

## Conjoining “Recklessness” in Securities Fraud Cases to Moral Culpability

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First, I would like to express my thanks for being invited to speak at this Conference on “Behavior Economics and State of Mind: Pleading and Proving Scienter in Securities Fraud Cases.” I am delighted to be part of the Conference, not least because it is at Loyola University Chicago. My wife is from Chicago, I love my wife, and therefore I love Chicago. I believe that is what Daniel Kahneman would call “System 1 Thinking.”<sup>1</sup>

I want to express a little bit of skepticism, with apologies, to much of what was presented at the Conference today (all of which was extremely interesting) about the role of behavioral economics in law. First, I think that the sciences—social sciences, neurosciences, and behavioral sciences—that are being cited are not as strong as they are sometimes assumed to be and, even where they are strong, do not necessarily provide implications for the legal system.<sup>2</sup> As Arthur Leff once said, law and economics may be “elegant, attractive, and useful,” but it is “ultimately doomed” as an “attempt to present a total picture.”<sup>3</sup> Or as Grant Gilmore claims, “So far as we have been able to learn, there are

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\* Honorable Jed S. Rakoff serves as a federal judge for the United States District Court for the Southern District of New York. This comment is taken from Judge Rakoff’s remarks at the Second Annual Institute for Investor Protection Conference, “Behavioral Economics and Investor Protection,” held at Loyola University Chicago School of Law. Judge Rakoff spoke on a panel entitled “Behavior Economics and State of Mind: Pleading and Proving Scienter in Securities Fraud Cases.”

1. See Keith E. Stanovich & Richard F. West, *Individual Differences in Reasoning: Implications for the Rationality Debate?*, in HEURISTICS AND BIASES: THE PSYCHOLOGY OF INTUITIVE JUDGMENT 421, 436 (Thomas Gilovich, Dale Griffin & Daniel Kahneman eds., 2002) (defining System 1 thinking as automatic and unconscious); DANIEL KAHNEMAN, THINKING, FAST AND SLOW 25 (2011) (describing System 1 thinking as being very good at allowing swift initial reactions to challenges).

2. Cf. NITA A. FARAHANY, THE IMPACT OF BEHAVIORAL SCIENCES ON CRIMINAL LAW (2009) (arguing that novel scientific, neurological approaches to criminal law are being introduced in an ill-conceived manner, but if properly utilized can have a great impact on the entire criminal justice system).

3. Arthur Allen Leff, *Law And*, 87 YALE L.J. 989, 1007–08 (1978).

no recurrent patterns in the course of human events; it is not possible to make scientific statements about history, sociology, economics—or law.”<sup>4</sup>

I am old enough to remember when in the 1950s, Freudian psychoanalysis was the big thing with progressive judges like Judge David L. Bazelon, a great jurist with whom some of you may be familiar.<sup>5</sup> Psychoanalysis played a big role in Bazelon’s development of the famous “*Durham*” test for insanity.<sup>6</sup> The fact that Freudian psychoanalysis was very weak scientifically was not exposed until sometime thereafter, at which point, ironically, Bazelon became one of its critics. But the *Durham* test remained the law in most jurisdictions until much later.<sup>7</sup>

The *Durham* test posited that one was not legally guilty of a crime if one’s acts were the product of a mental disease or defect.<sup>8</sup> But it was left to psychoanalysts and psychologists to define “mental disease or defect.” Eventually, this was done by reference to the *Diagnostic and Statistical Manual of Mental Disorders* (“*DSM*”). It is sad, but revealing, that until 1973 the *DSM* classified homosexuality as a mental disease or defect—albeit one that could be “cured” through a few decades of therapy.<sup>9</sup> Partly as a result of this debacle, the current *DSM* actually cautions the legal community from attaching too much importance to its mental disease classifications when making conclusions of law:

“[D]angers arise because of the imperfect fit between the questions of ultimate concern to the law and the information contained in a clinical diagnosis. In most situations, the clinical diagnosis of a DSM-IV

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4. GRANT GILMORE, *THE AGES OF AMERICAN LAW* 100 (1977).

5. For biographical information on Judge Bazelon, see *Judge David L. Bazelon*, JUDGE DAVID L. BAZELON CTR. FOR MENTAL HEALTH L. (2012), <http://www.bazelon.org/Who-We-Are/History/Judge-David-L.-Bazelon.aspx>. For a great description of Freud’s theory of the rule of law, see Robin West, *Law, Rights, and Other Totemic Illusions: Legal Liberalism and Freud’s Theory of the Rule of Law*, 134 U. PA. L. REV. 817 (1986). See also Davida A. Williams, Note, *Punishing the Faithful: Freud, Religion, and the Law*, 24 CARDOZO L. REV. 2181, 2216 (“[C]ourts in many jurisdictions have used Freudian psychology in a multiplicity of ways and in various types of cases . . .”).

6. See *Durham v. United States*, 214 F.2d 862 (D.C. Cir. 1954).

7. See *United States v. Brawner*, 471 F.2d 969 (D.C. Cir. 1972) (overruling *Durham*).

8. See *Durham*, 214 F.2d at 874–75.

9. Until 1973, the *DSM* listed homosexuality as an official diagnosis in the section on sexual deviations. See ROBERT L. SPITZER, M.D., AM. PSYCHIATRIC ASS’N, A PROPOSAL ABOUT HOMOSEXUALITY AND THE APA NOMENCLATURE: HOMOSEXUALITY AS ONE FORM OF SEXUAL BEHAVIOR AND SEXUAL ORIENTATION DISTURBANCE AS A PSYCHIATRIC DISORDER, in *HOMOSEXUALITY AND SEXUAL ORIENTATION DISTURBANCE: PROPOSED CHANGE IN DSM-II*, 6TH PRINTING, PAGE 44, at 2 (1973), available at [http://www.torahdec.org/Downloads/DSM-II\\_Homosexuality\\_Revision.pdf](http://www.torahdec.org/Downloads/DSM-II_Homosexuality_Revision.pdf).

mental disorder is not sufficient to establish the existence for legal purposes of a “mental disorder,” “mental disability,” “mental disease,” or “mental defect.” In determining whether an individual meets a specified legal standard (e.g., for competence, criminal responsibility, or disability), additional information is usually required beyond that contained in the [DSM] . . . .<sup>10</sup>

Even very good science does not immediately translate into legal analysis. A short time ago, I had the great privilege of serving for four years on the governing board of the McArthur Foundation’s project on law and neuroscience.<sup>11</sup> That project has sponsored some very careful and important neuroscience studies and experiments, but I think all the project’s scientists would agree that neuroscience has not yet reached the level that allows one to translate its findings into legal developments or legal changes. At most it is suggestive—in the way that behavioral legal economics is suggestive—of things we have not looked at, things we need to consider, and things that should open our minds. The research, however, is a long way from being at the point where one can say, “Oh yes we know X, and therefore, legal approach Y is required.” I just want to express the need for caution in that regard.

Now, turning to the immediate issue, I do not know if Judge William T. Hart<sup>12</sup>—a panelist at the Conference—agrees with me, but my own experience is that judges and juries have little difficulty in determining intent in most cases. As Oliver Wendell Holmes famously said, “Even a dog distinguishes between being stumbled over and being kicked.”<sup>13</sup> I have not experienced that either judges or juries have great difficulty in accurately determining when someone has acted intentionally in undertaking a fraud. I appreciate that intent to commit fraud in a securities case raises special problems. The Supreme Court and Congress have set very high barriers for plaintiffs’ counsel in securities fraud cases, requiring the dismissal of cases at the outset if the plaintiffs cannot allege facts giving rise to a “strong inference” that the defendant

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10. AM. PSYCHIATRIC ASS’N, DIAGNOSTIC & STATISTICAL MANUAL OF MENTAL DISORDERS, at xxxiii (4th ed. rev. 2000).

11. The following is a brief description of the project:

The *Research Network on Law and Neuroscience*, supported by the John D. and Catherine T. MacArthur Foundation, addresses a focused set of closely-related problems at the intersection of neuroscience and criminal justice: 1) determining the law-relevant mental states of defendants and witnesses; 2) assessing a defendant’s capacity for self-regulating his behavior; and 3) assessing whether, and if so how, neuroscientific evidence should be admitted and evaluated in individual cases.

*Law and Neuroscience*, [www.lawneuro.org](http://www.lawneuro.org) (last visited Feb. 17, 2013).

12. Judge Hart serves as a federal judge for the United States District Court for the Northern District of Illinois.

13. OLIVER WENDELL HOLMES, *THE COMMON LAW* 2 (Empire Books 2012) (1881).

acted with fraudulent intent.<sup>14</sup> Nevertheless, at the end of the day when the proof is in, I do not usually find it difficult to determine whether there was actual intent to defraud, and I do not think juries do either.

What *does* present problems, as my fellow panelists Donald Langevoort, Ann Olazábal, and Geoff Rapp have indicated, is proving “recklessness” in securities fraud litigation. Recklessness is a vague concept that is subject to manipulation, yet I think it is still a useful concept and one that corresponds to certain common sense states of mind that we all can recognize: in the securities fraud context, for instance, “an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers [in a manner] that is either known to the defendant or is so obvious that the actor must have been aware of it.”<sup>15</sup>

The classic example of recklessness is reckless driving. At least once a week while I am driving to work, there will be that one driver who swerves in and out of traffic at approximately ninety miles per hour and I think to myself, “Gosh, maybe that person is drunk?”<sup>16</sup> And if that person were drunk, that would put him in a different category: still culpable under the law but not for recklessness *per se*.<sup>17</sup> Or maybe I think “that person is a kid”—a teenager who was just an inexperienced driver and accidentally pressed on the gas pedal too hard. That would perhaps be a mitigating factor, because one could make the argument that the teenage driver lacks both impulse control and experience.<sup>18</sup>

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14. See *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 313 (2007) (“Exacting pleading requirements are among the control measures Congress included in the PSLRA. The PSLRA requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, i.e., the defendant’s intention ‘to deceive, manipulate, or defraud.’” (quoting *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 & n.12) (citing Private Securities Litigation Reform Act of 1995, 15 U.S.C. § 78u-4(b)(1), (2) (2006))).

15. *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977).

16. See Geoffrey C. Rapp, *The Wreckage of Recklessness*, 86 WASH. U. L. REV. 111, 143 (2008) (noting that incidences of drunk driving (and thus the perception that people are drunk driving) in America are exceptionally high). Polling data estimates that Americans make between 809 million and 1 billion driving trips a year within two hours of consuming alcohol. U.S. DEP’T OF TRANSP., NAT’L HIGHWAY TRAFFIC SAFETY ADMIN., NATIONAL SURVEY OF DRINKING AND DRIVING ATTITUDES AND BEHAVIORS, 2001, at 1 (2003), available at <http://www.nhtsa.dot.gov/people/injury/alcohol/traffic-tech2003/TT280.pdf>.

17. The Seventh Circuit has opined that a drunk-driving accident is “recklessness at worst and misfortune at best.” See *Bazan-Reyes v. INS*, 256 F.3d 600, 612 (7th Cir. 2001) (quoting *United States v. Rutherford*, 54 F.3d 370, 372 (7th Cir. 1995)). Perhaps drunk driving may be more simply characterized as posing a risk that is more substantial than the risk sober driving creates. Rapp, *supra* note 16, at 143. Many other courts have simply determined that recklessness requires a showing of a “high degree of probability” of harm. See, e.g., *Scanlon v. Dep’t of Army*, 277 F.3d 598, 600 (1st Cir. 2002).

18. There are a variety of factors that increase the likelihood of speeding among teen drivers. See U.S. DEP’T OF TRANSP., NAT’L HIGHWAY TRAFFIC SAFETY ADMIN., NATIONAL SURVEY OF

The adolescent driver has yet to experience an automobile accident that would serve as a lesson on the dangers of driving.

But then we come to the stop light (it is always such a pleasure to pull up next to this driver three minutes after he sped by me going ninety miles per hour), I look over at the driver, and lo and behold it is a forty-year-old adult. At which point I imagine that one can reasonably draw the inference that the driver simply felt that his own desire to get wherever he was going, as fast as he could, overcame his knowledge that he was creating a risk for everyone involved. *That* is reckless driving. In my opinion, we can all easily recognize *that*. Perhaps Daniel Kahneman would say the driver is guilty of the “It Won’t Happen to Me” bias—an overoptimistic, skewed perception of risk that leads us to believe we are personally immune from hazards.<sup>19</sup> Either way, whether because of subconscious psychological pitfalls or conscious disregard for the safety of other drivers and pedestrians, the driver who is going ninety in a sixty-five zone is driving recklessly.

Now, there is something else going on among the drivers on the road. The rest of us were not driving ninety miles per hour. Instead, we were all driving sixty or sixty-five miles per hour.<sup>20</sup> The speed limit on the particular highway I am referencing is, of course, fifty miles per hour.

In other words, we are *all* disobeying the law. Although we are honking (at the very least) at the guy driving ninety miles an hour because he is a lawbreaker and we feel he is making the road a dangerous place, if we thought about it all of us other drivers may

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SPEEDING AND UNSAFE DRIVING ATTITUDES AND BEHAVIORS: 2002, at 2 (2003) [hereinafter 2002 SURVEY], available at [www.nhtsa.gov/people/...driving1/.../SpeedVolumeIIFindingsFinal.pdf](http://www.nhtsa.gov/people/...driving1/.../SpeedVolumeIIFindingsFinal.pdf). Some studies indicate that teen drivers are more likely to speed as a result of their lack of patience with slow drivers, enjoyment of fast rides, and tendency to pass other vehicles once they have been passed. *Id.*

19. See KAHNEMAN, *supra* note 1, at 260 (“[P]eople tend to be overly optimistic about their relative standing on any activity in which they do moderately well.”); Paul Slovic et al., *Facts versus Fears: Understanding Perceived Risk*, in JUDGMENT UNDER UNCERTAINTY: HEURISTICS AND BIASES 463, 468–70 (Daniel Kahneman et al. eds., 1982)) (explaining the “Won’t Happen to Me” cognitive bias).

20. 2002 SURVEY, *supra* note 18, at 2. At least 75% of drivers admit to typically driving over the speed limit, with most having a boundary of about ten miles over the speed limit while driving on interstate highways. A smaller percentage, 12%, reported typically driving twenty miles per hour over the speed limit. People are most likely to speed when drivers are on an unobstructed lane of highway with no obstacles that create an incentive to slow down. See *The Psychology Behind Speeding*, PENSKE, <http://www.penskesocial.com/2011/08/09/the-psychology-behind-speeding/> (last visited Apr. 17, 2013). Another factor contributing to speeding is the theory of “speed adaptation,” which holds that after traveling at faster speeds for some time, the sensation of speed decreases and the perception is that we are traveling at slower speeds. Frank P. McKenna, *The Psychology of Speeding*, in 18 BEHAVIOURAL RESEARCH IN ROAD SAFETY 2008, at 213, 215 (2010).

deserve to be honked at as well. (By the way there is always one driver who is going fifty, oblivious to anything but the posted speed limit. I won't embarrass my wife, who is here, by mentioning who that might be.) Deep in the back of our minds, we other drivers recognize that we are creating a slightly increased risk of accidents and deaths by collectively driving above the speed limit.<sup>21</sup> Within the scope of the legal definition, therefore, we were *all* being reckless—consciously disregarding a substantial and unjustifiable risk of injury to property or person. This definition resembles the Model Penal Code's definition of reckless conduct.<sup>22</sup> Although there are other definitions, such as Rapp's,<sup>23</sup> all involve the conscious disregard of a substantial risk.<sup>24</sup> In my example, we drivers were all consciously disregarding a substantial risk; yet no one, or almost no one, would accuse the rest of us drivers who are driving along at sixty-five of being reckless.<sup>25</sup> And that is part

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21. See, e.g., *Speed Management Safety*, U.S. DEP'T OF TRANSP., FED. HIGHWAY ADMIN., <http://safety.fhwa.dot.gov/speedmgt/> (last visited Apr. 21, 2013) (noting that excessive speed plays a factor in almost a third of all fatal traffic accidents).

22. MODEL PENAL CODE § 2.02(2)(c) (2011) ("A person acts recklessly with respect to a material element of an offense when he consciously disregards a *substantial and unjustifiable risk* that the material element exists or will result from his conduct. The risk must be of such a nature and degree that, considering the nature and purpose of the actor's conduct and the circumstances known to him, its disregard involves a gross deviation from the standard of conduct that a law-abiding person would observe in the actor's situation" (emphasis added)).

23. In a 2008 article, Rapp argued that law makers should "reconceptualize the tort concept of recklessness not in terms of what it is, but in terms of what it does: allow a particular plaintiff to recover for a defendant's carelessness where ordinary negligence doctrine would bar relief." Rapp, *supra* note 16, at 111.

24. Section 500 of the Restatement (Second) of Torts (1965) provides a legal description of recklessness:

The actor's conduct is in reckless disregard of the safety of another if he does an act or intentionally fails to do an act which it is his duty to the other to do, knowing or having reason to know of facts which would lead a reasonable man to realize, not only that his conduct creates an unreasonable risk of physical harm to another, but also that such risk is substantially greater than that which is necessary to make his conduct negligent.

See also BALLENTINE'S LAW DICTIONARY (3d ed. 2010) ("Careless. Disregard or indifference to consequences under circumstances involving danger to life or safety of others."); BLACK'S LAW DICTIONARY 1385 (9th ed. 2009) ("Characterized by the creation of a substantial and unjustifiable risk of harm to others and by a conscious (and sometimes deliberate) disregard for or indifference to that risk; heedless; rash.").

25. Generally, drivers perceive their own speeding as within their general control and therefore do not deem it reckless. See KIRAN SARMA, UNDERSTANDING THE PSYCHOLOGY OF RISK DRIVING BEHAVIOR: RESULTS OF A NATIONAL SURVEY (2011), available at [http://www.rsa.ie/Documents/Seminars/RSA\\_Kiran\\_Sarma\\_Final.pdf](http://www.rsa.ie/Documents/Seminars/RSA_Kiran_Sarma_Final.pdf) ("When Driving fast, I believe my driving ability is up to the challenge."). See also *The Psychology Behind Speeding*, *supra* note 20 (stating that people generally do not believe that speed is related to increased danger on the road). Another factor contributing to collective driving over the speed limit is social pressure to conform to other drivers' speed on the road and time pressure. Thus, the need to conform to society and arrive somewhere in a timely manner tend to outweigh the risk (or

of the problem. “Disregarding a substantial and unjustifiable risk” is a little too vague, a little too manipulable. As Ann Olazábal notes with respect to recklessness in securities fraud litigation,

At least in the securities fraud case law, recklessness has remained stubbornly ill-defined and in most decisions awkwardly conjoined to actual intent. The recklessness standard that is rather mechanically articulated by courts in connection with motions to dismiss in [securities fraud] cases is rarely assessed as a separate level of intent, and its intellectual underpinnings are strained at best and altogether unmoored at worst.<sup>26</sup>

But why are the rest of us not reckless? After all, we are increasing the risk of death by driving over the speed limit. It is, in my opinion, because we are not viewed, we do not view ourselves, and we do not view our fellow drivers, as morally culpable. Subconsciously, we are adhering to the peer group view of what is appropriate in that circumstance. The law is fifty miles an hour in this particular situation (i.e., the government’s view of a “safe” speed given the conditions of the particular road), but the view of the users of the highway, the drivers, is that sixty-five is an acceptable speed. And that touches a little bit on what Don Langevoort was referring to in his remarks at the Conference: In a given social context, when you have a situation where everyone is taking on a greater degree of risk, those people may in one sense fit the definition of reckless but probably *should not* be penalized.<sup>27</sup> At the least, it is difficult to penalize them, because they are adhering to what is essentially accepted as the social norm of their immediate peer group.<sup>28</sup>

I mention the speed limit analogy to illustrate a form of groupthink that may minimize the penalties for a group of persons who act with a conscious disregard for the substantial risk of their actions. To put it more into context of securities fraud, for me it has been very striking and surprising that there have not been more criminal prosecutions of persons who, in some sense, could have been held responsible for the economic crisis that still permeates today.<sup>29</sup> I would submit that at least

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perceived risk) of speeding. McKenna, *supra* note 20, at 214–15.

26. Ann Morales Olazábal, *Behavioral Science and Science in Class Action Securities Fraud Litigation*, 44 LOY. U. CHI. L.J. 1423, 1441 (2013) (internal footnotes omitted).

27. See generally Donald C. Langevoort, *State of Mind and the Global Financial Crisis* (2013) (unpublished manuscript), available at <http://www.luc.edu/law/media/law/centers/investor/pdfs/langevoort.pdf>.

28. For an excellent discussion about social norms—i.e., social attitudes of approval or disapproval, specifying what ought or what ought not to be done—see Cass. R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903 (1996).

29. See Halah Touryalai, *The Real Reason Wall Street Always Escapes Criminal Charges?*

one of the reasons is what prosecutors have told me: that they have found it very difficult to single out any individual as acting differently in the way that the first driver I described was acting differently from everyone else in the immediate situation.

I had an example of the prosecutors' dilemma in my court this past summer in a case called *SEC v. Stoker*.<sup>30</sup> In that case, Mr. Stoker was alleged to have taken a number of mortgage-backed derivatives,<sup>31</sup> which were being sold by Citigroup, and inserted them into a larger package selected by Credit Suisse that was represented to be AAA-rated.<sup>32</sup> According to the complaint, the derivatives selected by Stoker were very risky investments, but their insertion into the overall pool allegedly selected by Credit Suisse created the impression that the investment was less risky than it was.<sup>33</sup> The Securities Exchange Commission (SEC) accused Stoker of having failed to disclose these risks along with other pieces of material information.<sup>34</sup> Stoker's defense was essentially that the investment was put together by numerous persons in different parts of Citigroup, and, while he worked on one part of the investment, other segments of the bank worked on other parts of the investment.<sup>35</sup> As a result, Stoker claimed, he did not have a complete picture of the investment's construction or condition.<sup>36</sup> Although *Stoker* was technically a negligence case (the SEC, unlike private parties, can bring a claim for negligence in a securities

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*The Justice Dept Fears the Aftermath*, FORBES (Mar. 6, 2013, 4:28 PM), <http://www.forbes.com/sites/halahtouryalai/2013/03/06/the-real-reason-wall-street-always-escapes-criminal-charges-the-justice-dept-fears-the-aftermath/> (discussing the U.S. Justice Department's lax criminal prosecution efforts against executives at large companies in the wake of the 2008 financial crisis).

30. *SEC v. Stoker*, 865 F. Supp. 2d 457 (S.D.N.Y. 2012).

31. A mortgage-backed security is an interest in a group of mortgage loans that have been pooled together. 2 CHARLES A. STONE & ANNE ZISSU, *THE SECURITIZATIONS MARKET HANDBOOK* 3–6 (2012); *Freidus v. ING Groep N.V.*, 736 F. Supp. 2d 816, 821 (S.D.N.Y. 2010). A mortgage-backed security derives its value from the cash-flow activity on a mortgage, allowing investors to receive payments, via pass-through, that are made on the mortgage loan itself. STONE & ZISSU, *supra*, at 3. A collateralized debt obligation, the type of security at issue in *Stoker*, is a debt security that is collateralized by fixed income obligations, such as residential mortgage-backed securities. *Stoker*, 865 F. Supp. 2d at 458.

32. *Stoker*, 865 F. Supp. 2d at 459–61. Rating agencies analyze the creditworthiness of securitized investments and issue letter-based ratings, AAA being the highest. Philippe Jorion et al., *Informational Effects of Regulation FD: Evidence from Rating Agencies*, 76 J. FIN. ECON. 309, 313 (2005). A high rating represents the opinion of the agency (e.g., Standard & Poor's, Fitch, Moody's Investors Services) that the security in question is a good investment and will likely offer full and timely returns. *Id.*

33. *Stoker*, 865 F. Supp. 2d at 457.

34. *Id.*

35. *Id.*

36. *Id.*

context<sup>37</sup>), the SEC’s allegations could be read to allege that Stoker was acting recklessly, and this was the tack the SEC took at trial. The SEC’s argument, in large part, was that Stoker really knew what the other parts of his operation were doing and consciously chose to disregard the entire picture.<sup>38</sup> Conversely, the defense argued, in essence, that numerous other people, not accused of any impropriety, were as involved as Stoker.<sup>39</sup>

On summation, the defense lawyer—who was excellent—put up a picture from one of those *Where’s Waldo*<sup>40</sup> books and said, in so few words, “Where’s my defendant?”<sup>41</sup> He argued that Stoker’s situation was analogous because, as in *Where’s Waldo*, you could barely perceive him in the context of people who were doing the same thing.<sup>42</sup> The jury—and this is what I found most interesting—found Stoker not liable; but, in a quite unusual circumstance, they sent out a note, which they asked me to read along with the verdict.<sup>43</sup> The note said, “Notwithstanding this verdict, we encourage the SEC to continue its efforts to get at the real perpetrators,” or words to that effect.<sup>44</sup> So, the

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37. See SEC v. Lum’s, Inc., 365 F. Supp. 1046, 1057–58 (S.D.N.Y. 1973) (stating that negligence suffices in an SEC action); SEC v. Resch-Cassin & Co., 362 F. Supp. 964, 978, 980–81 & n.11 (S.D.N.Y. 1973) (same).

38. *Stoker*, 865 F. Supp. 2d at 468.

39. See *id.* at 464 (arguing that the government failed to show that Stoker should be the one person at Citigroup responsible for the omissions made in offering materials).

40. MARTIN HANDFORD, *WHERE’S WALDO?* (1987). The popular book series “provides readers with the challenge of locating Waldo among the ‘hoards of people milling around on each page.’ Finding Waldo is a ‘game of concentration’ because ‘[i]t’s difficult to find him in the middle of a crowd.’” Stacey Neumann Vu, Note, *Corporate Criminal Liability: Patchwork Verdicts and the Problem of Locating a Guilty Agent*, 104 COLUM. L. REV. 459, 461 n.9 (2004) (citations omitted) (alterations in original).

41. See Peter Lattman, *A Jury’s Message for Wall Street*, N.Y. TIMES, Aug. 4, 2012, at B1 (noting that John W. Kecker, Mr. Stoker’s attorney, showed the jury an illustration from *Where’s Waldo* during closing arguments to underscore his point that Mr. Stoker had become a scapegoat—a mere target for the banking industry’s sin).

42. See *id.* (explaining that Mr. Kecker, Mr. Stoker’s attorney, argued that his client “shouldn’t be blamed for the faults of banking any more than a person who works in a lawful casino should be blamed for the faults of gambling”).

43. Jake Zamansky, *The Jury Has Spoken—The Feds Must Go After the Big Guys*, FORBES (Aug. 8, 2012, 11:50 AM), <http://www.forbes.com/sites/jakezamansky/2012/08/14/the-jury-has-spoken-the-feds-must-go-after-the-big-guys/> (last visited Apr. 21, 2013). One juror explained the purpose of the note:

We were afraid that we would send a message to Wall Street that a jury made up of regular American folks could not understand the complicated transactions and so they could get away with their outrageous conduct[.] We also did not want to discourage the government from investigating and prosecuting financial crimes.

*Id.*

44. The note read, “The verdict should not deter the S.E.C. from continuing to investigate the financial industry, review current regulations and modify existing regulations as necessary.”

jury was of the view that some wrong had been perpetrated, yet they found it very difficult to identify, in a morally culpable way, the guilty party in the transaction.

I think it is by reference to the question of moral culpability that I have difficulties with what Ann Olazábal is suggesting, which sounds to me as more along the lines of gross negligence.<sup>45</sup> We have here, even in private civil actions under the securities laws, an intentional fraud. There has to be scienter,<sup>46</sup> and that is ultimately a concept that says, “You should be punished, through financial liability, because you knew what you were doing was improper.”<sup>47</sup> Recklessness fits that mold, where it is a conscious turning away from behavior perceived by the general public as risky.<sup>48</sup> If you take that out of the equation, you deprive the action of its moral justification.

So, I’m back to a very simple-minded judge’s approach to all this. I find that recklessness is a useful concept, but I think it has to be tied to its moorings, if you will, in moral culpability.

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Lattman, *supra* note 41.

45. See Olazábal, *supra* note 26, at 1442 (proposing a “more meaningful conception of recklessness on a motion to dismiss” in securities fraud cases). Gross negligence is “conduct that evinces a reckless disregard for the rights of others or ‘smacks’ of intentional wrongdoing.” *Assured Guar. Mun. Corp. v. Flagstar Bank, FSB*, 892 F. Supp. 2d 596, 606 n.7 (2012).

46. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194 (1976) (defining scienter as having the state of mind that embraces the intent to deceive, manipulate, or defraud).

47. See *Dura Pharm., Inc. v. Brondo*, 544 U.S. 336, 341 (2005) (defining scienter as a “wrongful state of mind”); *Hochfelder*, 425 U.S. at 197 (“The words ‘manipulative or deceptive’ used in conjunction with ‘device or contrivance’ strongly suggest that [section] 10(b) was intended to proscribe *knowing or intentional misconduct*.” (emphasis added)).

48. Christopher J. Miller, “*Don’t Blame Me, Blame the Financial Crisis*”: A Survey of Dismissal Rulings in 10b-5 Suits for Subprime Securities Losses, 80 FORDHAM L. REV. 273, 288 (2011) (“[E]very circuit court that has considered [scienter] has held that a plaintiff may allege scienter by showing that the defendant acted either intentionally or recklessly.”).