The CHICKENSHIT CLUB

WHY THE JUSTICE DEPARTMENT FAILS TO PROSECUTE EXECUTIVES

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Chapter Eleven

JED RAKOFF'S RADICALIZATION

Judge Jed Rakoff leaned back in his chair, appalled. Then he took a sip of his now-cold coffee (extra cream and Splenda) and grimaced. The cup tasted even lousier than what his clerks made for him, but he had no one to complain to. No clerks had come into the office this warm Sunday in August 2009. The judge sat alone with his bad thoughts and bad coffee.

With his white hair and beard and an impish grin, Rakoff sometimes looks like one of Santa Claus's thin cousins. In conversation and from the bench, he speaks efficiently but without haste, his gravelly voice working through the logic of his thoughts. Rakoff, avuncular and sweet natured in public, is always at the ready with self-deprecating jokes. One of his favorites is to respond, after a glowing introduction before a speech or panel performance, that'd he'd now like to bring in his wife for the rebuttal.

Rakoff gazed around his wood-paneled office in the district courthouse in downtown Manhattan—out the window, at the portraits of his wife and family on the wall, and back to his desk cluttered with papers, mementos, and baseball tchotchkes. Rakoff lined his expansive chambers not only with photos of his family and photos of himself ballroom dancing with his wife, but also *New Yorker* legal cartoons, paintings by friends, news clippings, his contributions to the Courthouse Follies, a private courthouse holiday celebration and satirical show, and portraits of his legal idols. His borscht-belt nature masked the indefatigable seriousness with which he approached his work.

That August weekend afternoon, Rakoff forced himself to focus again and started going over the agreement between the Securities and Exchange Commission and Bank of America one more time. Like many other district court judges, Rakoff grew accustomed to signing off on SEC agreements with companies—three or four a year—without thinking about them much. (Most government regulatory settlements needed a judicial okay.) He possessed confidence in the agency ever since he'd worked with Stanley Sporkin in the 1970s. Rakoff believed that SEC lawyers were tough and smart. What's more, the two sides in this case arrived at a settlement, so who was he to look askance at it? He just wanted to get matters off his docket and get on with his real cases and more important work. He'd made a name for himself by opposing death penalty cases; he'd traveled to war-torn Iraq to train judges; he was known for his eloquent and surprising decisions. Judicial reputations weren't won by spending time rubber-stamping SEC settlements. He wanted to dispense with them.

At first glance, the agency's case against Bank of America and its top officers appeared simple. The financial crisis crescendoed in September 2008. Bush Treasury secretary Henry Paulson seized mortgage giants Fannie Mae and Freddie Mac earlier that month. With the government as midwife, Bank of America and Merrill Lynch negotiated over the weekend of September 13 and 14. They announced the takeover on Monday—the same day that Lehman filed for bankruptcy. AIG was taken over by the government on Tuesday.

Without Bank of America's salvation bid, banks would have stopped lending to Merrill. The wounded investment firm was leaking tens of billions in losses, some of the biggest that any corporation has ever recorded. The investment bank would have been at the bottom of the ocean if not for the Bank of America takeover and generous government bailouts. In what now reads as unintended comedy, Bank of America's chairman and chief executive officer, Ken Lewis, called the deal the "strategic opportunity of a lifetime."[1]

As Bank of America raced to complete the deal to acquire Merrill in late 2008, with the global financial system teetering, Bank of America executives misled the public. The SEC alleged that Bank of America hadn't told its shareholders about bonuses to Merrill Lynch bankers, secretly paid out just ahead of the deal's scheduled closing date. (Later, the SEC would amend the complaint to allege that Bank of America had also hidden from the public how massive Merrill Lynch's losses were.)

This crime is appalling, Rakoff thought. And the remedy the agency sought? The bank admitted nothing. The SEC entered one of its typical no-admit, no-deny settlements. No-admit, no-deny didn't resemble punishment as much as being fanned with a palm frond. And that wasn't half as gross as the fine. The SEC sought to fine the bank—which had about $2 trillion in assets—only $33 million.[2] Not trillion, not billion, not even hundreds of millions. The sum was, Rakoff knew, less than trivial for Bank of America.

The fine contained an even more outrageous twist: the SEC alleged that Bank of America lied to its shareholders, but the agency was making shareholders pay the bank's fine. The victims of the scheme had to pay the penalty. The shareholders were getting screwed twice. Once by Bank of America and once by the SEC.

"Even now, I can't believe they did that," Rakoff says. After his second reading of the settlement agreement, the judge swiveled his chair around from his desk to his computer and started drafting an order for the parties to come see him. He had a naïve thought: maybe he was missing something. Maybe the SEC had written the agreement in code, with some reasonable explanation that couldn't be spelled out in a public document. He'd call the two sides in and have the lawyers explain it all to him.

control of Bank of America settlement

BE A JUDGE, BE A JUDGE, BE A JUDGE

Born in 1943, Rakoff grew up in Germantown, a middle-class neighborhood of Philadelphia with trim houses and lawns, attending public schools. He was the middle son, with a brother on either side. His father, Abraham, was a gynecologist and fertility specialist who had been one of the doctors whose early research led to the development of the contraceptive pill. Abraham had many grateful patients who came up to Jed to express their gratitude. He had treated Midge Rendell, the wife of Edward Rendell, who would serve as Pennsylvania's governor. Midge, a judge, would see Jed at a function, throw her arms around him, and declare in a loud voice for all to hear: "His father is responsible for my son!"

His mother, Doris, was an English teacher, with a wide-ranging intellect. It was a mixed marriage: Abraham's background was Polish Orthodox Jewish; Doris's was German Reform Jewish. Doris scored 182 on her IQ test—off the charts. (Rakoff had to be satisfied with his "mere" 154.) What Rakoff's father, he, and his two brothers had to reason to get to, she arrived at with blinding speed, which she dismissed as her intuition. She read widely, preferring mysteries for entertainment. Doris always read the last chapter first, preferring to know the solution so that she could trace how the author wove in the hints and clues.

Doris had been victimized repeatedly by the routine discrimination that women of her generation faced. When she was seven years old, the public school system steered talented children into careers in science. All the children were tested; Rakoff's mother made the top score. But her own mother wouldn't allow her to study science, contending that she'd never find a husband working in a lab. Later, she suffered age discrimination. Just before retiring from teaching, Doris decided to go to law school. She had graduated from the University of Pennsylvania at the top of her class and had earned her master's from Bryn Mawr College. She had a high LSAT score. She had her heart set on Penn Law School but didn't get in. When she inquired with the dean of admissions to find out why, he conceded that she did have higher scores and grades than other candidates.

But, he said, at most she would have only ten years of practicing law, while the younger applicants would have decades. Doris got into Temple University; however, Rakoff's father soon became sick, and she decided not to become a lawyer after all.

The Rakoff children had a classic secular Jewish upbringing of the 1950s, the kind of childhood that characters in a Philip Roth novel might have envied. They had strong Jewish identities without any piety or strictures. None of the boys was bar mitzvahed, because the parents felt the rite had become overly materialistic. Only too happy to forgo the ritual, Rakoff and his brothers chose to attend a camp in New Mexico instead. They celebrated Christmas with a tree, and Santa Claus visited their house. Doris and Abraham gave their sons first names that were not overtly Jewish: Jan for his older brother (pronounced with a hard *J*), Todd for his younger. But their parents made sure their middle names were the opposite: David, Saul, and Daniel. Todd recalls their mother told them they could switch if they wanted.

Their parents were socially conscious, but neither was overly political. Doris, active in interracial social work groups, was a fan of Truman but never a fire-breather. Todd still has his NAACP card from the 1950s. Abraham had even less explicit political views, though he had been so outraged when a colleague of his was blacklisted that he supported him financially for a while until the man found another position.

All the Rakoff boys attended Central High, a public school that required an admissions test. Jed graduated early and attended Swarthmore College. His brother Todd went to Harvard, aided in part by a glowing recommendation from a high school teacher for his championship debate skills. Except that the teacher had gotten confused, praising Todd for Jed's accomplishments.

After his successful career at the Southern District, Rakoff left in 1980. He went to the US attorney Bob Fiske, one of his mentors, to ask what he should do. Fiske suggested Mudge Rose. The suggestion took Rakoff aback. For one, it was Richard Nixon's old firm, and memories of Watergate were still fresh. Mudge Rose was also a tier below the most prestigious firms of the day: Cravath, Swaine & Moore; Sullivan & Cromwell; Davis Polk; Debevoise; Cleary Gottlieb Steen & Hamilton. But Rakoff wanted to start a white-collar practice, and Mudge Rose was looking for someone to do that.

As with the prosecutor's office, Rakoff knew he would have to make his name all over again in the private sector. He'd been prosecutor for about eight years. It took him twice that time as a defense attorney to achieve a similar level of success. Big cases came around less frequently. He faced more competition. Trials were rare. At Mudge Rose, he scored one of his highest-profile clients: Martin Siegel, a golden-boy investment banker who joined the pirate firm of Drexel Burnham Lambert after a successful run at Kidder, Peabody & Co., where he had been a prominent mergers-and-acquisitions advisor. While at Kidder, however, Siegel joined an insider trading ring with the arbitrageur Ivan Boesky. To make his first payoff for inside information, Boesky had him go to the Plaza Hotel. There Siegel exchanged code words with a hulking courier, who handed him a briefcase containing $150,000 in stacks of $100 bills.[3] When Rakoff first met Siegel, it impressed him that the investment banker did not deny wrongdoing. Siegel described everything, in detail. Siegel wanted to cooperate with the government. Rakoff facilitated his plea bargain.

Defense attorneys can become fond of clients, if they aren't the most hardened or sleazy of criminals. Rakoff did more than that with Siegel. They became friends. Rakoff found Siegel forthright and genuinely contrite.

Back then, after a plea agreement, the action came at the presentencing hearings. The prosecutors would tell judges that they left the terms entirely to their discretion. The defense attorneys would then make their appeals. At a presentencing hearing, Rakoff was masterful. He described all of the good that Siegel had done in his life. He explained how cooperative he'd been with the government's investigation, an assertion the prosecution verified. Rakoff didn't just choke up. Tears streamed down his face. He hadn't planned it. The display wasn't a turn for dramatic effect but a genuine outpouring of emotion. He had to turn away. He looked out the window for a good long moment. Then he recovered and went on.

At the sentencing, Rakoff and Siegel waited anxiously. Most observers expected the judge to give Siegel significant prison time. Judge Robert Ward began excoriating Siegel. He laid into him viciously for his betrayals and crimes. "After Mr. Boesky received a three-year sentence, I began to think about Mr. Siegel," the judge said. "I was of the view that a [prison term] of eighteen months to two years would be reasonable." Such sentences were long in those days.[4] Rakoff felt a wave of relief and thrill wash over him. He knew Ward's technique. When the judge was about to bring down a long prison term, he looked pained and went about his task gently. When he sentenced lightly, he brought his most unforgiving rhetoric. As Ward went on with all of his righteous fury, Rakoff knew he had won the argument. Siegel received two months of prison and five years' probation. Years later, Rakoff presided over the marriage of Siegel's daughter.

Sometimes loves that come later in life are the more ardent, and that was what Rakoff found with the law. Rakoff had loved being a prosecutor. He felt as if he were playing a crucial role in upholding the moral order. In a world filled with corruption, deception, and cynicism about the government, prosecutors made sure that truth won out on occasion. They put away bad guys. In making cases, prosecutors advanced the cause of justice, he felt.

Yet Rakoff made the transition from prosecutor to defender with ease, believing in the righteousness of his new job as well. He knew the terrifying apparatus of the state. He believed defense attorneys were champions of liberty, as the saying has it. To win against the government was a victory against all odds. He had represented people so unsavory that friends stopped talking to him. Winning when everyone was against him was the greatest thrill of all.

That is, until he became a judge. He put himself up to be a candidate for a judgeship, and then met with Daniel Patrick Moynihan, who, as the senior New York senator, had the prerogative of suggesting candidates to the president. Rakoff hit it off with Moynihan, bonding with the former ambassador to India about Indian history. In October 1995 President Bill Clinton nominated Rakoff to the federal bench. Later, he would contribute to the Courthouse Follies these lines about being a judge, set to the tune of Cole Porter's "Be a Clown":

> Don't just be a lawyer,
> It's nothing but a drudge;
> You'll feel more self-important
> If you get to be a judge . . .
> You can't become a doctor, you would wind up a quack,
> You can't become a porn star, you're no good in the sack,
> But you can be a judge because you're such a big hack.
> CHORUS: Be a judge, be a judge, be a judge.

Well, some of Rakoff's doggerel reflected his actual views more truly than others. A judgeship, he felt, was the best legal job of them all.

A RAKOFF TRAGEDY

For the most part, lawyers liked arguing in Rakoff's court. He could be tough on them, but he was fair. If they had a good argument, he'd listen. He paid attention to the lawyering. He was not a pushover for the plaintiffs, defendants, or the prosecution. He moved his docket much faster than most judges. He made quick decisions and wrote clearly, without jargon or muddle. "He thinks he's the smartest guy in the court, and in almost every instance he's right," one lawyer said.[5] Remarked another, "His bravado and bravery are very alluring."

He came to understand the most important aspect of being a judge: "Both sides of an argument are really good, but you have to choose." And choose he did. Rakoff's judicial activism wasn't born fully formed, like Athena, after the 2008–09 financial crisis. He'd been willing to stake out new directions, wield bold arguments, and then—perhaps most controversially in the staid world of judicial chambers—talk about them publicly.

In 2002 Rakoff took one of his most imaginative stands, ruling the death penalty unconstitutional.[6]

In 2000 he was, as judges are, randomly assigned a case. It was the first federal death penalty case to come before the Manhattan bench in about fifty years. Congress passed new death penalty laws in the 1980s and 1990s, as part of the crackdown against rising crime rates. In 2000 the government charged a group of drug dealers in the Bronx with racketeering and narcotics violations. Two of them faced the death penalty for torturing and murdering a suspected police informant.[7]

The death penalty case preoccupied Rakoff more than usual. He understood its historic significance and wanted to take his time. He researched, turning over both the law and how he felt about the state's right to take life. At night, Rakoff read death penalty cases, mentally cataloging the cases with legitimate questions about a convicted criminal's innocence. As the new science of DNA evidence emerged, lawyers and activists turned up scores of cases that lead to multiple exonerations.

At the time, Rakoff was not against the death penalty. He had experienced a personal horror and family tragedy fifteen years earlier. At four o'clock on a midwinter morning in 1985, his brother Todd received a call from the Philippines. Jan, their older brother, had been murdered. Todd called his mother, who called Jed. He was at his home in Larchmont, New York, getting ready to go into the Mudge Rose offices. His mother was calm and businesslike, asking Jed to make the arrangements to bring the body home. Jed, also methodical, agreed, and went to her in Philadelphia right away.

Doris always said she loved her sons equally, but she had felt more protective of Jan. As a boy, Jed heard him awake in the middle of the night, howling from night terrors. Even though Jed was three years younger, he was stronger and more athletic than Jan, able to best him in fights. For years, Jan was closeted, coming out in the mid-1970s. Doris and Abraham did not mind, but their relationship with Jan was never as smooth as theirs was with Jed and Todd. Jan resisted their overprotectiveness.

Jan, brilliant and creative, did not have a steady or prominent career. After college, he spent several years trying to become an opera singer in Chicago. When that didn't work out, he founded a private school in Vermont, but he couldn't keep up the fund-raising, and it closed. Todd hadn't seen Jan in several years, and he'd been closer to Jan than Jed was. Jan was never good at keeping his opinions to himself. Once, when staying with Jed in his Manhattan home in the 1970s, he heard Jed, stressed from work, speak sharply to Ann, his wife. Jan told his brother he didn't treat his wife well. "Jan, that's none of your fucking business!" Jed cried, though he knew Jan was in the right.

Jed might have once shed tears in closing arguments for a client, but he did not for his brother—or for his father, Abraham, who had died in the hospital four years before Jan, after going in for a routine hernia operation. Jed didn't display his emotions that way. But he was grateful that after he had gotten into an argument with Jan about a year earlier, they had resolved it, and both said how much they had loved and admired each other. That was their last substantive conversation.

Jan had moved to the Philippines only a few months earlier to help the government there with its education policies. He moved into a gated community for foreigners, in a small bungalow. One evening, he hired a male prostitute. Afterward, he and the man haggled over the price. The argument became heated, and the prostitute picked up a pipe burner and an ice pick, bludgeoning and stabbing Jan to death. He was forty-four years old. When the mortician opened the casket to show the family the body, Jan's head was so disfigured, Jed hardly recognized him.

To cover his tracks, the prostitute set fire to Jan's house. Luckily, a security guard saw the smoke and detained him before he could escape. The prostitute confessed to the police. Jed realized soon that the prosecution was going wrong, convinced it was corrupt. At one point, the assailant escaped from jail, only to be recaptured. Another time, the prosecutor declared in court that his office had lost the confession. Fortunately, an American diplomat, attending that day, stood up to say he had a copy of it. The prosecutor was forced to continue with the case. After years, the murderer was found guilty but given only a three-year sentence. Since he had already served most of it, he got out in a matter of months.

Back then, Jed Rakoff—brother, husband, father, and lawyer in private practice—would have had little compunction had Jan's killer been sentenced to death. He was an evil man who had killed a wonderful man, Rakoff believed. In his judicial confirmation hearings, he was asked, like most nominees, about the death penalty. Legislators supported it overwhelmingly. Rakoff said he could support it, if necessary.

Now, years later, Judge Rakoff had been rethinking the issue and began changing his mind. He turned the opinion over and over, more than any other decision he'd made. He understood that this opinion would have serious consequences for his future. It was the only time he discussed a decision with Ann beforehand.

"Any chance for going up on the Second Circuit is going to be eliminated once I decide against the death penalty," he told her. "But I'm going to do it."

"Well, you're doing the right thing," she said.

In his preliminary ruling on the case, *US v. Quinones*, in April 2002, Rakoff introduced a novel theory against the death penalty. With the rise of new DNA science, the accused could now demonstrate their innocence beyond any doubt. Clearly, an innocent man who had been put to death could not appeal his sentence. He had no ability to seek redress. Despite that capital punishment has existed for centuries, Rakoff argued that society's notion of what the rights of the accused were throughout the legal process had changed. He contended the death penalty violated the accused's due process. Death penalty opponents more commonly argue that it violates the Eighth Amendment's ban on cruel and unusual punishments. Even activists and defense lawyers had not made Rakoff's point. It thrilled opponents and outraged some of his former prosecutorial colleagues, who believed in the most serious sanction for the worst criminals. Conservative media denounced him as an activist, but supporters showered him in praise. The renowned Harvard Law constitutional scholar

Laurence H. Tribe told the *New York Times*, "I've been thinking about this issue in a serious way for at least twenty years, and this is the first fresh, new, and convincing argument that I've seen."[8] Rakoff enjoyed the attention, both from allies and critics. In his office, he later put up two tabloid headlines next to each other. One read "Fed Judge KOs Death Penalty."[9] He paired it with another, from a different case. That one read "Rakoff, the Hanging Judge."

In professional settings, he had kept quiet about his own personal tragedy. But during this case, he opened up from the bench. At a June 2002 sentencing for a codefendant in the case, a prosecutor brought the victim's mother to the stand to address the perpetrator: "You have no idea the pain and agony you have caused me!" she cried out. "You took away my firstborn son." She moved Rakoff.

"Let me say," he began in an agonized voice, "that I understand more fully than you might realize the pain you feel." He explained to the mother, "Twenty years ago, my older brother was murdered in cold blood."[10]

Despite his emotional tumult, Rakoff finalized his ruling the next month. It did not stand. In December 2002 the Second Circuit Court of Appeals overturned his decision.[11] The panel of three judges wrote, "The District Court erred in looking to 'evolving standards' in conducting its due process analysis." The novelty of Rakoff's argument did not impress the appellate judges. They contended that many death penalty opponents have long raised the possibility that innocent people would be put to death. The Supreme Court was well aware of the argument, the appeals court wrote, but had not ruled the death penalty unconstitutional. The appeals court therefore ruled, circularly, that it wasn't.

The reversal disappointed Rakoff. "I had some hope it would get to the Supreme Court," he says. Two judges of the circuit court, who had not been on the panel that reversed him, told him independently that they had the same hope and thought his theory would have a shot. But the highest court passed. Still, Rakoff remains proud of the opinion, saying, "I am convinced to this day that if the Supreme Court ever rules the death penalty unconstitutional, it will be on the basis of my theory."

HIGHFALUTIN BALONEY

For the public, Rakoff's death penalty case became his most famous ruling. He had cases related to the government's prison in Guantanamo Bay, Cuba, ruling the government had to disclose information requested under the Freedom of Information Act. He ruled against the FBI when the agency had abused lie-detector tests in a terrorism case after 9/11. In legal circles, Rakoff built his reputation in complex commercial litigation. He handled the WorldCom accounting fraud. He oversaw cases related to the Enron scandal. He observed his former colleagues at the Southern District and his former investigative partners at the SEC turn away from prosecutions of individuals, becoming obsessed with changing corporate cultures through their regulation and enforcement. The settlements with corporations troubled him.

Whether a corporation should be held criminally liable remains a controversial topic among legal scholars. The notion that one employee's wrongdoing implicates the entire company seems thin to many legal-world students. Europe has no analogous law. Scholars wonder if any company might be bold enough to challenge the notion in court, going up against the government and risking a prolonged legal struggle that might weigh on their reputation, profits, or stock price. How the current Supreme Court would respond to such a challenge is intriguing.

Rakoff complained that the resolutions were inadequate. Since fines came out of the pockets of shareholders, they were unjust. The shareholders were often the victims of the corporation's fraud—and then were victimized again by being made to pay for the crime.

Prosecutors argued that the government needed to charge corporations to change rotten cultures. Rakoff didn't know what such an aspiration meant. Of course, an institution could influence the behavior of its employees. "But it's vastly overstated. It's untestable. And because it's so nebulous, you can always claim, 'Oh, I've made a big difference, and I've changed the corporate culture of X because I've put in compliance programs or I got them to admit their mistakes' or whatever. A lot of it is just highfalutin baloney," he said.

Prosecutors argued that corporations were more complex than in Rakoff's day. They had a much more difficult task finding culpable individuals and proving their cases than he'd had during his time in the Southern District. The judge regarded this argument as ahistorical nonsense. Want complexity? he'd argue. Try an organized crime network or a narcotics distribution ring based overseas. Yet the government routinely charges people at the highest levels for those crimes.

Or take a look at the structure of corporations from the nineteenth century, he'd contend. The structure of modern companies was nothing like what the complexity and opacity of the big trusts that dominated the American economy back then. Jay Gould, John D. Rockefeller, J. P. Morgan —all incorporated maddening *matryoshka* dolls of overlapping ownership, designed to defeat scrutiny. Yet the government managed to break them up.

After the financial crisis and during the Bank of America–Merrill Lynch case, Rakoff began to regard prosecutorial arguments about their approach to corporate criminality as worse than baloney. They built the machinery of injustice. In emphasizing changing the culture of an organization, prosecutors neglected to pursue individuals for their wrongdoing. Would anyone say, "We're not going to prosecute bank robbers; we're going to change the culture of the bank robbery system"? he asked. It would be absurd.

Instead, he believed in trials of individuals. Rakoff loved a trial. He always felt disappointed when the parties, on the eve of trial, settled on the courthouse steps, even though such capitulations are commonplace. In a well-run trial, he thought, the truth comes out. The jury mostly gets it right.

No doubt taking more top executives to trial would be more difficult. It would cost the government money and time, and it would sometimes lose. But victories would be more meaningful. One top executive would be worth ten deferred prosecution agreements. The government needed to become more assertive and less worried. The dangers of governmental overreach were minimized in this area of criminal enforcement because, unlike for the poor, the executives had access to great lawyers.

"HALF-BAKED JUSTICE AT BEST"

On November 3, 2008, Merrill Lynch filed a proxy statement, the official filing necessary to describe the important information about the takeover by Bank of America. The proxy failed to mention, in any of its 222 pages, that Merrill could lavish up to $5.8 billion in employee bonuses for 2008. Merrill Lynch ended up with an operating loss of $28 billion in 2008 and paid out bonuses of $3.6 billion. The investment bank normally paid out bonuses for the previous year in January, but Merrill chief executive John Thain moved up the payouts to December, just days before the merger was finalized. Within weeks, the government poured $20 billion in additional funding into Bank of America to shore it up, on top of the $25 billion invested in October. A flabbergasted public met the news of the bonuses with fury.

Not even dismal performance and a spectacular implosion, it seemed, could change Wall Street compensation culture. The government bailed out financial firms, and they funneled the money to reward executives who had run their companies asunder. As the public raged, the banks dissembled, and the main regulators reacted lackadaisically. Bank of America initially claimed that Merrill's board and CEO had made the decision to pay the bonuses independently. This claim was false. In truth, Bank of America had not only known about the plans but also had negotiated the bonuses months earlier when it agreed to take over the investment bank, requiring changes to the compensation.

Andrew Cuomo, then the New York State attorney general, opened an investigation into whether Bank of America misled the public about what it knew about the payments. Ben Lawsky, a young and ambitious lawyer in Cuomo's office, headed the probe. As a federal prosecutor in the Southern District, Lawsky attended Jim Comey's famous Chickenshit Speech, and drew inspiration from its message. Cuomo, briefly, replayed the Eliot Spitzer dynamic, pushing the federal regulators through aggressive enforcement. The attorney general's probe pressured the SEC. Embarrassed, the agency followed with its own probe.

After a financial panic, the country looks to the Securities and Exchange Commission for guidance and correction. The agency employs the finest financial-markets and securities law experts in government. Unlike the banking regulators, the Federal Reserve and the Office of the Comptroller of the Currency, the SEC had been a tough regulator in the past.

But Sporkin's SEC no longer existed. President Bush's last chairman of the agency had been Christopher Cox, an undistinguished congressman and deregulation champion. He became chairman in the summer of 2005, doing little to combat the credit or housing bubbles and the increasing speculation and leverage in the markets. During the frenzied bailouts of autumn 2008, the SEC was noteworthy only for its chairman's absence.

The case before Rakoff was one of the agency's first regulatory responses to the crisis. On August 3, 2009, less than a year after the height of the panic, the SEC announced with a whimper that Bank of America would have to pay $33 million to settle charges it had misled the public about Merrill's bonuses. After a season of trillions of global capital market losses and billions in bailouts, people had almost lost the ability to grasp the meaning of such small numbers. The great postcrisis crackdown had begun bizarrely.

After having reviewed the settlement, on August 10, 2009, Rakoff brought in the SEC and Bank of America to explain how they had arrived at this settlement. The type of settlement the parties were seeking required the court's approval. He wanted to know why he should give it. The hearing focused on the bonuses. Rakoff felt the settlement materials contained laughably bare detail about what had happened.

Rakoff couldn't believe how unconvincing the SEC lawyers were. They stammered. They couldn't remember facts. They couldn't explain how the agency had arrived at the fine. Rakoff laid into the SEC lawyers. The lead attorney attempted to explain why the regulator had brought an action in the first place. He said the Merrill bonuses were "clearly something that shareholders would have wanted to know in advance of the vote."

Rakoff leapt in. "What you are saying, if I understand it, is that Bank of America and Merrill effectively lied to their shareholders about a highly material matter."

Well, the SEC lawyer couldn't come right out and admit that. In its settlement, the agency wasn't saying that anyone lied—a much more serious securities law violation. It was merely accusing the bank of having been negligent. Lying had to be intentional. The SEC attorney interjected to explain.

"What we are saying—"

"Is that right?" Rakoff interrupted.

"That is essentially correct," the attorney said, in trouble now. "We are saying they made representations—"

"So who at Bank of America and Merrill was responsible for that?" Rakoff asked.

"We have not alleged any individual misconduct."

Rakoff was on. "Was this some sort of government that performed these actions, or were there human beings that wrote these documents?"

"There were indeed human rogues who wrote these documents."

"Were there human beings who made the decision?"

"Yes, there were human beings who made the decision."

"So who were they?"

Here was the issue. Rakoff kept his judicial calm, but he was infuriated and baffled. Under his probing, an SEC lawyer conceded that the chief executives of the two institutions, Ken Lewis of Bank of America, and John Thain of Merrill, signed off on the proxy statement. Yet the regulator hadn't managed to query them adequately, much less charge them for misleading shareholders. The SEC was merely asking approval for a settlement, without an admission, with a faceless, monolithic "Bank of America" that existed only as an abstract entity in incorporation documents.

Rakoff turned to the Bank of America lawyer, Cleary Gottlieb's Lewis Liman.

"I would like to know," Judge Rakoff said, "whether you admit or deny it."

Liman hesitated, telling the judge he didn't want to violate the settlement. Rakoff told him to answer.

"The Bank of America's position is that it did not violate the proxy law or any other federal securities law," said Liman.

So much for settlement. Not only was Bank of America refusing to admit that it had misled shareholders, but also it was denying it. Rakoff couldn't figure out why he should approve the settlement. If the SEC's version of events was correct, the fine was inadequate, and there should be some charges against top executives. If the bank was right, it was throwing money at the problem to make it go away. And why should the government force any entity to do that? "Well, it seems to me that I need a lot more material from the parties before I can assess whether this is a fair and reasonable settlement and meets the requirements of law for my approval." Rakoff went on: "It's the truth, not the stick, it's the truth, not each party's adversarial position, that is the warp and the woof of the legal process, and I need to know more before I can approve this settlement."

As the case progressed, it became clearer that the SEC's investigation had been pathetic. It had reached its initial settlement without having done much investigating at all. The agency had not taken depositions of almost any of the key executives. Bank of America was claiming its attorney-client privilege for much of its materials. In keeping with governmental timidity following the Thompson memo, the SEC hadn't bothered to get the bank to waive it.

At one point in court, the SEC explained to Rakoff that it had moved quickly on this probe, as if that were much of a defense: "Normally, in cases of magnitude such as this, it is not uncommon for it to take years for the commission to bring claims."

Rakoff shot back, "That certainly is the commission's reputation."

"We are working on it," the SEC lawyer replied sheepishly.

At another hearing, Rakoff parried with the defense. "If anything," Liman said at one point, trying to explain the pay disputes, "Bank of America's pay practices were too stringent and were—"

"Compared with Merrill's," Rakoff interrupted slyly.

"Right."

"Maybe not compared with China's, for example."

Jed Rakoff had started to grasp something awful: the SEC was no longer the agency he once admired. This incompetence would never have happened under Sporkin. It wouldn't have happened throughout the 1980s and 1990s. He recalled Richard Breeden, the chairman of the SEC under the first George Bush, once declared that he wanted to see corporate executives who violated the securities laws "naked, homeless, and without wheels."[12] Now the agency was scared. It didn't want to look like it was doing nothing, but it didn't want to take tough adversaries to trial. "They haven't given me any adequate answers," Rakoff thought. "The SEC has allowed the engine of a big bank and a big firm to overwhelm them." His beloved SEC was in more trouble than he had realized. Unlike those shareholders getting defrauded by Bank of America, Rakoff had the power to do something about it.

On September 14, 2009, Jed Rakoff broke with zombified judicial tradition. He refused to sign off on a settlement that he regarded as a sham. He labeled it "a contrivance designed to provide the SEC with the facade of enforcement and the management of the bank with a quick resolution of an embarrassing inquiry."[13] It was a remarkable revolt. Judges did not reject such agreements. They were required to show deference to the government. But judges had become overcoats that the agency and the companies walked over to prevent their shoes from being covered in mud. Rakoff wanted it to end.

"The proposed Consent Judgment is neither fair, nor reasonable, nor adequate," he wrote. Rakoff shredded the SEC's arguments and rationale. He was outraged that the agency was making Bank of America shareholders pay. That "does not comport with the most elementary notions of justice and morality," he wrote. He attacked the SEC for not having identified wrongdoing executives or lawyers. He concluded: "All this is done at the expense, not only of the shareholders, but also of the truth." He set February 1, 2010, as the trial date.

The public, revealing its fury about the financial crisis, showered Rakoff in letters of praise. "Only you have had the courage to stand up to the abusers!!! Why has none of these bank CEOs or Wall Street executives gone to jail?" a woman from Massachusetts wrote to him. A geology professor in Brazil commended him, as did a former CEO of publicly traded companies. "Finally, a jurist who lives up to our highest aspirations for our judges and our judicial system," wrote a doctor from Beverly Hills, while a fellow US district judge wrote, "You've just elevated the federal judiciary another notch."

That September, the same month Rakoff rejected the SEC settlement, Cuomo's investigators threatened to bring charges against Bank of America executives. They complained that the bank was thwarting their probe by denying them access to certain information, claiming protection under attorney-client privilege.

Cleary Gottlieb, Bank of America's law firm on regulatory matters, made miscalculations. The firm appeared not to grasp how frustrated Rakoff was. At one point, Rakoff chastised the Cleary lawyers and the SEC for draping a proposed order related to the attorney-client privilege dispute in legalese with a first sentence that spanned two and a quarter single-spaced pages and featured, he wrote, "no fewer than nine recitations of the word 'whereas.'" Cleary, along with another New York law firm, Wachtell, Lipton, Rosen & Katz, which had advised on the Merrill acquisition, and the bank's management, also seemed to have misread the dangers of a looming class action suit about the Merril acquisition. The bank began to realize its exposure looked staggering, perhaps as much as $15 billion.

In October Bank of America brought in a new law firm, Paul, Weiss. The three firms and the bank argued about which concessions to make or whether to make any at all.[14] Soon the bank waived attorney-client privilege for the investigations, a move to placate government investigators.

Paul, Weiss also offered to increase the size of the SEC settlement and suggested some corporate governance improvements. The bank and the Paul, Weiss lawyers would not, however, agree to any SEC charges against individuals. The commission had no problem agreeing.

On February 4, 2010, the SEC and Bank of America upped their settlement to $150 million.[15] That same day, Cuomo filed civil fraud charges against the bank's former CEO, Ken Lewis, and ex-CFO Joe Price for misleading shareholders about the bonuses. It added explosive new details to allegations that the bank and its executives had misled shareholders about the size of the losses at Merrill. Cuomo's complaint also accused Lewis of blackmailing the government into injecting $20 billion more into the bank by threatening to walk away from the acquisition.[16]

According to Lawsky's investigation for Cuomo, Bank of America executives wrestled over whether to tell investors about the mounting Merrill losses. On November 13, 2008, the bank's general counsel, Timothy Mayopoulos, and its outside lawyers decided that the numbers would have to be disclosed in a Securities and Exchange Commission filing, as stated by the complaint. Then they consulted with Price and decided to reverse their decision.

On December 3, 2008, the CFO knew that the losses had breached the threshold that Mayopoulos had laid out as the benchmark for requiring disclosure. The shareholder vote went ahead without any filing. Then six days later, Mayopoulos listened while Price told the board that Merrill was going to lose $9 billion in the fourth quarter. This statement was not accurate. Merrill had already lost $9 billion and expected to lose billions more before the quarter was over. After the board meeting, Mayopoulos tried to discuss the losses with Price. He was unavailable.

The next morning, the bank fired Mayopoulos, marching him out of the building. Bank of America installed another top bank executive, Brian Moynihan, as general counsel, though Moynihan hadn't practiced law in fifteen years. His legal career was such an afterthought that he had let his bar membership lapse. He would go on to become the chief executive of the bank.

Mayopoulos wasn't alone in his concerns. Merrill's auditors, Deloitte

& Touche, told Bank of America that it "might want to consider" informing shareholders of the losses, according to the complaint. Bank of America's corporate treasurer, urging the bank to disclose, said in a conversation with Price that he did not want to be talking about Merrill's losses "through a glass wall over a telephone."

Under pressure from Cuomo, and seeking to resolve the matter before a trial, Bank of America and the SEC agreed to give Rakoff facts. The bank tried to get everyone, including Rakoff, to consider the findings to be "nonbinding": in other words, that they wouldn't be stipulating to them for the purposes of any future legal proceedings. At a hearing on February 8, 2009, Rakoff grilled the SEC over why it had such a different set of facts and interpretations than the New York attorney general.

"Are you in disagreement, then, with the attorney general's conclusions?" he asked lead lawyer George Canellos.

"Let me be a little bit roundabout in saying—" the man began to respond.

"It won't be unheard of in this litigation," Rakoff interjected.

"I apologize for being a little circuitous," Canellos stammered.

The SEC, desperate to avoid the appearance that it had neglected to examine much of Bank of America's wrongdoing, had tried to shoehorn these new allegations into a new complaint, but Rakoff disallowed it because their efforts came too late for the trial date. (The SEC did roll allegations that Bank of America misled investors about the size of the Merrill losses into the revised settlements soon to be presented to Rakoff.)

The SEC disputed the notion that Mayopoulos was fired because he advocated that the bank disclose the size of the Merrill losses before the proxy vote on the merger. The real reason the general counsel was pushed out, the SEC asserted, was because Moynihan was about to leave, amid the uncertainty of the merger. The board scrambled to give him a new position to retain him.

Rakoff ended up thinking Cuomo's complaint was overheated—longer on rhetoric and shorter on facts than it should have been. But the judge believed there was some serious wrongdoing. Top officers of Bank of America knew about giant, surprising Merrill losses and about how it had agreed to bonus payments but did not disclose them promptly or precisely to the board or shareholders. They cut out people who advocated disclosing the information. That sure seemed like a lot of smoke. The SEC was content to think the failures to disclose were negligence, not intentional wrongdoing.

At least one regulator thought otherwise, that the matter merited a criminal investigation. The Office of the Special Inspector General for the Troubled Asset Relief Program (TARP) referred the case for criminal investigation to the United States attorney's office in Manhattan. Raymond Lohier, who was then the chief of the Securities and Commodities Fraud Task Force at the Southern District, took charge of the investigation personally, but reluctantly. Colleagues thought he viewed the charges skeptically. The Federal Reserve, both a regulator of Bank of America and one of its potential victims because it was lending to the bank, contended that it did not consider the losses material.

Mary Jo White, now one of the premier defense lawyers in the country at Debevoise & Plimpton, represented Ken Lewis. White passionately defended her clients, unafraid to use her sterling reputation as a former Manhattan US attorney to her advantage. The future SEC head blasted the Cuomo effort, saying the decision to bring the charges was "a badly misguided decision without support in the facts or the law" and there was "not a shred of objective evidence" to support the case.[17]

The Southern District received such complaints only too receptively. Justice Department officials in DC and Southern District officials in Manhattan reacted furiously to Cuomo's effort, seeing it as political grandstanding. Typically, in such investigations, lawyers from different offices are loath to share materials out of parochial self-interest. They want the glory of the investigation. Cuomo's office, to make peace, decided to share its materials with the Department of Justice. Lohier pledged to look at them. Mayopoulos, the fired general counsel, never implicated his former bosses. Lohier and the Southern District did little investigation, conducting no significant interviews that anyone could see. President Obama soon appointed Lohier to become a judge on the Second Circuit. The Justice Department brought no charges in the case.

On February 22, 2010, Rakoff signed off reluctantly on the SEC's revised settlement with Bank of America. The agency's attorneys took depositions and examined the documents. Under pressure, the SEC investigated. Rakoff wasn't satisfied or convinced it had been thorough. But the judge had spurred the agency to issue details to the public.

Rakoff wrote, "The proposed settlement, while considerably improved over the vacuous proposal made last August in connection with the Undisclosed Bonuses case, is far from ideal . . . While better than nothing, this is half-baked justice at best."

Obviously wrestling with what to do, Rakoff wrote that if he could, he would reject the agreement again. He called the fine "paltry." Legally, however, he believed he was obligated to show deference to the government now that it had furnished him with more information about what went into the settlement. And Rakoff wanted to hold himself back. He wrote: "In the words of a great former justice of the Supreme Court, Harlan Fiske Stone, 'The only check upon our own exercise of power is our own sense of self restraint.' In the exercise of that self-restraint, this Court, while shaking its head, grants the S.E.C.'s motion and approves the proposed Consent Judgment."

Given the facts he'd pushed the agency to produce, Rakoff put a number of them into his opinion. Going further than the SEC was willing to go, he suggested that Bank of America had violated securities laws as it took over Merrill Lynch. Bank of America and Paul, Weiss were chagrined. So much for the facts being "nonbinding." Rakoff's opinion proved valuable in the class action lawsuit, which was settled for $2.4 billion in September 2012.[18] The huge payment put the SEC's efforts even more to shame.

Andrew Cuomo moved on to become governor of New York. With his departure, the New York attorney general case fizzled. The state moved too slowly to finalize the case. Since the bank had settled with the shareholders before the state could resolve its own case, a law precluded the state from getting a significant settlement itself. In March 2014 Ken Lewis received a modest penalty of $10 million, paid for by his former employer, and a temporary ban from the banking industry. Given that he was retired, this punishment resembled the bite from a no-see-um. He did not admit or deny any of the charges. Bank of America paid $15 million to New York.[19] The settlement the following month with Joe Price wasn't much, either. The state fined him and barred him from being a corporate officer or director of a public company for a year and a half.

A NATIONAL SCANDAL

The financial crisis and the Bank of America case radicalized Rakoff. For many years, he focused his energies more narrowly. "What really gets him upset is fraud and unfairness, as opposed to a broader social theory," says his brother Todd, a professor at Harvard Law School. "At the time, I was more focused on the pain working people had been subjected to [after the 2008 meltdown]. People losing their jobs. I hadn't begun to focus on the causes of the financial crisis. This case got me focused on the causes," he says.

American justice operated under a shroud, opaque, in plea bargains and corporate settlements. "A trial is nearly the only place where the entire criminal justice system is put to the test of truth: Do you have the proof of guilt, or don't you?" Judge Rakoff told a reporter. "A system of justice that chiefly operates behind closed doors will sooner or later be a system that leads to abuse."[20]

As Obama started making his judicial appointments, Rakoff was curious about whether he might yet get nominated to the Second Circuit Court of Appeals, despite his death penalty ruling from years earlier. The new administration appeared to have an age test for its judicial appointees. Rakoff was sixty-five. He would never be an appellate judge.

Rakoff realized it was for the good. He remembered his wife's wisdom when he'd been mulling his death penalty decision. As an appellate judge, he'd be one voice of many. His job would be to seek compromise and tamp down his strong opinions. He could pick legal battles more readily from the district court bench. Indeed, now he had a chance to express those opinions more boldly. With the financial crisis, all the country's institutions had failed: politicians, regulators, the banks, the capital markets—and now prosecutors. He had a duty and nothing constraining him. Jed Rakoff was free.