Criminal Investors

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Abstract

This Article reassesses the culpability of those who invest in law-breaking firms. Prosecutors currently treat investors as victims of corporate wrongdoing rather than as actors who might bear responsibility for it. This Article observes, though, that investment can facilitate, and even cause, illicit corporate activity. When investors intentionally contribute to those effects, substantive criminal law imposes liability on them just the same as it does on accomplices, conspirators, or principals in other contexts. Despite this formal parity, however, investor criminal liability is more a theoretical proposition than a practical reality.

This Article questions that status quo by asking whether and when culpable investors should be held criminally accountable for corporate wrongdoing. The answer, it explains, must balance the public's interests in law compliance and capital formation. It finds individual investors in private law-breaking firms, who have at least a knowing intent, to be plausible enforcement targets. For other investors, the status quo merits keeping. Yet, if culpable investors are at realistic risk of prosecution, law-abiding investors might, even if erroneously, perceive themselves as exposed. If so, they might make fewer and less efficient investments. To address this danger, this Article calls for safe harbors to protect investors who rely on firms' representations of having adequate corporate compliance programs or who rely on their own pre-investment investigations. These safe harbors would incent proactive compliance by firms and due diligence by investors while also distinguishing law-abiding from criminal investors.

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Introduction

Federal prosecutors have accused Ruthia He ("RH"), a former Facebook product designer, of running a massive illegal drug operation.[1] They allege that between 2020 and 2024, RH illicitly distributed forty million pills of Adderall and other stimulants.[2] From these forty million pills, RH is said to have generated about $100 million in revenue.[3] She is alleged to have achieved these staggering sums not as the leader of a drug-trafficking network or as a prolific street dealer but rather as the founder and chief executive officer of telemedicine startup Done Global, Inc. ("DGI").[4] RH's startup employed licensed clinicians to remotely examine patients and write prescriptions for controlled substances that pharmacies filled and insurers paid for.[5] Prosecutors allege, however, that despite possessing the trappings of a legitimate medical provider, DGI was, in fact, an illegal pill mill.[6] Publicly, RH said that her company's mission was "to empower everyone living with [attention deficit hyperactivity disorder ("ADHD")] to reach their fullest potential."[7] But her true business model, prosecutors say, was giving drug-seeking customers false ADHD diagnoses and medically unnecessary prescriptions in violation of the Controlled Substances Act[8] and healthcare fraud statutes.[9]

This case serves as a productive example for thinking about criminal activity and liability in the corporate context. It raises questions, however, that look beyond the culpability of either the founder or DGI itself. After all, RH is not the first founder to be accused of criminal wrongdoing,[10] and DGI is not the first company to be implicated in

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1 Indictment at 1, 11, United States v. He, No. 24-cr-00329 (N.D. Cal. June 12, 2024) (indicting RH and an employee for conspiracy to distribute controlled substances, commit healthcare fraud, and obstruct justice); Ruthia He, Linkedin, https://www.linkedin.com/in/rujia/ [https://perma.cc/EEX3-QA89] (disclosing that He worked at Facebook as a product designer from 2014 to 2018).

2 Indictment, *supra* note 1, at 11, 13. These drugs are used to treat conditions like attention deficit hyperactivity disorder; they are also commonly misused to "improve performance" and "induce euphoria." Shaheen E. Lakhan & Annette Kirchgessner, *Prescription Stimulants in Individuals with and Without Attention Deficit Hyperactivity Disorder: Misuse, Cognitive Impact, and Adverse Effects*, 2 Brain & Behav. 661, 662 (2012).

3 Indictment, *supra* note 1, at 11.

4 *Id.* at 11, 13.

5 *Id.* at 2, 12, 14, 16.

6 *See id.* at 16–17.

7 *Done. Announces Appointment of World-Renowned Psychiatrist and Psychopharmacologist as Newest Company Advisor*, Done. (Aug. 1, 2022), https://www.donefirst.com/company-news/dr-stahl-psychiatrist-adhd-done [https://perma.cc/7AZ8-ESL7].

8 21 U.S.C. §§ 801–904.

9 Indictment, *supra* note 1, at 13, 15, 18.

10 *See, e.g.*, *infra* notes 310–16 and accompanying text.

executive misdeeds.[11] This Article looks beyond the executive and the corporation and refocuses on actors who, to date, are largely missing from corporate enforcement policy and practice.[12] It asks, What about law-breaking firms' investors?[13] What blame do *they* bear, if any?

It was not cheap, after all, for DGI to grow large enough to distribute forty million pills or generate $100 million in revenue.[14] Finding customers is a challenge for any startup.[15] In DGI's case, it required "spending tens of millions of dollars on deceptive social media advertisements, intentionally targeting drug-seeking patients, and advertising that members could obtain easy access to prescriptions for Adderall and other stimulants in exchange for payment of a monthly subscription fee."[16] Those fees presumably supported some of DGI's marketing and other expenses. But, as is typical of technology startups, DGI also sought investment from venture capital ("VC") firms.[17] VC firms pool cash from institutions and wealthy individuals to be invested by professional managers in private startups that have the potential to grow into

11 Although DGI has not been charged, it is vicariously liable for any criminal acts of its chief executive officer given that the alleged acts were within RH's scope of employment and meant to benefit DGI. *See* N.Y. Cent. & Hudson River R.R. v. United States, 212 U.S. 481, 493 (1909).

12 That is, unless the policy or practice regards those actors as blameless or victims of corporate crime. *See infra* notes 114–18 and accompanying text.

13 With exceptions noted in Section I.C.2, substantive criminal law usually does not *directly* prohibit investment in or financing of illicit activity. Rather, substantive law criminalizes a wide range of conduct—including investment—under accomplice and conspiracy liability theories. *See infra* notes 160, 167 and accompanying text. Still, an application of these theories to investors requires defining "investor" or "investment," a task that substantive criminal law does not seriously attempt. Because "investment" covers innumerable forms of transactions and economic interests, a generic definition meets the needs of this Article's analysis. *See* Barton Legum, *Defining Investment and Investor: Who Is Entitled to Claim?*, 22 Arb. Int'l 521, 522 (2006) ("[C]apital is fungible and investment of capital takes a multitude of forms in the world today."). For this Article, investors are those who provide financial support, broadly considered, to business enterprises through primary or secondary purchases of equity or debt interests or through other arrangements or transactions that have the effect of providing an enterprise with financial resources or improving its financial condition. *See* United States v. Schullo, 363 F. Supp. 246, 250–51 (D. Minn. 1973) (suggesting that providing insurance to illegal bookmakers is a form of financing because it reduces the bookmaker's financial risk), *aff'd sub nom.* United States v. Thomas, 508 F.2d 1200 (8th Cir. 1975); *see also Investor*, Black's Law Dictionary (12th ed. 2024) (defining "investor" as a "buyer of a security or other property who seeks to profit from it without exhausting the principal" or "[b]roadly, a person who spends money with an expectation of earning a profit"). Importantly, these definitions remove from the Article's scope those who finance illicit activity *without* profit motive, such as those who finance crime out of some ideological, social, or familial motive.

14 *See* Indictment, *supra* note 1, at 14.

15 *See* Shaun Buck, *Getting New Customers Is Hard!*, Entrepreneur (Oct. 12, 2017), https://www.entrepreneur.com/growing-a-business/getting-new-customers-is-hard/297518 [https://perma.cc/36N5-YZKA].

16 Indictment, *supra* note 1, at 14.

17 *See infra* note 20 and accompanying text.

large, profitable businesses.[18] In return for this cash, VC firms receive equity in the startup, as well as governance rights designed to protect their financial interests.[19] In DGI's case, it raised capital from three San Francisco Bay Area-based VC firms with over $3.5 billion in collective assets under management.[20]

There is no public reporting on how much cash DGI received from its three VC investors. But the venture capitalists' presence in its capital structure suggests three illuminating counterfactuals of what could have happened at DGI, in both commercial and compliance terms, *without* their investments. First, without VC backing—especially in its early days—DGI likely would not have had the financial resources necessary to grow its customer base as quickly or to the same scale as it had achieved at the time of its founder's indictment.[21] That is, without VC, DGI likely would have distributed far fewer pills by now. Second, without the pressure to grow quickly that startups face after they accept VC, DGI might have kept pace with federal and state regulations on the practice of telemedicine and the prescription of controlled substances.[22] That is, without VC, the startup might have remained a smaller and slower-growing, but law-abiding, concern that served ADHD patients and not those who sought to misuse Adderall or other stimulants. Third, without VC backing, DGI might have lacked the resources necessary to run a telemedicine startup, including hiring clinical staff, finding patients, and so on.[23] In that case, it might have failed to launch or gone

18 *See* Paul A. Gompers, Will Gornall, Steven N. Kaplan & Ilya A. Strebulaev, *How Do Venture Capitalists Make Decisions?*, 135 J. Fin. Econ. 169, 169, 173 n.4 (2020).

19 *See id.* at 183 ("The least negotiable provisions for VC firms in descending order are pro-rata rights, liquidation preference, anti-dilution protection, valuation, board control, and vesting. The provisions on which VCs are most flexible (again, in descending order, the first being most flexible) are dividends, redemption rights, option pool, investment amount, and participation.").

20 PitchBook, Craft Ventures, Pitchbook 225318-25 (database updated June 19, 2025) (reporting assets under management and listing DGI among the firm's investments); PitchBook, F7 Ventures, Pitchbook 327215-89 (database updated June 18, 2025) (same); PitchBook, Offline Ventures, Pitchbook 437109-76 (database updated June 19, 2025) (same). On June 16, 2024, the Author sent an email to each of the foregoing VC firms inviting them to make a comment about the DGI case or to speak with the Author. Letter from author to Craft Ventures (June 16, 2024) (on file with author); Letter from author to F7 Ventures (June 16, 2024) (on file with author); Letter from author to Offline Ventures (June 16, 2024) (on file with author). The Author received no replies.

21 *See* Jeremy Greenwood, Pengfei Han & Juan M. Sánchez, *Venture Capital: A Catalyst for Innovation and Growth*, 104 Fed. Rsrv. Bank St. Louis Rev. 120, 126 (2022) ("VC-backed companies are more R&D intensive and grow faster than their non-VC-backed counterparts.").

22 *See* Manju Puri & Rebecca Zarutskie, *On the Life Cycle Dynamics of Venture-Capital- and Non-Venture-Capital-Financed Firms*, 67 J. Fin. 2247, 2249 (2012) ("Venture capitalists might push their companies hard to grow quickly . . . .").

23 *See generally* Guoqian Xi, Jörn Block, Frank Lasch, Frank Robert & Roy Thurik, *The Survival of Business Takeovers and New Venture Start-Ups*, 29 Indus. & Corp. Change 797 (2020) (reviewing the literature on how VC funding impacts a startup's viability).

out of business early, serving neither those who truly needed ADHD treatment nor those merely seeking drugs.

Whether DGI's investors might themselves be exposed to criminal liability depends on several unknowns, particularly what they knew about illicit drug distribution at the startup and when they knew it.[24] But, as the counterfactuals suggest, providing DGI with capital bore on the occurrence and scale of its alleged criminal activity. Financial investment in an illicit business, in other words, can enable and increase returns to crime.[25] This effect appears in three forms. First, investment can satisfy upfront costs needed to commence illicit activity.[26] Second, it can fund the growth of preexisting illicit activity.[27] Third, and most troublingly, it can shape the incentives of a firm's personnel to engage in or foster illicit activity that otherwise would not have occurred.[28] Given this potential for investment's criminogenic influence on corporate activity, the role of investors in corporate crime requires reconsideration along doctrinal, structural, and policy lines. This Article's three Parts begin that reconsideration.

Part I revisits corporate law's doctrine of shareholder limited liability. It observes that although under most circumstances shareholders—in their capacities as such—are shielded from corporate liabilities, corporate law does not protect them against liability for their own acts.[29] Thus, to the extent that investment-related conduct can satisfy a theory of criminal liability, corporate law leaves shareholders exposed.[30] This doctrinal point yields in practice, however, to a rhetoric of investor "innocence" that more readily treats investors as victims of corporate wrongdoing rather than as persons who might bear responsibility

24 Section III.B.2 presents twelve hypotheticals regarding the conduct and intent of DGI's VC investors.

25 *See* Mirko Draca, Theodore Koutmeridis & Stephen Machin, *The Changing Returns to Crime: Do Criminals Respond to Prices?*, 86 Rev. Econ. Stud. 1228, 1255 (2019) (presenting results "suggest[ing] that the returns to illegal activity are an important input into criminal decision-making").

26 *Cf.* William R. Kerr & Ramana Nanda, *Financing Constraints and Entrepreneurship* 1 (Harvard Bus. Sch., Working Paper No. 10-013, 2009) ("Surveys of current and potential entrepreneurs suggest that obtaining adequate access to capital is one of the biggest hurdles to starting and growing a new business.").

27 *See* Greenwood et al., *supra* note 21, at 126.

28 *See* Brian J. Broughman & Matthew T. Wansley, *Risk-Seeking Governance*, 76 Vand. L. Rev. 1299, 1306 (2023) ("Many startups accelerate growth through 'blitzscaling'—taking shortcuts like hiring candidates without vetting them, bringing unfinished products to market, and neglecting compliance and other long-term risks.").

29 *See infra* Section I.A.

30 This Article uses the term "criminal" or its equivalent in the sense of a person having done an act that could be objectively said to have violated substantive criminal law. It does not mean that the act has been identified by law enforcement or prosecuted, nor that it has led to conviction. *See* Anna Roberts, *Arrests as Guilt*, 70 Ala. L. Rev. 987, 990–94 (2019) (observing the distinction between arrests or indictments and legal guilt).

for it.[31] Part I explains that although this solicitous rhetoric toward investors has superficial appeal, it relies on erroneous assumptions about investors' roles within business enterprises. In truth, investors sometimes bear responsibility for corporate crime. Beyond the financial responsibility for corporate wrongs that investors bear, they might also be responsible in a moral or legal sense, or both.[32] Yet, despite their potential culpability, the rhetoric of investor innocence removes those influential actors from decision-making about the appropriate targets of corporate enforcement.

Although investors' moral responsibility for corporate wrongdoing is worthy of inquiry,[33] Part I focuses on their criminal-legal liability and its consequences.[34] In doing so, Part I outlines three theories under which prosecutors could charge investors for investment-related conduct. The first is that an investor acts as an accomplice to corporate crime.[35] The second is that an investor joins a conspiracy by agreeing to finance some corporate criminal objective.[36] And the third is that the act of investment itself is sometimes a principal offense.[37] For each theory, the underlying act and its causal effect—making an investment that advances some illicit corporate activity—are indistinguishable between culpable and nonculpable investors. For example, whether DGI's VC investors knew that RH would use their cash to violate federal law or not, the act (investment in DGI) and its alleged effect (enabling illegal distribution of controlled substances) were the same. The distinguishing mark of a culpable investor, then, is the presence of criminal intent.[38]

The doctrinal analysis in Part I informs Part II's structural analysis of criminal investment. That analysis considers three aspects of illicit corporate activity: organizational legitimacy, capital structure, and ownership structure.[39] It addresses three questions. First, how does an

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31 *See infra* Section I.B.

32 Martin E. Sandbu, *Stakeholder Duties: On the Moral Responsibility of Corporate Investors*, 109 J. Bus. Ethics 97, 100 (2012) ("Most will think that by investing in my shadowy money-making activity, you carry some moral responsibility for my wrongful conduct.").

33 *See id.*

34 Civil and regulatory liability are alternatives or complements to criminal enforcement against investors. A comparative treatment of private, regulatory, and criminal enforcement against culpable investors would be a valuable contribution to the literature and policy intervention. This Article's scope, however, is limited to investigating the criminal dimensions of investor culpability.

35 In that case, a person aids and abets illicit activity through the act of investment or investor participation in governance. *See infra* Section I.C.2.

36 *See infra* Section I.C.2.

37 Some laws—such as the federal statute against illegal gambling operations—directly prohibit investment in specific types of criminal enterprises. *See* 18 U.S.C. § 1955. More general laws—including state and federal anti-money-laundering and anti-racketeering statutes—also proscribe the act of investment in illicit activity. *See infra* Section I.C.2.

38 *See infra* Section I.C.1.

39 *See infra* Part II.

enterprise's apparent legitimacy—for example, a telemedicine startup that illicitly offers controlled substances as opposed to a street gang that illicitly offers those same substances—affect investor culpability?[40] Second, how does capital structure—whether an investment is made in the form of debt or equity—affect investor culpability?[41] And last, how does ownership structure—whether the enterprise is publicly or privately held—affect investor culpability?[42]

Part III answers the question at the Article's heart: When investors *can* be prosecuted for illicit activity that happens within a firm, when, if ever, *should* they be? The answer requires appreciating the social cost of prosecuting culpable investors, as well as that of their *nonprosecution*. The chief social cost of prosecuting is that culpable investors' realistic risk of prosecution is apt to increase ex ante risk perception among even investors who lack the criminal intent that demarks their culpable peers.[43] If so, the consequence would be less and less-efficient capital formation.[44] But *not* prosecuting culpable investors tends to impose parallel social costs in the form of diminished law compliance.[45] If investors know that they will not be held accountable for culpable investment-related conduct, then they will be more likely to engage in that conduct and hence to foster illicit corporate activity.[46]

Part III explains, then, that the decision whether to prosecute culpable investors requires careful balancing of both costs. The composition of the investor class matters to that calculus. Culpable investors are likely a small minority of all investors.[47] Given the substantial cost of chilling good-faith investors, proper balancing of the social costs of investor prosecution and nonprosecution would lead to charging only egregious cases in which pursuing investors would contribute meaningfully to general deterrence.[48] Prime cases will be those in which an individual investor has made a substantial investment in a private law-breaking firm with a knowing or purposeful intent and with a significant law violation resulting from the firm's activities.[49]

After outlining that standard, Part III calls for prosecutorial agencies that do pursue culpable investors to adopt two safe harbors. These safe harbors are designed to reduce criminogenic investment, motivate corporate compliance, and protect good-faith investors. Each turns on

40 *See infra* Section II.A.

41 *See infra* Section II.B.

42 *See infra* Section II.C.

43 *See infra* Section III.A.1.

44 *See infra* Section III.A.1.

45 *See infra* Section III.A.2.

46 *See infra* Section III.A.2.

47 *See infra* note 265 and accompanying text.

48 *See infra* Section III.B.1.

49 *See infra* Section III.B.1.

the negation of criminal intent as establishing that law-abiding investors are not to blame should their investments go on to facilitate corporate wrongdoing. Neither alters the scope of investor criminal liability; rather, the safe harbors clarify conditions under which investors lack criminal intent. The first would allow investors to rely in good faith on firms' representations that they have appropriate compliance programs or are undertaking appropriate remedial efforts, if and after violations occur.[50] This safe harbor would be particularly protective of investors in public companies.[51] The second would provide that investors who conduct good-faith due diligence into a firm's compliance before investing in it will be presumed to lack criminal intent regarding any wrongdoing that should happen later.[52] This safe harbor would be particularly protective of investors in private companies, including startups.[53] Part III's discussion of each safe harbor closes with model policy text and commentary.

I. Investors in Corporate Law and Criminal Law

This Part tackles a puzzle: Those who help facilitate criminal activity in all kinds of ways—from supplying weapons,[54] to selling drug precursors,[55] to driving getaway cars[56]—are routinely prosecuted. But those who invest in businesses that engage in criminal activity rarely, if ever, face charges.[57] Why do those who help facilitate crime via finan-

50 *See infra* Section III.C.1.

51 *See infra* note 335 and accompanying text.

52 *See infra* Section III.C.2.

53 *See infra* notes 249–50 and accompanying text.

54 *See, e.g.*, Cal. Penal Code § 12022.4(a) (West 2022) (imposing additional punishment on those who furnish firearms to another "for the purpose of aiding, abetting, or enabling that person or any other person to commit a felony").

55 *See, e.g.*, United States v. Karawi, 213 F. App'x 570 (9th Cir. 2006) (affirming the conviction of a convenience-store owner who sold pseudoephedrine that he knew would be used to manufacture methamphetamine); People v. Lauria, 59 Cal. Rptr. 628, 634 (Ct. App. 1967) ("It seems apparent . . . that a supplier who furnishes equipment which he *Knows* will be used to commit a serious crime may be deemed from that knowledge alone to have intended to produce the result." (emphasis added)).

56 People v. Bartlett, 414 N.E.2d 253, 256 (Ill. App. Ct. 1980) ("Where a defendant knowingly drives a getaway car, he is legally accountable for the crime committed.").

57 As part of the research for this Article, the Author searched extensively for cases in which a mere investor was charged in connection with some corporate crime. Although the Author expected to find few such cases, *none* were identified. One case came close to dealing with a mere investor, though. In *United States v. Bell*, a participant in a retail investment scam appealed his conviction by arguing in part that he was merely a "big-picture investor with no involvement in day-to-day operations." 112 F.4th 1318, 1335 (11th Cir. 2024). The Eleventh Circuit held, however, that a reasonable jury could convict him as a conspirator for "bankroll[ing]" the scam and *actively* participating in maintaining the scam's website. *Id.*

cial investment avoid prosecution when those who do so through other means do not?

Two explanations for the nonprosecution of investors hold particular promise and are consistent with one another.[58] First, those who invest in businesses that engage in illicit activity rarely do so with criminal intent.[59] Even when they do, prosecutors might struggle to obtain evidence sufficient to prove that intent.[60] That is, there is a limited supply of investors to prosecute. The second explanation is that law enforcement looks past investors, even the culpable ones, because it privileges the investor class. That is, there is limited demand for investor prosecution. Under this explanation, a foundational principle of modern corporate law—that a company's shareholders generally enjoy a privilege against vicarious liability for its debts or obligations[61]—constrains prosecutors' conception of investors as actors who might contribute to corporate crime.

The second explanation is the more interesting one because it calls into question the decisions prosecutors make today and asks what effects would follow if they were to choose a different path. This explanation embraces the modal corporation as having "powerless" shareholders.[62] Such shareholders do not know what managers are doing and cannot reasonably hope to influence their actions, whether for right or wrong.[63]

As part of this separation of investors from management, prosecutors might view shareholders sympathetically as ordinary people saving for retirement and life's other financial needs.[64] If they act based on this conception, prosecutors would hold investors blameless and instead

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58 They are not the only explanations, however. For example, investigating or prosecuting investors is costly. Given that cost, enforcers might find that focusing on the organization and culpable insiders is the most efficient use of limited public enforcement resources. That could be especially so if opening the door to investor prosecution would massively expand the universe of defendants—not just legal investors, like VC funds, but also the individuals who made decisions for those investors, like VC professionals.

59 *See infra* Sections I.C, II.C.

60 *See* Miriam H. Baer, Myths and Misunderstandings in White-Collar Crime 121 (2023) ("[U]nderenforcement arises when liability thresholds are met and exceeded well in advance of viability thresholds. Under this scenario, numerous individuals violate the law, but they nevertheless evade detection, prosecution or punishment.").

61 *See supra* note 68 and accompanying text.

62 *See* Jennifer G. Hill, *Images of the Shareholder – Shareholder Power and Shareholder Powerlessness*, *in* Research Handbook on Shareholder Power 53, 54 (Jennifer G. Hill & Randall S. Thomas eds., 2015) (attributing the popular image of the "powerless" shareholder to the depiction of shareholders in Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property (1932)).

63 *See id.* at 54.

64 *See, e.g.*, Dorothy S. Lund & Natasha Sarin, *Corporate Crime and Punishment: An Empirical Study*, 100 Tex. L. Rev. 285, 350 (2021) ("Put simply, corporate crime affects all of us—as consumers, employees, and investors who increasingly save for retirement by investing in the stock market.").

turn their focus to other actors, including firms themselves, but especially culpable insiders.[65] Indeed, prosecutors might view investors as victims of corporate wrongdoing along with other sympathetic stakeholders like nonculpable employees and customers.[66] This Part explains, however, that limited-liability doctrine has little bearing on *criminal* liability. It further explains that a rhetoric treating investors as generally blameless misapprehends their liability-bearing role and their potential as a lever over corporate compliance.[67] After offering these points, Section I.C outlines culpable accomplice, conspiracy, and principal liability theories under which motivated prosecutors could charge investment-related conduct.

A. Limited Liability and Its Limits

A core feature of corporate law is that shareholders avoid personal liability for a corporation's debts or other obligations.[68] Some scholars, especially in the tort context, have questioned this doctrine on risk-allocation and equity grounds.[69] Around the globe, some jurisdictions have crafted exceptions to the doctrine, particularly concerning labor and environmental claims.[70] Still, the doctrine prevails in the United States and other jurisdictions, and scholars and market participants celebrate it as essential for promoting efficient capital formation.[71] This Section contributes to the doctrine's literature by observing that

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65 *See infra* note 94 and accompanying text.

66 *See infra* notes 114, 118 and accompanying text.

67 *See infra* Sections I.A.2, I.B.

68 Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 40 (paperback ed. 1996) ("Limited liability is a distinguishing feature of corporate law—perhaps *the* distinguishing feature."); 18 Am. Jur. 2d *Corporations* § 46 (2025) ("The corporate form normally insulates shareholders . . . ."). This doctrine extends to other forms of business organizations—including limited liability companies and limited partnerships—but for simplicity, this Article generally maintains the corporation and shareholder frame throughout, or else refers more generally to "firms," "entities," "enterprises," or the like.

69 For the most famous contribution to that literature, see generally Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 Yale L.J. 1879 (1991) (challenging the doctrine of shareholder limited liability, especially in the context of corporate torts).

70 *See* Mariana Pargendler, *Corporate Law in the Global South: Heterodox Stakeholderism*, 47 Seattle U. L. Rev. 535, 543–51 (2024) (observing that some jurisdictions in the Global South have narrowed limited-liability doctrine, especially in the environmental and labor cases).

71 *See, e.g.*, David W. Leebron, *Limited Liability, Tort Victims, and Creditors*, 91 Colum. L. Rev. 1565, 1566 (1991) ("[F]ew topics are liable to strike the reader as less likely to produce changes in the law than an analysis of limited liability. No principle seems more established in capitalist law or more essential to the functioning of the modern corporate economy." (footnotes omitted)).

criminal liability is beyond its limits.[72] Several points support this conclusion. First, investor criminal liability arises directly from an investor's own acts or conduct.[73] Limited-liability doctrine, in contrast, protects against *vicarious*, rather than *direct*, liability.[74] That is, a shareholder is not responsible for corporate liabilities solely by virtue of being a shareholder.[75] The shareholder *is* responsible, however, for acts taken personally. Further, the doctrine allocates *private* liabilities, leaving exposure under regulatory or criminal law unaltered. Relatedly, the doctrine does not disturb a sovereign's power to enforce its penal laws against foreign business entities or their affiliates.

1. *Limited Liability's Limit to Vicarious Liability*

Limited-liability doctrine offers investors a narrow protection against vicarious liability: It protects shareholders from personal responsibility for corporate liabilities derived merely from their status as shareholders.[76] This rule is underscored by the veil-piercing exception to limited liability, under which abuses of the corporate form justify the imposition of vicarious liability on a corporation's shareholders.[77]

If the modal shareholder is understood to be an investor in a public corporation, then it is sensible enough to conceive of limited liability, in practical terms, as immunity.[78] For those passive investors, corporate law's narrow protection against vicarious liability is realistically total: Given their remoteness from the firm, that liability theory would be

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72 United States v. Sain, 141 F.3d 463, 474 (3d Cir. 1998) ("[A corporation] has the capacity of being aided and abetted. To hold otherwise would allow the controlling stockholder of a corporation to enjoy the benefits of the corporate form . . . without accepting the burden of assuming criminal responsibility when the individual causes the corporation to commit a crime."); United States v. Lovett, No. 11-cr-00165, 2013 WL 1405421, at *10 (D. Nev. Apr. 5, 2013) ("Defendant insinuates that this Court impermissibly allowed the Government to 'reach beyond the wall of protection that divides a corporation from the people or entities that exist behind it.' However, Defendant incorrectly applies a *civil* liability limitation to a *criminal* case.").

73 *See, e.g.*, *Sain*, 141 F.3d at 468 (imposing criminal liability on a defendant for fraudulently submitting invoices on behalf of a company); *Lovett*, 2013 WL 1405421, at *1 (imposing criminal liability on a defendant for falsifying records to induce a loan to the defendant's company).

74 *See* Stephen B. Presser, Piercing the Corporate Veil, at v (2024–2025 ed. 2024) (clarifying that the veil-piercing exception to limited liability relates to *vicarious* liability, whereas the alter-ego theory relates to *direct* liability).

75 *Id.*

76 Andrew K. Jennings, *Criminal Subsidiaries*, 92 Fordham L. Rev. 2013, 2030 (2024).

77 *Cf.* Robert B. Thompson, *Unpacking Limited Liability: Direct and Vicarious Liability of Corporate Participants for Torts of the Enterprise*, 47 Vand. L. Rev. 1, 2 (1994) ("The corporate form limits the liability of shareholders and other participants arising from the enterprise[, including] . . . vicarious liability for the acts of others . . . ." (footnote omitted)).

78 *See* Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 Cornell L. Rev. 1036, 1047 (1991) (noting that in a large dataset of veil-piercing cases, the veil was never pierced against shareholders of a publicly traded corporation).

the only one under which they plausibly could be held responsible.[79] That practical immunity is consistent with an understanding of shareholders as passive participants in a public firm's capital structure and governance.[80]

But investors who actively engage in a firm's affairs remain *directly* liable for their own personal conduct—the Delaware General Corporation Law,[81] for instance, announces a rule that "stockholders of a corporation shall not be personally liable for the payment of the corporation's debts."[82] It excludes, however, shareholders' liabilities that arise "by reason of their own conduct or acts."[83] Similarly, under the Model Business Corporation Act—which over thirty states have adopted[84]—a "shareholder of a corporation is not personally liable for any liabilities of the corporation (including liabilities arising from acts of the corporation)" but remains subject to liability "by reason of the shareholder's own acts or conduct."[85]

Although scant case law discusses what acts or conduct fall within those statutory exclusions,[86] personally committed criminal or tortious acts would fit easily.[87] Imagine, for example, a public corporation that manufactures a product that injures consumers. A stranger to the company who purchases a few of its shares would bear no legal responsibility for the decisions its personnel made in selling the dangerous product. The stranger's nonliability for those injuries would rest in the heartland of limited-liability doctrine.[88] But a shareholding executive

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79 *Cf.* PRESSER, *supra* note 74 ("[T]here is a continuing awareness that controlling individuals and entities who *directly participate* in causing harm ought consequently to have liability imposed on them.").

80 *See infra* notes 219–20 and accompanying text.

81 DEL. CODE ANN. tit. 8, §§ 101–398 (2025).

82 *Id.* § 102(b)(6).

83 *Id.*

84 *See Model Business Corporation Act Resource Center*, AM. BAR ASS'N (Jan. 1, 2023), https://www.americanbar.org/groups/business_law/resources/model-business-corporation-act/ [https://perma.cc/8GYF-97WD].

85 MODEL BUS. CORP. ACT § 6.22(b) (AM. BAR ASS'N 2024).

86 *See* Cigna Health & Life Ins. Co. v. Audax Health Sols., Inc., 107 A.3d 1082, 1096 (Del. Ch. 2014) ("[T]here is virtually no case law on 8 *Del. C.* § 102(b)(6).").

87 Robert B. Thompson, *The Limits of Liability in the New Limited Liability Entities*, 32 WAKE FOREST L. REV. 1, 11 (1997) ("The second major exception to the use of a business form to insulate participants from liability is based on the participants' direct liability for their own acts. Individuals who act for the corporations are held personally liable . . . if their action on behalf of the entity is tortious, criminal, or otherwise wrongful."); *see also* Miller v. Am. Tel. & Tel. Co., 507 F.2d 759, 763 (3d Cir. 1974) (holding that the business-judgment rule does not protect corporate directors against allegations of intentional violations of law); Guttman v. Huang, 823 A.2d 492, 506 n.34 (Del. Ch. 2003) ("[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey.").

88 *See* Jennings, *supra* note 76, at 2030 (offering the hypothetical of a retired teacher who holds shares in a corporate offender whose conduct the teacher has no influence over).

who knew that a product was dangerous and nevertheless directed its sale would enjoy no real protection—to be sure, the executive's status as a shareholder would not create vicarious liability for the injuries, but the executive could be liable as a direct participant in the acts that gave rise to the product liability.[89] Similarly, imagine an influential shareholder who was not employed by the firm and who, despite knowing of the product's dangers, pressured management to market it anyway. That shareholder might be protected qua shareholder from liability for the resulting injuries, but tort law might nevertheless hold the shareholder responsible as an aider and abettor for the act of encouraging the harm-causing decision.[90]

This distinction between vicarious and direct liability matters because the concepts manifest differently between the firm and other corporate actors. Substantive criminal law imposes vicarious liability on corporations under a respondeat superior theory for on-the-job offenses committed by their employees and agents.[91] Other actors—including officers, directors, and employees—are usually not liable for corporate offenses due solely to their association with the firm.[92] This is also the case for shareholders.[93] Nevertheless, insider shareholders routinely face liability, in both the civil and criminal contexts, for acts they personally take within their employing firms.[94] This point is unremarkable given that it is the corporation's insiders who most prominently do, or encourage, the unlawful acts it might become liable for.[95] But outsider shareholders and insiders are not always dissimilarly situated.

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89 *See, e.g.*, Leon v. Shmukler, 992 F. Supp. 2d 179, 194 (E.D.N.Y. 2014) ("[T]he general principle is that a corporate officer who commits or participates in a tort, even if it is in the course of the officer's duties on behalf of the corporation, may be held individually liable.").

90 *See* Restatement (Second) of Torts § 876 (Am. L. Inst. 1979) ("For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or *encouragement* to the other so to conduct himself . . . ." (emphasis added)).

91 *See* N.Y. Cent. & Hudson River R.R. Co. v. United States, 212 U.S. 481, 493 (1909).

92 *But see* V.S. Khanna, *Corporate Criminal Liability: What Purpose Does It Serve?*, 109 Harv. L. Rev. 1477, 1492–96 (1996) (considering alternative approaches, including imposing vicarious civil or criminal liability on managers).

93 *See* Jennings, *supra* note 76, at 2030–31.

94 *See* U.S. Dep't of Just., Justice Manual § 9-28.010 (2023) ("[Individual] accountability deters future illegal activity, incentivizes changes in corporate behavior, ensures that the proper parties are held responsible for their actions, and promotes the public's confidence in our justice system. Prosecutors should focus on wrongdoing by individuals from the very beginning of any investigation of corporate misconduct."); *see also, e.g.*, Indictment, *supra* note 1, at 13–17 (describing the personal actions taken by RH to illegally distribute controlled substances through DGI); Press Release, U.S. Dep't of Just., Backpage Principals Convicted of $500M Prostitution Promotion Scheme (Nov. 17, 2023), https://www.justice.gov/opa/pr/backpage-principals-convicted-500m-prostitution-promotion-scheme [https://perma.cc/JS43-4NS4] (announcing the convictions of several defendants who used their corporate entities to promote prostitution).

95 *See supra* note 94.

Although mere investors might spend less time around the crime scene than active participants do, that absence does not mean that the two groups are not working together.[96] This possibility requires reassessment of outsider investors' roles in, and culpability for, the illegal conduct within law-breaking firms.

2. *Limited Liability's Limit to Corporate Law*

Limited-liability doctrine only protects corporate actors from the liabilities allocable by corporate law, which chiefly includes contract, tort, and other private liabilities—that is to say, limited-liability doctrine does not limit the application of regulatory or criminal law to corporate actors, including investors.[97] For example, when courts enforce regulatory law in the context of corporate groups—in which multiple entities hold interests in each other as a single firm—they sometimes impose common-enterprise liability on the group rather than respect the legal separation of its constituents.[98] Doing so satisfies the regulatory objectives of noncorporate substantive law—such as environmental or employee benefits law—that diverge from the liability-allocation principles of corporate law.[99] These non-corporate-law interventions in corporate-related liability are further justified by a need to harmonize conflicting areas of law.[100]

Earlier work has noted that corporate borders become "porous" when exposed to criminal liability.[101] This work has focused on the porousness between entities within corporate groups rather than between entities and outside investors.[102] But a corporate group's constituents and outside investors are not dissimilarly situated in the criminal context. The entity-to-entity relationships within a corporate group are fundamentally shareholding relationships in that one entity is

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96 *See infra* Section I.C.2.

97 *See* Jennings, *supra* note 76, at 2030–31.

98 FTC v. AMG Servs., Inc., 558 F. Supp. 3d 946, 963 (D. Nev. 2021) ("Under the theory of common enterprise, each entity in a group of interrelated companies can be held jointly and severally liable for the actions of other entities in that group.").

99 *See* Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 Cornell L. Rev. 99, 115–23 (2014).

100 *Cf.* FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 133 (2000) ("A court must therefore interpret the statute 'as a symmetrical and coherent regulatory scheme,' and 'fit, if possible, all parts into an [sic] harmonious whole.'" (citation omitted) (first quoting Gustafson v. Alloyd Co., 513 U.S. 561, 569 (1995); and then quoting FTC v. Mandel Bros., Inc., 359 U.S. 385, 389 (1995))); Davis v. Mich. Dep't of the Treasury, 489 U.S. 803, 809 (1989) (recognizing the "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme").

101 *See* Jennings, *supra* note 76, at 2030.

102 *See id.*

the shareholder of another.[103] The shared criminal liability in corporate groups generally arises not from shareholding relationships, however, but rather from the actions of shared employees and agents—that is to say, the shared liability centers on criminal *acts* fairly attributable to each entity and is undisturbed by their legal separateness.[104] Similarly, prosecution of an outside investor might center on the investor's own actions in contributing to wrongdoing at a corporation. That focus on the investor's own acts would look past the legal separation between investor and corporation.[105]

This limitation appears even more clearly in cross-jurisdictional enforcement, such as when sovereign *A* enforces its regulatory and penal laws against actors associated with a firm formed under the laws of sovereign *B*. Although state corporate law's limited-liability protections cross jurisdictional borders, that extension is limited to the doctrine's narrow, private-liability-allocating scope.[106] That is, the law of a corporation's incorporating jurisdiction governs its shareholders' vicarious liability for corporate debts, but it does not constrain other sovereigns' enforcement of their own public laws.[107] This point explains why federal courts have "consistently refused to give effect to the corporate form where it is interposed to defeat legislative policies."[108] Because federal courts, in deciding whether to respect the corporate form "must consider the importance of [its] use . . . in the federal statutory scheme," they are apt to be less deferential to the legal separation of corporate actors than is state corporate law.[109] This cross-jurisdictional point is important given that corporate wrongdoing often transgresses sovereigns other

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103 *See id.*; Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 Calif. L. Rev. 12, 19 (1926) (noting that "in the ordinary case" the corporate entity relationship "is that of shareholder to corporation and does not constitute the subsidiary an agent").

104 *See* Jennings, *supra* note 76, at 2031 ("Although courts often look to corporate law's veil-piercing doctrine in deciding whether to disregard entity borders, they must also consider the commands of other areas of common and statutory law. . . . [Q]uestions of corporate crime may require applying more criminal law than corporate.").

105 *See id.* ("[M]ere observance of separate corporate formalities would tend to receive less weight from a criminal judge than from a civil one.").

106 *See supra* note 72 and accompanying text.

107 *Compare* Restatement (Second) of Conflict of L. § 307 cmt. a (Am. L. Inst. 1971) ("The local law of the state of incorporation will be applied to determine the liability to which a person subjects himself by purchasing, or subscribing to, shares of a corporation."), *with id.* § 89 cmt. e ("A state will only entertain a criminal prosecution brought under its own local law.").

108 First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba, 462 U.S. 611, 630 (1983); *accord* Bangor Punta Operations, Inc. v. Bangor & Aroostook R.R. Co., 417 U.S. 703, 713 (1974) ("[T]he corporate form may be disregarded in the interests of justice where it is used to defeat an overriding public policy. In such cases, [federal courts] . . . will deal with the substance of the action and not blindly adhere to the corporate form." (citations omitted)).

109 Lowen v. Tower Asset Mgmt., Inc., 829 F.2d 1209, 1220 (2d Cir. 1987).

than firms' incorporating states.[110] In those cases, especially, there is no reason to expect sovereign *B*'s corporate law to constrain sovereign *A*'s penal law.

B. The Rhetoric of the "Innocent" Investor

Modern finance theory teaches investors "to be more or less indifferent to the fate of any given corporation" and to diversify their holdings across firms whose governance they might rationally ignore.[111] The contemporary investor, particularly the shareholder in a public company, can thus be regarded as something of an absentee owner. An attenuated relationship to the firm implies that the investor has no, or at least cannot be expected to exercise any, influence over its conduct. The investor, then, as so many other counterparties that interact with a law-breaking firm,[112] is not responsible for its wrongdoing.

Consistent with that learning, prosecutors have embraced a well-established rhetoric of investor innocence.[113] As a matter of policy, the U.S. Department of Justice ("DOJ") instructs corporate prosecutors to consider the interests of "blameless investors," in addition to "blameless" employees and other stakeholders.[114] It even approves of mitigating penalties against corporate offenders to avoid indirectly punishing their investors.[115] DOJ justifies this policy because investors "may, depending on the size and nature of the corporation and their role in its operations, have played no role in the criminal conduct, have been unaware of it, have been unable to prevent it, or have been victimized

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110 The small state of Delaware, for example, is "the state of incorporation for nearly 68.2 percent of the Fortune 500, 65 percent of the S&P 500, and approximately 79 percent of all U.S. initial public offerings in calendar-year 2022." Amy L. Simmerman et al., *Delaware's Status as the Favored Corporate Home: Reflections and Considerations*, Wilson Sonsini, Goodrich & Rosati (Apr. 23, 2024) (footnote omitted), https://www.wsgr.com/en/insights/delawares-status-as-the-favored-corporate-home-reflections-and-considerations.html [https://perma.cc/N3FV-6TLE]. Most operate primarily outside the state, however, and so their law violations would be expected to occur primarily in other states.

111 Lawrence E. Mitchell, *The Morals of the Marketplace: A Cautionary Essay for Our Time*, 20 Stan. L. & Pol'y Rev. 171, 174 (2009).

112 *See, e.g.*, Sanabria v. United States, 437 U.S. 54, 70 n.26 (1978) ("Numerous cases have recognized that [the federal illegal-gambling statute] proscribes any degree of participation in an illegal gambling business, except participation as a mere bettor.").

113 Lawrence E. Mitchell, *The "Innocent Shareholder": An Essay on Compensation and Deterrence in Securities Class-Action Lawsuits*, 2009 Wis. L. Rev. 243, 288 (observing that the rhetoric of investor innocence is a longstanding trope).

114 *See* U.S. Dep't of Just., Justice Manual § 9-28.010 (2023) ("Thus, the manner in which prosecutors perform their jobs—including the professionalism and civility demonstrated, willingness to secure the facts in a manner that encourages corporate compliance and self-regulation, and appreciation that corporate prosecutions can cause harm to *blameless investors*, employees, and others—affects public perception of the Department's mission." (emphasis added)).

115 *Id.* § 9-28.1100.

by it."[116] This rhetoric features in DOJ officials' public articulations of corporate enforcement policy.[117] In discrete corporate criminal resolutions, prosecutors regularly invoke the interests of innocent investors in justifying their settlement decisions.[118]

The rhetorical appeal of shareholder innocence grows stronger if investors are not merely remote from the firm and passive in its affairs, but also sympathetic in their investment purposes. Surely, the rhetoric would suggest, workers investing for their retirement or parents investing

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116 *Id.*

117 *See, e.g.*, *Cleaning Up the C-Suite: Ensuring Accountability for Corporate Criminals: Hearing Before the S. Comm. on the Judiciary*, 118th Cong. 9 (2023) (statement of Nicole Argentieri, Acting Assistant Att'y Gen. of the United States, Criminal Division & Matthew Olsen, Assistant Att'y Gen. of the United States, National Security Division) ("We also want to encourage companies to claw back or withhold compensation from culpable executives, which will shift the burden of financial penalties resulting from criminal conduct onto individual wrongdoers and away from often innocent shareholders."); Press Release, U.S. Dep't of Just., Deputy Assistant Attorney General Matthew S. Miner Remarks at the American Conference Institute 9th Global Forum on Anti-Corruption Compliance in High Risk Markets (July 25, 2018), https://www.justice.gov/opa/pr/deputy-assistant-attorney-general-matthew-s-miner-remarks-american-conference-institute-9th [https://perma.cc/UY5Z-Z68N] ("[W]e are working to avoid imposing excessive corporate penalties that harm innocent shareholders, employees, and other stakeholders."); Eric H. Holder, Jr., Att'y Gen. of the U.S., Attorney General Holder Remarks on Financial Fraud Prosecutions at NYU School of Law (Sept. 17, 2014), https://www.justice.gov/opa/speech/attorney-general-holder-remarks-financial-fraud-prosecutions-nyu-school-law [https://perma.cc/W3P8-CECA] ("[I]t's not right for punishment to be borne *exclusively* by the company, its employees, and its innocent shareholders.").

118 *See, e.g.*, Deferred Prosecution Agreement at 6, United States v. Genzyme Corp., No. 15-cr-00352 (M.D. Fla. Sept. 3, 2015), ECF No. 2-1 (listing "potential collateral consequences of proceeding with a prosecution, which may cause undue harm to innocent individuals including . . . shareholders" as a settlement consideration); Deferred Prosecution Agreement at 2, United States v. Unico, Inc., No. 13-cr-00355 (S.D. Cal. Jan. 30, 2013), ECF No. 5 (recognizing that "a guilty plea and criminal conviction of Unico [for filing false information with the SEC] would have caused negative collateral consequences to Unico's . . . shareholders . . . incommensurate with their roles in the offense"); Letter from Seth R. Aframe & Arnold H. Huftalen, Assistant U.S. Att'ys, Dist. of New Hampshire, to Maria A. Barton, Benton J. Campbell & Barry M. Sabin, Att'ys for Imperial Holdings, Inc. 1 (Apr. 30, 2012), https://www.sec.gov/Archives/edgar/data/1494448/000119312512193743/d344352dex101.htm [https://perma.cc/5DNR-9M5U] (resolving a corporate enforcement in light of "the negative impact and collateral consequences that charging the Company would have on the Company's . . . shareholders"); Deferred Prosecution Agreement at 2–3, United States v. CommunityOne Bank, No. 11-cr-122 (W.D.N.C. Apr. 28, 2011), ECF No. 2 (citing the "negative collateral consequences to hundreds of employees not involved in the [defendant's] BSA/AML program, its shareholders and the communities it serves" as justifying a bank's deferred prosecution); Letter from Michael J. Sullivan, U.S. Att'y, Dist. of Massachusetts, to Joseph F. Savage, Jr., Couns. to NeuroMetrix, Inc. 2 (Jan. 26, 2009) (on file with author) (declining to indict a corporation due to potential collateral harm to shareholders); Letter from Michael J. Sullivan, U.S. Att'y, Dist. of Massachusetts, to Brien T. O'Connor, Couns. to Express Scripts, Inc. 2 (Sept. 11, 2007) (on file with author) (declining to indict a corporation due to potential collateral harm to "current employees, ESI clients and their members, and shareholders"); Press Release, U.S. Dep't of Just., Prudential Financial Subsidiary Agrees to Pay $600 Million to Settle Securities Fraud Allegations (Aug. 28, 2006), https://www.justice.gov/archive/opa/pr/2006/August/06_odag_574.html [https://perma.cc/8JKK-KXML].

for their children's education are *victims* of value-destroying corporate crime.[119] That solicitude for the small investor might persist even in capital markets in which most shares are held by large, sophisticated, and powerful money managers.[120] Many of the ultimate beneficiaries of those managers' holdings are, after all, retirement or college savers.[121] Sympathy for small investors, in other words, might be conveyed to those who indirectly invest on their behalf.[122] But this rhetoric obscures three points about the proper understanding of investors and corporate wrongdoing. In consequence, it risks distorting enforcement decisions in corporate cases.

This distortion first follows from an underappreciation that investors accept a trade-off between bearing a corporation's business and legal risks and receiving a share of its profits and residual value.[123] Although that balance varies depending on the nature of an investment—for instance, the inverse relationships between risk and reward among common equity, preferred equity, and debt—risk bearing is an essential function of the investor.[124] A failure by prosecutors to impose realized risk on investors—that is, bearing collective losses in consequence of corporate offending—distorts the risk-reward bargain that investors accept.[125] It does so by securing the profits of corporate activity to shareholders while inequitably sharing the costs of corporate wrongdoing with the public.[126]

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119 Of course, prosecutors as a group likely overlap, and so identify, with those who save for retirement, college costs, or other financial needs. *See* Lund & Sarin, *supra* note 64, at 350.

120 See generally Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17 (2019), for a comprehensive explanation of the nature of these intermediary investors and their role in corporate governance.

121 *Id.* at 34 ("[A] substantial percentage of all mutual fund investing occurs within the framework of employer-sponsored 401(k) retirement plans.").

122 *See* Leo E. Strine, Jr., *Stewardship 2021: The Centrality of Institutional Investor Regulation to Restoring a Fair and Sustainable American Economy*, 24 U. PA. J. BUS. L. 1, 17 (2021) ("[I]nstitutional investors who take human investors' money . . . should be required to consider the investment objectives and horizons of their ultimate beneficiaries, such as saving for retirement, saving for their children's education, or investing in a socially responsible manner, when making voting and other stewardship decisions.").

123 *See* Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 290 (1980) ("We . . . commonly observe that the joint functions of risk bearing and ownership of capital are repackaged and sold in different proportions to different groups of investors."); *see also* Mitchell, *supra* note 113, at 288 (observing that it is appropriate to penalize "innocent shareholders" for corporate wrongs against third parties so that the shareholders internalize those harms).

124 *See* Fama, *supra* note 123, at 290.

125 *See* Thompson, *supra* note 78, at 1070 ("The value of shareholders' investments in public corporations declines when civil or criminal liability is assessed against the enterprise . . . .").

126 *See* Andrew K. Jennings, *The Market for Corporate Criminals*, 40 YALE J. ON REGUL. 520, 555–56 (2023) (criticizing resolutions of enforcement actions in which the public bears some of an offender corporation's sanction).

Second, investors as a collective are not powerless over corporate conduct. Money managers that hold large blocks of securities for the ultimate benefit of small investors have the ability to influence the election of corporate directors and the adoption of compliance-enhancing corporate policies.[127] Investors' collective power over corporate governance marks them as a potential lever over corporate compliance.[128] Holding investors blameless writ large, or permitting law-breaking firms to claim their innocence as a shield, tends to demotivate them from pressing corporate management to maintain and improve law compliance.[129]

The prior two points raise descriptive and pragmatic cautions against a rhetoric of investor innocence. But such a rhetoric also overlooks a third point, as a moral and legal matter, that some investors might be individually responsible for corporate wrongdoing. For example, in a public company, a large or controlling shareholder might knowingly encourage management to take actions that would be profitable but lead to law violations.[130] Or, in a private company, an investor might know that a firm has an illegal business model, yet still agree to finance it.[131] As the next Section explains, either scenario just described could embrace an investor's prosecution.[132] A firm could thus have culpable investors in its capital structure, a possibility that must be reckoned with if the rhetoric touting the interests of truly innocent investors is to be coherent.

The rhetoric of investor innocence has superficial appeal, no doubt. Although this Article questions a presumption of investor blamelessness, it does not dispute that most of the time, investors are blameless or,

127 Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Colum. L. Rev. 2029, 2046 (2019) ("[T]he large and growing stakes held by [the three largest index fund managers] give them significant influence over the outcomes of corporate votes. This influence leads, in turn, to their substantial influence over the decisions of corporate managers, even before matters come to a vote." (emphasis omitted)).

128 *See* Asaf Eckstein, *The Virtue of Common Ownership in an Era of Corporate Compliance*, 105 Iowa L. Rev. 507, 538–46 (2020) (theorizing that institutional investors have incentive and power to mitigate macro legal risks).

129 *See* Jennings, *supra* note 126, at 557 (calling for enforcement practices that motivate investors to value corporate compliance).

130 *See* Kevin E. Davis & Mariana Pargendler, *Corruption and Controlling Shareholders*, 25 Theoretical Inquiries L. 107, 109 (2024) ("[C]ontrolling shareholders of family-controlled companies often have both opportunities and incentives to become personally involved in corrupt activity."). The same avenues for direct involvement in illicit acts, primarily board seats and management roles, might naturally enable majority shareholders, the direct and indirect electors of these positions, to pressure or encourage management to undertake them without the shareholders' direct involvement.

131 *See infra* Section III.B.2.

132 *See infra* Section I.C.

as a matter of prosecutorial discretion, should be held so.[133] But it urges that corporate enforcement policy and practice ought also to account for investor culpability. That accounting would include a rhetorical shift that concedes the social cost of holding investors uniformly blameless, acknowledges their collective power to influence corporate compliance, and admits that some investors are not so innocent.

C. Prosecuting Criminal Investors

The last two Sections dismiss the idea that corporate law protects investors from prosecution in connection with corporate wrongdoing.[134] This Section offers a positive account of how investment-related conduct could satisfy one or more theories of criminal liability. Although not an exhaustive treatment—facts are variable and prosecutors are creative, after all—it outlines potential scenarios under which investors' conduct might satisfy accomplice, conspiracy, or principal theories of liability.[135]

1. Investment as Criminal Act, Investment with Criminal Intent

This Section looks beyond the actors traditionally scrutinized for responsibility in corporate offending, such as a firm's managers, rank-and-file employees, and agents. It considers, rather, investors in their capacities as such. That is, it focuses on the "mere investor," one whose sole relationship with an enterprise is as investor, rather than as investor *plus* controller, officer, director, employee, contractor, commercial counterparty, or so on. Three kinds of acts by the mere investor could constitute the actus reus required for a violation of substantive criminal law: the act of investment itself, formal participation in corporate governance, or informal participation in corporate governance. Throughout the rest of the Article, these three kinds of acts will be referred to collectively as "investment-related conduct."

The act of investment, the actual transfer of value in exchange for an interest in an enterprise, is the essence of investor status. When a person transfers value to a firm that is engaged, or will engage, in illicit activity, that person provides the enterprise with resources it needs to carry out illicit activity. For preexisting activity, those financial resources can permit its scaling up or maintenance.[136] The act of investment thus results in more law violation than would occur in its absence.[137]

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133 *See infra* Section III.B.

134 *See supra* Sections I.A–.B.

135 It is not inconceivable that investment-related conduct could satisfy an accessory-after-the-fact theory, but it is a less likely case.

136 *See supra* note 28 and accompanying text.

137 *See* Greenwood et al., *supra* note 21, at 122, 124.

Investors, particularly equity investors, also enjoy rights to participate in corporate governance. These rights follow from the act of investment, but they are not always exercised by the actor who transferred value to the firm.[138] Because investment interests are typically transferrable—such as by sale or bequest—multiple persons could become investors following a single act of investment, including the original purchaser and those who later succeed to that person's interests.[139] This point distinguishes how one can engage in culpable conduct as an investor. Most obviously, investment-related conduct includes making an investment, but it can also include participating in governance. These two types of conduct do not necessarily coincide in the same person.

The following illustration helps outline the distinctions. Imagine, for example, that *A* receives shares in a primary offering by company *X* in exchange for cash.[140] Disappointed in company *X*'s business results, *A* agrees to sell those shares to *B*. *B*, having bought the shares in a secondary transaction, has succeeded to investor status by virtue of purchasing the shares.[141] What *B* does with that purchased status could fit within this Article's definition of criminal investment-related conduct. Imagine further, for example, that *B* uses this new status to encourage company *X*'s management to improve the business's results by undertaking new efforts that are profitable but illegal. This wrongful investment-related conduct would follow from *B*'s purchased right to participate in company *X*'s governance but not the act of purchasing the shares itself.

Investors participate in governance both formally and informally. As a formal matter, corporate law or a firm's governing documents give shareholders rights meant to enable monitoring and to mitigate agency costs.[142] These rights include electing the company's board of directors,[143] approving extraordinary transactions,[144] obtaining information about

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138 *See* Henry Hansmann & Reinier Kraakman, *What Is Corporate Law?*, *in* THE ANATOMY OF CORPORATE LAW 1, 1 (2004) (listing share transferability among the five basic legal features of a corporation, along with legal personality, limited liability, delegated management, and investor ownership).

139 *See id.*

140 *Offering*, BLACK'S LAW DICTIONARY (12th ed. 2024) (defining "primary offering" as "[a]n offering of newly issued securities").

141 *Id.* (defining "secondary offering" as "[a]n offering of previously issued securities by persons other than the issuer").

142 *See* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 800 (2017) ("[D]iscretionary control rights[]are rights that principals may exercise without first having to prove that the agent violated an established restriction.").

143 *Id.*

144 *Id.*

the company's affairs,[145] and suing for breaches of fiduciary duty by directors or officers.[146] In some cases, those formal governance rights are contractually augmented.[147] Informally, investors—especially large investors in public companies or VC investors in startup companies—might solicit information from management or offer advice or encouragement to management.[148] Management responds to this informal engagement for several reasons. In public companies, engagement between management and an important investor happens under the implicit threat that the investor could exercise formal governance powers in ways undesirable to management[149] or put downward pressure on the price of the company's securities by selling.[150] In private firms, management might heed investors' informal input out of genuine regard for their advice[151] or, less volitionally, by understanding the implicit threat that failure to heed current investors could undermine future access to capital.[152]

Those are the acts that could give rise to criminal liability. Setting aside the rare strict liability offense, criminal liability requires coupling such an act with illicit intent.[153] Every day, countless investors engage in the investment-related conduct just described. Some invest in companies that use the capital they receive to break the law—even if breaking the law is not those firms' entire purpose. Presumably, most

145 *See, e.g.*, DEL. CODE ANN. tit. 8, § 220 (2025) (granting inspection rights to shareholders); MODEL BUS. CORP. ACT § 16.02 (AM. BAR ASS'N 2024) (same).

146 Julian Velasco, *The Fundamental Rights of the Shareholder*, 40 U.C. DAVIS L. REV. 407, 421–22 (2006) (outlining shareholder derivative suits).

147 *See* Gabriel Rauterberg, *The Separation of Voting and Control: The Role of Contract in Corporate Governance*, 38 YALE J. ON REGUL. 1124, 1148–54 (2021) (documenting the practice in public companies); Jill E. Fisch, *Stealth Governance: Shareholder Agreements and Private Ordering*, 99 WASH. U. L. REV. 913, 930–33, 946–53 (2021) (documenting the practice in private companies).

148 *See* Lucian Bebchuk & Scott Hirst, *Big Three Power, and Why It Matters*, 102 B.U. L. REV. 1547, 1571–82 (2022); Stefano Bonini, Senem Alkan & Antonio Salvi, *The Effect of Venture Capitalists on the Governance of Firms*, 20 CORP. GOVERNANCE: INT'L REV. 21, 23–24, 30 (2012).

149 Caleb N. Griffin, *Humanizing Corporate Governance*, 75 FLA. L. REV. 689, 736 (2023).

150 *See generally* Anat R. Admati & Paul Pfleiderer, *The "Wall Street Walk" and Shareholder Activism: Exit as a Form of Voice*, 22 REV. FIN. STUD. 2645 (2009) (discussing how large shareholders can discipline management through the credible threat of exit, which can depress stock prices and influence managerial behavior).

151 *See generally* Harry J. Sapienza, *When Do Venture Capitalists Add Value?*, 7 J. BUS. VENTURING 9 (1992) (examining how venture capitalists can influence firm performance through advisory roles and management support beyond formal control mechanisms).

152 *See* Anat R. Admati & Paul Pfleiderer, *Robust Financial Contracting and the Role of Venture Capitalists*, 49 J. FIN. 371, 374 (1994).

153 *See* WAYNE R. LAFAVE, SUBSTANTIVE CRIMINAL LAW § 5.1 (3d ed. 2024) (describing the general requirement for both actus reus and mens rea before criminal liability can attach). *But see* People v. Lauria, 59 Cal. Rptr. 628, 633 (Ct. App. 1967) (holding that intent may be inferred from the acquisition of a "special interest in the operation of [an] illegal enterprise").

of those investors did not know about, and would not have condoned, the violations.

Imagine, for example, one who buys shares in an offering by a global construction company, which then secretly pays bribes to obtain business. Because money is fungible, part of the investor's cash contributed to the bribe payments, even if the shareholder expected the company to obtain business through lawful means only. The lack of a culpable mental state, however, separates this unwitting investor from those who could plausibly be enforcement targets.[154] Although an investor's actions might indirectly facilitate corporate offending, the investor is not personally blameworthy without some intent that the offenses be carried out.[155] From least to most culpable, that intent can be satisfied by a negligent, reckless, knowing, or purposeful state of mind.[156] Because many, although perhaps not all, offenses likely to be committed in the corporate context require at least a knowing intent, this Article's analysis will generally treat knowledge as the threshold mens rea at which investment-related conduct gives rise to criminal liability.[157]

2. *Potential Approaches to Prosecuting Investors*

When firms break the law, federal and state prosecutors rarely, if ever, prosecute their mere investors.[158] But what if that were to change? What approaches might prosecutors take to charge investment-related conduct? Federal and state criminal codes are capacious and malleable, and so an accounting of potential theories is not feasible. This subsection, however, provides a high-level view of how prosecutors could pursue culpable investors under accomplice, conspiracy, or principal theories.

The likeliest sources of investor criminal liability are accomplice—that is, aider and abettor—and conspiracy liability. In those cases,

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154 *See* United States v. X-Citement Video, Inc., 513 U.S. 64, 72 (1994) ("[T]he presumption in favor of a scienter requirement should apply to each of the statutory elements that criminalize otherwise innocent conduct.").

155 *See* Rehaif v. United States, 588 U.S. 225, 231 (2019) (citing to the "legion" of "cases in which [the Supreme Court has] emphasized scienter's importance in separating wrongful from innocent acts").

156 *See* United States v. Bailey, 444 U.S. 394, 404 (1980) (setting forth "a hierarchy of culpable states of mind . . . in descending order of culpability, as purpose, knowledge, recklessness, and negligence").

157 *See* Rosemond v. United States, 572 U.S. 65, 79–80 (2014) ("The law does not, nor should it, care whether [an accomplice] participates with a happy heart or a sense of foreboding. Either way he has the same culpability, because either way he has knowingly elected to aid in the commission of a peculiarly risky form of offense."). *But see* Robert Weisberg, *Reappraising Complicity*, 4 BUFF. CRIM. L. REV. 217, 236 (2000) ("For decades, the American courts and legislatures have debated whether knowledge or 'true purpose' should be the required mens rea for accomplice liability.").

158 *See supra* notes 117–20 and accompanying text.

investment-related conduct is not itself a criminal act, but rather gives rise to responsibility derivative of another's conduct. Accomplice liability most directly challenges the rhetoric of the innocent investor.[159] An indictment as an aider and abettor should not surprise a knowing investor who funds a clearly illegal business,[160] as such an investor "associated with a criminal venture, purposefully participated in the criminal activity, and sought by [their] actions to make the venture successful."[161] Although the investor might have tried to avoid liability by merely cutting a check and not participating in the firm's governance,[162] that check alone represented an "affirmative" act "designed to aid the venture."[163] Indeed, even an "act of relatively slight moment may warrant a jury's finding participation" in corporate offenses.[164] Further, so long as prosecutors can prove the investor's knowing intent, "it does not take much to satisfy [accomplice liability's] facilitation element,"[165] although admittedly the patina of legitimacy examined in Section II.A could complicate efforts to prove intent.[166]

Alternatively, a prosecutor could proceed on a conspiracy theory. It could be alleged that there was "an agreement between two or more persons to break the law"[167]—that is, an agreement to pool resources and talents to conduct illicit corporate activity. The investor's investment-related conduct would be "an overt act in furtherance of the conspiracy[]"[168]—that is, providing the company with funds to carry out illicit acts. An investor who knows of present or planned illicit activity

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159 United States v. Baca-Valenzuela, 118 F.3d 1223, 1232 (8th Cir. 1997) ("A fundamental theory of American criminal law is that there is no offense of aiding and abetting or accomplice liability as such. Instead, accomplice liability is merely a means of determining which persons were closely enough related to the underlying offense to be prosecuted and convicted of that offense.").

160 *See* Luke Scheuer, *The "Legal" Marijuana Industry's Challenge for Business Entity Law*, 6 Wm. & Mary Bus. L. Rev. 511, 518 (2015) ("In the case of the marijuana industry, law breaking permeates the entire business, from the investors who provide funding, to the managers and the employees who are engaging in an enterprise that is criminal under federal law.").

161 *See* United States v. Landerman, 109 F.3d 1053, 1068 n.22 (5th Cir. 1997); *accord, e.g.*, Jud. Council of Cal., Criminal Jury Instructions § 401 (2024) ("Someone aids and abets a crime if he or she knows of the perpetrator's unlawful purpose and he or she specifically intends to, and does in fact, aid, facilitate, promote, encourage, or instigate the perpetrator's commission of that crime." (emphasis omitted)).

162 *See* Andrew K. Jennings & Kimberly D. Krawiec, *Vice Capital*, 15 U.C. Irvine L. Rev. (forthcoming 2025) (reporting that VC investors in cannabis startups sometimes attempt to limit their exposure to criminal enforcement by not participating in governance).

163 *See Landerman*, 109 F.3d at 1068 n.22. Investors who purchase securities second hand would appear to have plausible defenses against an aider-and-abettor liability theory in that they do not directly fund the firm. *See infra* Section II.B.

164 United States v. Garguilo, 310 F.2d 249, 253 (2d Cir. 1962).

165 United States v. Bennett, 75 F.3d 40, 45 (1st Cir. 1996).

166 *See infra* Section II.A.

167 United States v. Summers, 414 F.3d 1287, 1295 (10th Cir. 2005).

168 *Id.*

and nevertheless decides to engage in investment-related conduct could be said to have joined the conspiracy willfully,[169] and the investor would be vicariously liable for that activity even after simply cutting a check and participating no further.[170]

Perhaps less likely, there are several principal-liability theories under which investment-related conduct is itself criminal. A number of industry-specific and generic federal and state criminal statutes impose such liability. Federal law, for instance, directly criminalizes "financ[ing] . . . or own[ing] . . . an illegal gambling business."[171] In one example, clients of Vanguard, a major investment manager, sued the firm following a DOJ crackdown on illegal gambling businesses that Vanguard had invested in.[172] Although prosecutors did not charge Vanguard along with the gambling operators under the statute, they *could* have.[173] In another setting, the Controlled Substances Act criminalizes "profit[ing] from" a "place for the purpose of unlawfully manufacturing, storing, *distributing*, or using a controlled substance."[174] Recalling the motivating example, if DGI's office space was a place for "distributing" controlled substances, then, read strictly, the statute could criminalize venture capitalists' knowing investments in it.[175]

More generic statutes could also be used by prosecutors to pursue investors as principals. Some states' money-laundering laws, for example, broadly criminalize a person who knowingly "finances or invests or intends to finance or invest funds that the person believes are intended to further the commission of criminal activity."[176] Further, federal and state racketeering influenced and corrupt organizations ("RICO")

169 United States v. Johnson, 42 F.3d 1312, 1319 (10th Cir. 1994). Although the viability of accomplice theories to charge secondary purchasers is questionable, *see supra* note 163, it could be more plausibly said that a knowing secondary purchaser has "joined" a conspiracy.

170 The case supplying this principle of vicarious liability for conspirators involved, suitably enough, an illegal liquor business. Pinkerton v. United States, 328 U.S. 640, 646 (1946).

171 18 U.S.C. § 1955(a). Courts give the word "finance" under the statute broad interpretation in line with its "ordinary sense." *See* United States v. Greco, 619 F.2d 635, 638 (7th Cir. 1980).

172 Grant McCool, *Vanguard Sued for "Illegal Gambling" Investments*, Reuters (Aug. 29, 2008, 6:49 PM), https://www.reuters.com/article/markets/us/vanguard-sued-for-illegal-gambling-investments-idUSN29472821/ [https://perma.cc/5KZR-ADW4]; *see also, e.g.*, Memorandum from Fox Rothschild, LLP to AdvisorShares Investments, LLC 9 (Apr. 15, 2019), https://www.sec.gov/Archives/edgar/data/1408970/000161577419005745/s117396_ex99-q2.htm [https://perma.cc/G89K-BS37] (listing several cannabis-related businesses that Vanguard had also invested in).

173 *See supra* note 171 and accompanying text.

174 21 U.S.C. § 856(a)(2) (emphasis added).

175 *See supra* note 1 and accompanying text.

176 Tex. Penal Code Ann. § 34.02 (West 2025); *accord* Del. Code Ann. tit. 11, § 951 (2025); N.C. Gen. Stat. § 14-118.8 (2025).

statutes could be used against those who knowingly take an interest in an enumerated racket.[177]

II. The Structure of Criminal Investment

Naturally, any type of organization can commit crimes, and organizations vary structurally, including in terms of their apparent legitimacy, their capital structure, and their firm structure. Culpable investment-related conduct inherently occurs in the context of those structures and is thus shaped by them. This Part analyzes the complications that these variations pose for assessing whether an investor is criminally liable and, if so, whether prosecution is warranted.

A. *Investment in Illicit and Licit Firms*

Whether a firm is generally of an illicit or licit nature shades analysis of its investors' culpability. As a practical matter, those who knowingly finance illicit activity *are* prosecuted in the United States,[178] but those who finance seemingly licit enterprises that engage in illicit activity are not.[179] Without expressing a normative view on what activities are or ought to be unlawful, licit enterprises can be defined as those engaged in activities that are at least superficially lawful, whereas illicit enterprises

177 *See* 18 U.S.C. § 1961(1) (defining "racketeering activity" to include violations of the Controlled Substances Act); *id.* § 1962(b) (prohibiting "any person through a pattern of racketeering activity . . . to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce"). Most RICO statutes have a limited set of predicate acts, at least one of which must be satisfied to give rise to liability. *See, e.g.*, N.Y. Penal Law §§ 460.10–.20 (McKinney 2025). Many of those acts align most directly with noncorporate illicit activity. *See, e.g.*, *id.* § 460.10. The federal RICO statute, however, includes wire fraud as a predicate act, which covers a wide range of white-collar or corporate offending. *See* 18 U.S.C. § 1961(1) (defining "racketeering activity" to include "wire fraud").

178 In *Ex parte Couch*, for example, a mother was charged with financing her son's flight from probation. 629 S.W.3d 509, 511 (Tex. App. 2021), *vacated*, 629 S.W.3d 217 (Tex. Crim. App. 2021). In a similar case, a wealthy businessman was charged with financing his father's flight from a murder prosecution. David Ovalle, *Pincho Part-Owner Accused of Funding Fugitive Dad Won't Get Jail Time*, Mia. Herald (Apr. 4, 2019, 4:37 PM), https://www.miamiherald.com/news/local/crime/article228822169.html [https://perma.cc/76J6-BQQH]. Outside of fugitive financing, a former Florida state legislator was charged with multiple campaign-finance violations for illicitly funding a fraudulent election campaign. Scott Glover, Curt Devine & Audrey Ash, *Former Florida State Senator Charged in Spoiler Candidate Scheme*, CNN (Mar. 18, 2021, 6:42 PM), https://www.cnn.com/2021/03/18/politics/frank-artiles-arrested-sham-candidate-invs/index.html [https://perma.cc/744W-JV4N]. In the national-security space, 18 U.S.C. § 2339A prohibits providing "material support" to terrorist organizations, and the government has used this statute heavily since the September 11 attacks. *See* Maryam Jamshidi, *The Private Enforcement of National Security*, 108 Cornell L. Rev. 739, 743–44 (2023) ("Since 9/11, the government has relied heavily on the concept of material support to prosecute and otherwise address the terrorist threat.").

179 *See supra* note 57 (discussing the paucity of cases in which mere investment in a licit enterprise is charged).

engage in activities that are plainly illegal. A licensed pharmacy and a drug-selling gang readily illustrate the distinction.

Although illicit and licit activity are objective and dichotomous states, the neat binary suggested by the two labels might often fail to capture the reality of organizational malfeasance. To be sure, although some firms' purposes are entirely licit or illicit, others might engage in a mix of lawful and unlawful activities, or they might engage in some lawful activities in an unlawful way.[180] A street gang that sells controlled substances, for example, is entirely unlawful.[181] But pills that would be unlawful for the gang to sell may be lawfully provided by licensed clinics or pharmacies—that is, the business of providing controlled substances is licit when done by certain actors but illicit when done by others.[182] Yet, those permitted actors must also sell controlled substances only in a certain way. They act illicitly when they provide controlled substances but fail to comply with a host of regulations meant to restrict access to patients with true medical need.[183]

This dichotomy is complicated by the idea of legitimacy, a normative overlay on what is and is not illicit. Legitimacy, for this Article's purposes, refers to the quality by which third parties perceive an enterprise as being lawful and otherwise within socially acceptable bounds.[184] Imagine, for example, that both a drug-selling gang and a VC-backed startup each exist for the true purpose of selling controlled substances to anyone who wants them. All things being equal, the former will sooner come under law enforcement's gaze, even if the latter illegally distributes drugs at a greater scale. That differential response can be attributed to several factors, including, potentially, differences in the

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180 *See* Andrew K. Jennings, *Criminal Recordkeeping*, 102 Wash. U. L. Rev. 223, 254–61 (2024) (typologizing illicit business activity as illicit activity in illicit organizations, illicit activity in licit organizations, and licit activity in licit organizations done illicitly).

181 *See generally* Steven D. Levitt & Sudhir Alladi Venkatesh, *An Economic Analysis of a Drug-Selling Gang's Finances*, 115 Q.J. Econ. 755 (2000) (analyzing a drug-selling gang as a business organization).

182 21 U.S.C. § 841(a) (criminalizing possession, dispensation, manufacture, and possession of controlled substances); *id.* § 822(b) (allowing those properly registered to engage in the same).

183 *See generally* 21 U.S.C. §§ 801–904 (establishing a regulatory framework to control the manufacture, distribution, and dispensation of controlled substances to prevent abuse and ensure use only for legitimate medical purposes); *see also* Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and EESG Strategy*, 106 Iowa L. Rev. 1885, 1893 (2021) (observing that "the first principle of corporate law" is that "corporations may only conduct lawful business by lawful means").

184 *See* Paul J. DiMaggio & Walter W. Powell, *The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields*, 48 Am. Socio. Rev. 147, 155 (1983) ("[O]rganizations with ambiguous or disputed goals are likely to be highly dependent upon appearances for legitimacy. Such organizations may find it to their advantage to meet the expectations of important constituencies about how they should be designed and run.").

socioeconomic backgrounds of the businesses' principals and related law enforcement bias.[185] But the expected differential is also directly attributable to the patina of legitimacy that the latter drug seller enjoys. After all, controlled substances may only be sold by certain people in certain settings under certain conditions. Those people, settings, and conditions are bound up in the professional and social authority signified by white lab coats.[186] By contrast, if law enforcement notices that those who are categorically prohibited from selling controlled substances are doing so, it might move quickly to investigate and arrest them.[187] Those investigations and arrests might include the use of physical, even deadly, force.[188]

The same conduct committed by a startup cloaked in white-lab-coat authority, however, might prompt a more cautious and methodical approach by law enforcement.[189] Even if it appears that the startup is illegally distributing drugs, can investigators be *sure* that it is violating the law to a degree that warrants criminal enforcement? The startup has the trappings, after all, of being a legitimate business in the health-care industry that provides drugs in line with professional standards of care. Superficial similarities between law-abiding and law-breaking enterprises, then, mean that an investigation of a putatively legitimate enterprise more likely proceeds via subpoenas and grand-jury testimony rather than by search warrants and station-house interrogations.[190]

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185 *See* Jeffrey Reiman & Paul Leighton, The Rich Get Richer and the Poor Get Prison 64 (9th ed. 2010); Michelle Alexander, The New Jim Crow 62 (10th anniversary ed. 2010) (noting, for example, that DOJ under President Ronald Reagan announced a shift in federal prosecutorial focus away from white-collar and toward street crime); Katherine Beckett & Theodore Sasson, The Politics of Injustice 179 (2d ed. 2004) ("Surveillance practices long associated with prison have spilled into communities, as law enforcers and security guards increasingly monitor public places—a trend captured in the phrase 'the prisonization of society.'").

186 *See generally* Dan W. Blumhagen, *The Doctor's White Coat: The Image of the Physician in Modern America*, 91 Annals Internal Med. 111 (1979) (providing a historical and symbolic analysis of the white lab coat).

187 *See* Julie R. O'Sullivan, *Is the Corporate Criminal Enforcement Ecosystem Defensible?*, 47 J. Corp. L. 1047, 1047 (2022) ("It has been widely acknowledged that, compared to many drug, immigration, or simple fraud cases, investigating corporate crime is difficult. That said, with sufficient effort and resources, it is possible to bring corporations and their executives to account.").

188 *See* Rachel A. Harmon, *When Is Police Violence Justified?*, 102 Nw. U. L. Rev. 1119, 1121 (2008) ("Police officers use force as an authorized form of state coercion, but they do so in tense and often emotionally charged interpersonal encounters.").

189 *See* O'Sullivan, *supra* note 187, at 1058–62.

190 The federal investigation into DGI, for example, began at least eighteen months before the company's founder was indicted. Rolfe Winkler, *DEA Investigating ADHD Telehealth Provider Done*, Wall St. J. (Sept. 16, 2022, 8:04 PM), https://www.wsj.com/articles/dea-investigating-adhd-telehealth-provider-done-11663239601 [https://perma.cc/RVU7-KFJV]; *see also* Miriam H. Baer, *Law Enforcement's* Lochner, 105 Minn. L. Rev. 1667, 1668–71 (2021) (characterizing the government's current use of subpoenas and internal investigations as an "ease-of-access era" for investigating corporate crime).

This patina of legitimacy can even shield illicit enterprises when they simply adopt generic signifiers of being proper businesses.[191] Would a truly illicit business, an enforcer might wonder, rent office space, enroll employees in a health plan, purchase advertising, and do other things typical of licit enterprises?

Whether a given firm projects legitimacy complicates a culpability analysis. Investors, knowingly or not, sometimes contribute to the impression that a firm is legitimate. Their presence in a firm's capital structure suggests to outsiders that the firm operates in rough accord with law.[192] Surely sophisticated venture capitalists, outside observers might assume, would be faithful fiduciaries to their limited partners and actively avoid investing in illegal businesses.[193] In that light, culpable investing could undermine enforcement against law-breaking firms by creating uncertainty around their illicitness. But, on the other hand, the patina of legitimacy might also fool investors into believing an enterprise is law-abiding, removing any criminal intent from the equation, or, at least, confounding efforts to prove its presence.[194]

Complicating this analysis further is that both illicit and licit activity can occur within a single firm. A global construction company that bribes foreign officials to obtain contracts engages in both licit acts (building things) and illicit acts (paying bribes). That mix of licit and illicit conduct could permit an investor to convincingly assert—whether truthfully or not—a lack of knowledge about the firm's illicit acts.

Illicitness also sometimes adopts a transitory quality. A firm's unlawful business model might become lawful in the future, perhaps because its entry into the market forced changes to existing law.[195] Ride-hailing company Uber and short-term-rental company Airbnb, for instance, allegedly facilitated illegal taxi and hotel operations until local officials acquiesced to their business models.[196] In another example, at the time of their foundings, real-money fantasy-sports companies

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191 Donald E. deKieffer, *Trade Diversion as a Fund Raising and Money Laundering Technique of Terrorist Organizations*, *in* COUNTERING THE FINANCING OF TERRORISM 150, 151 (Thomas J. Biersteker & Sue E. Eckert eds., 2008) (noting that front businesses created to finance terrorist organizations must create "trappings of legitimacy").

192 Greg Fisher, Suresh Kotha & Amrita Lahiri, *Changing with the Times: An Integrated View of Identity, Legitimacy, and New Venture Life Cycles*, 41 ACAD. MGMT. REV. 383 (2016) (identifying channels by which new ventures obtain legitimacy, including from the signal provided by outside investment).

193 *But cf.* Hartsel v. Vanguard Grp., Inc., No. 5394, 2011 WL 2421003 (Del. Ch. June 15, 2011) (addressing allegations that an investment manager knowingly invested client funds in illegal offshore gambling operations), *aff'd*, 38 A.3d 1254 (Del. 2012).

194 *See supra* Section I.C.

195 See Elizabeth Pollman & Jordan M. Barry, *Regulatory Entrepreneurship*, 90 S. CAL. L. REV. 383, 398–403 (2017), for the leading account of how entrepreneurs enter markets illegally and later achieve market and legal acceptance.

196 *See id.* at 399–403.

DraftKings and FanDuel allegedly offered illegal gambling services.[197] Later, a U.S. Supreme Court decision and changes in state law legalized online sports betting in many jurisdictions.[198] In these transitory cases, attempts to prove investors' mental states could be confounded by the effects of changing regulatory environments. Alternatively, prosecutors might elect not to pursue subsequently legalized conduct.[199] Thus, perniciously, investors could escape accountability for culpable investment-related conduct if law-breaking firms use their cash to secure favorable regulatory developments.[200]

The transitory quality also appears when corporate practices mature from violating to complying with law. Software company Zenefits, for example, started life as an unlicensed insurance broker.[201] As it raised capital and engaged more experienced management, it obtained required broker licenses and became compliant.[202] In cases of similar shifts in internal practices, investors could credibly claim that their investment-related conduct was compliance enhancing. That is, they used their influence as potential or actual investors to force reforms at a law-breaking firm. If such a claim were true, it would tend to undermine that an investment happened with criminal intent. Indeed, it would be consistent with an optimistic thesis that investors have latent power to promote corporate compliance.[203]

B. *Capital Structure and Criminal Investment*

The form that an investment in a law-breaking firm takes also informs its culpability analysis. Consider two investors: one who

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197 *See id.* at 402–03; Walt Bogdanich, Joe Drape & Jacqueline Williams, *Attorney General Tells DraftKings and FanDuel to Stop Taking Entries in New York*, N.Y. Times (Nov. 10, 2015), https://www.nytimes.com/2015/11/11/sports/football/draftkings-fanduel-new-york-attorney-general-tells-fantasy-sites-to-stop-taking-bets-in-new-york.html [https://perma.cc/4QNT-FJXE].

198 *See* Murphy v. Nat'l Collegiate Athletic Ass'n, 584 U.S. 453, 454 (2018); Brian Pempus, *States Where Sports Betting Is Legal – January 2025*, Forbes (Jan. 1, 2025, 9:00 AM), https://www.forbes.com/betting/legal/states-where-sports-betting-is-legal/ [https://perma.cc/Y95A-TEGY].

199 *See, e.g.*, Kurtis Lee & Yesenia Robles, *Denver Joins Boulder in Dropping Prosecution of Limited Pot Possession*, Denver Post (Apr. 30, 2016, 4:10 PM), https://www.denverpost.com/2012/11/15/denver-joins-boulder-in-dropping-prosecution-of-limited-pot-possession/ [https://perma.cc/5RBQ-YVQX].

200 *Cf.* Pollman & Barry, *supra* note 195, at 392 (presenting political activity as a major component of law-breaking firms' business models).

201 YourPeople, Inc., Securities Act Release No. 10,429, 117 SEC Docket 3715 (Oct. 26, 2017).

202 Heather Clancy, *Zenefits CEO David Sacks Talks Compliance, Mobile Aspirations*, Fortune (June 2, 2016, 11:36 AM), https://fortune.com/2016/06/02/zenefits-david-sacks-compliance-mobile/ [https://perma.cc/R2D4-CB2G] (quoting the company's replacement chief executive officer as saying "[w]here I feel good is where we have brought our licensing into compliance [, b]ut the thing I said when I took over is that we couldn't just see the licensing problem as a failure of technology").

203 *Cf. supra* note 128 and accompanying text.

specializes in equity and the other in debt.[204] The equity investor purchases a share of the firm's profits and residual value and, along with it, governance rights.[205] This investor enjoys an interest in the firm's upside. Yet because equity holders have the lowest priority if the firm becomes insolvent, the investor also risks losing the entire value of the investment.[206] The debt investor, on the other hand, purchases the right to receive a return of principal and a payment of interest, along with negative control rights designed to minimize the chances that the debt goes unpaid.[207] This investor does not share in the firm's upside but does face comparatively less downside because it has a higher-priority claim on the firm's assets.

All things being equal, culpable investors will tend to be equity investors. Equity signals a stronger commitment to the success of a firm. That commitment follows because equity shares in the upside enterprise value created by profitable illicit activity. Debt investors, in contrast, have weaker commitments to the success of a firm beyond its ability to repay.[208] Indeed, their limited upside makes them rationally risk averse, and knowingly lending funds to support illegal activity is exceptionally risky. First, there is the typical credit risk associated with debt investment—that the financed activity might not generate enough cash to repay the financing. *Culpable* lending carries additional risks, however. In addition to everyday credit risk, the borrower's prosecution might drive it into insolvency or its assets might be forfeited to the government.[209] Further, a culpable debt investor would itself be exposed to prosecution.[210] These added risks—potential total loss of investment for reasons unrelated to commercial credit risk plus the

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204 Other forms of investment, including preferred equity and convertible debt, blur these equity and debt lines. In the interests of analytical clarity, though, this Section adheres to the dichotomy just described.

205 *See supra* notes 142–46 and accompanying text.

206 *See* Douglas G. Baird, *Chapter 11's Expanding Universe*, 87 Temp. L. Rev. 975, 979 (2015) ("By the early 2000s, equity commonly received nothing in the vast majority of [corporate bankruptcy] cases.").

207 *See* Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. Pa. L. Rev. 785, 794 (2017) ("Creditors also enjoy control rights. By virtue of their ability to waive defaults instead of accelerating their loans, creditors can also influence the behavior of their debtor." (footnote omitted)).

208 Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 Calif. L. Rev. 745, 760–61 (2020) ("[T]he directors of an insolvent firm may consider the interests of creditors when assessing their fiduciary duty to the corporation, which in some cases might justify taking a 'less risky' course of action . . . .").

209 *See* 21 U.S.C. § 853(a)(2) (subjecting to criminal forfeiture any of a firm's "property used, or intended to be used, in any manner or part, to commit, or to facilitate the commission of" a crime); *see also id.* § 853(b) (permitting third parties with security interests to retain property that would be otherwise forfeited, provided that they were unaware of the property's criminal use).

210 *See supra* Section I.C.

potential for criminal enforcement—would require equity-like returns to compensate for them.[211] They thus would tend to be accepted only by risk-preferring equity investors.[212]

Beyond that structural theory, there are other reasons why equity investors are more likely to culpably invest than debt investors. These reasons point toward the policy interventions called for in Part III. Equity investors—such as general partners of VC funds—might be contractually bound not to invest in illegal businesses, but they are subject to practically no compliance-forcing public regulation.[213] Conducting pre-investment due diligence could alert equity investors to compliance risk at a prospective investee, thus allowing them to avoid financing illicit corporate activity or to insist on remediation in return for investment.[214] But equity investors might forgo diligence if they perceive it as inefficient in light of their overall investment expectations.[215] As a result, considerable ex ante opportunity for those equity investors to use diligence to improve compliance would be lost if there are insufficient consequences for dispensing with diligence.

Lenders, on the other hand, are more likely to be subject to compliance-forcing regulations, as they often operate in highly regulated industries.[216] Banks, for example, must engage in appropriate risk assessment before lending, and outside regulators scrutinize their compliance.[217] These two regulatory settings—one in which compliance-promoting due diligence is not mandatory and the other in which it is both mandatory and policed—suggest that equity investors are comparatively freer in their actions and thus even more likely to culpably invest.

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211 *See generally* William N. Goetzmann & Roger G. Ibbotson, The Equity Risk Premium (2006) (exploring the risk-return tradeoff that underlies equity investment and the premium required to compensate for heightened uncertainty and potential loss).

212 *Id.*

213 *See* Jennings & Krawiec, *supra* note 162, at 37, 45–46 (noting that some VC funds' limited-partnership agreements contain "vice clauses," which prohibit the funds' managers from investing in illegal businesses or in specific normatively objectionable industries).

214 *See* Gompers et al., *supra* note 18, at 187.

215 Marina Temkin, *OpenAI Tumult, FTX Blowup Help Bring VC Governance Back in Vogue*, PitchBook (Nov. 30, 2023), https://pitchbook.com/news/articles/VC-investors-start-up-board-seats-FTX-OpenAI-governance [https://perma.cc/M3X4-PN2F] ("[In the late 2010s and early 2020s, m]any investors, driven by fear of missing out during the last boom cycle, relaxed various aspects of investment criteria, from the thoroughness of their due diligence to governance, even relinquishing certain information rights, including access to detailed financials and business plans.").

216 *Laws & Regulations*, Off. of the Comptroller of the Currency, https://www.occ.treas.gov/topics/laws-and-regulations/index-laws-and-regulations.html [https://perma.cc/WBL7-B6EY] ("National banks and federal savings associations are among the most highly regulated institutions in the country, with many laws and regulations that govern their activities.").

217 Karen Schnatterly, Brent B. Clark, John Howe & Michael L. DeVaughn, *Regulatory and Governance Impacts on Bank Risk-Taking*, 21 Risk Mgmt. 99, 100 (2019).

C. Firm Structure and Criminal Investment

Firms vary in size and in the composition of their equity holders, again complicating culpability assessment. On one extreme, consider a small business that is wholly owned by its manager. On the other, consider a publicly traded company with shareholders numbering in the thousands,[218] many of whom do not vote in corporate elections[219] or who unsentimentally buy and sell shares based on the ebbs and flows of quarterly earnings.[220] In the middle of that spectrum fall countless other ownership configurations, including closely held firms whose shareholders are members of the same family or founder group; VC-backed startups owned by their founders, outside investors, and employees;[221] portfolio companies owned by one or more private-equity sponsors; and so on.

This variation contains baroquely layered ownership structures. A shareholder in a public company, for instance, might be an investment fund that invests on behalf of individual and institutional investors; those institutional investors might, in turn, invest on behalf of hundreds of thousands of individual beneficiaries.[222] A VC-backed startup might be owned in part by funds that invest on behalf of dozens of institutional limited partners, which in turn invest on behalf of still more beneficiaries.[223] Even the ownership of a family business might be split among a handful of individuals, intermediary companies, and trusts.

For analytical clarity, this Section collapses all that variation into two ownership structures: public and private. The divide between the public and private firm is long-standing, evolving, and contested.[224] A workable definition, however, is as follows: The equity interests of public companies are freely tradeable and available to anyone to purchase, often via a centralized exchange, whereas the equity interests of

218 *See* 15 U.S.C. § 78l(g)(1)(A)(i) (providing that companies with 2,000 shareholders or more are public companies).

219 *See generally* Marcel Kahan & Edward Rock, *The Hanging Chads of Corporate Voting*, 96 Geo. L.J. 1227 (2008) (analyzing widespread issues with shareholder voting in public companies, including low participation rates and systemic obstacles to effective shareholder influence).

220 *But see* George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 Del. J. Corp. L. 97, 105 (2010) (acknowledging that "many investors hold stocks briefly" but refuting that they are short-termists).

221 *See infra* Section II.C.2.

222 *Facts and Figures*, Vanguard, https://corporate.vanguard.com/content/corporatesite/us/en/corp/who-we-are/sets-us-apart/facts-and-figures.html [https://perma.cc/VQ49-HNAT].

223 *The Ideal Number of Limited Partners in a VC Fund*, VC Lab, https://govclab.com/2023/12/04/the-ideal-number-of-lps-in-a-vc-fund [https://perma.cc/5C87-72Y3] (recommending that VC managers should "have 20 – 30 LPs in their funds").

224 See generally George S. Georgiev, *The Breakdown of the Public–Private Divide in Securities Law: Causes, Consequences, and Reforms*, 18 N.Y.U. J.L. & Bus. 221 (2021), for a comprehensive review of this divide.

private firms are not available to everyone, and their transfers are often restricted.[225]

1. Public Firms

In the public company, many, if not most, investors have an attenuated, financialized, and transitory connection to the firm. Their identities are often unknown to the firm's management,[226] they often do not exercise their governance rights,[227] and they buy and sell shares without particular attachment to the issuers of those shares.[228] Because public-company investors are remote from the firms they hold shares in and because such firms are often quite complex, they cannot directly monitor the actions of management and other employees and whether those actions are lawful. True, they receive some disclosure about corporate activities,[229] but casual and fleeting investors can be expected to rationally ignore such disclosure other than the aggregate effect it has on the prices of the company's securities.[230]

"Investment" is perhaps a misnomer in this setting because, over time, most shareholders will have obtained their shares through secondary transactions rather than primary offerings.[231] Instead of giving the firm cash in return for shares—cash that the firm could then use for illicit purposes—most public-company shareholders have purchased their shares from someone else. That person, in turn, likely purchased the shares from someone else, and so on, in a series of anonymous market transactions.[232] How public-company shareholders acquire their

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225 *See, e.g.*, DEL. CODE ANN. tit. 8, § 202 (2025) (permitting restrictions on stock transfers).

226 *See* Kahan & Rock, *supra* note 219, at 1237–40 (explaining the "street name" system of managing stock ownership and transfers).

227 *See generally* Kahan & Rock, *supra* note 219.

228 In an era in which some investors are motivated by environmental, social, and governance factors, however, investors might evaluate firms on more than financial considerations. *See, e.g.*, Jessica Ground, *ESG Global Study 2022*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 17, 2022), https://corpgov.law.harvard.edu/2022/06/17/esg-global-study-2022/ [https://perma.cc/W9YU-YTJG] (reporting on investors' positive and negative screening strategies for environmental, social, and governance factors).

229 *See generally* Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 VA. L. REV. 669 (1984) (arguing that mandatory disclosure requirements improve market efficiency and protect investors by ensuring access to material corporate information).

230 Jill E. Fisch & Hillary A. Sale, *The Securities Analyst as Agent: Rethinking the Regulation of Analysts*, 88 IOWA L. REV. 1035, 1040–42 (2003) ("[C]hanges in analyst recommendations typically trigger substantial price movements. . . . Analysts read and digest company reports and other secondary sources . . . .").

231 *See supra* notes 140–41 and accompanying text.

232 *See* Merritt B. Fox, Lawrence R. Glosten & Gabriel V. Rauterberg, *Informed Trading and Its Regulation*, 43 J. CORP. L. 817, 829 (2018) (noting that transactions on the stock market are anonymous).

shares matters for assessing their responsibility for corporate wrongdoing: Only investors in primary offerings directly fund the firm and its activities.[233]

Directly funding a law-breaking public company, however, does not necessarily signal investor culpability. Public-company status is a powerful signal of commercial legitimacy,[234] and even law-breaking public companies usually engage in some business activities that are perfectly lawful.[235] Primary purchasers thus likely do not know if they are funding criminal activity, meaning that they lack criminal intent—after all, a company would have no incentive to disclose such funding.[236]

Even for companies with a known history of offending and a propensity to recidivate, investors in primary offerings cannot know for certain whether the company has turned the compliance corner.[237] New investors in prior-offender companies thus face the risk that the prior-offender companies will use the new investor cash to engage in further wrongdoing. But in light of that uncertainty, and barring some disclosure about illicit corporate plans, those investors at most could be said to have a negligent or reckless mental state.[238] Even if those mental states were sufficient to obtain conviction, when facts involve complex business scenarios, juries might be reluctant to convict without convincing evidence of culpable knowledge or purpose.[239] Further, prosecutors must ques-

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233 *See* Sandbu, *supra* note 32, at 101 ("Buyers of equity or debt securities in secondary markets are incontrovertibly 'investors in' corporations . . . but they have in no way financed the corporation in the sense of providing it with funds." (emphasis omitted)).

234 *See* Ailsa Röell, *The Decision to Go Public: An Overview*, 40 Eur. Econ. Rev. 1071, 1075–76 (1996) (reporting perceptions that going public enhances a company's reputation).

235 *See, e.g.*, Joseph Kahn & Jonathan D. Glater, *Enron Auditor Raises Specter of Crime*, N.Y. Times, Dec. 13, 2001, at C1.

236 One counterexample, though, is that several cannabis-related companies—whose businesses are illegal under the federal Controlled Substances Act despite being permitted under some state and local laws—are publicly traded. These companies warn investors that they could be personally subject to prosecution under aiding-and-abetting theories were the federal government to fully enforce the Controlled Substances Act. *See, e.g.*, Innovative Indus. Props., Inc., Annual Report (Form 10-K) 39–40 (Feb. 27, 2024) ("[F]ollowing [a] change in the federal government's enforcement position [on those who provide services to federally illegal cannabis businesses], we could be subject to criminal prosecution, which could lead to imprisonment and/or the imposition of penalties, fines, or forfeiture."); Green Thumb Indus. Inc., Annual Report (Form 10-K) 24 (Feb. 29, 2024) ("It is further possible that Department of Justice or an aggressive federal prosecutor could allege that Green Thumb Industries Inc., and our Board, our executive officers and, potentially, our shareholders, 'aided and abetted' violations of federal law by providing finances and services to our portfolio cannabis companies."); Lowell Farms Inc., Annual Report (Form 10-K) 21 (Mar. 28, 2024) (same); Goodness Growth Holdings, Inc., Annual Report (Form 10-K) 23 (Apr. 1, 2024) (same).

237 *See* Andrew K. Jennings, *Follow-Up Enforcement*, 70 Duke L.J. 1569, 1593 (2021) ("After a company breaks the law, uncertainty abounds whether it will do so again.").

238 *See* Model Penal Code § 2.02 (Am. L. Inst. 1962).

239 *See* Stephanie Holmes Didwania, *Regressive White-Collar Crime*, 97 S. Cal. L. Rev. 299, 348 (2024) (arguing that "complicated financial crimes are . . . burdensome to prove").

tion whether acts committed with lesser intent would merit prosecution given the high social cost associated with prosecuting investors.[240] This high cost coupled with a low probability of success creates a doubtful case for the prosecution of primary purchasers. That case is even more doubtful for secondary purchasers, who do not fund the firm directly.[241]

2. *Private Firms*

Public companies in the United States have meaningfully converged in their governance structures, practices, and policies.[242] The structures among privately held companies, in contrast, vary greatly.[243] For the sake of brevity, this discussion on private-firm structures will focus on VC-backed startups, which effectively illustrate the culpability considerations arising in the private-firm setting. That is, the points raised here about information asymmetries and investor governance can be extended to other private structures.

Investors take on qualitatively distinct roles in the VC-backed startup. Consider three investor personas: entrepreneurs, outside investors, and employees. Entrepreneurs, either alone or as small teams, conceive a startup's business and direct its earliest stages, including the development of products, commercial strategies, and fundraising.[244] Their investments take the form of labor, intellectual property, cash, or, most often, a combination thereof.[245] They might also take below-market salaries, especially in the early days.[246] Instead, they expect ultimately to be compensated for their entrepreneurial efforts via their equity in the business: When the company is acquired or goes public, its founders' stakes could bring them fabulous wealth.[247] Entrepreneurs, almost

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240 *See infra* Sections III.A–.B.

241 Under a capacious view of some criminal statutes, an aggressive theory would be that secondary purchasers support the firm's securities prices, thereby incenting management to engage in unlawful but profitable activity to meet investors' expectations. Another aggressive theory would assert that the presence of a secondary market motivates investment ex ante in primary markets. These theories would test the frontiers of criminal intent and prosecutorial discretion, however. If a secondary purchaser *is* to be seen as culpable for corporate wrongdoing, it would be more plausible that the culpable investment-related conduct relates to using a meaningful stake to encourage management to violate the law.

242 *See* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 Colum. L. Rev. 2563, 2565–66 (2021) (attributing this convergence to a "vast array of institutional players," including "proxy advisors, stock exchanges, ratings agencies, institutional investors, and associations"). *But see* Geeyoung Min, *Strategic Compliance*, 57 U.C. Davis L. Rev. 415 (2023) (documenting divergence in the adoption of compliance policies by large public companies).

243 *See* Lund & Pollman, *supra* note 242, at 2626.

244 Daniel F. Spulber, The Innovative Entrepreneur 2 (2014).

245 *See id.* at 61.

246 *See id.* at 68.

247 Steven N. Kaplan & Per Strömberg, *Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts*, 70 Rev. Econ. Stud. 281, 296 (2003) (explaining

definitionally, are risk-preferring investors with regard to their own firms. And as managers, they have superior information about their firms' affairs, including compliance with law.[248]

Outside investors enter a startup's capital structure in early stages as angel investors investing relatively small amounts of cash and in later stages as venture capitalists investing successively larger rounds.[249] These investors have opportunities to conduct due diligence into the firm and to receive disclosure from the firm's entrepreneurs, thereby reducing the information asymmetry that typifies the investor-manager relationship.[250] Less formally, they may exert control via their ability to provide more capital as needed and to provide nonfinancial support, such as by using their business networks to advance the firm's interests.[251] Outside investors are risk-preferring in that they choose to invest in speculative private companies.[252] Unlike entrepreneurs—who make highly specific investments in their own firms—outside investors expect many of their investments to end in loss and so reduce their aggregate risk by diversifying into a portfolio of startups.[253]

Lastly, startup employees are comparatively the least risk-preferring of the three personas. They receive a roughly market salary, although they might choose or be forced to trade some present salary for equity.[254] They are disempowered, however, from fully participating in the firm's governance. Further, they face the greatest formal information asymmetry vis-à-vis management in that they cannot conduct due diligence before making an investment[255] and are not entitled to useful

that "[i]nvestors can screen out entrepreneurs by offering high-powered [meaning heavily equity-weighted] compensation contracts because only high-ability entrepreneurs will accept such contracts" given that failure will cause equity compensation to be worthless).

248 George G. Triantis, *Financial Contract Design in the World of Venture Capital*, 68 U. Chi. L. Rev. 305, 307 (2001) ("First, some information is observable by only one party (the entrepreneur) who cannot credibly communicate it to others (information asymmetry).").

249 Off. of the Advoc. for Small Bus. Cap. Formation, *Early-Stage Investors*, U.S. Sec. & Exch. Comm'n (Dec. 23, 2024), https://www.sec.gov/education/capitalraising/building-blocks/investor-types [https://perma.cc/A2EN-JMYS].

250 *See* Gompers et al., *supra* note 18, at 176.

251 *See* Admati & Pfleiderer, *supra* note 152.

252 *See* Paul Gompers & Josh Lerner, The Venture Capital Cycle 183–87 (2d ed. 2004).

253 *See* Chris Dixon, *Performance Data and the 'Babe Ruth' Effect in Venture Capital*, Andreessen Horowitz (June 8, 2015), https://a16z.com/2015/06/08/performance-data-and-the-babe-ruth-effect-in-venture-capital [https://perma.cc/S2YY-CC55] (explaining the many failures are made up for by the explosive growth of their home-run investments).

254 *See* Saul Levmore, *Puzzling Stock Options and Compensation Norms*, 149 U. Pa. L. Rev. 1901, 1924 (2001).

255 *See* Anat Alon-Beck, *Bargaining Inequality: Employee Golden Handcuffs and Asymmetric Information*, 81 Md. L. Rev. 1165, 1206–07 (2022) (reporting that startups force employees to waive inspection rights in connection with equity awards).

pre-investment disclosures.[256] This effect is mitigated, however, to the extent that employee-investors obtain private information in the course of their employment.

Entrepreneurs and employees, as day-to-day insiders, are already exposed to prosecution for their personal contributions to corporate crime.[257] Setting that insider exposure aside, two factors—knowledge and influence—appear central to assessing the culpability of these three personas when their firms violate the law. Knowledge is a relevant factor because investors who know of the company's wrongful conduct have a culpable mental state when they engage in the act of investment—that is, they are aware that their investment will facilitate illicit activity.[258] Influence—the ability to encourage or force action or inaction by management—is a relevant factor because those investors who exercise formal or informal governance rights to promote illicit corporate activity meet both the actus reus and mens rea for liability.[259] Influence, in turn, implies a capacity for steering the company toward greater or lesser law compliance.[260] That capacity, as the next Part explains, can be exploited to promote compliance-enhancing outcomes.

III. Prosecutorial Discretion and Investor Criminal Liability

This final Part turns to the question at the Article's heart: When investors are criminally responsible for corporate wrongdoing, when, if ever, should they be charged with a crime? It answers this question first by identifying the social cost of prosecuting investors and the social cost of *not* doing so. It then draws on the Article's earlier doctrinal and theoretical contributions to recommend a five-factor test to guide the exercise of positive prosecutorial discretion. It closes by calling for the adoption of safe harbors for good-faith investors' benefit.

A. *The Social Cost of Investor Criminal Liability*

Substantive criminal law permits the prosecution of those who engage in culpable investment-related conduct.[261] Despite that doctrinal

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256 Yifat Aran, *Making Disclosure Work for Start-Up Employees*, 2019 Colum. Bus. L. Rev. 867, 871 (criticizing the lack of useful disclosure given to startup employees in connection with their equity awards).

257 *See supra* note 94 and accompanying text.

258 *See supra* Section I.C.

259 *See supra* Section I.C.

260 *See* Broughman & Wansley, *supra* note 28, at 1307 (positing a model in which venture capitalists "behave more subversively" by "skip[ing] monitoring, indulg[ing in] self-dealing, and push[ing] managers to take risks").

261 *See supra* Section I.C.

possibility, it has not been the practice of prosecutors in the United States to pursue those whose sole connection to a criminal offense is as an investor.[262] This Article urges a more nuanced approach in which any prosecutorial policy around culpable investors accounts for two competing public interests: the interest in promoting welfare-enhancing capital formation and the interest in preventing welfare-destroying law violation. The question of whether to prosecute criminal investors sits in tension between these interests. That is, prosecuting criminal investors is apt to impose social cost in the form of less and less-efficient capital formation, whereas *not* prosecuting them is apt to impose social cost in the form of greater law violation.[263]

1. The Social Cost of Prosecuting Criminal Investors

This Article challenges a status quo in which investors are understood by all concerned—prosecutors, corporate insiders, the public, and investors themselves—to be outside enforcement's scope.[264] That understanding might be doctrinally and pragmatically sound as applied to a considerable majority of investors. Most investors are, after all, too remote from the uses of their invested capital to form criminal intentions toward its illicit use.[265] But there likely are some investors whose investment-related conduct facilitates corporate violations and who *do* act with culpable mental states. In those latter cases, if prosecutorial practice shifts away from uniform nonprosecution, then culpable investing becomes riskier.[266]

If this prosecutorial shift were to occur, then the increased risk, or at least the perception of it, could be shared by law-abiding investors as well. Whereas all investors—the law-abiding and the criminal—currently enjoy an implicit policy of nonprosecution, culpable investors do not deserve that peace. Yet, perversely, if culpable investors face realistic enforcement risk, then even law-abiding investors might find their peace disturbed. Substantive criminal law is, after all, expansive and enforced by overlapping jurisdictions that might have divergent laws, policies, and interests.[267] Given that reality, even good-faith investors would not be unjustified in worrying about exposure to some

262 *See* U.S. Dep't of Just., Justice Manual § 9-28.100 (2023).

263 *See* Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 198 (1968).

264 *See supra* Section I.B.

265 *See supra* Sections I.B, II.C; *see also* U.S. Dep't of Just., Justice Manual § 9-28.1100 (2023) (providing that when charging corporations with crimes, prosecutors should consider that many investors are the victims of corporate crime and bear no responsibility).

266 *See* Becker, *supra* note 263, at 178.

267 *See* Darryl K. Brown, *Prosecutors and Overcriminalization: Thoughts on Political Dynamics and a Doctrinal Response*, 6 OHIO ST. J. CRIM. L. 453, 461–63 (2009).

unexpected law enforcement agency or novel criminal theory.[268] That worry can only grow when considering the incentives of an entrepreneurial prosecutor to engage in publicly salient enforcement[269] or of a partisan prosecutor to target political enemies. These concerns enter the picture if there is new receptivity to pursuing criminal cases against investors.[270] Treating investors as blameless undoubtedly shields some who ought not to be shielded. Yet today it also properly protects many more who deserve such protection. If investors join the usual suspects in corporate investigations, then that sweep of suspicion might well put them *all* at ill ease.

To be sure, law-abiding investors definitionally lack criminal intent regarding the commission of corporate wrongdoing. That absence of intent alone should foreclose their liability. But this point cannot grant full comfort given that the threat faced by law-abiding investors would be litigation risk rather than epistemic uncertainty over their culpability.[271] Juries can, and do, erroneously convict despite a defendant's literal innocence.[272] Moreover, for offenses that can be proved by reckless or negligent intent, investors must worry that they have innocently missed red flags but that with the bias of hindsight, prosecutors or juries might unjustly hold those failures against them.[273]

Even setting litigation risk aside, the sweep of suspicion could impose serious costs on investors. Imagine if, for example, each time a VC-backed startup engages in criminal behavior its investors expect to bear a long and costly investigation into whether they might share in the company's guilt.[274] This not unreasonable risk perception could produce a chilling effect among good-faith investors. In turn, this effect would be expected to undermine capital formation and increase costs of capital, especially for those businesses perceived as riskier from a

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268 *See* William J. Stuntz, *The Pathological Politics of Criminal Law*, 100 MICH. L. REV. 505, 588–94 (2001).

269 Beth A. Wilkinson & Steven H. Schulman, *When Talk Is Not Cheap: Communications with the Media, the Government and Other Parties in High Profile White Collar Criminal Cases*, 39 AM. CRIM. L. REV. 203, 223 (2002) (recognizing an "increasing prosecutorial appetite for high profile white collar defendants").

270 *See* Miriam H. Baer, *Corporate Compliance's Achilles Heel*, 78 BUS. LAW. 791, 812 (2023) (warning of the ill effects for corporate compliance if federal prosecutors succumb, or are perceived as succumbing, to increased political polarization in American society).

271 *See* CARISSA BYRNE HESSICK, PUNISHMENT WITHOUT TRIAL: WHY PLEA BARGAINING IS A BAD DEAL (2021) (criticizing a plea-bargaining system that imposes litigation risks high enough to make innocent defendants plead guilty).

272 *See* NAT'L INST. OF JUST., U.S. DEP'T OF JUST., WRONGFUL CONVICTIONS: THE LITERATURE, THE ISSUES, AND THE UNHEARD VOICES 12 (2023).

273 *See* Maggie Wittlin, *Hindsight Evidence*, 116 COLUM. L. REV. 1323, 1359–62 (2016).

274 *See* Veronica Root Martinez, *Complex Compliance Investigations*, 120 COLUM. L. REV. 249, 306 (2020) (noting the high costs associated with corporate investigations).

compliance perspective.[275] This effect could also lead riskier businesses to attract more investors who do not value compliance, which could exacerbate illicit activity at those firms.[276]

The social cost of prosecuting criminal investors follows chiefly, as just mentioned, from the indirect effects such a practice would have on capital markets. There would be direct costs, too. Prosecuting investors could increase the difficultly and expense of corporate enforcement.[277] More targets would significantly increase the complexity and expense of corporate criminal investigations.[278] Beyond investigative costs, outside investors faced with criminal liability might also have less incentive to settle and thus would be more likely to go to trial, creating additional expense and generating litigation risk for the government.[279]

2. *The Social Cost of Not Prosecuting Criminal Investors*

Not prosecuting criminal investors also imposes social costs. Insulating a class of actors who intentionally or knowingly contribute to organizational wrongdoing could undermine corporate deterrence and postenforcement reform by neglecting investment's criminogenic influence on corporate behavior.[280] Nonprosecution also produces a moral hazard. When culpable investors perceive themselves as having low or no risk of prosecution, they would be expected to invest marginally more in enterprises that break, or are at risk of breaking, the law.[281] The result would be marginally lower costs of capital for—and thus more attractive returns to—corporate crime.[282]

B. *When Should Culpable Investors Be Prosecuted?*

In most cases, the social cost of prosecuting investors, chiefly the chilling effect on nonculpable investors,[283] will outweigh the social cost

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275 *Cf.* Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. Chi. L. Rev. 89, 98–99 (1985) (theorizing that a corporation's cost of capital would be higher if its shareholders were exposed to its liabilities).

276 *Cf.* Jennings, *supra* note 126, at 564 (warning that acquisition of a firm with criminal liability by a low-compliance buyer could exacerbate compliance problems in the acquired firm).

277 *Supra* note 94 and accompanying text.

278 *See supra* note 274 and accompanying text.

279 *Cf.* Brandon L. Garrett, *The Corporate Criminal as Scapegoat*, 101 Va. L. Rev. 1789, 1824 (2015) (questioning whether individual defendants are more likely to go to trial than corporate defendants).

280 *See supra* notes 25–27 and accompanying text.

281 *Cf.* Daniel Henninger, *Welcome to 'Moral Hazard*,*'* Wall St. J. (Oct. 2, 2008, 12:01 AM), https://www.wsj.com/articles/SB122290454416296295 [https://perma.cc/6RY8-B6ZH] ("[E]very corner bar and hair salon is filled with experts on the perils of moral hazard. Everyone gets it: Cut risk down to next to nothing and some people do crazy things.").

282 *See* Draca et al., *supra* note 25, at 1255.

283 *See supra* Section III.A.1.

of holding investors blameless. In those cases, law enforcement should not pursue investors even if substantive criminal law prohibited their investment-related conduct. However, in narrow circumstances, the cost of *not* prosecuting culpable investors[284] exceeds the cost of doing so, implying that they could be efficiently charged. Drawing on the doctrinal, structural, and policy considerations above, this Section recommends five factors for identifying cases that fall in the latter category. It closes by applying those factors to hypothetical scenarios rooted in the Article's opening example of DGI, the VC-backed pill mill.

1. A Five-Factor Investor-Prosecution Test

Only the most egregious cases of criminal investment-related conduct, if any, should warrant prosecution. For all other chargeable cases, the status quo of investor nonprosecution will best satisfy the prior Section's social-cost considerations. This Section sets out a five-factor test for identifying egregious cases. Specifically, this test counsels prosecutors to limit enforcement to investment-related conduct by (1) individuals (2) in private firms (3) who act with knowing or purposeful intent and (4) who make substantial contributions (5) to significant corporate wrongdoing.

Beyond the social-cost justifications for a test applying these five factors, their adoption by prosecutorial agencies would produce rule-of-law benefits. In questioning the status quo of investor blamelessness, this Article opens the door to new and expanded criminal accountability. Deciding whom to hold criminally accountable is generally committed to prosecutorial discretion.[285] Although this approach allows for flexibility, it risks biased application, especially along racial, ethnic, gender, and other demographic lines.[286] If prosecutorial agencies consider charging culpable investors, adoption of this five-factor test—or some similar policy—would not only provide clear guidance to the capital markets, but it could also limit arbitrary or biased decision-making by line prosecutors.[287]

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284 *See supra* Section III.A.2.

285 *See* Inmates of Attica Corr. Facility v. Rockefeller, 477 F.2d 375, 379 (2d Cir. 1973).

286 *See* Rachel E. Barkow, *Prosecutorial Administration: Prosecutor Bias and the Department of Justice*, 99 Va. L. Rev. 271, 313–14 (2013); Stephanos Bibas, *The Need for Prosecutorial Discretion*, 19 Temp. Pol. & C.R.L. Rev. 369, 371 (2010) ("We rightly fear that justice will vary from prosecutor to prosecutor, with each one a law unto himself and his own whims, biases, and shirking.").

287 *See* Bibas, *supra* note 286, at 371 ("The solution, then, is to create a culture, structures, and incentives within prosecutors' offices so that prosecutors use their discretion consistently and in accord with the public's sense of justice.").

a. Prosecute Individual, Not Institutional, Investors

In the corporate context, human volition produces crime.[288] For instance, if a VC fund chooses to knowingly invest in an illegal business, that choice and that knowledge ultimately belong to the investment professionals who manage the fund.[289] Although the fund is vicariously liable for its managers' actions, the pragmatic focus on culpable individuals in contemporary corporate enforcement policy follows a normative and pragmatic logic that individual investors—whether they invest on their own or others' behalf—are the most appropriate targets for enforcement.[290] After all, investment professionals, unlike the institutions they represent, exercise their own agency and are likely more susceptible to deterrence given the availability of carceral sanctions.[291] Moreover, pursuing culpable outsider individuals promotes parity with prosecutors' contemporary focus on identifying and charging culpable insider individuals.[292] It also places culpable individual investors on more equal footing with noninvestors who are routinely charged as accomplices or coconspirators to noncorporate offenses.[293]

Further, prosecuting only individual investors achieves economy. Most culpable investment decisions are made by a small number of people. A person investing for a personal account or for a small fund might be a sole decision-maker.[294] Even in larger funds that require more thorough internal vetting and approvals before an investment is made, one or two professionals will shepherd an investment and be the people with access to information sufficient to form criminal intent.[295] Limiting the prospect of enforcement to those key players avoids recursive liability in which the managers of limited partners are potentially

288 Samuel W. Buell, *The Responsibility Gap in Corporate Crime*, 12 Crim. L. & Phil. 471, 488 (2018).

289 *See* Gompers & Lerner, *supra* note 252, at 65.

290 *E.g.*, Indictment, *supra* note 1, at 13–17.

291 John C. Coffee, Jr., *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 Mich. L. Rev. 386, 409 (1981) (theorizing that individuals are more deterrable by criminal law than are corporations because, in part, they can be imprisoned).

292 *See* Restatement (Second) of Torts § 876(b) (Am. L. Inst. 1979).

293 *See supra* note 178 and accompanying text.

294 *See* Ilya A. Strebulaev & Alex Dang, *Make Decisions with a VC Mindset*, Harv. Bus. Rev. (May 2024), https://hbr.org/2024/05/make-decisions-with-a-vc-mindset [https://perma.cc/4Z9P-3H4C] ("In VC firms, once a partner decides to invest in a start-up, the deal can quickly be finalized.").

295 *See generally* Jennings & Krawiec, *supra* note 162 (describing internal decision-making processes of VC firms and how those processes affect investment or noninvestment in morally or legally objectionable startups).

exposed and so on.[296] Instead, the line stops at those most closely linked to wrongdoing at a firm.

Still, this factor is not an essential one. The earlier logic of shareholders bearing risk for corporate wrongdoing, and thus having an incentive to police corporate compliance, applies with some strength to those who invest in collective funds managed by third parties.[297] Thus, prosecutors should not categorically decline cases against limited partners or their managers. Unusual circumstances might warrant pursuing such cases. A limited partner that invests in a VC fund that it knows specializes in funding illegal businesses, for example, is similarly situated to a VC fund that invests in a portfolio company that it knows operates an illegal business.[298]

b. Prosecute Private, Not Public, Investors

Part II suggests that private-company investors are best positioned to directly influence corporate compliance, whereas at best, public investors influence compliance indirectly and in ways generally insufficient to establish criminal intent.[299] Beyond that doctrinal point, pragmatism also counsels against prosecuting even culpable public-company investors.[300] A policy that expresses openness to holding culpable private-company investors criminally accountable but presumes against the same for public-company investors could mitigate risk perception and its attendant drag on capital formation among good-faith public investors.[301] It would also avoid the obvious enforcement costs around attempting investigations of a public firm's investors when they number in the thousands, are largely anonymous, and have transitory relationships with the firm.[302]

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296 Given that each step of financial intermediation between the ultimate sources and recipients of capital reduces the likelihood that an investor acts with a culpable mental state, the problem of recursion should not be overstated. But it is nevertheless one to be avoided by all involved, including investors and prosecutors.

297 *See supra* Section I.B.

298 *See* Jennings & Krawiec, *supra* note 162, at 66 (theorizing that VC funds that specialize in stigmatized—and even illegal—industries can reduce search costs by marketing themselves as vice specialists).

299 *See supra* Sections II.B–.C.

300 This factor is not essential, however. Public-company controllers, major shareholders, or investors in private-investment-in-public-equity deals are qualitatively analogous to private-company investors, and so it would not be unsensible to treat them as such for enforcement purposes.

301 *Cf.* Thompson, *supra* note 78, at 1070–71 ("The willingness to sometimes hold shareholders of close corporations liable, but never shareholders of public corporations, suggests that limited liability's positive role in facilitating the public market for shares is strong enough to overcome any justification for piercing.").

302 *See supra* notes 218–20 and accompanying text.

c. Prosecute Only Investors with Knowing or Purposeful Mens Rea

When substantive law supports investor liability for negligent or reckless conduct, charging investors based on those mental states is apt to create higher risk perception among even good-faith investors. That is, the chilling effect Section III.A warns of could be particularly acute if prosecutors treat these less culpable mental states as meriting enforcement.[303] This heightened risk perception might prevent socially desirable projects from obtaining funding or force them to bear higher costs for any capital they do obtain. Additionally, investors might conduct excessive, value-destroying levels of due diligence to protect themselves from future accusations that they negligently or recklessly invested in an illicit business.[304] Although the prosecution of negligent or reckless investment-related conduct could perhaps achieve some incremental deterrence, the tradeoff is unlikely to be profitable in social-cost terms. Instead, bringing only those cases with more culpable—knowing or purposeful—mens rea strikes an appropriate balance between the public's interests in capital formation and law compliance.

d. Prosecute Only Investors Who Substantially Contribute to Corporate Crime

Substantial investments—with substantiality varying in the context of a given firm—correlate with the ability to directly influence corporate compliance.[305] As said in the prior discussion on the public and private divide, there is pragmatism and economy in focusing on the most important investors.[306] After all, culpable investment-related conduct can be an essential input of corporate offending. If the most important investors are deterred, there is a lower likelihood that corporate offending will occur or, if it does, that it does so at a large scale. Insubstantial investments, in contrast, are on their own unlikely to contribute meaningfully to a firm's ability to engage in illicit activity, and thus their deterrence will be less likely to affect the course of the firm's compliance.

The substantiality of investment-related conduct is not necessarily a quantitative factor. It might be so if the only potentially culpable act is *investment*—that is, if the scale of investment-related conduct's criminogenic effect was driven solely by the cash sum invested. Assessing

303 *See supra* Section III.A.1 (discussing the hierarchy of culpability).

304 *See supra* Section III.A.2. This excessive due diligence could be value destroying in the sense that it is costly to perform. More troubling, it could destroy value by creating frictions that prevent value-creating deals from closing.

305 The Restatement (Second) of Torts defines "substantial" as "denot[ing] the fact that the defendant's conduct has such an effect in producing the harm as to lead reasonable men to regard it as a cause, using that word in the popular sense . . . ." RESTATEMENT (SECOND) OF TORTS § 431 cmt. a (AM. L. INST. 1965).

306 *See supra* Sections II.B–.C.

this factor might require more qualitative analysis, however, when the conduct in question is governance participation, such as appointing board members or informally communicating with management.

e. *Prosecute Only Investors in Firms That Engage in Significant Criminal Activity*

Total enforcement of criminal law in the corporate context is not practicable, nor would it be efficient.[307] Enforcers must choose what conduct is quantitatively or qualitatively significant enough to expend limited resources pursuing.[308] The same is doubly true for corporate crime, which is often more complex and costly to investigate compared to nonorganizational offenses.[309] It follows that if corporate offending is not significant enough to merit criminal enforcement at the entity level, then neither would it be at the investor level.

Applying this factor requires making value judgments around what kind of corporate offending—and consequently, culpable investment-related conduct—merits law enforcement's attention. A VC firm might, for example, invest in a startup knowing that it sells insurance without required licenses;[310] facilitates financial transactions that violate anti-money-laundering laws or economic sanctions;[311] offers taxicab services that violate municipal law;[312] lies to patients about the efficacy of its medical tests;[313] facilitates prostitution;[314] distributes child-exploitation

307 *See* George J. Stigler, *The Optimum Enforcement of Laws*, *in* ESSAYS IN THE ECONOMICS OF CRIME AND PUNISHMENT 55, 56 (Gary S. Becker & William M. Landes eds., 1974) ("There is one decisive reason why the society must forego 'complete' enforcement of the rule: enforcement is costly.").

308 *See* Andrew K. Jennings, *State Securities Enforcement*, 47 BYU L. REV. 67, 78–79, 91 (2021) (observing that enforcers of securities law pursue some cases because they represent significant offending in monetary terms and others because they involve conduct prioritized by an enforcement regardless of their monetary impact).

309 *See* Martinez, *supra* note 274, at 266, 306.

310 Chris Rauber, *Zenefits Executives and Employees Could Face Criminal Charges*, S.F. BUS. TIMES (Feb. 17, 2016), https://www.bizjournals.com/sanfrancisco/blog/techflash/2016/02/zenefits-insurance-licensing-conrad-david-sacks.html [https://perma.cc/DQ8P-UBSA] ("Regulatory agencies in California and Washington caution that Zenefits . . . could face criminal charges related to the alleged sale of health insurance without proper brokers' licenses.").

311 Press Release, U.S. Dep't of Just., Binance and CEO Plead Guilty to Federal Charges in $4B Resolution (Nov. 21, 2023), https://www.justice.gov/opa/pr/binance-and-ceo-plead-guilty-federal-charges-4b-resolution [https://perma.cc/6425-9T3J] (reporting on cryptocurrency exchange Binance's guilty plea to money-laundering and sanctions-violations charges).

312 Gregory Wallace, *Uber CEO Charged with Operating Illegal Taxi Service in South Korea*, CNN (Dec. 24, 2014, 5:17 PM), https://money.cnn.com/2014/12/24/technology/uber-south-korea/ [https://perma.cc/X47Y-HMXS].

313 *Theranos Founder Elizabeth Holmes Jailed for Fraud*, BBC (Nov. 18, 2022), https://www.bbc.com/news/world-us-canada-63685131 [https://perma.cc/9D76-M8NU].

314 Press Release, U.S. Dep't of Just., Justice Department Leads Effort to Seize Backpage.Com, the Internet's Leading Forum for Prostitution Ads, and Obtains 93-Count Federal

or nonconsensual sexual content;[315] or markets nicotine products to minors.[316] Prosecutors might uniformly agree that some of those examples—like distributing child-exploitation content or facilitating sanctions violations—are significant corporate offenses. They might disagree, however, on some of the others, like running illegal taxi cabs.

2. *Applying the Five-Factor Test to DGI's Investors*

Recall the Introduction's motivating example: DOJ has accused telemedicine startup DGI of illegally distributing tens of millions of stimulant pills and defrauding insurers of tens of millions of dollars.[317] DGI raised capital from at least three VC funds, although the indictment charging its founder omits any mention of them or their involvement in the company.[318] Because it is not known what, if anything, the funds knew, this omission presents an opportunity to consider hypothetical applications of this Section's proposed five-factor test, unburdened by what has been already reported.

In these hypotheticals, several factors are fairly assumed to be satisfied. Under the first and second factors, individual venture capitalists chose to invest in DGI, a private company.[319] Under the fourth factor, their investment-related conduct was presumably *quantitatively* substantial given the company's marketing expenditures and the commercial scale it achieved.[320] And under the fifth factor, the scale of the company's alleged drug distribution and fraud would fit any prosecutor's idea of significant criminal activity.[321] That leaves the third factor and the *qualitative* aspect of the fourth factor for consideration: Did the hypothetical venture capitalists engage in investment-related conduct with knowing or purposeful intent, and did that conduct make a qualitatively substantial contribution to illicit activity at DGI?

To consider the fourth factor, each of the following three hypotheticals presents different investment-related conduct that the investors

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Indictment (Apr. 9, 2018), https://www.justice.gov/opa/pr/justice-department-leads-effort-seize-backpagecom-internet-s-leading-forum-prostitution-ads [https://perma.cc/UL3Y-PS3W].

315 Press Release, U.S. Att'y's Off., E.D.N.Y., Pornhub Parent Company Admits to Receiving Proceeds of Sex Trafficking and Agrees to Three-Year Monitor (Dec. 21, 2023), https://www.justice.gov/usao-edny/pr/pornhub-parent-company-admits-receiving-proceeds-sex-trafficking-and-agrees-three-year [https://perma.cc/3FLL-SQ3H].

316 Jennifer Maloney, *Federal Prosecutors Conducting Criminal Probe of Juul*, Wall St. J. (Sept. 23, 2019, 5:49 PM), https://www.wsj.com/articles/federal-prosecutors-conducting-criminal-probe-of-juul-11569268759 [https://perma.cc/UH6M-RG2G].

317 *See* Indictment, *supra* note 1, at 11, 13.

318 *See id.*; *supra* note 20 (identifying the VC firms with known investments in DGI).

319 *See supra* note 20.

320 Indictment, *supra* note 1, at 14.

321 *Id.* at 11 (alleging that DGI distributed forty million pills and generated around $100 million in revenue).

could have engaged in. To consider the third factor, each hypothetical applies four different levels of intent. These four intents are the hypothetical investors (1) knew DGI was illicitly distributing controlled substances or planned to do so, (2) did not know, but should have known based on available information, (3) did not know and would not have been expected to know based on available information, and (4) did not know and were actively deceived as to DGI's actions or planned actions. These three hypotheticals are respectively presented in Tables 1, 2, and 3.

TABLE 1: HYPOTHETICAL 1

Act	Intent
Provided investment only.	A. Knew DGI was illicitly distributing controlled substances or planned to do so.
	B. Did not know, but should have known based on available information.
	C. Did not know and would not have been expected to know based on available information.
	D. Did not know and was actively deceived as to DGI's actions or planned actions.

In Hypothetical 1, the substantiality of the venture capitalists' investment-related conduct would be assessed quantitatively: All they did was provide cash. Given the assumptions stated above, the only outstanding factor is criminal intent. Hypotheticals 1C and 1D suggest that the venture capitalists invested in, but had no intent to enable illicit activity at, DGI. Hypothetical 1B suggests that the investors were negligent or reckless about the risk that they were funding illicit activity. But it also makes clear that they lacked actual knowledge of that fact; the five-factor test thus counsels against charging them. Under the test, only Hypothetical 1A presents sufficiently high culpability—knowledge—to warrant enforcement.

TABLE 2: HYPOTHETICAL 2

Act	Intent
Provided investment funds and participated in VC-typical governance.	A. Knew DGI was illicitly distributing controlled substances or planned to do so.
	B. Did not know, but should have known based on available information.
	C. Did not know and would not have been expected to know based on available information.
	D. Did not know and was actively deceived as to DGI's actions or planned actions.

Hypothetical 2 adds an additional fact to Hypothetical 1: that the investors participated in corporate governance in a fashion typical of venture capitalists, such as by designating directors to board seats or informally communicating with or advising management. This participation would not alter their mental states at the time of investment or afterward, and thus the same results would follow from Hypotheticals 1B, 1C, and 1D to Hypotheticals 2B, 2C, and 2D.

But Hypothetical 2A requires further analysis. If, for example, the venture capitalists invested in DGI knowing that it engaged in illicit activity or planned to do so *and* they exerted pressure through governance participation not to make changes—including compliance with the law—that might harm revenue growth, then their conduct would be more egregious than the investment-only facts of Hypothetical 1A. On the other hand, if they invested and then used their participation in DGI's governance to insist that it cease illicit activity or cancel plans to pursue such activity, then their actions were compliance-enhancing. The investors would have prevented law violations while promoting the success of a business that honestly provided medical care to those who need it, and so no enforcement would be warranted.[322]

TABLE 3: HYPOTHETICAL 3

Act	Intent
Provided investment and encouraged DGI management to engage in more aggressive practices to increase sales.	A. Knew DGI was illicitly distributing controlled substances or planned to do so.
	B. Did not know, but should have known based on available information.
	C. Did not know and would not have been expected to know based on available information.
	D. Did not know and was actively deceived as to DGI's actions or planned actions.

Hypothetical 3 offers more information about how the venture capitalists participated in DGI's governance: They urged management to improve revenues, market share, or some other relevant metric by engaging in more aggressive sales practices.[323] They encouraged management, in other words, to take steps necessary to distribute more pills.[324]

322 This conclusion follows because the investors in that scenario have not acted "to aid" the criminal aspect of the firm or to join the criminal conspiracy embedded within it. Rather they have acted to defeat it. *Cf.* United States v. Landerman, 109 F.3d 1053, 1068 n.22 (5th Cir. 1997); United States v. Summers, 414 F.3d 1287, 1295 (10th Cir. 2005).

323 *Cf.* Settlement Agreement Between the United States et al. and Richard Sackler et al. add. A, paras. 3–4 (Oct. 21, 2020), https://www.justice.gov/archives/opa/press-release/file/1329736/dl [https://perma.cc/ZQ5D-FNXA] (stipulating that Purdue Pharma investors knew that the "legitimate market for Purdue's opioids had contracted" but nevertheless pressured management to adopt an "aggressive marketing program" to increase opioid sales despite those sales lacking a legitimate medical purpose).

324 *Cf. id.*

Notably, aggressive sales practices are not per se *unlawful*, although they do abut that line and risk that salesforces cross it.[325]

The analyses for Hypotheticals 3B, 3C, and 3D follow their analogs in the prior hypotheticals. Yet for Hypothetical 3A, culpable knowledge at the time of making an investment suggests that subsequent encouragement in favor of "more aggressive" sales practices was *purposeful* conduct to increase the scale of the company's illicit activity.[326] Given this most-culpable mens rea, Hypothetical 3A would be an even more appropriate case for enforcement than would be Hypotheticals 1A or 2A.

This hypothetical also suggests that investor liability can arise after an initial act of investment. The "aggressive practices" that the venture capitalists urged could have been actions that those investors knew to be illegal. Imagine, for example, that in a meeting with DGI's founder, the investors said "sales are not where they need to be; we suggest you make the customer experience more efficient by ending examinations by clinicians and instead prescribe Adderall based on customers' self-diagnoses of having ADHD."[327] Under this extension, even if the venture capitalists' initial act of investment would fail to satisfy the five-factor test's required level of criminal intent, the subsequent governance engagement would substantially contribute to more illicit activity *and* would be done with a knowing or purposeful intent. In those cases, under Hypotheticals 3B, 3C, and 3D, the venture capitalists would not be appropriate targets for prosecution based on their time-of-investment conduct, yet their postinvestment conduct would satisfy the test.

C. Safe Harbors for Nonculpable Investors

Section III.A recognizes that if prosecutors begin to hold culpable investors accountable for corporate crime, then even nonculpable investment could be chilled.[328] To avoid this social cost, this last Section calls on prosecutorial agencies—including DOJ and federal civil and quasi-criminal enforcers,[329] as well as state and local agencies—to

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325 *See, e.g.*, Indep. Dirs. of the Bd. of Wells Fargo & Co., Sales Practices Investigation Report overview (2017) ("The root cause of sales practice failures was the distortion of the Community Bank's sales culture and performance management system, which, when combined with aggressive sales management, created pressure on employees to sell unwanted or unneeded products to customers and, in some cases, to open unauthorized accounts.").

326 *See* LaFave, *supra* note 153, § 13.2 ("It may generally be said that one is liable as an accomplice to the crime of another if he (a) gave assistance or *encouragement* . . . (b) with the intent thereby to promote or facilitate commission of the crime." (emphasis added)).

327 *Cf.* Broughman & Wansley, *supra* note 28, at 1307 (positing a model in which venture capitalists "push managers to take risks").

328 *See supra* Section III.A.1.

329 See Jennings, *supra* note 76, at 2018 n.30, for a discussion of why corporate criminal enforcement by DOJ and civil enforcement by regulatory agencies are analogous.

adopt guidelines recognizing two safe harbors around investor criminal intent should they start bringing mere investor cases. If lack of criminal intent demarks law-abiding and criminal investors, then safe harbors that establish the lack of intent would counter the risk perception this Article's move might otherwise prompt. The discussion in this Section around each safe harbor includes model policy text that can be adopted by agencies.[330]

Before introducing these safe harbors, however, a note of caution about their use is in order. Both offer not only private protections to investors but also nudge them to undertake steps—pushing for more effective corporate compliance programs and better policing in the private capital market—that would serve a public interest in law compliance. If implemented, these safe harbors should not, however, be viewed as mandates or minimum efforts that must be undertaken if investors hope to avoid criminal exposure. As Section III.B makes clear, investor culpability is—and even more so investor *prosecution* ought to be—exceptional.[331] Given that, prosecutors should not view investors' nonobservance of these safe harbors as signaling wrongdoing.[332]

1. Safe Harbor 1: Reliance on Corporate Compliance Programs

Safe Harbor 1 provides that when an investor relies in good faith on an enterprise's representation that it has an effective compliance program in place, but a violation of law nevertheless happens, prosecutors will treat the investor as lacking criminal intent. "Good faith" is an important qualifier, as the model policy text explains, and would not include those investors who are in a position to know that such a representation is false.[333] This safe harbor aims at protecting the passive investor,

330 This exemplar text tracks the format of DOJ's existing corporate enforcement policies. *See* U.S. Dep't of Just., Justice Manual § 9-28.000 (2024).

331 *See supra* Section II.B.

332 *See* Susan C. Morse, *The Truth About Safe Harbors*, 92 Tenn. L. Rev. 743, 771 (2025) ("Because a safe harbor is an objective *nonexclusive* test, it does not penalize behavior outside safe harbor boundaries. Nevertheless, a safe harbor can have the silent-implication effect of discouraging that behavior.").

333 In a parallel context, civil liability under section 11 of the Securities Act of 1933 is subject to due-diligence defenses, but those defenses are qualified by the reasonable and actual belief of those who assert them. 15 U.S.C. § 77k(b)(3) (qualifying due-diligence defenses to those with exculpatory information developed via "reasonable investigation" for which there is "reasonable ground to believe" and who actually "did believe" such information).

particularly one in a public company,[334] whose knowledge about the firm and its conduct is in large part controlled by management.[335]

Although at first glance this safe harbor might imply a significant undertaking by a firm, it merely offers an incremental incentive. Criminal and civil enforcement policies already strongly encourage firms to implement compliance programs, and Safe Harbor 1 calls for nothing more than what those policies already incent.[336] Instead, it offers a novel benefit. Existing policies encourage corporate compliance programs by promising mitigation for firms that happen to incur vicarious liability despite their efforts to the contrary.[337] As a result, most large firms have embraced that some form of corporate compliance program is in the corporate interest.[338] This safe harbor would differ, however, from existing incentives around corporate compliance programs; those incentives offer benefits at the organizational level. Safe Harbor 1, however, would inure to the benefit of investors directly.

If prosecutors were to view investors as not categorically blameless, then under this safe harbor, the presence of a corporate compliance program would become personally valuable to investors. In such an environment, investors would be expected to exercise what influence they have over firm governance—not just to mitigate the collective costs, such as fines, that follow corporate criminal violations, but also to protect against personal exposure.[339] Substantial investors, who have the most leverage over corporate management and would be the most at risk in an age of investor culpability, would have the greatest interest in motivating law compliance.[340] This safe harbor would thus offer a positive social policy in addition to providing private benefits. To the extent that compliance programs, combined with incremental support from shareholders, better prevent offending in the corporate context,

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334 Section III.B.1.b concludes that public investors usually should not be targets. But there could be marginal cases, such as when a corporation appears to be at high risk of recidivism or there is derogatory information about its compliance practices in the public domain.

335 *See* Merritt B. Fox, *Required Disclosure and Corporate Governance*, 62 Law & Contemp. Probs. 113, 118 (1999) (observing that management is unlikely to disclose evidence of fiduciary violations absent a mandate to do so).

336 *But see* Jennifer Arlen, *The Failure of the Organizational Sentencing Guidelines*, 66 U. Mia. L. Rev. 321, 361–62 (2012) (questioning whether incentives for implementing corporate compliance programs adequately compensate for their costs).

337 *See* Donald C. Langevoort, *Compliance as Liability Risk Management*, *in* The Cambridge Handbook of Compliance 123 (Benjamin van Rooij & D. Daniel Sokol eds., 2021).

338 For public firms, they also do so because the Securities and Exchange Commission mandates disclosure of the firm's code of ethics or an explanation why the firm has not adopted such a code. 17 C.F.R. § 229.406(a) (2024).

339 *See generally* Jennings, *supra* note 126 (theorizing how aggregate corporate sanctions are imposed, or could be imposed, on shareholders).

340 *See supra* Sections II.B–.C, III.B.1.d.

this safe harbor would protect investors while avoiding the social costs that Section III.A outlines.

The remainder of this Section comprises the Article's proposed text for Safe Harbor 1, which reads as follows:

Investor Reliance on Corporate Compliance Programs

General Principle: In circumstances in which a business enterprise represents to investors that it has established and maintains a compliance program that it believes to be adequate for the prevention and detection of misconduct within the enterprise, an investor may rely in good faith on such representation.

Comment: Investors provide financial support, broadly considered, to business enterprises through primary or secondary purchases of equity or debt interests or through other arrangements or transactions that have the effect of providing an enterprise with financial resources or improving its financial condition.[341] Under some circumstances, investors as a matter of law are subject to personal liability for investment-related conduct in the context of such enterprises.[342] For example, if *X* invests in *Y* corporation after learning that the investment will be used by *Y* corporation to fund illicit acts, then *X* is generally liable for the commission of those acts or a conspiracy to commit them.[343] Typically, however, investors will lack the sort of information necessary to intend that an investment facilitate such wrongdoing. In those circumstances, investors would lack a culpable mental state and thus would not be liable for an enterprise's illicit acts. The latter case is most likely to occur in the context of publicly traded enterprises.[344]

Investor liability as just described arises by operation of law.[345] This safe harbor does not expand or reduce the scope of such liability. Rather it resolves potential factual ambiguities by clarifying that investors who rely in good faith on an enterprise's compliance program lack the requisite mental state to intend that the enterprise engage in misconduct. In that light, the safe harbor promotes capital formation by providing good-faith investors additional assurance that they are not subject to individual liability for corporate misconduct.[346] Further, the safe harbor enhances the total incentives enterprises have to adopt effective compliance programs. Under this safe harbor, such programs provide a protective benefit directly to the enterprise's investors. As a result, investors' interests align with the public interest in compliance through

341 *See supra* note 13.

342 *See supra* Section I.C.

343 *See supra* Section I.C.2.

344 *See supra* Sections II.C, III.B.1.b.

345 *See supra* Section I.C.

346 *See supra* Section III.A.1.

the establishment and maintenance of effective corporate compliance programs.

When misconduct does occur within an enterprise and prosecutors consider appropriate enforcement resolutions, remediation is often of paramount importance to the public interest in preventing future violations.[347] Given this interest, the safe harbor applies with equal force to both pre-enforcement compliance programs and postenforcement remediation programs.

The safe harbor is qualified, however, by an investor's good faith. It would not apply, for example, when an investor knows or should know an enterprise's activities or proposed activities are unlawful because that knowledge would render representations about the effectiveness of a corporate-compliance program nonreliable as to that investor.[348] It would also not apply when an investor knows or should know that the enterprise has materially misrepresented the establishment, maintenance, or adequacy of its compliance program.[349] Further, the safe harbor is limited to liability arising from a person's capacity as investor. To the extent that a person has engaged in other acts—including, but not limited to, as a director, officer, employee, agent, advisor, contractor, counterparty, or otherwise—that advances misconduct in the enterprise, such acts would be outside the scope of this safe harbor.[350]

2. *Safe Harbor 2: Reliance on Pre-Investment Investigations*

Safe Harbor 2 establishes a policy that investors lack criminal intent when they rely in good faith on appropriate investigations of the firms they intend to invest in and from those investigations conclude that the company is not engaged in illicit activity or that the investor's capital will not be used for it.[351] This safe harbor accounts for the fact that primary investment can be criminogenic but that purchasing securities in secondary transactions has a more attenuated, and thus less

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347 *See* Jennings, *supra* note 237, at 1610 (theorizing the "public interest in deterring violations by means of ex ante compliance or ex post remediation").

348 *Cf. supra* note 333.

349 *Cf. supra* note 333.

350 *See supra* note 87 and accompanying text.

351 There are some scenarios in which an investor knowingly invests in a firm that engages in illicit activity but can credibly ensure that its investment will not facilitate that activity. Imagine, for example, that a real estate company owns and leases commercial buildings via limited partnerships formed with outside investors. Imagine that as part of its business, it leases retail properties to cannabis dispensaries, a violation of the Controlled Substances Act. 21 U.S.C. § 856(a)(2) (prohibiting allowing any place under one's "manage[ment] or control" to be used for certain drug related activities, including their distribution). An outside investor who purchases interests in that partnership would be potentially liable. But if the investor participates in a separate partnership that deals only in apartment buildings, presumably there would be no liability for that investor related to the manager's cannabis-related properties.

plausibly culpable, connection to corporate crime.[352] Thus, the safe harbor incrementally incents those who directly fund firms to be reasonably sure that their capital will not be used to fund illicit activity. Just as the compliance programs embraced by Safe Harbor 1 need not always prevent law violations, the pre-investment investigations called for by Safe Harbor 2 need not be entirely certain.[353] Even a thorough investigation can miss derogatory information. That possibility increases when entrepreneurs mislead prospective investors.[354] Requiring perfection would undermine the procompliance incentive the safe harbor intends to offer. Rather, the investigation need only be designed and conducted in a way that gives the investor reasonable certainty, an open-ended and flexible standard.

Safe Harbor 1 is especially valuable for passive investors in public companies, whereas Safe Harbor 2 is particularly useful for investors in private firms in which investment-related conduct tends to be more active.[355] That greater activity includes personally engaging with the firm's management and serving in formal and informal governance roles, such as designating seats on a board or providing advice.[356] This safe harbor is especially valuable from a deterrence perspective because private companies, especially newer ones, often lack compliance programs,[357] but they increasingly have the capacity to raise large sums and potentially to cause large-scale violations of law.[358] Safe Harbor 2 would incent due diligence that leads investors either to avoid investing in law-breaking firms or to insist that those firms reform themselves as a condition of investment.

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352 *See supra* Section II.C.1.

353 *See* Jennings, *supra* note 237, at 1603 ("[A]n enforcer can look to a firm's misconduct and compliance program to make a judgment whether the program was adequate to prevent the kind of misconduct that occurred, notwithstanding that it did.").

354 In one particularly flagrant case, for example, a startup's founder faked contracts and impersonated a customer to deceive investors during the diligence process. Press Release, U.S. Att'y's Off., E.D.N.Y., Carlos Watson, Founder and Former CEO of Ozy Media Inc., Convicted of Multi-Million Dollar Fraud Scheme (July 16, 2024), https://www.justice.gov/usao-edny/pr/carlos-watson-founder-and-former-ceo-ozy-media-inc-convicted-multi-million-dollar [https://perma.cc/WV7J-TR44].

355 *See supra* Section II.C.

356 *See supra* Section I.C.1.

357 *See* Jeff J. Marwil & Jerry J. Burgdoerfer, *Private Companies Can Benefit from Compliance Programs Too*, Law.com (Aug. 2, 2006), https://www.law.com/corpcounsel/almID/900005459335/ [https://perma.cc/Y94H-CM2L] ("[T]he public company has come to serve as a mentor of sorts to the private company in the arena of corporate compliance programs, offering certain 'best practices' that may also be useful to the privately held company, its management and its shareholders or owners.").

358 *See* Allison Herren Lee, Comm'r, Sec. & Exch. Comm'n, Remarks at The SEC Speaks in 2021: Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy (Oct. 12, 2021), https://www.sec.gov/newsroom/speeches-statements/lee-sec-speaks-2021-10-12 [https://perma.cc/K8U5-33UR].

Unlike Safe Harbor 1, Safe Harbor 2 does not merely add incremental benefits to an already ubiquitous practice. Although due diligence is a best practice among private-company investors, deals sometimes come together with only modest, or even no, diligence.[359] Due diligence is, across many business dimensions, a risk-mitigation tool for the benefit of investors.[360] For especially enthusiastic private-company investors, however, the expected value of buying into the next big thing can outweigh the expected value of risk mitigation via due diligence.[361] Such enthusiastic investors might rationally forgo due diligence that is meant for their, or their limited partners', downside protection.[362] But as Part II explains, private-company investment is risky in law-compliance terms.[363] Moreover, the deals that investors are most willing to forgo due diligence on are perhaps the riskiest of all in terms of compliance—given their potential scale—and thus are among the more appropriate sites of law enforcement scrutiny. In an environment with such scrutiny and given the unique risks of criminal prosecution compared to other investment risks—that is, imprisonment versus loss of capital—due diligence would be a compelling undertaking even for those investors who would otherwise be willing to forgo it.

The remainder of this Section comprises the Article's proposed text for Safe Harbor 2, which reads as follows:

Investor Reliance on Pre-Investment Investigation

General Principle: In circumstances in which an investor has, after reasonable investigation, reasonable ground to believe and does believe, at the time of an investment in a business enterprise that the investment would not facilitate or further misconduct within the enterprise, the investor may rely on such pre-investment investigation.[364]

Comment: Refer to the commentary for the "Investor Reliance on Corporate Compliance Programs" safe harbor for a general discussion regarding the nature of investors and their potential liability with respect to misconduct within business enterprises.[365]

Many private enterprises, especially those that have yet to be formed or that are in early stages of operation, lack corporate compliance programs.[366] In those early-stage settings, investor decision-making

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359 *See supra* note 215 and accompanying text.

360 *Cf.* Jeffrey J. Reuer, *Avoiding Lemons in M&A Deals*, MIT Sloan Mgmt. Rev., Spring 2005, at 15, 15 ("The process of due diligence provides a useful starting point for obtaining detailed and reliable information about the quality of the resources to be acquired . . . .").

361 *See supra* note 215 and accompanying text.

362 *See supra* note 215 and accompanying text.

363 *Cf. supra* Sections II.B–.C, III.B.1.b.

364 *Cf. supra* note 333 and accompanying text.

365 *See supra* Section III.C.1.

366 *See supra* note 357 and accompanying text.

can meaningfully influence whether an enterprise remains, or becomes, compliant with applicable law.[367] Further, in these settings, investors could face heightened exposure to liability relative to passive investors in public firms.[368] This safe harbor permits investors to negate a culpable mental state through the conduct of pre-investment due diligence. Further, it promotes the public interest in compliance by incenting investors to provide capital only to enterprises that will refrain from using such capital to engage in unlawful conduct.

Although it is likely to be particularly valuable to investors in private enterprises, the safe harbor also applies to investors in public companies, including those purchasing securities in primary offerings or in private-investment-in-public-equity transactions.[369] The safe harbor is modeled in part on the affirmative due-diligence defenses available under section 11 of the Securities Act of 1933[370] and should be construed in line with those defenses.[371]

A "reasonable investigation" is one that provides reasonable assurance that a business enterprise is not engaging, and will not engage, in unlawful conduct or otherwise that a proposed investment will not advance such conduct. "Reasonable assurance" does not, however, require perfect or complete assurance.[372] Such investigations might be carried out by the investor or the investor's personnel, or by appropriate third parties, including, but not limited to, legal counsel, financial advisors, accountants, subject-matter experts, or consultants.

Conclusion

In the United States, federal and state criminal codes prohibit an expansive array of conduct. Capacious accomplice and conspiracy theories of liability give prosecutors considerable room to charge those they allege to have helped principal offenders.[373] Prosecutors routinely use this power.[374] That is, unless, the potential accomplice or conspirator is merely an investor in a law-breaking firm.[375]

This Article has questioned a status quo in which law enforcement more readily views investors as victims of corporate crime than as actors who might bear some responsibility for it. Because investment-related conduct can contribute to the initiation, maintenance, or expansion of

367 *See supra* Sections II.B, II.C.2, III.B.1.b.

368 *See supra* Sections II.B, II.C.2, III.B.1.b.

369 *See supra* note 300 and accompanying text.

370 15 U.S.C. § 77k.

371 *See supra* note 333.

372 *See supra* note 353 and accompanying text.

373 *See supra* Section I.C.2.

374 *See supra* notes 54–56 and accompanying text.

375 *See supra* note 57 and accompanying text.

illicit corporate activity, it is a worthy site of law enforcement attention. Although the vast majority of investors likely lack the minimal intent necessary to be criminally responsible for corporate wrongdoing,[376] those who knowingly facilitate such wrongdoing through their actions as investors are appropriate subjects for deterrence.[377] Under some circumstances, they might also be appropriate targets for enforcement.[378]

Still, upsetting the status quo would not be without expected cost, which would manifest in greater risk perception among good-faith investors that they too could be exposed to criminal liability or, at least, to costly investigations.[379] To mitigate that risk, this Article recommends guidelines for the positive exercise of prosecutorial discretion in charging culpable investors. Moreover, should prosecutors break through to investor prosecution, it calls for the adoption of two safe harbors—one aimed at investors in public companies and the other at investors in private companies—to distinguish good-faith investors from their criminal peers.

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376 *See supra* Sections I.C, II.C.

377 *See supra* Section III.B.1.

378 *See supra* Section III.B.1.

379 *See supra* Section III.A.1.