Dodd-Frank Wall Street Reform & Consumer Protection Act

S. 3217 introduced by Senator Dodd (D-CT)
H.R. 4173 introduced by Barney Frank (D-MASS)

The Dodd-Frank Wall Street Reform & Consumer Protection Act exemplifies the main problems identified by NACDL and The Heritage Foundation's joint report entitled "Without Intent: How Congress is Eroding the Criminal Intent Requirement in Federal Law."[1] Upon our initial review, we have identified over two dozen criminal offenses that will further proliferate the federal code if signed into law. This bill has not been referred to either chamber's Judiciary Committee and, given the plan for passage, no full Judiciary Committee will ever review all the criminal offenses in the bill. Further, this bill allows un-elected officials to enact new, broad regulations for the financial sector, many of which will be directly tied to criminal enforcement provisions and thus criminally punishable. Finally, the overwhelming majority of the criminal offenses contained in this bill lack adequate *mens rea* requirements and, consequently, will fail to protect innocent or inadvertent actors from being criminally prosecuted or punished.

What follows below is a set of recommendations for improving the quality of some of the criminal offenses included in this bill and making the overall bill more consistent with the fundamental principles of the American criminal justice system. Some provisions are beyond salvage and the recommendation is to strike them in full. In many instances, however, the particular provision can be improved by adding more protective *mens rea* requirements, limiting the scope of conduct covered by the offense, or both. Finally, where an offense allows for the unlimited creation of additional offenses through the authorization of regulatory criminalization, the recommendation is to limit the punishment for violations to a civil penalty.

Recommendations

I. Offenses to Strike in Full

A. Sec. 202(a)(1)(C). Criminal Penalties for the Disclosure of Systematic Risk Determinations and Related Acts. (pages 69, 71).[2]

This criminal offense is the quintessential example of overcriminalization and the problem of inadequate *mens rea* requirements. The only *mens rea* term present—"recklessly"—does not protect most innocent actors from criminal prosecution nor does it require a person to have had the intention to act unlawfully or wrongfully. This offense does **not** require the person to (1) know that disclosure is prohibited, (2) knowingly make the disclosure, or (3) know what it is that he or she is disclosing. A person lacking an understanding of the underlying information could be prosecuted for inadvertently or accidentally disclosing, or causing to be disclosed, any of the prohibited pieces of information. Further, the actual language of this offense does not limit its application to those who would be on notice of the rules surrounding disclosure.

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[1] The full report and its appendices are available at www.nacdl.org/withoutintent.

[2] This document was amended on July 22, 2010. All page numbers herein refer to the Dodd-Frank Wall Street Reform & Consumer Protection Act, as presented in the Enrolled Bill, H.R. 4173.ENR [Final as Passed Both House and Senate].

A search of the current code reveals no provision identical to this. Other provisions concerning disclosure prohibitions contain more protective *mens rea* term(s), are limited to a defined class of individuals likely to be on notice, or are attached to civil, not criminal, penalties.[3] Substantively this provision is particularly alarming given the criminal offenses and penalties imposed on individuals and companies for *failure* to disclose certain types of information to shareholders. For these reasons, Sec. 202(a)(1)(C) should be removed from this bill or, at a minimum, be amended to explicitly limit the punishment for violations to *civil* penalties.

B. Sec. 741. Enforcement. Adds (e) to 7 U.S.C. § 6b (pages 354, 356).

The federal criminal code already contains a criminal provision addressing the conduct covered by this offense. The mail fraud and wire fraud statutes,[4] which are two of the broadest criminal statutes in American law, punish schemes devised or intending to defraud or for obtaining money or property by fraudulent means, including material misstatements. This proposed offense is duplicative of the mail and wire fraud statutes and unnecessary. To the extent this offense would cover additional conduct not currently prohibited by the mail and wire fraud statutes, as may be the purpose of clause (2), it does so by weakening the *mens rea* requirements to an unacceptable level. This offense should therefore be completely removed from this bill.

C. Sec. 747. Antidisruptive Practices Authority. Amends 7 U.S.C. § 6c(a) by adding "(5) Disruptive Practices" (page 364).

Provision (B) of (5) would make it unlawful for "any person to engage in any trading, practice, or conduct . . . that . . . demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period." This catch-all provision could be used to criminalize behavior that has not been specifically prohibited or even identified. Such a provision fails to provide adequate notice to persons of what types of conduct the law actually prohibits and could become a dangerous tool in the hand of an overzealous prosecutor as it could potentially cover a broad range of conduct. Further, the use of the tort law standard "reckless disregard" fails to protect innocent actors from unfair criminal prosecution where they acted without criminal intent. This provision lacks an adequate *mens rea* requirement and fails to properly define the prohibited conduct. Section 747 therefore should be amended by removing provision (B) in its entirety.

[3] *See* 42 U.S.C. § 3537a (criminal penalty for "willful" advance disclosure of HUD funding decisions; limited to disclosure to applicants and their agents); 42 U.S.C. § 300i-2 (misdemeanor for "knowingly and recklessly" revealing a vulnerability assessment; limited in application to a set class of individuals); and 42 U.S.C. § 299b-22 (civil penalty for disclosure of certain privileged patient health information).

[4] *See* 18 U.S.C. §§ 1341, 1343.

D. Sec. 747. Antidisruptive Practices Authority. Amends 7 U.S.C. § 6c(a) by adding "(7) Use of Swaps to Defraud" (page 364).

This provision would make it unlawful for "any person to enter into a swap knowing or acting in reckless disregard . . . that its counterparty will use the swap . . . to defraud . . . ." The federal criminal code, however, already contains an aiding and abetting liability criminal provision.[5] This type of conduct could also be prosecuted under the federal conspiracy laws. Therefore, this offense is unnecessary duplicative of the current law and should be removed from this bill. Further, the use of the tort law standard "in reckless disregard" fails to protect innocent actors from unfair criminal prosecution where they acted without criminal intent. This failure is exacerbated here, where the "reckless disregard" is applied to the conduct of another person. This offense lacks an adequate *mens rea* requirement and targets conduct that is *already* criminal under current federal law. For these reasons, this offense is another example of overcriminalization and should be removed from this bill in its entirety.

E. Sec. 1036(3). Prohibited Acts. (pages 635-636).

This provision would make it unlawful for "any person to knowingly or recklessly provide substantial assistance to a covered person or service provider in violation of the provisions of section 1031, or any rule or order issued thereunder . . . ." The federal criminal code, however, already contains an aiding and abetting liability criminal provision.[6] This type of conduct could also be prosecuted under the federal conspiracy laws. Therefore, this offense is unnecessarily duplicative of the current law and should be removed from this bill. Further, the "recklessly" requirement fails to protect innocent actors from unfair criminal prosecution where they acted without criminal intent. This failure is exacerbated here, where the "recklessly" is applied to providing substantial assistance to another person. This offense lacks an adequate *mens rea* requirement and targets conduct that is *already* criminal under current federal law. For these reasons, this offense is another example of overcriminalization and should be removed from this bill in its entirety.

[5] *See* 18 U.S.C. § 2.

[6] *See* 18 U.S.C. § 2.

II. Offenses Lacking Adequate *Mens Rea* Requirements

Many offenses in this bill lack adequate *mens rea* requirements and need more protective language in order to prevent the unfair criminal prosecution of persons who lacked a criminal intent. In fact, all of the following offenses either do not contain any *mens rea* requirements or inappropriately use tort standards, such as *reckless disregard*, in place of traditional criminal law standards. The following material identifies these offenses and categorizes them by recommendation.

- NACDL recommends adding "knowingly and willfully" and "with knowledge of a participation restriction" to the following:
  - **Sec. 723. Clearing. Limitation on Participation.** (Adds (e) to 7 U.S.C. § 2) (page 300).
  - **Sec. 768(b). Amendments to the Securities Act of 1933; Treatment of Security-Based Swaps.** (Adds (d) to 15 U.S.C. § 77e) (pages 425-426).

- NACDL recommends adding "knowingly and willfully" and "with knowledge of a registration requirement" to the following:
  - **Sec. 724. Swaps; Segregation and Bankruptcy Treatment. Registration Requirement.** (Adds (f)(1) to 7 U.S.C. § 6d) (page 307).
  - **Sec. 728. Swap Data Repositories; Registration Requirement.** (Adds Section 21(a)(1) to the Commodity Exchange Act) (page 322).
  - **Sec. 731. Registration and Regulation of Swap Dealers and Major Swap Participants. Registration.** (Creates 7 U.S.C. § 6o-3(a)) (page 328).
  - **Sec. 733. Swap Executive Facilities. Registration.** (Creates 7 U.S.C. § 7b-3) (page 337).
  - **Sec. 975(a)(1). Regulation of Municipal Securities and Changes to the Board of the MSRB.** (Adds (b) to 15 U.S.C. § 78o-4(a)(1)) (pages 540-541).

- NACDL recommends adding "knowingly and willfully" and "with knowledge of the order" to the following:
  - **Sec. 764. Registration and Regulation of Security-Based Swap Dealers and Major Security-Based Swap Participants. Unlawful Conduct.** (Creates 15 U.S.C. § 78o-8(l)(4)) (pages 409, 421). The recommended *mens rea* provisions should be added to both (4)(A) and (4)(B) and any reference to a "should have known" tort standard should be deleted.

- NACDL recommends replacing "knowingly fail or refuse to obey or comply with such order" to read "with knowledge of such order, knowingly and willfully fail or refuse to obey or comply with such order" in the following:
  - **Sec. 753(b). Anti-Manipulation Authority. Cease and Desist Orders, Fines.** (Amends 7 U.S.C. § 136) (pages 375, 378-379).

- NACDL recommends adding "knowingly and willfully" and "with knowledge that the information is nonpublic" to the following:
  - **Sec. 746. Insider Trading.** (Adds (3) to 7 U.S.C. § 6c(a)) (pages 362-363).
  - **Sec. 746. Insider Trading.** (Adds (4)(A) to 7 U.S.C. § 6c(a)) (page 363).
  - **Sec. 746. Insider Trading.** (Adds (4)(B) to 7 U.S.C. § 6c(a)) (page 363).
  - **Sec. 746. Insider Trading.** (Adds (4)(C) to 7 U.S.C. § 6c(a))[7] (pages 363-364). The phrase "or acts in reckless disregard of the fact" should be deleted.[8]

- NACDL recommends adding "knowingly and willfully" to the following provision and also amending the provision to conclude with the following phrase, "and with knowledge that such trading, practice, or conduct is prohibited."
  - **Sec. 747. Antidisruptive Practices Authority. Disruptive Practices.** (Adds (5) to 7 U.S.C. § 6c(a)) (page 364).

- NACDL recommends adding "knowingly and willfully" and "with knowledge that this conduct is prohibited" to the following:
  - **Sec. 724(a). Swaps; Segregation and Bankruptcy Treatment. Prohibition.** (Adds (f)(6) to 7 U.S.C. § 6d) (pages 307, 309).
  - **Sec. 730. Large Swap Trader Reporting.** (Creates 7 U.S.C. § 6o-4) (pages 327-328).
  - **Sec. 929. Unlawful Margin Lending.** (Amends 15 U.S.C. § 78g(c)(1)(A)) (page 477).

- NACDL recommends adding "knowingly and willfully" to the following provision and also amending the provision to conclude with the following phrase, "and acts with the intent to engage in any fraudulent, deceptive, or manipulative act or practice."
  - **Sec. 975(a)(5). Regulation of Municipal Securities and Changes to the Board of the MSRB.** (Add (5) to 15 U.S.C. § 78o-4(a)) (pages 540-541).

- NACDL recommends adding "knowingly and willfully" and "with intent to violate Federal consumer financial law" to the following:
  - **Sec. 1036. Prohibited Acts. Clause (1)** (pages 635-636).
  - **Sec. 1036. Prohibited Acts. Clause (3)** (pages 635-636).

[7] While the offense in (4)(c) does require some "misappropriation," it does not require that misappropriation be done knowingly.

[8] The "reckless disregard" phrase is a tort law standard, not a criminal law standard, and therefore this provision does not provide adequate *mens rea* protection given the breadth of the information covered by this provision.

- NACDL recommends adding "knowingly and willfully" and "with knowledge of this requirement" to the following:
  - **Sec. 1036. Prohibited Acts. Clause (2)** (pages 635-636).[9]

III. Offenses that Are Overbroad or Vague

A. Sec. 746. Insider Trading. Adds (3), (4)(A), (4)(B), and (4)(C), to 7 U.S.C. § 6c(a) (pages 362-364).

These newly proposed offenses are broader and vaguer than the insider trading prohibitions that are already part of the federal code. They expand coverage beyond insiders and to information that "may affect or tend to affect the price . . . ." These offenses should be more narrowly drafted and the language of these offenses should be amended to cover only "material nonpublic information" as that term is used in the insider trading provisions of 7 U.S.C. § 13.

B. Sec. 975. Regulation of Municipal Securities and Changes to the Board of the MSRB. Adds (5) to 15 U.S.C. § 78o-4(a)(5) (pages 540-541).

The conduct constituting this offense is defined, and thus only limited by, the phrase "fraudulent, deceptive, or manipulative act or practice." This phrase is broad and the definition is not easily ascertainable. There are other criminal provisions in the code that are similar to this proposed offense, but they are more limited in scope. For example, 15 U.S.C. § 78j prohibits the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . ." This new proposed offense should, at the least, be amended to require the conduct to be done "in contravention of such rules and regulations . . . ."

C. Sec. 934. Referring Tips to Law Enforcement or Regulatory Authorities. Adds (u) to 15 U.S.C. § 78o-7 (page 509).

This provision seeks to criminally punish organizations for failure to provide "tips" to law enforcement relating to suspected violations of the law, yet the provision itself does not provide any guidance on how or when referrals are appropriate, nor what is the appropriate method for compliance. Without instruction on what is required by the law, organizations likely will be unable to comply with the law and will be at risk of criminal prosecution. Because this provision fails to define compliance, that definition will most certainly come from individual prosecutors and therefore vary dramatically case by case. Furthermore, criminal penalties are unduly harsh for this type of provision. For these reasons, this offense should be amended to include specific language stating that violations are not criminally punishable.

[9] Because Clause (2) criminally punishes failures to act, as opposed to the affirmative acts prohibited in Clauses (1) and (3), this clause should be amended to include stronger *mens rea* requirements.

IV. Inappropriate Regulatory Criminalization

The following offenses contain authorization for un-elected officials to define the conduct constituting the criminal offense. This unfettered grant of regulatory criminalization is inconsistent with the fundamental concepts of criminal justice—due process and fair notice—and constitutional law. The sheer magnitude and ever-changing nature of regulations make them inappropriate vehicles for criminal punishment. These offenses include:

- **Sec. 730. Large Swap Trader Reporting.** Creates 7 U.S.C. § 6o-4 (pages 327-328).
- **Sec. 929. Unlawful Margin Lending.** Amends 15 U.S.C. § 78g(c)(1)(A) (page 477).
- **Sec. 1036. Prohibited Acts.** (pages 635-636).

Violations of regulations should not be criminally punishable, particularly when the innocent actor makes a good faith attempt to comply with the regulations and acts without knowledge that his or her conduct is unlawful. For these reasons, these three sections should be amended to include explicit exceptions from criminal enforcement and punishment.

V. Conforming Amendments

Sections 763 and 764, at pages 387 and 409, repeat many of the aforementioned offenses. To the extent any of the above recommendations are implemented, these two sections should be reviewed and made to conform with those changes as appropriate.

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