
86. 18 U.S.C.A. § 1347 (West 2003).
87. *See supra* note 58.
88. 18 U.S.C.A. § 1341 (West 2003).
89. 18 U.S.C.A. § 1343 (West 2003).
90. *See supra* note 58. Similarly, in another part of the Judiciary Report, the Senate underscores

prosecutions under the Securities Fraud Statute, there have been numerous prosecutions under these templates, particularly the mail fraud and wire fraud statutes.[91]

A. 18 U.S.C. § 1348(1)

1. Intent To Defraud

The Securities Fraud Statute states that to be convicted, defendants must "knowingly" execute or attempt to execute a fraudulent scheme.[92] The Judiciary Committee report dictates that "[t]he intent requirements [of the Securities Fraud Statute] are to be applied consistently with those found in 18 U.S.C. §§ 1341, 1343, 1344, 1347,"[93] the mail fraud,[94] wire

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that "[t]he intent requirements are to be applied consistently with those found in 18 U.S.C. §§ 1341 (mail fraud), 1343 (wire fraud), 1344 (bank fraud), 1347 (health care fraud)." S. REP. NO. 107-146, at 20 (2002) (parentheticals added). As for the "scheme or artifice to defraud" requirement, the Judiciary Committee again suggested that courts and prosecutors should look to court interpretations of the mail fraud, wire fraud, bank fraud, and health care fraud statutes: "*By covering all 'schemes and artifices to defraud' (see 18 U.S.C. §§ 1344, 1341, 1343, 1347)*, new § 1348 will be more accessible to investigators and prosecutors and will provide needed enforcement flexibility . . . ." *Id*. (emphasis added).

See also KATHLEEN F. BRICKEY, CORPORATE AND WHITE COLLAR CRIME: CASES AND MATERIALS 4 (3d ed. Supp. 2002). Professor Brickey argues that courts will examine the mail fraud statute to determine the elements of the Securities Fraud Statute:

> There are obvious parallels between § 1348 and the mail fraud statute. Both statutes prohibit executing a "scheme or artifice" whose objective is "to defraud" or "to obtain money or property." And while both statutes prohibit fraudulent schemes, neither defines what constitutes fraud. It should be noted, however, that as used in the mail fraud statute, "fraud" is a nontechnical and highly elastic concept that differs from "fraud" as embodied in the securities laws. It is likely that courts construing § 1348 will rely on case law interpreting the mail fraud statute—rather than the securities laws—to flesh out these terms.

Id.

91. First, many more appellate cases deal with the mail and wire fraud statutes, as opposed to the bank and health care fraud statutes, because the mail and wire fraud statutes substantially predated the two later fraud statutes. Second, one should note that "[b]ecause the [mail fraud and wire fraud] statutes are in pari material, they are subject to the rule that they should be given parallel construction." KATHLEEN F. BRICKEY, CORPORATE AND WHITE COLLAR CRIME: CASES AND MATERIALS 126 (3d ed. 2002) [hereinafter BRICKEY] (internal citations omitted).

92. *See supra* note 4.

93. S. REP. NO. 107-146, at 20.

94. The mail fraud statute, 18 U.S.C.A. § 1341 (West 2003), reads as follows:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, or to sell, dispose of, loan, exchange, alter, give away, distribute, supply, or furnish or procure for unlawful use any counterfeit or spurious coin, obligation, security, or other article, or anything represented to be or intimated or held out to be such counterfeit or spurious article, for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited

fraud,[95] bank fraud,[96] and health care fraud[97] statutes respectively. Thus, to determine the intent requirement courts should require in prosecutions under the Securities Fraud Statute, one must first consider prior judicial interpretations of the fraudulent intent requirement under these template statutes.

Generally, to prove fraudulent intent, the government must demonstrate that the defendant intentionally devised or participated in a scheme with knowledge of the scheme's fraudulent nature and with the intent that the scheme's illicit objectives be achieved.[98] For example, in *United States v.*

> any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier according to the direction thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

95. The wire fraud statute, 18 U.S.C.A. § 1343 (West 2003), reads as follows:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both. If the violation affects a financial institution, such person shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

96. The bank fraud statute, 18 U.S.C.A. § 1344 (West 2003), reads as follows:

> Whoever knowingly executes, or attempts to execute, a scheme or artifice—
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> (1) to defraud a financial institution; or
>
> (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises;
>
> shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

97. The health care fraud statute, 18 U.S.C.A. § 1347 (West 2003), reads as follows:

> Whoever knowingly and willfully executes, or attempts to execute, a scheme or artifice—
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> (1) to defraud any health care benefit program; or
>
> (2) to obtain, by means of false or fraudulent pretenses, representations, or promises, any of the money or property owned by, or under the custody or control of, any health care benefit program,
>
> in connection with the delivery of or payment for health care benefits, items, or services, shall be fined under this title or imprisoned not more than 10 years, or both. If the violation results in serious bodily injury (as defined in section 1365 of this title), such person shall be fined under this title or imprisoned not more than 20 years, or both; and if the violation results in death, such person shall be fined under this title, or imprisoned for any term of years or for life, or both.

98. *See, e.g.*, United States v. Autuori, 212 F.3d 105, 115 (2d Cir. 2000) (concluding that the defendant must have scienter or fraudulent intent); United States v. Montani, 204 F.3d 761, 768 (7th Cir. 2000) (concluding that fraudulent intent requirement must be satisfied for mail fraud conviction); United States v. Walker, 191 F.3d 326, 334 (2d Cir. 1999) (requiring that the defendant specifically

Bailey,[99] a federal jury convicted two defendants of mail fraud for their participation in a scheme to defraud the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation (the "FSLIC"). Because highly regarded and respected real estate brokers and the president of the FSLIC had assured the defendants that the predicate transaction was legitimate, however, the Seventh Circuit Court of Appeals reversed their convictions.[100] The court emphasized that while the government did show that the two defendants "participated in a transaction that turned out to be part of a fraudulent scheme,"[101] the government failed to show "willful participation in [the] scheme with knowledge of its fraudulent . . . intent that these illicit objectives be achieved."[102] Hence, to convict a defendant of mail fraud under the Seventh Circuit's interpretation of the fraudulent intent requirement, the government must show that (1) the defendant consciously understood his or her actions[103] and (2) specifically intended to execute a fraudulent scheme.[104] This interpretation of the fraudulent intent requirement typifies other federal courts' interpretation of the same element under the mail fraud, wire fraud,

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intend to harm or defraud victims); United States v. Sayakhom, 186 F.3d 928, 940 (9th Cir. 1999) (necessitating fraudulent intent for mail fraud conviction); United States v. Gold Unlimited, Inc., 177 F.3d 472, 478 (6th Cir. 1999) (enumerating fraudulent intent as an element of mail fraud); United States v. Powers, 168 F.3d 741, 746 (5th Cir. 1999), *cert. denied*, 528 U.S. 945 (1999) (requiring specific intent to harm); United States v. Rodriguez, 140 F.3d 163, 167 (2d Cir. 1998) (requiring specific intent to convict a defendant of bank fraud); United States v. Wicker, 80 F.3d 263, 267 (8th Cir. 1996) (requiring intent to defraud, not intent to violate mail fraud law); United States v. Costanzo, 4 F.3d 658, 664 (8th Cir. 1993) (stating that specific intent is an essential element, and guilt hinges on whether a defendant intended to defraud); United States v. Porcelli, 865 F.2d 1352, 1358 (2d Cir. 1989) (declaring that specific intent requires intent to defraud, not intent to violate the statute), *cert. denied*, 493 U.S. 810 (1989); United States v. Bailey, 859 F.2d 1265, 1273 (7th Cir. 1988) (holding that the prosecution must present sufficient evidence that the defendant acted with the intent to defraud); United States v. Diggs, 613 F.2d 988, 997 (D.C. Cir. 1979) (stating "[b]ecause only 'a scheme to defraud' and not actual fraud is required, proof of fraudulent intent is critical."), *cert. denied*, 446 U.S. 982 (1980).

99. 859 F.2d 1265, 1273-75 (7th Cir. 1988), *cert. denied*, 449 U.S. 1016 (1980), *overruled on other grounds by*, United States v. DeBright, 730 F.2d 1255 (9th Cir. 1984), *cert. denied*, 488 U.S. 1010 (1989).

100. *Bailey*, 859 F.2d at 1273-75.

101. *Id*. at 1273.

102. *Id.* (quoting United States v. Price, 623 F.2d 587, 591 (9th Cir. 1980)).

103. *See supra* notes 99-102 and accompanying text. *See also* First Cir. Pattern Crim. Jury Instr. § 4.13 (1998) ("[Defendant] acted "knowingly" if he/she was conscious and aware of his/her actions, realized what he/she was doing or what was happening around him/her, and did not act because of ignorance, mistake or accident."). *See also id.* at § 4.12 (providing same definition of "knowingly" in mail fraud context); Eighth Cir. Model Crim. Jury Instr. § 6.18.1341 (2003) ("To act with 'intent to defraud' means to act knowingly . . . . [With respect to false statements the defendant must have known the statement was untrue when made . . . .]").

104. *See supra* notes 99-102 and accompanying text.

and bank fraud statutes.[105] Consequently, for the government to yield a conviction under the Securities Fraud Statute, courts should impose the same knowledge and specific intent requirements.[106]

2. *Execute or Attempt To Execute a Scheme or Artifice To Defraud*

To convict a defendant under section 1 of the Securities Fraud Statute, the government must also prove that the defendant executed or attempted to execute "a scheme or artifice to defraud any person."[107] Like "knowingly," the "scheme or artifice to defraud" language appears in the mail fraud, wire fraud, bank fraud, and health care fraud statutes.[108] The Judiciary Committee thus suggested that courts should interpret "scheme

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105. *See supra* note 98.

106. Because it is impossible to read the minds of fraud defendants, federal prosecutors will probably need to present circumstantial evidence to prove perpetrators' fraudulent intent. *See* United States v. Alston, 609 F.2d 531, 538 (D.C. Cir. 1979), *cert. denied*, 445 U.S. 918 (1980) ("The requisite intent under the federal mail and wire fraud statues may be inferred from the totality of the circumstances and need not be proven by direct evidence.").

Jurors may infer the existence of a defendant's fraudulent intent based on at least three types of circumstantial evidence. *See* Department of Justice, Criminal Resource Manual § 949, *available at* http://usdoj.gov/usao/eousa/foia_reading_room/usam/title9/crm00949.htm (last updated October 1997) [hereinafter Criminal Resource Manual]. *See also* United States v. Reid, 533 F.2d 1255, 1264 n.34 (D.C. Cir. 1976); Shani S. Kennedy & Rachel Price Flum, *Mail and Wire Fraud*, 39 AM. CRIM. L. REV. 817, 826, n.82 (2002).

First, jurors may infer fraudulent intent from a defendant's statements and conduct. *See* United States v. Cusino, 694 F.2d 185, 187 (9th Cir. 1982) (citing United States v. Beecroft, 608 F.2d 753, 757 (9th Cir. 1979), *cert. denied*, 461 U.S. 932 (1983). *See also* Criminal Resource Manual, *supra* note 106, at § 949 (explaining that if a securities fraud victim sends a complaint letter to the perpetrator, a federal prosecutor could offer the perpetrator's subsequent participation in the scheme to prove that the perpetrator knowingly defrauded investors).

Second, jurors may infer fraudulent intent from evidence indicating that the perpetrator attempted to conceal his or her fraudulent activities. *See* Kennedy & Flum, *supra* note 106, at 826 & n.82. For example, in an Internet fraud case, the prosecutor could offer the fact that the perpetrator used a false screen name to prove that the perpetrator intentionally avoided detection.

Finally, jurors may infer fraudulent intent "from the modus operandi of the scheme." United States v. Reid, 533 F.2d 1255, 1264 n.34 (D.C. Cir. 1976). The District of Columbia Circuit noted that "[o]f course proof that someone was actually victimized by the fraud is good evidence of the schemer's intent." *Id.* (quoting United States v. Regent Office Supply Co., 421 F.2d 1174, 1180-81 (2d Cir. 1970). In other words, if the "necessary result" of a perpetrator's securities fraud scheme is to injure others, jurors may infer fraudulent intent from the existence of the scheme itself. United States v. D'Amato, 39 F.3d 1249, 1257 (2d Cir. 1994). In holding that the government failed to produce sufficient evidence of the defendant's specific intent, the Second Circuit Court of Appeals emphasized that "[w]hen the 'necessary result' of the actor's scheme is to injure others, fraudulent intent may be inferred from the scheme itself. Where the scheme does not cause injury to the alleged victim as its necessary result, the government must produce evidence independent of the alleged scheme to show the defendant's fraudulent intent." *Id.*

107. *See supra* note 4.

108. *See supra* notes 94-97.

or artifice to defraud" based on prior judicial interpretations of the same language in these other statutes.[109]

Congress failed to define the words "scheme" or "artifice" in the mail fraud, wire fraud, bank fraud, and health care fraud statutes.[110] Federal courts have traditionally been reluctant to limit definitively "scheme" and "artifice" and have accordingly construed the terms expansively.[111] Generally, courts analyze potential violations of the template fraud statutes based on elastic standards of "moral uprightness, fundamental honesty, fair play and right dealing in the general and business life of members of society."[112] For example, in *United States v. Lindsey*,[113] a jury convicted the defendant of mail fraud. To obtain a higher resale profit, the defendant swapped the Illinois titles of cars he salvaged for Missouri titles containing no "salvaged" designation.[114] Although the defendant's act of swapping titles was legal under both Illinois and Missouri law,[115] the Seventh Circuit Court of Appeals concluded that the defendant nevertheless committed a "scheme or artifice to defraud" under the federal mail fraud statute.[116] The court underscored that "the scheme is not to be measured by technicalities. Rather, the measure of fraud is its departure from moral uprightness, fundamental honesty, fair play and candid dealings in the general life of

109. *See supra* note 90.

110. *See supra* notes 94-97.

111. *See*, *e.g.*, United States v. Doherty, 969 F.2d 425, 428-20 (7th Cir. 1992) (holding that one need not make a false representation to execute a scheme to defraud under the bank fraud statute), *cert. denied*, 506 U.S. 1002 (1992); United States v. Stull, 743 F.2d 439, 442 n.2 (6th Cir. 1984) ("It is well established that proof of every allegation is not required in order to convict; the government need only prove that the scheme to defraud existed."); United States v. Lemire, 720 F.2d 1327, 1335 (D.C. Cir. 1983) ("Congress did not define 'scheme or artifice to defraud' when it first coined that phrase, nor has it since. Instead that expression has taken on its present meaning from 111 years of case law.") (internal citations omitted); Foshay v. United States, 68 F.2d 205, 211 (8th Cir. 1933) ("To try to delimit 'fraud' by definition would tend to reward subtle and ingenious circumvention and is not done."), *cert. denied*, 291 U.S. 674 (1934); BRICKEY, *supra* note 91, at 125 ("The [mail fraud] statute's broad proscription against using the mails to execute a scheme to defraud provides virtually open-ended liability, in part because the statute does not define the term 'defraud.'").

112. United States v. Van Dyke, 605 F.2d 220, 225 (6th Cir. 1979), *cert. denied*, 444 U.S. 994 (1979). *See also* Carpenter v. United States, 484 U.S. 19, 27 (1987) ("[T]he words 'to defraud' in the mail fraud statute have the 'common understanding' of 'wronging one in his property rights by dishonest methods or schemes,' and 'usually signify the deprivation of something of value by trick, deceit, chicane, or overreaching.'") (quoting McNally v. United States, 483 U.S. 350, 358 (1987)).

113. 736 F.2d 433, 435 (7th Cir. 1984).

114. *Id*. The defendant, a licensed automobile rebuilder, bought and rebuilt six previously wrecked automobiles registered in Illinois. *Id*. at 434. The Illinois vehicle titles for the six cars designated that the cars were salvaged. *Id*. To sell the vehicles for a higher profit, the defendant exchanged the six Illinois vehicle titles for five Missouri titles and one Kentucky title containing no notation that the vehicles had been salvaged. *Id*.

115. *Id*. at 436.

116. *Id*. at 437.

members in society."[117] Because the defendant swapped the titles to deceive consumers, his actions satisfied the "scheme or artifice to defraud" requirement and the court affirmed his conviction.[118]

The Judiciary Committee incorporated the "scheme or artifice to defraud" language into the Securities Fraud Statute to "provide needed enforcement flexibility and, in the context of publicly traded companies, protection against all the types [of] schemes and frauds which inventive criminals may devise in the future."[119] In 1995, however, the United States Supreme Court limited the extent to which federal courts may broadly construe "scheme or artifice to defraud." In *Neder v. United States*,[120] the Supreme Court held that materiality is an implicit element in the bank fraud statute,[121] despite the fact that the plain meaning of the statute does not require materiality.[122] Because the Court reasoned that the common law understanding of "defraud" always included a materiality requirement,[123] the Court also held that the mail fraud and wire fraud statutes contain materiality elements.[124] Under *Neder*, "a false statement is material if it has 'a natural tendency to influence, or is capable of influencing, the decision of the decisionmaking [sic] body to which it was addressed.'"[125] Hence, courts should construe the "scheme or artifice to defraud" language found in the Securities Fraud Statute expansively, subject to the *Neder* limitation that defendants' schemes must be capable of influencing the decision-making processes of their intended victims.

3. In Connection with any Security of a Publicly Traded Company

The government can sustain a conviction under the Securities Fraud Statute only if the defendant defrauds a person (a) "in connection with any security" (b) "of an issuer with a class of securities registered under section 12 of the Securities Exchange Act of 1934 (15 U.S.C. 78*l*), or that is required to file reports under section 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78*o*(d))."[126] The "class of securities" clause is

117. *Id*. at 436.
118. *Id*. at 437.
119. S. REP. NO. 107-146, at 20 (2002).
120. Neder v. United States, 527 U.S. 1 (1999).
121. *Id*. at 25.
122. *See supra* note 96.
123. *Neder*, 527 U.S. at 21-23.
124. *Id.* at 25.
125. *Id.* at 16 (quoting United States v. Gaudin, 515 U.S. 506, 509 (1995)) (quoting Kungys v. United States, 485 U.S. 759, 770 (1988) (internal quotation marks and brackets omitted)).
126. *See supra* note 4.

relatively straightforward: sections 12[127] and 15(d)[128] of the Securities Exchange Act of 1934 ("1934 SEA") encompass all securities publicly traded on the national stock exchanges. Courts generally interpret the word "security" broadly to include "notes; stocks; debentures; oil, gas or other mineral rights; investment contracts; insurance products; bank products; employee benefit plans; voting trust certificates; certificates of deposit; equipment trust certificates; and warrants, options and commodity futures."[129] The Securities Fraud Statute thus applies to any scheme or artifice to defraud "in connection with any security" of any publicly traded company.

Federal courts generally interpret the "in connection with the purchase or sale of a security" language found in section 10(b) of the 1934 SEA[130]

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127. 15 U.S.C.A. § 78*l* (West 2003) reads in relevant part as follows:

> It shall be unlawful for any member, broker, or dealer to effect any transaction in any security (other than an exempted security) on a national securities exchange unless a registration is effective as to such security for such exchange in accordance with the provisions of this chapter and the rules and regulations thereunder.

15 U.S.C.A. § 78*l*(a).

128. 15 U.S.C.A. § 78*o*(d) (West 2003) reads in relevant part as follows:

> Each issuer which has filed a registration statement containing an undertaking which is or becomes operative under this subsection as in effect prior to August 20, 1964, and each issuer which shall after such date file a registration statement which has become effective pursuant to the Securities Act of 1933, as amended, . . . shall file with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors, such supplementary and periodic information, documents, and reports as may be required pursuant to section 78*m* of this title in respect of a security registered pursuant to section 78*l* of this title. The duty to file under this subsection shall be automatically suspended if and so long as any issue of securities of such issuer is registered pursuant to section 78*l* of this title. The duty to file under this subsection shall also be automatically suspended as to any fiscal year, other than the fiscal year within which such registration statement became effective, if, at the beginning of such fiscal year, the securities of each class to which the registration statement relates are held of record by less than three hundred persons. For the purposes of this subsection, the term "class" shall be construed to include all securities of an issuer which are of substantially similar character and the holders of which enjoy substantially similar rights and privileges.

129. Steven Amchen, Jessica Cordova, & Paul Cicero, *Securities Fraud*, 39 AM. CRIM. L. REV. 1037, 1058 (2002).

130. 15 U.S.C.A. § 78*j*(b) (West 2003) reads in relevant part as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange
>
> . . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, or any securities-based swap agreement (as defined by section 206B of the Gramm-Leach-Bliley Act), any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

and SEC Rule 10b-5[131] expansively.[132] For example, in *United States v. O'Hagan*,[133] the Supreme Court endorsed the "misappropriation theory" of insider trading under section 10(b) and Rule 10b-5.[134] Under this theory, a person who trades in securities for personal profit, using confidential information misappropriated in breach of a fiduciary duty owed to the source of the information, is guilty of criminal insider trading.[135] The Court reasoned that such transactions are "in connection with" securities trading because "the fiduciary's fraud is consummated, not when the fiduciary gains the confidential information, but when . . . he [subsequently] uses the information to purchase or sell securities."[136] Because the "in connection with" language in section 1 of the Securities Fraud Statute is not followed by "the purchase or sale of any security," courts should interpret the wording equally, or even more broadly than the Supreme Court in *O'Hagan*.

B. 18 U.S.C. § 1348(2)

1. Intent To Defraud

Like section 1 of the Securities Fraud Statute, section 2 states that to be convicted, a defendant must "knowingly" execute or attempt to execute a scheme or artifice to defraud.[137] Thus, the same fraudulent intent analysis

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131. 17 C.F.R. 240.10b-5 (West 2003) reads as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

132. *See, e.g.*, United States v. O'Hagan, 521 U.S. 642, 653-54 (1997); Superintendant of Ins. of New York v. Bankers Life & Cas. Co., 404 U.S. 6, 10-13 (1971); McGann v. Ernst and Young, 102 F.3d 390, 397 (9th Cir. 1996); United States v. Newman, 664 F.2d 12, 18 (2d Cir. 1981), *cert. denied*, 464 U.S. 863 (1983) ("[T]he [Supreme] Court construed the phrase 'in connection with' flexibly to include deceptive practices 'touching' the sale of securities, a relationship which has been described as very tenuous indeed") (internal citations omitted); SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 860 (2d Cir. 1968).

133. 521 U.S. at 653.

134. *Id*.

135. *Id*. at 652.

136. *Id*. at 656.

137. *See supra* note 4.

that applies to section 1 of the Securities Fraud Statute applies to section 2 as well. To establish fraudulent intent under the mail fraud, wire fraud, and bank fraud statutes, the government must demonstrate that (1) the defendant consciously understood his or her actions[138] and (2) specifically intended to execute a fraudulent scheme.[139] Courts should impose these same intent requirements in order for the government to secure a conviction under section 2 of the Securities Fraud Statute.

2. *Scheme or Artifice To Obtain Money or Property by Means of False or Fraudulent Pretenses, Representations, or Promises*

While section 1 of the Securities Fraud Statute addresses a "scheme or artifice to defraud," section 2 of the statute pertains to a "scheme or artifice to obtain by means of false or fraudulent pretenses, representations, or promises, any money or property."[140] As noted earlier, federal courts generally interpret the words "scheme" and "artifice" broadly to encourage prosecutorial flexibility.[141] The term "false or fraudulent pretenses" similarly encompasses a broad class of statements and assertions.[142] For example, in *United States v. Blastos*,[143] the First Circuit Court of Appeals affirmed the defendant's bank fraud conviction using the following flexible definition of "false and fraudulent pretenses":

> [A]ny false statements or assertions that concern a material aspect of the matter in question, that were either known to be untrue when made or that were made with reckless indifference to their truth and that were made with the intent to defraud. They include actual, direct false statements as well as half-truths and the knowing concealment of facts.[144]

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138. *See supra* notes 92-106 and accompanying text.
139. *Id*.
140. *See supra* note 4.
141. *See supra* notes 111-12.
142. United States v. Blastos, 258 F.3d 25, 29 (1st Cir. 2001). *See also* United States v. Dillman, 15 F.3d 384, 392-93 (5th Cir. 1994) (affirming district court's jury instruction that "[a] statement or representation is 'false' or 'fraudulent' within the meaning of [the bank fraud] statute when . . . it is known to be untrue or is made with reckless indifference to its truth or falsity."); United States v. Gunther, 876 F.2d 1113, 1120 (5th Cir. 1989) (upholding same language in jury instruction). The "to obtain money or property" requirement should rarely, if ever, present a prosecutorial obstacle because the ultimate objective of almost all securities fraud schemes is to obtain money or property.
143. 258 F.3d at 28.
144. *Id*. at 28-29.

Similarly, in *United States v. Dillman*,[145] the Fifth Circuit Court of Appeals affirmed the district court's instruction to the jury that a statement or representation "is 'false' or 'fraudulent' within the meaning of [the bank fraud] statute when it pertains to a material fact; it is known to be untrue or is made with reckless indifference to its truth or falsity; and is made or caused to be made with intent to defraud."[146] Thus, under both *Blastos* and *Dillman*, a false or fraudulent representation (1) pertains to a material fact, (2) is known or recklessly not known by the perpetrator to be false, (3) and is intentionally made by the perpetrator in order to defraud another person.[147] The *Blastos* and *Dillman* interpretation of the "false or fraudulent pretenses" requirement typifies other judicial interpretations of the same element;[148] courts should apply the *Blastos* and *Dillman* test to determine whether the government has satisfied its burden of proof under section 2 of the Securities Fraud Statute.

3. *In Connection with the Purchase or Sale of any Security of a Publicly Traded Company*

Like section 1 of the Securities Fraud Statute, section 2 applies only to schemes that connect to the security of any publicly traded company.[149] Unlike section 1 of the Securities Fraud Statute, which applies to fraud schemes "in connection with any security," section 2 of the statute applies to fraud schemes "*in connection with the purchase or sale of any security*."[150] Nevertheless, federal courts should interpret the language broadly.

First, federal courts generally interpret the term "in connection with the purchase or sale of any security" expansively.[151] For example, in *SEC v. Texas Gulf Sulphur Company*,[152] the Second Circuit Court of Appeals held that under Rule 10b-5, perpetrators make false and misleading assertions "in connection with" securities trading "whenever [such] assertions are made . . . in a manner reasonably calculated to influence the investing

145. 15 F.3d at 392-93.
146. *Id.* at 392.
147. *See supra* notes 143-46 and accompanying text.
148. *See, e.g.*, United States v. Jenkins, 210 F.3d 884, 886 (8th Cir. 2000); United States v. Lilly, 983 F.2d 300, 302-04 (1st Cir. 1992); United States v. Heath, 970 F.2d 1397, 1403 (5th Cir. 1992); United States v. Barnhart, 979 F.2d 647, 648-50 (8th Cir. 1992); United States v. Bonnett, 877 F.2d 1450, 1456-58 (10th Cir. 1989).
149. *See supra* note 4.
150. *See supra* note 4 (emphasis added).
151. *See supra* notes 130-36 and accompanying text.
152. 401 F.2d 833 (2d Cir. 1968) (*in banc*).

public,"[153] regardless of whether "the makers of [the] misleading statement[s] also participated in pertinent securities transactions."[154] This broad interpretation of the "in connection with the purchase or sale of any security" language exemplifies treatment of the term by other federal courts.[155]

Second, when drafting the Securities Fraud Statute, the Judiciary Committee specifically cited with strong disapproval *SEC v. Zandford*.[156] In *Zandford*, the Fourth Circuit Court of Appeals took a minority position and relied on a narrow interpretation of the "in connection with the purchase or sale of any security" language to dismiss the SEC's action against a securities broker who sold the securities of both an elderly man in poor health and of the elderly man's mentally challenged daughter, and then pocketed the proceeds.[157] The Judiciary Committee declared that rather than reading the Securities Fraud Statute to "require proof of technical elements from the securities laws,"[158] courts should interpret the Securities Fraud Statute expansively to facilitate enforcement.[159] Consequently, courts should interpret the "in connection with the purchase or sale of any security" broadly, in conformance with federal precedent and Congress' intent.

IV. THE IMPACT OF THE SECURITIES FRAUD STATUTE ON PROSECUTIONS OF SECURITIES DEFRAUDERS

Because there have not yet been any prosecutions under the Securities Fraud Statute, one may only theoretically consider the extent to which it will affect federal securities fraud prosecutions. On the one hand, it appears that the Securities Fraud Statute will significantly impact securities fraud prosecutions. First, the statute will make it easier, in a limited class of cases, for prosecutors to convict securities defrauders.[160] Even if a defendant uses interstate commerce or the mail or wire systems to further a fraudulent scheme, it can sometimes be difficult for federal

153. *Id.* at 862.
154. *Id.* at 860.
155. *See supra* notes 132-36 and accompanying text.
156. 238 F.3d 559 (4th Cir. 2001). The Judiciary Committee cited *Zandford* to explain why federal prosecutors usually decide not to charge willful violations of securities laws and statutes. S. REP. NO. 107-146, at 6 (2002).
157. *Zandford*, 238 F.3d at 566.
158. S. REP. NO. 107-146, at 20.
159. *Id.* Also, Federal courts generally interpret the term "in connection with the purchase or sale of any security" flexibly. *See supra* notes 140-49 and accompanying text.
160. *See supra* note 56 and accompanying text.

prosecutors to prove the actual existence of a transaction, letter, e-mail, fax, or phone-call.[161] Under the Securities Fraud Statute, prosecutors will not have to prove these elements,[162] which only tangentially relate to the crux of the defendant's scheme—intentional misrepresentations regarding securities.[163]

Second, the elements of the Securities Fraud Statute are flexible enough to enable federal prosecutors to keep up with the most complex new fraud schemes that relate to securities of publicly traded companies.[164] Most importantly, federal prosecutors can use the new statute to prosecute the type of complex corporate book-cooking schemes that Enron's executives orchestrated.[165] Also, prosecutors will most likely be able to use the statute to combat many broker-initiated schemes, including churning, self-dealing, skimming, and front-running.[166] All of these broker-initiated schemes entail fraudulent intent, the execution or attempted execution of a scheme or artifice to defraud, and connections to the securities of publicly traded companies.[167]

Finally, the strict twenty-five-year sentence the Judiciary Committee injected into the Securities Fraud Statute will likely deter some potential violators and thus enable federal agents and prosecutors to target particularly egregious schemes.[168] Since the enactment of the Securities Fraud Statute, numerous law firms in the United States have posted interpretation memorandums on their websites warning clients about potential criminal liability under the new provision.[169] Such publicity about the new statute, combined with its harsh twenty-five-year maximum sentence, should deter violators and empower federal prosecutors and investigators to combat particularly insidious, deceitful conduct.

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161. *See* S. REP. NO. 107-146, at 6 ("Currently, in securities fraud cases, prosecutors must rely on generic mail and wire charges that . . . require prosecutors to carry the sometimes awkward burden of proving the use of the mail or the interstate wires to carry out the fraud.").

162. *See supra* note 4.

163. *See supra* note 161. According to the Judiciary Committee, the Securities Fraud Statute will eliminate this "awkward burden." *Id*.

164. *See supra* notes 57-77 and accompanying text.

165. *See, e.g.*, S. REP. NO. 107-146, at 2-6, 10-11, 14, 20, 30. After all, the Enron fiasco was Congress' primary impetus for enacting the flexible and adaptable Securities Fraud Statute.

166. *See supra* notes 70-73 and accompanying text. The probable elements of section 1 of the Securities Fraud Statute may be applied to each of these schemes.

167. *See supra* notes 70-73, 86-136, and accompanying text.

168. *See supra* notes 78-83 and accompanying text.

169. *See, e.g.*, Luis Avila, Lisa Sawyer Cadet, and Janet Love, *Sarbanes-Oxley Act of 2002*, Lord, Bissell, & Brook, LLP, *available at* http://www.lordbissel.com/newstand.cfm (last visited Oct. 25, 2002); Robert Saville, Laurence Hirsch, Richard Swanson, *Sarbanes-Oxley Act of 2002: Summary and Analysis of Criminal Provisions*, Thelen, Reid, & Priest, LLP, *available at* http://www.thelenreid.com/articles/article/art_138.htm (last visited Oct. 25, 2002).

While it may seem that the Securities Fraud Statute will significantly impact federal securities fraud prosecutions, three significant factors suggest that the Securities Fraud Statute will only nominally impact securities fraud prosecutions. First, the mail fraud and wire fraud statutes are written and interpreted flexibly,[170] and these "catch-all" provisions embrace nearly all securities fraud schemes. After all, it is extremely unlikely that a securities defrauder could orchestrate a scam without at some point using the mail or wire systems in furtherance of his or her scheme.[171] Although the Securities Fraud Statute obviates the need for prosecutors to prove the actual existence of an illegal letter, e-mail, fax, or phone-call, proving the existence of these documents and transmissions rarely presents a prosecutorial hurdle:

> The government may use circumstantial evidence to prove the mails were used to further an alleged scheme to defraud. In effect this relieves the government of the burden of proving who actually mailed the communications in question and precisely how and when they were mailed. The proof may consist of evidence concerning routine office procedures for processing documents like those in question or evidence of conduct that is consistent with a response to the material allegedly mailed.[172]

Because the SOA increases the prison sentence for mail fraud and wire fraud from five years to twenty years,[173] these two statutes constitute very effective tools for federal prosecutors.

Second, even though the Securities Fraud Statute eliminates the need for prosecutors to prove technical elements such as reliance[174] and the use of interstate commerce or mail[175] that inhere in section 10(b)[176] and Rule 10b-5,[177] the elements of the Securities Fraud Statute and these two other securities laws substantially overlap. All three laws require the

170. *See supra* notes 111-18 and accompanying text.

171. Interview with Kathleen F. Brickey, James Carr Professor of Criminal Jurisprudence at Washington University School of Law in St. Louis, Mo. (Jan. 16, 2003).

172. BRICKEY, *supra* note 91, at 183.

173. *Compare* the maximum sentences under the current mail fraud statute, 18 U.S.C.A. § 1341 (West 2003), and current wire fraud statute, 18 U.S.C.A. § 1343 (West 2003), *with* the same provisions before July 1, 2002.

174. *See supra* note 20.

175. *See* United States v. O'Hagan, 521 U.S. 642, 651 (1997) (stating that the use of interstate commerce or the mail system is a necessary element of Rule 10b-5).

176. 15 U.S.C.A. § 78*j*(b) (West 2003).

177. 17 C.F.R. § 240.10b-5 (2003).

government to prove fraudulent intent,[178] the existence of material,[179] substantive fraud,[180] and a connection between the scheme and any security.[181] Furthermore, it is very difficult to envision a prosecutable securities fraud scheme on which no person relied or in which the defendant failed to utilize interstate commerce. Thus, the mere fact that the Securities Fraud Statute does not require prosecutors to satisfy the reliance and interstate commerce or interstate mail elements adds very little, if anything, to the prosecutorial utility of the new statute.

Third, the Securities Fraud Statute will not enable prosecutors to target some of the most pervasive and pernicious schemes that have spawned during the past decade. Because the Securities Fraud Statute applies only to schemes that connect to publicly traded securities, federal prosecutors will be unable to utilize the new statute to combat Micro-Cap schemes, prime bank schemes, and many Internet transaction schemes.[182] Securities and commodity fraud cost United States investors approximately $40 billion per year.[183] Micro-Cap fraud accounts for approximately $10 billion of this annual amount.[184] Micro-Cap fraud will rarely be susceptible to prosecution under the new statute, however, because it almost always involves risky stock in "start-up companies with little or no track record."[185] Prime bank schemes emerged "as a significant problem in the late 1990's"[186] and accounted for over one hundred federal criminal investigations as of March, 2002.[187] Because prime bank schemes involve

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178. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 215 (1976) (concluding that defendant was not liable under section 10(b) and Rule 10b-5 because negligence does not satisfy the intent requirement); United States v. Schlei, 122 F.3d 944, 967 (11th Cir. 1997) (holding that government met intent requirement by proving that defendant sold a deliberately forged Japanese government bond to investors); *supra* notes 92-106 and accompanying text.

179. *See* Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988) (requiring materiality for cases brought under Rule 10b-5); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976) (requiring materiality under similar federal securities statute); Lewis v. Chrysler Corp, 949 F.2d 644, 651-53 (3d Cir. 1991) (applying materiality test in civil Rule 10b-5 case); *see also supra* notes 121-25 and accompanying text.

180. *See* Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000) (enumerating substantive fraud as element of Rule 10b-5 action); *see also supra* notes 107-25, 140-48 and accompanying text.

181. *See* United States v. O'Hagan, 521 U.S. 642, 658 (1997) (requiring deceit "in connection with" the purchase or sale of a security in order to hold defendant liable under Rule 10b-5); *supra* notes 126-36, 149-59 and accompanying text.

182. *See supra* notes 64-67 and accompanying text.

183. *See* Economic Crimes Unit, *supra* note 1.

184. *Id.* ("Micro-Cap or 'Chop stocks' constitute a vast underworld of the securities markets that accounts for a $10 billion a year business.").

185. *Id.*

186. Joel E. Leising & Michael McGarry, *Prime Bank/High Yield Investment Schemes*, United States Attorneys' Bulletin 10, 11 (Mar. 2002).

187. *Id.*

investments in "fanciful" securities, these schemes will be impervious to prosecution under the Securities Fraud Statute.[188] Finally, like Micro-Cap schemes, Internet transaction schemes also account for approximately $10 billion in annual losses.[189] Except for schemes relating to publicly traded companies, however, federal prosecutors will be unable to use the new statute to attack traditional Internet schemes perpetrated online, as well as schemes involving fake internal memos from investment firms that induce recipients to invest online in artificial securities.[190]

V. PROPOSED AMENDMENT TO THE SECURITIES FRAUD STATUTE

Congress should expand the reach of the Securities Fraud Statute by broadening the language to encompass any fraudulent scheme connected to a "contrived security." The term "contrived security" would be defined as follows:

> Any false, fraudulent, illegal, or illegally marketed security, note, stock, or bond that a person markets or attempts to market, knowing or recklessly not knowing the investment to be false, fraudulent, illegal, or illegally marketed.[191]

The "contrived security" language would expand the reach of the Securities Fraud Statute beyond the scope of section 10(b) and Rule 10b-5 by prohibiting not only schemes in which perpetrators deceitfully market securities of publicly traded companies but also schemes in which

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188. *See supra* note 69.

189. Economic Crimes Unit, *supra* note 1 ("The North American Securities Administrators Association (NASAA) has estimated that Internet-related stock fraud is currently the second most common form of investment fraud. That same source estimated that investors lose $10 billion per year (or $1 million per hour) to this type of fraud.").

190. Actors frequently use the Internet to carry out traditional fraud schemes as well as "internal memo" fraud schemes. *See supra* note 67. Although the government may prosecute these Internet schemes under the wire fraud statute, the Securities Fraud Statute carries a higher maximum sentence and relates more directly to the crux of perpetrators' schemes—intentional misrepresentations about securities.

191. This definition is partially derived from 15 U.S.C.A. § 77(b)(1) (West 2003), which defines the word "security" for purposes of the 1933 Securities Act. The definition would also apply to the following types of investments: treasury stock; security futures; debentures; certificates of interest or participation in profit-sharing agreements; collateral-trust certificates; preorganization certificates or subscriptions; transferable shares; investment contracts; voting-trust certificates; certificates of deposit for securities; fractional undivided interests in oil, gas or other mineral rights; puts, calls, straddles, options, or privileges on securities; groups or indexes of securities; puts, calls, options, or privileges entered into on a national securities exchange relating to foreign currency; interests or instruments commonly known as a "securities"; or certificates of interest or participation in, temporary or interim certificates for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. *Cf.* 15 U.S.C.A. § 77(b)(1).

perpetrators market fraudulent securities. While section 10(b) and Rule 10b-5 apply to the earlier class of fraud schemes, they are wholly inapplicable to the latter class of schemes.[192] Thus, the new statute would broaden the scope of federal securities fraud prohibitions.[193]

More importantly, the "contrived security" language would enable federal prosecutors to combat the particularly pervasive and pernicious schemes that have thrived during the past two decades.[194] First, federal prosecutors would be able to use the Securities Fraud Statute to combat Micro-Cap fraud.[195] Because Micro-Cap fraud almost always entails the sale of high-risk stock in non-publicly-traded companies,[196] the schemes are currently immune from prosecution under the Securities Fraud Statute. Because a "contrived security" would include, *inter alia*, "illegally marketed" investments,[197] the new language would enable the government to prosecute most Micro-Cap schemes.

Second, the "contrived security" language would enable the government to use the Securities Fraud Statute to prosecute prime bank schemes.[198] Because prime bank schemes usually involve "fanciful" securities,[199] they are immune from prosecution under the current version of the Securities Fraud Statute. The "contrived security" language would enable the government to prosecute prime bank schemes by prohibiting people from knowingly or recklessly marketing such "fanciful" securities.[200] Because the number of prime bank schemes has risen significantly in recent years, prosecutors need the statutory authority to legally combat them.[201]

Finally, the "contrived security" language would enable the government to prosecute nearly all Internet fraud schemes not currently prohibited by the Securities Fraud Statute.[202] Most importantly, the

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192. *See supra* notes 130-32, 151-55 and accompanying text.

193. *Compare* a version of the Securities Fraud Statute containing language that extends its prohibition to contrived securities *with* the language of section 10(b) and Rule 10b-5, *supra* notes 130-31.

194. *See supra* notes 64-76 and accompanying text.

195. *See supra* notes 65, 182-85 and accompanying text.

196. *Id*.

197. *See supra* note 191 and proposed statutory text.

198. *See supra* notes 66, 186-88 and accompanying text.

199. *Id*.

200. *See supra* note 191 and proposed statutory text.

201. *See supra* notes 67, 186-87 and accompanying text.

202. *See supra* notes 67, 189-90. The government could either charge an online securities defrauder under both the Securities Fraud Statute and the wire fraud statute, or alternatively, charge the defrauder under whichever provision applies more precisely to the defendant's conduct. *See supra* notes 67, 188-89 and accompanying text.

government could use the new statute to prosecute schemes in which criminals use the Internet to induce trusting people to invest in false securities.[203] For example, if a perpetrator sends a bulk e-mail message that appears to be an internal memo from a major investment firm, and the e-mail induces recipients to invest in false securities,[204] the "contrived security" language would enable the government to prosecute the scheme. Furthermore, the language would enable the government to prosecute traditional securities fraud schemes implemented online,[205] even when the schemes do not connect to publicly traded securities. The government could also use the statute to prosecute online Ponzi schemes, which rarely involve investments in publicly traded securities.[206] In short, the "contrived security" language would enable the federal government to combat Internet fraud schemes connecting to both publicly-traded and non-publicly-traded securities.[207]

Of course, in many instances, federal prosecutors would still be able use the mail fraud and wire fraud statutes to prosecute Micro-Cap, prime bank, and Internet schemes. Rather than charging a defendant with merely mail fraud and wire fraud, however, it would be wise for the prosecutor in these situations to charge the defendant with mail fraud, wire fraud, *and* securities fraud under the new statute. As a practical matter, it would make more sense to jurors for the government to *charge securities defrauders with securities fraud*, rather than merely mail fraud and wire fraud. This is because the defendant's use of the mail or wire systems bears no relation to the crux of his or her scheme—intentionally lying about a security to receive an unwarranted gain. Furthermore, while the mail fraud and wire fraud statutes require prosecutors to prove that a defendant used the mail or wire systems in furtherance of his or her scheme, the Securities Fraud Statute lacks these jurisdictional elements.[208] Because it is occasionally difficult to prove a defendant's use of the mail or wire systems, this would make it easier for federal prosecutors in such cases to convict securities defrauders.

203. *See supra* note 190 and accompanying text.
204. *Id.*
205. *Id.*
206. *See supra* notes 68, 190 and accompanying text.
207. *See supra* note 191 and proposed statutory text.
208. *Compare* 18 U.S.C.A. § 1341 and 18 U.S.C.A. § 1343 *with* 18 U.S.C.A. § 1348. *See supra* note 51 and accompanying text.

VI. CONCLUSION

In conclusion, Congress enacted the Securities Fraud Statute to close major gaps in federal securities and fraud laws, as well as to provide prosecutors with an elastic statute that can be applied to multifarious securities fraud schemes. On the one hand, it appears that the statute will significantly impact securities fraud prosecutions because the government will no longer need to prove the defendant's use of the interstate mail or wire systems. Also, the flexibly written statute will enable prosecutors to keep up with the most complex new fraud schemes and target the most egregious and deceitful scams. On the other hand, it seems that the statute will minimally impact securities fraud prosecutions because the conduct it illegalizes is already prohibited to a large extent by the mail and wire fraud statutes, as well as section 10(b) and Rule 10b-5. Most importantly, it is impossible for prosecutors to use the new statute to combat Micro-Cap fraud, prime bank fraud, and most Internet securities fraud. To rectify these problems, Congress should add language to the Securities Fraud Statute that will allow federal prosecutors and agents to target all schemes based on the knowing or reckless marketing of "contrived" securities.

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