UNDERGRADUATE LAW REVIEW AT UC SAN DIEGO

RYLAN CHIU

Deceptive Debt Practices Undermining Transparency in the Corporate World: The Legal Issues Behind Special Purpose Vehicles and Collateralized Debt Obligations

ABSTRACT. An issue that continues to afflict the securities field is the existence of special purpose vehicles (SPVs), which are financial entities disclosed in companies' off-sheet balance reports to fund business operations and collateralize debt. Since their inception in the early 20th century, SPVs have proved to be one of the most widespread financial tools in the corporate world, allowing companies to display exaggerated revenue margins on their balance sheets while supposedly adhering to a standard of public transparency. This was coupled with the rise of Collateralized Debt Obligations (CDOs) in the 21st century, another financial entity that pooled assets together to appease investors. Despite the functionality of SPVs, misusing these financial tools results in devastating costs, including company bankruptcy, mass layoffs, and deterioration of public trust. The Sarbanes–Oxley Act of 2002 and the Dodd–Frank Act aimed to curb the power of internal corporate operations by establishing regulatory mechanisms to ensure consumer transparency and industry confidence. However, the regulations established within both acts exhibit gaps in the proper mitigation of abuse of SPVs by corporations, requiring further amendments to avoid detrimental consequences on the world economy and the general public.

AUTHOR. Rylan Chiu is a second-year Political Science major with a concentration in Public Law and a Business Economics minor at the University of California, San Diego. He would like to extend his deepest gratitude and appreciation to Alice Jiang and Aadyant Suresh for their thoughtful editing and advice, Professor Germaine Hoston for her considerate insights, and to the Undergraduate Law Review's Editors-in-Chief for their support and leadership throughout the academic year.

INTRODUCTION

Special Purpose Vehicles (SPVs) have played an integral role in assisting corporations to maintain efficient business operations. SPVs are defined as "legally distinct [entities] with a limited life created to carry out a narrow pre-defined activity or series of transactions for a 'sponsor' company."[1] To simplify, SPVs are legal entities created by a pre-existing company to separate assets and financial activities from the initial company. Parent companies establish SPVs for reasons including risk management in isolating debts from financial reports, avoidance of corporate income taxes, and "bankruptcy-remote" status, where the SPV is protected if the original company declares bankruptcy.[2] In 2014, a reported 228,401 SPVs were established in the United States (U.S.), generating nearly $330 billion worth of incremental cash tax savings.[3] Despite the legality of SPVs in the U.S., excessive reliance on these entities creates a detriment to companies and the public.

SPVs have the ability to hide troubling financial activity, possessing a dangerous capacity to mislead shareholders and create a domino effect of widespread collapse.[4] The Enron scandal demonstrates how the abuse of SPVs leads to damaging consequences. Enron was a U.S. company specializing in energy production that grew into a multimillion-dollar company.[5] Enron's outstanding financial growth was attributed to Andrew Fastow, the company's Chief Financial Officer, who established the first SPVs that enabled the company to disguise its struggling status.[6] However, an internal audit performed by the accounting firm Arthur Andersen in 2001 unveiled questionable legal practices around the corporation's use of SPVs, specifically Enron's failure to properly disclose unconsolidated entities in their off-balance sheet footnotes.[7] This revelation forced Enron to publicly report a loss of $600 million and a reduction of $1.2 billion in shareholder equity, which ultimately led to the corporation going

---

[1] *See* Stephen V. Arbogast, *Resisting Corporate Corruption: Practical Cases in Business Ethics from Enron through SPACs* (4th ed. 2022).

[2] *See* Janet M. Tavakoli, *Structured Finance and Collateralized Debt Obligations: New Developments in Cash and Synthetic Securitization* (WILEY 2d ed. 2012).

[3] *See* Paul Demeré et al., *The Economic Effects of Special Purpose Entities on Corporate Tax Avoidance*, 37 Contemp. Acct. Res. 1562-1597 (2020).

[4] *Id*.

[5] *See* Gavin Benke, *Risk and Ruin: Enron and the Culture of American Capitalism* (University of Pennsylvania Press 2018).

[6] *Id.* at 2–4.

[7] Jay C. Thibodeau & Deborah Freier, *Auditing and Accounting Cases: Investigating Issues of Fraud and Professional Ethics* (McGraw-Hill Education 4th ed. 2013).

bankrupt.[8] The scandal defrauded shareholders out of substantial amounts of money due to falling stock prices, leading to a class action lawsuit that resulted in a partial settlement of $7.2 billion.[9]

As a result of the Enron scandal, Congress passed the Sarbanes–Oxley Act of 2002 (SOX). The legislation introduced new regulations on public companies and accounting firms to be imposed by the Securities and Exchange Commission (SEC).[10] The implementation of SOX illustrated a recovery effort to minimize widespread corporate fraud while regaining public confidence in the transparency of major corporations. The act was met with initial dissidence, as there were some concerns over the restrictiveness and enforceability of certain regulatory rules imposed by the Financial Accounting Standards Board (FASB).[11] However, SOX was the government's attempt to curb future abuses of financial tools and realized significant improvements in corporate governance.[12]

Despite the continuing improvements brought by SOX to securitization, systemic abuses of SPVs continue to appear. This issue can be attributed to a lack of specified guidelines regarding SPV regulations. The failure to adequately address SPV misuse has fueled fraudulent financial behavior surpassing the severity of the Enron scandal, such as the 2008 recession involving Collateralized Debt Obligations (CDOs). CDOs are defined as a type of SPV "that issue long-dated liabilities in the form of rated tranches in the capital markets and use the proceeds to purchase structured products for assets."[13] Banks created CDOs as mortgage-backed securities (MBS), through which they continually purchased debt-riddled residential mortgage-backed securities (RMBS) to sell to investors.[14] In 2008, six years after SOX came into effect, the continuous process of masking debts through CDOs and selling RMBSs to investors caused the subprime mortgage bubble to burst, causing the 2008 recession.[15] The recession saw international widespread effects, including the closure of major banks

[8] Thibodeau & Freier, *supra* note 7, at 69.
[9] Newby v. Enron Corp. *(In re* Enron Corp. Sec.), 586 F. Supp. 2d 732, (S.D. Tex. 2008).
[10] *See* James D. Cox & Thomas Lee Hazen, *Business Organizations Law* (West Academic Publishing 4th ed. 2016).
[11] *See* Accounting under Sarbanes–Oxley: Are Financial Statements More Reliable?: Hearing before the Comm. on Financial Services, 108th Cong. (2003).
[12] *See* Betty Chu & Yunsheng Hsu, *Non-audit Services and Audit Quality — The Effect of Sarbanes–Oxley Act*, Asia Pacific Management Rev. (2017).
[13] *See* Gary B. Gorton, *The Subprime Panic*, National Bureau of Economic Research (2008), https://www.nber.org/system/files/working_papers/w14398/w14398.pdf.
[14] *Id.*
[15] *Id*.

such as Lehman Brothers, heightened unemployment rates, and the foreclosure of hundreds of thousands of mortgages in the U.S.[16]

Even with government interference in corporate governance, the cases of Enron and the 2008 subprime mortgage crisis demonstrate the overexploitation of SPVs and the consequences of securitization abuse. In holding public companies accountable, this paper questions the degree of regulation necessary to make companies' financial decisions transparent and deter them from establishing excessive SPVs. This paper examines loopholes left through regulatory legislation and proposes possible solutions for government interference and stable alternatives to SPVs. Section I delves into the process of setting up SPVs as a debt collateralization tool and how they were overexploited by companies such as Enron. Section II outlines key reactionary legislations, including the Sarbanes–Oxley Act of 2002 and the Dodd–Frank Act of 2010, and how the new standards changed corporate governance in the securities field. This section also explores the exclusionary details specific to SPVs that each act fails to address. Section III proposes solutions to the abuse of SPVs, including an independent auditing committee established by the SEC. This proposal aims to hold companies accountable for their fiduciary duties towards the public by increasing transparency of their financial operations while minimizing compromises to productivity.

I. CORPORATE GOVERNANCE OF SPVS

Since their inception, SPVs have supplied corporations with a reliable financial method of debt collateralization and economic growth. However, the overexploitation of SPVs compromises consumer transparency as the public lacks awareness of a corporation's true profits and debts. This issue leads to severe consequences when corporations are exposed for their actions. The Enron scandal and the 2008 recession serve as examples of potential consequences that arise from the abuse of SPVs.

A. The Establishment of SPVs

SPVs are legal entities created by a firm to separate assets and financial activities from the sponsoring company.[17] SPVs can take on different business structures depending on their purpose, including limited liability companies (LLCs), limited

[16] Gorton, *supra* note 13.

[17] *See* Gary Gorton & Nicholas Souleles, *Special Purpose Vehicles and Securitization*, National Bureau of Economic Research (2005), https://www.nber.org/system/files/working_papers/w11190/w11190.pdf.

liability partnerships (LLPs), or trusts.[18] When a company establishes an SPV, the new entity obtains equity investments from outside investors and borrows money from lenders. The SPV uses this money to purchase assets from a sponsor, or a third party, and leases these assets to the parent company.[19] The following illustration maps the general structure that an SPV is typically formatted as:

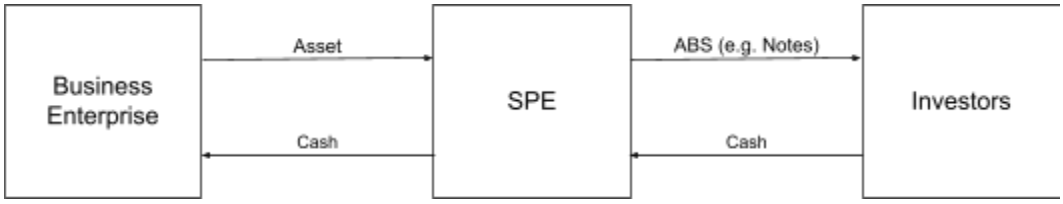

Figure 1: General Special-Purpose Entity structure[20]

Using the SPV to allocate assets from outside investors allows parent companies to raise off-balance sheet funds that can help them repay debts, fund expansions of operations, and legally isolate the company from bankruptcy risks.[21] In addition to the risk management opportunities, SPVs alleviate tax burdens on companies through pass-through or pay-through structures.[22] With the pass-through structure of the SPV, principal and interest payments for the assets pass directly to the investors rather than to the entity, meaning that SPVs can act as passive tax vehicles to avoid double taxation.[23] Alternatively, the pay-through structure gives SPVs the flexibility to restructure their cash flow, allowing them to purchase additional assets for the parent company.[24]

With its tax-neutral status and bankruptcy-remote designation, SPVs enable companies to legally collateralize their debt within separate entities.[25] SPVs have been regulated since the early 20th century, with the Securities Act of 1933. Title 17 Section 230.504 (d) limits the offering price for securities meant for investor purchases to $10

[18] Gorton & Soulele, *supra* note 17.
[19] Mei Feng, Jeffrey D. Gramlich & Sanjay Gupta, *Special Purpose Vehicles: Empirical Evidence on Determinants and Earnings Management*, 84 Acct. Rev. 1833–1876 (2009).
[20] Zabihollah Rezaee, *Corporate Governance Post–Sarbanes–Oxley* 127 (John Wiley & Sons 2007).
[21] *Id*.
[22] *See* Tavakoli, *supra* note 2.
[23] *Id.*
[24] *Id.*
[25] *Id*.

million and requires sales to register with the SEC, preventing oversaturation of the securities market through outside investments.[26] However, despite its importance in mitigating fraudulent activity with securities offerings, modern legislation has since amended the act.

Even with legislation such as the Securities Act of 1933 minimizing the bounds of SPVs' ability to collateralize debt, companies continued to push past the restrictions and reap the benefits of SPVs. With off-balance sheet financing, there are two classifications of SPVs: qualified and non-qualified. Qualified off-balance sheet SPVs issue publicly rated debt, meaning that the quality of the debt security has been evaluated by a rating agency.[27] With non-qualified off-balance sheet SPVs, parent companies do not take the necessary steps to qualify these entities, as they lack a rating and proper registration.[28] Low standards for non-qualified SPVs allow the parent company to hide its existence from financial sheets altogether, making it difficult to track the number of SPVs that actually exist in the U.S.[29] The latter type of SPV classification was revealed to have been established by Enron when the company collapsed, which created further discussion on the legality of off-balance sheet SPVs.[30] The Enron case provides a real-world example of how continually abusing the legal provisions of SPVs can result in severe repercussions.

B. The Case of Enron: Overexploitation and Deception Through SPVs

Enron struggled with poor financial performance and debts in the late 1980s, before becoming a profitable corporation. Primarily focused on energy, the company's depleting financial resources were coupled with below investment grade credit ratings as well as the oil bust of 1986, which lowered production output.[31] As a result, Enron's Chief Financial Officer sought out Andy Fastow to help him securitize loans that the company made to producers.[32] Fastow's plan of action, titled Cactus, involved the creation of an SPV where the parent company would group producer loans and sell them to investors, allowing Enron to receive cash to reimburse their producers.[33]

---

[26] Securities Act of 1933, 15 U.S.C. § 230.504 (1933).
[27] *See* Gorton & Soulele, *supra* note 17.
[28] *Id*.
[29] *Id*.
[30] *Id.*
[31] *See* Arbogast, *supra* note 1.
[32] *Id.*
[33] *See* Arbogast, *supra* note 1.

In 1999, the professional standards group (PSG) in the accounting firm Arthur Andersen began to question Enron's business practices since the appointment of Fastow as Enron's Chief Financial Officer. When Fastow attempted to set up another SPV under Enron, PSG member Benjamin Neuhausen took issue with Fastow's management of the company's venture equity.[34] Furthermore, PSG member Carl Bass noted that Enron could not substantiate the creation of the new SPV, as they put funds from another SPV as collateral instead of utilizing assets from the parent company.[35] These observations concerned Arthur Andersen, which contemplated halting business relations with Enron due to the company's lack of disclosure in their financial footnotes and debt masking.[36] When Enron's misdeeds were exposed, the company announced a loss of $600 million and a reduction of shareholder equity by $1.2 billion in October 2001, which became Enron's ultimate demise.[37]

C. Continuing Abuses with CDOs and the 2008 Financial Crisis

Despite the devastating consequences of the Enron scandal, the misuse of SPVs remained prevalent. SOX failed to consider the different financial entity structures, including Collateralized Debt Obligations (CDOs). Within five years of Enron's collapse, continued predatory practices in the securities market around CDOs resulted in greater regulatory action in the corporate world.[38]

CDOs are financial investment products backed by a combination of assets, including loans, bonds, asset-backed securities (ABS), or tranches from other CDOs.[39] CDOs originated in the late 1980s when investors expressed interest in acquiring a diverse pool of cheap high-yield bonds while isolating credit risk.[40] The early 1990s saw a decline in bond yields until 1999, when the "U.S. bond market was approaching $600 billion" in comparison to the $35 billion European market.[41] Similar to SPVs, CDOs have evolved to have multiple structures with different purposes and benefits for investors. This section will focus on synthetic CDOs, which are credited with

---

[34] Jay C. Thibodeau & Deborah Freier, *Auditing and Accounting Cases: Investigating Issues of Fraud and Professional Ethics* (McGraw-Hill Education Int'l ed. 2014).
[35] *Id*.
[36] *Id*.
[37] *Id*.
[38] Tavakoli, *supra* note 2, at ch. 6.
[39] *Id.*
[40] *Id.*
[41] *Id.*

promoting the initial 1999 market growth and regarded as the catalyst for worsening financial conditions in 2008.[42]

Synthetic CDOs are a subset of financial products that "sell credit protection via credit default swaps (CDS) rather than purchase cash assets."[43] Synthetic CDOs allow investors to receive compensation when a debtor defaults on a loan.[44] This investment product was popular from the mid-1990s to the mid-2000s, as the valuation of created synthetic CDOs rose from $1 billion in 1995 to $1 trillion in 2005.[45] An example to further explain the function of synthetic CDOs is residential mortgage-backed securities and subprime mortgages. Subprime mortgages are classified as risky loans due to their poor credit history.[46] Borrowers meet the qualification of "subprime" if they incur "two or more 30-day delinquencies in the last 12 months...; foreclosure, repossession, or charge-off in the last 24 months; bankruptcy in the last five years; [or] relatively high probability of default..."[47]

II. LEGISLATION RESPONDING TO FINANCIAL SECURITIES SCANDALS

This section addresses major legislative actions undertaken by the U.S. Congress, including the Sarbanes–Oxley Act of 2002 and the Dodd–Frank Act of 2010, in the aftermath of major corporate scandals. These actions signify the government's attempts to curb corporate abuses of financial tools and reinvigorate public consumer and investor confidence. However, despite stronger regulations improving checks and balances, widespread pushback and related cases highlight the inadequacy of current corporate governance.

A. The Sarbanes–Oxley Act of 2002

In 2002, the U.S. Congress passed the Sarbanes–Oxley Act (SOX) in reaction to the unfolding Enron scandal. SOX aimed to increase corporate responsibility, enhance

[42] Tavakoli, *supra* note 2, at ch. 6.
[43] Gary B. Gorton, *The Panic of 2007*, National Bureau of Economic Research (2008), https://www.nber.org/system/files/working_papers/w14358/w14358.pdf.
[44] *Id.*
[45] Douglas J. Lucas, Laurie S. Goodman & Frank J. Fabozzi, *Collateralized Debt Obligations: Structures and Analysis* ch. 11 (John Wiley & Sons 2nd ed. 2006).
[46] Gorton, *supra* note 43.
[47] *Id.*

proper financial disclosures, and improve public accounting and auditing standards.[48] The Act implemented an auditing oversight board and stricter punishments for high-ranking executives

Title I Section 101 of the SOA established an advisory board for auditing oversight titled the Public Company Accounting Oversight Board (PCAOB).[49] The goal of the PCAOB was to:

> (1) register public accounting firms that prepare audit reports for issuers...(3) conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, registered public accounting firms and associated persons of such firms...[and] (6) enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the preparation and issuance of audit reports.[50]

Accounting firms that audited public companies were required to register with the PCAOB to avoid disciplinary action.[51] Five members composed the board: three members with no experience in public accounting, and two with a Certified Public Accountant designation.[52] These requirements ensured that firms were independent from public companies, as connections between the two parties could result in a conflict of interest, as illustrated by Enron and Arthur Andersen. The Act's Title II further addressed the role of independent auditors by extending sections from the 1934 Securities Exchange Act to modify the capacity of auditors and their firms.[53] These titles aimed to control the use of SPVs and other securities-related financial tools through third-party auditing committees and reformed governance.

Title III of SOX established the fiduciary responsibility upheld by public auditing firms.[54] Sections 301 and 302 established the role of auditing firms and companies,

---

[48] Joseph Canada, J. Randel Kuhn & Steve G. Sutton, *Accidentally in the Public Interest: The Perfect Storm That Yielded the Sarbanes-Oxley Act,* 19 Critical Perspectives on Accounting 987 (2008).
[49] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 101, 116 Stat. 748 (2002).
[50] *Id*.
[51] Mark Jickling, *Sarbanes-Oxley Act of 2002: A Side-by-Side Comparison of House, Senate, and Conference Versions,* University of North Texas Libraries (2002), https://digital.library.unt.edu/ark:/67531/metacrs2819/m1/2/.
[52] 15 U.S.C §101 (2002).
[53] *Id*.
[54] Sarbanes-Oxley Act of 2002 §301–308.

expanding on the responsibilities instated by the 1934 Securities Exchange Act.[55] Sections 303 to 306 prohibited improper actions taken by companies to influence business activities in their favor. Actions addressed in these sections include improper influence on audits through fraudulent coercion or manipulation, earning profits from sales of securities that fail to meet new standards, and insider trading.[56] In Sections 307 and 308, the title concludes by shifting away from the improper influence of companies and focusing on assisting investors. In the case that a company violates the rules imposed by the Act, Section 307 established attorney responsibilities in representing the public interest, while Section 308 focused on providing monetary relief for investors affected by any violation of the Act.[57] Title III examined the general influence that companies had over the monitoring of their assets and limited the extent of those influences while incorporating compensation for affected investors.

Title IV of SOX focused on improving financial reporting by emphasizing increased standards and internal controls in disclosures. Sections 401 and 402 established new provisions regarding limitations of off-balance sheet reporting (under which SPVs are commonly disclosed) to meet the Generally Accepted Accounting Principles (GAAP) standards.[58] Sections 403, 404, and 406 detailed disclosure responsibilities imposed on internal affairs, including liability held by stockholders and senior financial officers.[59] These sections required disclosures to be filed with SEC for "every person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security…"[60] and rules requiring annual financial reports to "(1) state the responsibility of management for establishing and maintaining an adequate internal control structure…and; (2) contain an assessment, as of the end of the most recent fiscal year of the issuer, of the effectiveness of the internal control structure."[61] Accountability for financial reporting rests with executives and internal controls over the company's financial operations. Section 406 also requires "(1) honest and ethical conduct…[and] (2) full, fair, accurate, timely, and understandable disclosure in the periodic reports," coupled with stricter deadlines to finalize rules after the initial date of enactment.[62]

---

[55] Sarbanes-Oxley Act of 2002 §§ 301, 302.
[56] *Id.* §§ 303, 306.
[57] *Id.* §§ 307, 308.
[58] *Id.* §§ 401–409.
[59] *Id.* §§ 403, 404, 406.
[60] *Id.*
[61] *Id*.
[62] Sarbanes-Oxley Act of 2002 § 406.

The last major topic addressed by SOX involves setting new and stricter penalties for companies that fail to adhere to fiduciary responsibilities outlined in the Act. Title VIII introduces charges to account for the abuses committed by Enron and Arthur Andersen. This included manipulation of records in Federal investigations as addressed by subsection 1519, fines and imprisonment punishments for accountants that participate in the destruction of corporate audit records under subsection 1520, and a new criminal penalty for defrauding shareholders of publicly traded companies through securities fraud.[63] Additionally, this title extends protection to whistleblowers in the public corporations sector against retaliatory conduct, as former federal statutes exclusively protected employees of the federal government.[64] Titles IX and XI enhance pre-existing penalties previously codified in the general United States Code and the 1934 Securities Exchange Act. Title IX, which addressed lower-level white-collar crimes, made amendments to Chapter 63 of Title 18 of the United States Code to increase the length of imprisonment terms and fines for mail and wire fraud, violations of the 1934 Securities Exchange Act, and failure to certify financial reports.[65] Title XI, which dealt with corporate-level fraud accountability, addressed more serious crimes committed by corporate executives.[66] Charges in this title saw a drastic increase in severity of punishment, including a 20-year prison term under Section 1102 for violations of the 1934 Securities Exchange Act.[67] In summary, these titles aim to deter corporate fraud by increasing the severity of penalties for violations of the statutes.

B. The Gaps Left by Sarbanes-Oxley

Despite the considerable success of SOX in regulating the securities market, the Act excluded information that diminished its effectiveness.

SOX addressed the securities market as a whole but failed to regulate SPVs. Section 401 is the only regulation directly addressing SPVs and off-sheet balance reporting. Subsection (c) details the process for the SEC to conduct a study on the extent of financial disclosures imposed by SPV issuers and whether the disclosures align with GAAP standards.[68] After the study, the SEC shall "submit the report to the President,

[63] Sarbanes-Oxley Act of 2002 §§ 801–807.
[64] Jennifer Christian, *Whistleblower Protection Under Sarbanes-Oxley: Key Provisions and Recent Case Developments*, 31 Oklahoma City University L. Rev. 331, 331-531 (2006).
[65] Sarbanes-Oxley Act of 2002 §§ 901-906.
[66] *Id.* §§ 1101–1107.
[67] *Id*. § 1102.
[68] 15 U.S.C. § 401 (2002).

the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives," who decide whether GAAP standards have been violated and make recommendations to the SEC to improve transparency in off-balance sheet transactions."[69] While the section aims to ensure the quality reporting of off-balance transactions with SPVs, it contains vague definitions and standards that do not outline the reporting process or potential consequences. The failure to specify the number of SPV issuances that raise concern, or clear punitive measures for lack of transparency, allows for broad interpretations of the law.

In the same title, Section 404 has been embroiled in controversy for the excessive compliance costs that companies endure due to stricter quality control.[70] This section introduces a requirement for corporate management to conduct quality assessments of internal controls.[71] The assessments shall "(1) state the responsibility or management for establishing and maintaining an adequate internal control structure...and (2) contain an assessment...of the issuer for financial reporting."[72] With this new rule, the SEC also provided an estimation of the increased compliance costs, which includes an "additional 5 burden hours per issuer..." and a monetary cost of around $91,000 per company.[73] However, conflicting analyses reported higher cost estimates, with Financial Executives International estimating $4.36 million in compliance costs per company and AMR Research predicting a total of $6 billion to comply with SOX.[74] The rule imposed by this section received widespread criticism from companies for underreporting the extent of the section's financial effect, demonstrating an issue that deters companies from supporting or adhering to new regulatory requirements proposed by SOX.[75]

Another concern that the Act failed to consider was the effect of compliance costs on smaller companies. A 2025 report conducted by the U.S. Government Accountability Office (GAO) found that although larger, nonexempt companies paid higher compliance costs, smaller exempt companies faced detriments that were not

[69] 15 U.S.C. § 401(c).
[70] *Id.* § 404.
[71] *Id.*
[72] *Id.*
[73] Henry N. Butler & Larry E. Ribstein, *The Sarbanes-Oxley Debacle: What We've Learned; How to Fix It* 40 (AEI Press 2006).
[74] *Id.*
[75] *Id.*

solely monetary.[76] Smaller companies can invoke an auditor attestment exemption, where they are allowed to abstain from auditor attestments to "redirect the cost, time, and resources saved from compliance toward business growth and development" that they otherwise would have to follow under Sections 404(a) and 404(b)[77] Utilizing the exemption allows small companies to increase focus on improving business operations without debts from compliance costs.[78] However, the report claims that companies that opt for exemption often face reduced investor confidence.[79] Conducting audits allows the public to see the quality of a company's internal controls. While the exemption would save regulatory costs, it simultaneously lowered the public's confidence in operations due to the lack of transparency. This forced a chain reaction in which smaller companies had to bear the high costs of capital and rates of return for their investors to compensate for the lack of transparency.[80] The issue presented by the GAO demonstrates the disproportionate effects of SOX, in that smaller companies are heavily penalized while larger companies face lesser consequences that do not discourage the use of SPVs. Without appropriate regulatory and punitive measures on large companies, standards of compliance are lowered, allowing those companies to continue using SPVs without fear of punishment.

C. The Dodd–Frank Act

The U.S. Congress enacted the Dodd–Frank Act to address the concerns exacerbated by the 2008 financial crisis. The focus of the Act ranges from stricter standards of existing securities market regulations to heightened consumer protection.[81] This paper will focus on Titles VI, VII, IX, and XIV.

Title VI addressed improvements in regulations for banks, supervised savings and loan holding companies, and depository institutions.[82] This title expands on existing standards introduced by the Bank Holding Company Act of 1956 and the Federal Deposit Insurance Act. Section 605 gives the Board of Governors of the Federal

[76] U.S. Gov't Accountability Off., Sarbanes-Oxley Act: Compliance Costs Are Higher for Larger Companies but More Burdensome for Smaller Ones (2025).
[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Id.*
[81] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).
[82] *Id.* §§ 601–628.

Reserve the authority to conduct examinations over the activities of depository institutions.[83] Harsher standards of operations were implemented through Sections 608 and 609, as both amplify restrictions on financial institutions and eliminate flexibility for certain transactions.[84] To increase consumer transparency and limit financial deception by corporations, Sections 614 and 615 set limits on loans and asset purchases, ensuring that an excess of these products does not create another financial bubble.[85]

Transparency and accountability are the focus of Title VII. This portion of the Act is split into two parts. Part one reviews the regulatory authority of the swaps market by the SEC, and part two outlines the specific regulations. Section 712 summarizes the duties associated with the SEC and the Commodity Futures Trading Commission (CFTC), an agency tasked with regulating markets involving derivatives.[86] This section emphasizes increased joint efforts between the two organizations in "assuring regulatory consistency and comparability" in the swaps market.[87] Efforts include applying the Commodity Exchange Act of 1936 to market violations and extending regulations over new financial agreements such as mixed swaps.[88] The Act amends the 1934 Securities Exchange Act in Section 717 to impose stricter procedures involving the approval of securities-related derivatives for purchase.[89] These amendments include clarification on whether certain securities fall under new rule changes and improved procedures involving the certification of securities.[90] Part two of Title VII introduces new standards of regulation for financial products such as swaps in Section 724, Derivatives Clearing Organizations in Section 725, and Swap Data Repositories in Section 728.[91] Proposals emphasized in this title include Chief Compliance Officer designations in conflicts of interest in Section 732, stronger enforcement powers possessed by CFTC over financial transactions in Section 741, and stricter guidelines for violations of insider trading as detailed in Section 746.[92]

---

[83] Dodd-Frank Wall Street Reform and Consumer Protection Act § 605.
[84] *Id.* §§ 608, 609.
[85] *Id*. §§ 614, 615.
[86] *Id.* § 712.
[87] *Id.*
[88] *Id.*
[89] *Id.* § 717.
[90] *Id.*
[91] *Id.* §§ 724, 725, 728.
[92] *Id.* §§ 732, 741, 746.

Title IX consisted of eight subtitles that build on the establishment of public transparency by specifically focusing on protections for investors.[93] Subtitle A increased investor protection based on government-sponsored studies involving investor literacy and conflicts of interest within companies.[94] Results from these studies led to mitigating measures in the subtitle, including the establishment of the Investor Advisory Committee in Section 911 and clarifying language regarding investor disclosures in Section 919.[95] Subtitle C focused on credit rating agencies.[96] As major conflicts of interest were exhibited by agencies during the 2008 financial crisis, the Act set stricter guidelines on agencies to limit predatory lending to the public.[97] The subtitle created universal standards for analysts and agencies to follow, including heightened qualification standards for analysts in Section 936 and universal ratings symbols introduced in Section 938 for widespread use by major credit agencies.[98] Subtitle D focused on asset-backed securitization. This section heightened regulations on transactions involving asset-backed securities and introduced improvements for public disclosure of securitization issues.[99]

D. The Gaps Left by Dodd–Frank

The Dodd–Frank Act similarly omits crucial details to address the use of SPVs. The Dodd–Frank Act fails to explicitly reform regulations regarding SPV creation and use. Title VII, Subtitle (b), which regulates security-based swap markets, is the extent of SPV regulation within the Dodd-Frank Act. This section amends the Securities Act of 1933 and the Investment Company Act of 1940 to clearly define new monitoring and disclosure requirements for securities in the swap market.[100] However, the section fails to include specific information regarding the certification of entities, such as SPVs. Introducing securities reforms with broad language in the Dodd–Frank Act allows companies to avoid certain procedures and punitive actions from the government. This sentiment continues the aforementioned gaps established by SOX and ultimately perpetuates a cycle of companies overstepping their fiduciary duties.

---

[93] Dodd-Frank Wall Street Reform and Consumer Protection Act §§ 901-991.
[94] *Id.*
[95] *Id.* §§ 911, 919.
[96] *Id.*
[97] *Id.* §§ 901-991.
[98] *Id.* §§ 936, 938.
[99] *Id.* tit. D.
[100] *Id.*

A major issue resulting from the passing of the Dodd-Frank Act involved the government's approach to enforcing the new guidelines. Many critics condemned commercial banks for being insured by the government, as continuing appeasement would not prevent banks from discouraging companies from excessively utilizing SPVs. Paul Kupiec with the American Enterprise Institute conducted a report on the Act's effectiveness in achieving its goals fifteen years after its introduction. The report mocks the government's choice to bail out bank institutions using the FDIC's Deposit Insurance Fund (DIF), which grants $250,000 to investors who experienced significant monetary losses as a result of economic downturn.[101] By bailing out banks with insured money, government over-interference makes the Dodd-Frank Act's effects on financial accountability difficult to analyze.

Kupiec further defended his perspective through the March 2023 banking crisis, in which several banking institutions collapsed after each bank experienced depositor runs, which "required a costly government-engineered bailout of the banking system"[102] reminiscent of the government's reaction to the 2008 financial crisis. According to Kupiec, the occurrence of depositor runs should have been monitored and mitigated by the Financial Stability Oversight Council (FSOC), whose creation and corrective powers are outlined in the Act.[103] However, the council's lack of preventive measures demonstrates the Act's inability to foresee collapses in financial institutions. Furthermore, the government repeated its response to the 2008 financial crisis by granting costly bailouts to banking institutions, amounting to nearly $25 billion in losses.[104]

As previously addressed, bailing out banks does not prove the effectiveness of the standards introduced by Dodd–Frank, but merely provides a temporary solution. The bailouts also present an issue with the fiduciary duty of the federal government, as they provide monetary assistance to banking institutions rather than to the general public. These issues demonstrate how SPVs and the broad financial world continue to be mishandled by corporations that value financial gain over transparency and efficiency over ethics.

Cases settled the implementation of SOX and Dodd–Frank continue to exemplify significant gaps in regulatory measures regarding SPV and general securities use. *United States SEC v. Spartan Sec. Grp., Ltd.* (2020) addresses SEC's action against

---

[101] Paul H. Kupiec, *The Dodd-Frank Act at 15: Has It Worked?* (American Enterprise Institute 2025).
[102] *Id.* at 27.
[103] *Id.*
[104] *Id.*

Spartan Securities Group, alleging that the brokerage firm committed securities fraud through the formation of fourteen shell companies.[105] Shell companies do not have a legitimate business operations plan despite being registered with the SEC, meaning that the defendants were able to "seek buyers from the company and negotiate a bulk sale of the shares"[106] from each entity. The court ultimately found Spartan Securities Group liable for violating Sections 5(a) and (c) of the Securities Act of 1933 for participating in and conducting fraudulent securities transactions.[107] While the case does not explicitly include SPVs, the issue revolves around continuing exploitation of financial entities that emulate their functions. The case *LifeVoxel Va. SPV, LLC v. LifeVoxel.Ai, Inc.* (2024) does involve misuse directly by an SPV created by an artificial intelligence platform and action by their investors. Through LifeVoxel's SPV, the parent company issued Simple Agreements for Future Equity Notes ("SAFE Notes"), which permitted stockholders to obtain shares in the company upon conversion into equity.[108] However, the company's CEO pulled $500,000 of investors' SAFE Notes to invest in another platform without disclosing their financial activities to their stockholders.[109] The plaintiffs also alleged that LifeVoxel executives "created foreign entities to which they transferred funds from LifeVoxel for their own personal use."[110]

Simultaneously, recent cases have set new precedent that threatens to minimize the monitoring and enforcement powers of the SEC. In *SEC v. Jarkesy* (2023), the commission filed a case against investment adviser George Jarkesy Jr. for violating antifraud provisions established by the Dodd–Frank Act.[111] For this case, the SEC adjudicated the matter with an in-house Administrative Law Judge (ALJ) selected by the commission presiding over the matter rather than a jury.[112] After Jarkesy was found liable for violating antifraud securities provisions, the defendant challenged the ruling with the Court of Appeals, which held that "when the SEC seeks civil penalties against a defendant for securities fraud, the Seventh Amendment entitles the defendant to a jury trial."[113] The decision ultimately places harsher limits on how the SEC rules, as civil penalty cases involving the SEC brought to court will require a jury to rule on its

[105] U.S. Sec. & Exch. Comm'n v. Spartan Sec. Grp., 409 F. Supp. 3d 1359 (11th Cir. Jan. 16, 2026).
[106] *Id.* at 4.
[107] *Id.* at 12.
[108] LifeVoxel Va. SPV v. LifeVoxel.AI, 693 F. Supp. 3d 1214 (9th Cir. 2024).
[109] *Id.* at 7.
[110] *Id.* at 9.
[111] SEC v. Jarkesy, 603 U.S. 109, 109 (2024).
[112] *Id.* at 117.
[113] *Id.* at 110.

cases, rather than allowing the agency to rule through its own adjudicatory system.[114] Through this restricted precedent of ruling on SEC cases, potential adverse effects arise that hinder how the commission monitors securities activity, such as slower enforcement on SEC rulings and diminished control over punishment decisions.[115] As a result, relaxed control of the commission has the potential to increase foreign entity abuse and make cases such as *Spartan* and *LifeVoxel* easier to occur in the modern securities time period.

The combination of vague standards set by both SOX and Dodd–Frank, excessive costs resulting from overreaching statutes, and recent cases involving continuing securities fraud demonstrates the gaps still exhibited in the corporate world despite attempts to strengthen securities regulation. Widespread revisions to regulate and monitor corporate financial activity are required to mitigate further exploitation of the securities market through entities such as SPVs and CDOs.

III. POTENTIAL SOLUTIONS FOR REGULATORY STANDARDS OF SPVS

Although legislation changes exhibit widespread but ineffective results in regulating SPVs, alternative solutions may mend the issue. Pre-existing standards should be reformed to increase controls over SPV usage without compromising efficiency in business operations. The creation of the board promoted higher quality and trends of increased disclosure rates of corporate deficiencies.[116] This increase in transparency of internal operations, facilitated by the establishment of the PCAOB, demonstrated the effectiveness of a third-party monitoring system in mitigating corporate deception of financial statements.

Despite the successes that the PCAOB has brought to ensure public confidence in companies, the board can still exhibit susceptibility to missing crucial information on company audits, given its member size and broad standards of monitoring. To ensure strong oversight with specific regard to SPV creation and use, the board could establish a subdivision within its operations tailored to focus on observing SPVs in the corporate world. This division could expand the board to track the number of SPVs that each company creates, set limitations on the amount and degree of influence that SPVs have, and carry out punishments for any violation of the Sarbanes–Oxley Act. By specifically

---

[114] *SEC,* 603 U.S. at 110.

[115] *Id.*

[116] Mark L. DeFond & Clive S. Lennox, *Do PCAOB Inspections Improve the Quality of Internal Control Audits?*, 55 J. Acct. Res. 591, 600–605 (2017).

enhancing monitoring on SPVs, companies can be more conscious and less inclined to overexploit their use of SPVs, which can also make their financial statements more transparent for the public and the government.

The revision and increased enforcement of regulations implemented by SOX and Dodd–Frank present an additional viable option to resolve inefficiencies in monitoring the securities market. Recent action taken by the Trump Administration has seen widespread deregulation of federal regulatory and enforcement agencies, which included a regulatory freeze that paused new regulations and guidance.[117] This issue exemplifies the increasing lack of effective regulation, which undermines the precedent set by each act and discourages public support for its implementation. To mitigate opposition and deterioration of SOX and Dodd–Frank, clearer standards for each legislation should be set as a replacement for the vague phrasing that the acts currently exhibit. New regulations that tackle the specific functions and formations of SPVs and CDOs need to be introduced to prevent corporations from taking advantage of legal loopholes that can spiral out of control. Reversal of case rulings, such as the *Jarkesy* case, should also be taken into consideration when discussing solutions to mitigate securities abuse. With increasing financial deregulations brought about by the current administration, cases such as *SEC v. Jarkesy* have a higher impact on the precedent set regarding limitations on government agencies.[118] These decisions further diminish the control that the SEC and general government agencies have over monitoring and enforcing legislative regulations, allowing for easier abuse of financial entities with less severe repercussions.[119] Reconsideration of previous cases could re-establish powers previously held by the SEC and prevent further financial exploitation from occurring.

CONCLUSION

While SPVs serve as an essential financial tool, their overexploitation potential throws their legality into question. As seen in the cases of Enron's bankruptcy and the 2008 financial crisis with CDOs, excessive abuse through the creation and collateralization of debt can have detrimental consequences that extend beyond involvement in the company. Not only does SPV exploitation bankrupt companies and increase unemployment, but it also has the potential to disrupt world economies and

[117] Marshall Lux, *An Overview of the Dodd–Frank Act and its Evolution* 9 (Georgetown Univ. Psaros Center for Financial Markets and Policy 2025).
[118] *Id.*
[119] *Id.*

drain deposits and stock shares. SPV abuse exemplifies corporate directors' poor adherence to fiduciary duty.

Modern approaches to corporate governance and securities market regulations established by SOX and the Dodd–Frank Act exclude clauses that oversee and manage the powers of SPVs in off-balance sheet reporting. Despite introducing amendments to previous laws, both acts use broad language and unclear procedures that allow for open interpretation of governance standards. To highlight the widespread issue of SPVs in the corporate world, this article evaluated the questionable legal status of SPVs through real examples and suggested possible solutions to restrict their use in the corporate world. Increased monitoring and amendments to pre-existing regulations ensure public confidence in corporate transparency without compromising companies' internal operations and productivity.